Pension Benefit Guaranty Corporation

Office of Inspector General

Audit Report

Audit of the Pension Benefit Guaranty Corporation's Fiscal Year 2007 and 2006 Financial Statements

Independent Auditor's Report

Pension Benefit Guaranty Corporation's
Fiscal Year 2007 and 2006 Financial Statements

November 15, 2007

2008-1/FA-0034-1

Pension Benefit Guaranty Corporation
Office of Inspector General
1200 K Street, N.W., Washington, D.C. 20005-4026

To the Board of Directors
Pension Benefit Guaranty Corporation

We contracted with Clifton Gunderson LLP, an independent certified public accounting firm, to audit the financial statements of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC) as of and for the years ended September 30, 2007 and 2006. They conducted their audits in accordance with auditing standards generally accepted in the United States of America; *Government Auditing Standards*, issued by the Comptroller General of the United States; Office of Management and Budget Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements;* and the *GAO/PCIE Financial Audit Manual*.

In the audit of PBGC's Single-Employer and Multiemployer Program Funds, Clifton Gunderson found:

- The financial statements were presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;

- PBGC's assertion about internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations, as of September 30, 2007, is fairly stated in all material respects. However, they also identified three significant deficiencies regarding PBGC's need to: complete its efforts to fully implement and enforce an effective information security program, effectively implement consistent controls to restrict access to its information systems, and integrate its financial management systems.

- No instances of noncompliance with tested laws and regulations.

Clifton Gunderson is responsible for the accompanying auditor's report dated November 8, 2007, and the conclusions expressed in the report. We do not express opinions on PBGC's financial statements or internal control, nor do we draw conclusions on compliance with laws and regulations.

Clifton Gunderson's report (2008-1/FA-0034-1) is also available on our website at http://oig.pbgc.gov.

Sincerely,

Deborah Stover-Springer

Deborah Stover-Springer
Acting Inspector General

November 8, 2007

Audit of the Pension Benefit Guaranty Corporation's Fiscal Year 2007 and 2006 Financial Statements Audit Report 2008-1/FA-0034-1

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Abbreviations

FIPS PUB	Federal Information Processing Standards Publication
FMFIA	Federal Managers' Financial Integrity Act of 1982
FY	Fiscal Year
IT	Information Technology
OIG	Office of Inspector General
OMB	Office of Management and Budget
PBGC	Pension Benefit Guaranty Corporation

Section I

Independent Auditor’s Report

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

To the Inspector General of the
Pension Benefit Guaranty Corporation
Washington, DC

In our audits of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC) for fiscal years (FY) 2007 and 2006, we found:

- the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;
- although internal controls could be improved, PBGC had effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations as of September 30, 2007; and
- no reportable noncompliance in fiscal year 2007 with laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions, (2) our audit objectives, scope, and methodology, and (3) agency comments and our evaluation.

Opinion on Financial Statements

The financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Single-Employer and Multiemployer Program Funds administered by PBGC as of September 30, 2007 and 2006, and the results of their operations and cash flows for the fiscal years then ended.

By law, PBGC's Single-Employer and Multiemployer Program Funds must be self-sustaining. As of September 30, 2007, PBGC reported in its financial statements net deficit positions (liabilities in excess of assets) in the Single-Employer and Multiemployer Program Funds of $13,111 million and $955 million, respectively. As discussed in Note 7 to the

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financial statements, losses as of September 30, 2007 for the Single-Employer and Multiemployer Programs that are reasonably possible as a result of unfunded vested benefits are estimated to be $65,665 million and $73 million, respectively. PBGC's net deficit and long-term viability could be further impacted by losses from plans classified as reasonably possible (or from other plans not yet identified as potential losses) as a result of deteriorating economic conditions, the insolvency of a large plan sponsor or other factors. PBGC has been able to meet their short-term benefit obligations. However, as discussed in Note 1 to the financial statements, management believes that neither program at present has the resources to fully satisfy PBGC's long-term obligations to plan participants.

Opinion on Internal Control

Management's assertion included in the Annual Management Report, that PBGC maintained, in all material respects, effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations as of September 30, 2007 is fairly stated, in all material respects, based on criteria contained in 31 U.S.C. 3512 (c), (d), the Federal Managers' Financial Integrity Act of 1982 (FMFIA).

However, we identified certain deficiencies in internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations and its operation that we consider to be significant deficiencies which adversely affect PBGC's ability to meet the internal control objectives listed in the objectives, scope, and methodology section of this report, or meet Office of Management and Budget (OMB) criteria for reporting matters under FMFIA.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. Significant deficiencies we noted are as follows:

1. PBGC needs to complete its efforts to fully implement and enforce an effective information security program.
2. PBGC needs to effectively implement consistent controls to restrict access to its information systems.
3. PBGC needs to integrate its financial management systems.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that none of the significant deficiencies described in this report are material weaknesses.

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SIGNIFICANT DEFICIENCIES

PBGC relies extensively on information technology (IT) systems to accomplish its mission and in the preparation of its financial statements. Internal controls over these operations are essential to ensure the confidentiality, integrity, and availability of critical data while reducing the risk of errors, fraud and other illegal acts.

PBGC implemented significant improvements in FY 2007. Of particular note, PBGC diligently addressed the significant deficiency (formerly reportable condition) relating to its preparedness for unanticipated incidences and disruptions of its business operations. PBGC's commitment, as a whole, to correcting this deficiency resulted in its removal from the internal control report. In addition, as a result of PBGC's progress in addressing data quality issues with the single employer premium system, the deficiency is no longer viewed separately. However, since there are remaining system issues the deficiency is included as part of the Integrated Systems significant deficiency.

In the IT area, the FY 2007 improvements included hiring a new Chief Information Officer and enhancing the roles and responsibilities for risk management and information security that resulted in an improved strategy to implement an effective entity-wide security program. However, our testing revealed general control weaknesses still exist in PBGC's entity-wide security management and access controls. These weaknesses prevent PBGC from implementing effective security controls to protect its information from unauthorized access, modification, and disclosure.

While PBGC implemented a new financial management system in October 2006 to consolidate three of its subsidiary ledger systems, PBGC still lacks an integrated financial system. As a result, extensive data manipulation and excessive manual processes are required to reconcile financial statement information.

Based on our findings we are reporting as significant deficiencies for FY 2007 the lack of fully effective entity-wide security management, access controls and financial management systems integration. We note that the lack of an effective entity-wide security program and an integrated financial system were reportable conditions in prior audit reports. The designation of access controls as a significant deficiency is based on the aggregation of control weaknesses, showing a systemic problem. Our detailed findings and recommendations have been provided to management in a separate limited disclosure report dated November 8, 2007. A summary of the significant deficiencies and related recommendations follows.

1. PBGC Needs to Complete its Efforts to Fully Implement and Enforce an Effective Information Security Program

An entity-wide security program should be in place to establish a framework and continuing cycle of activity to manage security risk, develop security policies, assign responsibilities, and monitor the adequacy of computer security related controls. It should also represent the foundation for an entity's security control structure and a reflection of senior management's commitment to addressing security risks. OMB Circular No. A-130, Appendix III *Security of*

Federal Automated Information Resources, requires agencies to implement and maintain a program to assure that adequate security is provided for all agency information collected, processed, transmitted, stored, or disseminated in general support systems and major applications.

PBGC has demonstrated its ability to remediate several specific IT findings identified in prior year audits and has taken the initiative to reorganize and improve its security planning and management through the design and initial implementation of an entity-wide security program, but has not fully developed and implemented its security program. Our current year audit work found inconsistent remediation on an entity-wide basis and deficiencies in the areas of security program management, including policy administration and the certification and accreditation of major applications and general support systems. An effective entity-wide security management program demonstrates the ability to implement enhancements to an organization's control environment on all new and existing systems and platforms in use.

Although a security program exists, without full development and implementation, security controls may be inadequate; responsibilities may be unclear, misunderstood, and improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low risk resources. For this reason, this issue remains a significant deficiency for FY 2007.

Recommendation:

PBGC management should continue developing and implementing its security program management that will enable the completion of an effective entity-wide security program.

2. PBGC Needs to Effectively Implement Consistent Controls to Restrict Access to its Information Systems

Although access controls are an integral part of an effective information security program, access controls are a systemic problem throughout PBGC. Though PBGC has made progress in correcting access control weaknesses, there are still a significant number of outstanding audit recommendations.

Access controls should be in place to consistently limit, detect, or monitor access to computer programs, data, equipment, and facilities thereby protecting against unauthorized modification, disclosure, loss or impairment. Such controls include both logical and physical security controls to ensure that federal employees, contractors and staff will be given only the privileges necessary to perform business functions, i.e., access privileges. Federal Information Processing Standards Publication (FIPS PUB) 200, *Minimum Security Requirements for Federal Information and Information Systems,* specifies minimum access controls for federal systems. PBGC's information system owners must limit information system access to authorized users.

Although a number of prior access control findings have been addressed through the initial implementation of PBGC's new security program, additional weaknesses still exist that require management's attention. We found deficiencies in system configurations and user account management across many of PBGC's systems. Based on the number and significance of our findings in the aggregate, the implementation of PBGC's comprehensive security program that includes access control and increased management oversight is needed to fully address the administration and reliability of computerized data and to decrease the risk of destruction or inappropriate disclosure of data. For this reason, this issue is a significant deficiency for FY 2007.

Recommendation:

PBGC management and information system owners should continue on its path to mitigate the systemic issues related to access control by strengthening system configurations and user account management for all of PBGC's information systems.

3. PBGC Needs to Integrate its Financial Management Systems

As reported in prior year audits, PBGC lacks integrated financial management systems. Though PBGC implemented a financial management system in October 2006, it has not completed the integration of its financial systems. OMB Circular A-127, *Financial Management System*, requires that federal financial management systems be designed to provide for effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems. The lack of a single integrated financial management system increases the risk of inaccurate, inconsistent, and redundant data that cannot be readily accessed and used by financial and program managers without extensive manipulation; excessive manual processing; and inefficient balancing of reports to reconcile disbursements, collections and general ledger data.

In the short term, PBGC's ability to accurately and efficiently accumulate and summarize information required for internal and external financial reporting may be impacted. For this reason, this issue is a significant deficiency for FY 2007.

Recommendation:

PBGC management should continue their efforts to integrate PBGC's financial management systems in accordance with OMB Circular A-127.

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In addition to the significant deficiencies described above, we noted certain matters involving PBGC's internal controls and operations that we reported to the PBGC management in a separate letter dated November 8, 2007.

Compliance with Laws and Regulations

Our tests for compliance in FY 2007 with selected provisions of laws and regulations disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance. However, the objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

This conclusion is intended solely for the information and use of PBGC's Office of Inspector General, Board of Directors, management of PBGC, Government Accountability Office, Office of Management and Budget, the United States Congress, and the President and is not intended to be and should not be used by anyone other than these specified parties.

Objectives, Scope, and Methodology

PBGC's management is responsible for (1) preparing the financial statements in conformity with accounting principles generally accepted in the United States of America; (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of FMFIA are met; and (3) complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America; and (2) management maintained effective internal control as of September 30, 2007 based on management's assertion included in the Annual Management Report and on the criteria contained in FMFIA, the objectives of which are the following:

- Financial reporting: Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.

- Compliance with applicable laws and regulations: Transactions are executed in accordance with laws and regulations that could have a direct and material effect on the financial statements and any other laws, regulations, and governmentwide policies identified by OMB audit guidance.

We are also responsible for testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and laws for which OMB audit guidance requires testing.

In order to fulfill these responsibilities, we (1) examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements; (2) assessed the accounting principles used and significant estimates made by management; (3) evaluated the overall presentation of the financial statements; (4) obtained an understanding of internal control related to financial reporting (including safeguarding assets) and compliance with laws and regulations; (5) tested relevant internal control over financial reporting (including safeguarding assets) and compliance, and evaluated the design and operating effectiveness of internal control for the FY ended September 30, 2007; and (6) tested compliance in FY 2007 with selected provisions of laws and regulations that have a direct and material effect on the financial statements.

We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with controls may deteriorate.

We did not test compliance with all laws and regulations applicable to PBGC. We limited our tests of compliance to those laws and regulations required by OMB audit guidance that we deemed applicable to the financial statements for the fiscal year ended September 30, 2007. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We performed our work in accordance with U.S. generally accepted government auditing standards and OMB audit guidance.

Agency Comments and Our Evaluation

In commenting on the draft of this report (see Page 73 of PBGC's Annual Management Report), PBGC's management concurred with the facts and conclusions in our report. We did not perform audit procedures on PBGC's written response to the significant deficiencies and, accordingly, we express no opinion on it.

Clifton Gunderson LLP

Calverton, Maryland
November 8, 2007

Section II

Pension Benefit Guaranty Corporation's
Fiscal Year 2007 and 2006
Financial Statements

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF FINANCIAL CONDITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
(Dollars in millions)	**2007**	2006	**2007**	2006	**2007**	2006
ASSETS						
Cash and cash equivalents	**$ 2,201**	$ 1,999	**$ 7**	$ 5	**$ 2,208**	$ 2,004
Securities lending collateral (Note 3)	**5,045**	6,491	**0**	0	**5,045**	6,491
Investments, at market (Note 3)						
Fixed maturity securities	**36,450**	35,503	**1,189**	1,159	**37,639**	36,662
Equity securities	**17,386**	13,730	**0**	0	**17,386**	13,730
Real estate and real estate investment trusts	**3**	4	**0**	0	**3**	4
Other	**37**	1	**0**	0	**37**	1
Total investments	**53,876**	49,238	**1,189**	1,159	**55,065**	50,397
Receivables, net:						
Sponsors of terminated plans	**68**	130	**0**	0	**68**	130
Premiums (Note 9)	**151**	374	**1**	1	**152**	375
Sale of securities	**5,571**	1,440	**0**	0	**5,571**	1,440
Investment income	**286**	259	**0**	1	**286**	260
Other	**2**	3	**0**	0	**2**	3
Total receivables	**6,078**	2,206	**1**	2	**6,079**	2,208
Capitalized assets, net	**41**	38	**0**	0	**41**	38
Total assets	**$ 67,241**	$ 59,972	**$1,197**	$1,166	**$ 68,438**	$ 61,138
LIABILITIES						
Present value of future benefits, net (Note 4):						
Trusteed plans	**$ 65,096**	$ 63,949	**$ 2**	$ 2	**$ 65,098**	$ 63,951
Plans pending termination and trusteeship	**298**	277	**0**	0	**298**	277
Settlements and judgments	**55**	55	**0**	0	**55**	55
Claims for probable terminations	**3,786**	4,862	**0**	0	**3,786**	4,862
Total present value of future benefits, net	**69,235**	69,143	**2**	2	**69,237**	69,145
Present value of nonrecoverable future financial assistance (Note 5)			**2,124**	1,876	**2,124**	1,876
Payable upon return of securities loaned	**5,045**	6,491	**0**	0	**5,045**	6,491
Unearned premiums	**302**	298	**26**	27	**328**	325
Due for purchases of securities	**5,659**	2,089	**0**	0	**5,659**	2,089
Accounts payable and accrued expenses (Note 6)	**111**	93	**0**	0	**111**	93
Total liabilities	**80,352**	78,114	**2,152**	1,905	**82,504**	80,019
Net position	**(13,111)**	(18,142)	**(955)**	(739)	**(14,066)**	(18,881)
Total liabilities and net position	**$ 67,241**	$ 59,972	**$1,197**	$1,166	**$ 68,438**	$ 61,138

The accompanying notes are an integral part of these financial statements.

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	For the Years Ended September 30,		For the Years Ended September 30,		For the Years Ended September 30,	
(Dollars in millions)	**2007**	2006	**2007**	2006	**2007**	2006
UNDERWRITING:						
Income:						
Premium (Note 9)	**$ 1,476**	$ 1,442	**$ 81**	$ 58	**$ 1,557**	$ 1,500
Other	**55**	79	**0**	0	**55**	79
Total	**1,531**	1,521	**81**	58	**1,612**	1,579
Expenses:						
Administrative	**328**	352	**0**	0	**328**	352
Other	**114**	2	**1**	0	**115**	2
Total	**442**	354	**1**	0	**443**	354
Other underwriting activity:						
Losses (credits) from completed and probable terminations (Note 10)	**399**	(6,155)	**0**	0	**399**	(6,155)
Losses from financial assistance (Note 5)			**319**	461	**319**	461
Actuarial adjustments (Note 4)	**(114)**	(424)	**0**	0	**(114)**	(424)
Total	**285**	(6,579)	**319**	461	**604**	(6,118)
Underwriting gain (loss)	**804**	7,746	**(239)**	(403)	**565**	7,343
FINANCIAL:						
Investment income (Note 11):						
Fixed	**1,730**	394	**23**	(1)	**1,753**	393
Equity	**2,988**	1,793	**0**	0	**2,988**	1,793
Other	**19**	(3)	**0**	0	**19**	(3)
Total	**4,737**	2,184	**23**	(1)	**4,760**	2,183
Expenses:						
Investment	**50**	53	**0**	0	**50**	53
Actuarial charges (credits) (Note 4):						
Due to passage of time	**3,269**	3,206	**0**	0	**3,269**	3,206
Due to change in interest rates	**(2,809)**	2,037	**0**	0	**(2,809)**	2,037
Total	**510**	5,296	**0**	0	**510**	5,296
Financial income (loss)	**4,227**	(3,112)	**23**	(1)	**4,250**	(3,113)
Net income (loss)	**5,031**	4,634	**(216)**	(404)	**4,815**	4,230
Net position, beginning of year	**(18,142)**	(22,776)	**(739)**	(335)	**(18,881)**	(23,111)
Net position, end of year	**$(13,111)**	$(18,142)	**$(955)**	$(739)	**$(14,066)**	$(18,881)

The accompanying notes are an integral part of these financial statements.

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF CASH FLOWS

(Dollars in millions)	Single-Employer Program For the Years Ended September 30, **2007**	2006	Multiemployer Program For the Years Ended September 30, **2007**	2006	Memorandum Total For the Years Ended September 30, **2007**	2006
OPERATING ACTIVITIES:						
Premium receipts	**$ 1,598**	$ 1,579	**$ 81**	$ 76	**$ 1,679**	$ 1,655
Interest and dividends received, net	**1,408**	1,689	**7**	44	**1,415**	1,733
Cash received from plans upon trusteeship	**165**	75	**0**	0	**165**	75
Receipts from sponsors/non-sponsors	**345**	884	**0**	0	**345**	884
Receipts from the missing participant program	**3**	7	**0**	0	**3**	7
Other receipts	**3**	9	**0**	0	**3**	9
Benefit payments – trusteed plans	**(4,170)**	(4,006)	**0**	0	**(4,170)**	(4,006)
Financial assistance payments			**(71)**	(70)	**(71)**	(70)
Settlements and judgments	**(2)**	(3)	**0**	0	**(2)**	(3)
Payments for administrative and other expenses	**(377)**	(373)	**0**	0	**(377)**	(373)
Net cash provided (used) by operating activities (Note 13)	**(1,027)**	(139)	**17**	50	**(1,010)**	(89)
INVESTING ACTIVITIES:						
Proceeds from sales of investments	**123,680**	90,261	**1,978**	2,119	**125,658**	92,380
Payments for purchases of investments	**(122,451)**	(90,073)	**(1,993)**	(2,177)	**(124,444)**	(92,250)
Net change in investment of securities lending collateral	**(1,446)**	(448)	**0**	0	**(1,446)**	(448)
Net change in securities lending payable	**1,446**	448	**0**	0	**1,446**	448
Net cash provided (used) by investing activities	**1,229**	188	**(15)**	(58)	**1,214**	130
Net increase (decrease) in cash and cash equivalents	**202**	49	**2**	(8)	**204**	41
Cash and cash equivalents, beginning of year	**1,999**	1,950	**5**	13	**2,004**	1,963
Cash and cash equivalents, end of year	**$ 2,201**	$ 1,999	**$ 7**	$ 5	**$ 2,208**	$ 2,004

The accompanying notes are an integral part of these financial statements

NOTES TO FINANCIAL STATEMENTS

SEPTEMBER 30, 2007 AND 2006

Note 1 -- Organization and Purpose

The Pension Benefit Guaranty Corporation (The PBGC or the Corporation) is a federal corporation created by Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) and is subject to the provisions of the Government Corporation Control Act. Its activities are defined in ERISA as amended by the Multiemployer Pension Plan Amendments Act of 1980, the Single-Employer Pension Plan Amendments Act of 1986, the Pension Protection Act of 1987, the Retirement Protection Act of 1994, the Consolidated Appropriations Act, 2001, the Deficit Reduction Act of 2005, and the Pension Protection Act of 2006. The Corporation insures the pension benefits, within statutory limits, of participants in covered single-employer and multiemployer defined benefit pension plans.

ERISA requires that the PBGC programs be self-financing. ERISA provides that the U.S. Government is not liable for any obligation or liability incurred by the PBGC.

For financial statement purposes, the PBGC divides its business activity into two broad areas – *Underwriting Activity* and *Financial Activity* – covering both single-employer and multiemployer program segments. The PBGC's Underwriting Activity provides financial guaranty insurance in return for insurance premiums (whether actually paid or not). Actual and expected probable losses that result from the termination of underfunded pension plans are included in this category, as are actuarial adjustments based on changes in actuarial assumptions, such as mortality. *Financial Activity* consists of the performance of the PBGC's assets and liabilities. The PBGC's assets consist of premiums collected from defined benefit plan sponsors, assets from distress or involuntarily terminated plans that the PBGC has insured, and recoveries from the former sponsors of those terminated plans. The PBGC's future benefit liabilities consist of those future benefits, under statutory limits, that the PBGC has assumed following distress or involuntary terminations. Gains and losses on the PBGC's investments and changes in the value of the PBGC's future benefit liabilities (e.g., actuarial charges such as changes in interest rates and passage of time) are included in this area

As of September 30, 2007, the single-employer and multiemployer programs reported deficits of $13.1 billion and $955 million, respectively. The single-employer program had assets of over $67.2 billion which is offset by total liabilities of $80.4 billion, which include a total present value of future benefits (PVFB) of approximately $69.2 billion. As of September 30, 2007, the multiemployer program had assets of approximately $1.2 billion offset by approximately $2.1 billion in present value of nonrecoverable future financial assistance.

Notwithstanding these deficits, the Corporation has sufficient liquidity to meet its obligations for a number of years; however, neither program at present has the resources to fully satisfy the PBGC's long-term obligations to plan participants.

Single-Employer and Multiemployer Program Exposure

Measures of risk in the PBGC's insured base of plan sponsors suggest that the single-employer deficit may begin to abate in the short term. The PBGC's best estimate of the total underfunding in plans sponsored by companies with credit ratings below investment grade, and classified by the PBGC as reasonably possible of termination as of September 30, 2007, was $66 billion. The comparable estimates of reasonably possible exposure for 2006 and 2005 were $73 billion and $108 billion, respectively. These estimates are measured as of December 31 of the previous year (see Note 7). For 2007, this exposure is concentrated in the following sectors: manufacturing; transportation, communication and utilities; services/other; and wholesale and retail trade.

The PBGC estimates that, as of September 30, 2007, it is reasonably possible that multiemployer plans may require future financial assistance in the amount of $73 million. As of September 30, 2006 and 2005, these exposures were estimated at $83 million and $418 million, respectively.

There is significant volatility in plan underfunding and sponsor credit quality over time, which makes long-term estimates of the PBGC's expected claims difficult. This volatility, and the concentration of claims in a relatively small number of terminated plans, have characterized the PBGC's experience to date and will likely continue. Among the factors that will influence the PBGC's claims going forward are economic conditions affecting interest rates, financial markets, and the rate of business failures.

Total underfunding reported under section 4010 is the current source of individual plan underfunding information; it has accounted for over 75% of the estimates of total underfunding reported in the recent past. Due to the degradation in the quality and reliability of the estimates resulting from the changes to section 4010 reporting requirements including the regulation-driven changes in the Required Interest Rate as well as PPA changes to who must file, the PBGC will no longer publish estimates of total underfunding in the Annual Management Report. However, the Corporation will continue to publish Table S-47, "Various Estimates of Underfunding in PBGC-Insured Plans", in its Pension Insurance Data Book where the limitations of the estimates can be fully and appropriately described.

Under the single-employer program, the PBGC is liable for the payment of guaranteed benefits with respect only to underfunded terminated plans. An underfunded plan may terminate only if the PBGC or a bankruptcy court finds that one of the four conditions for a distress termination, as defined in ERISA, is met or if the PBGC involuntarily terminates a plan under one of five specified statutory tests. The net liability assumed by the PBGC is generally equal to the present value of the future benefits payable by the PBGC less amounts provided by the plan's assets and amounts recoverable by the PBGC from the plan sponsor and members of the plan sponsor's controlled group, as defined by ERISA.

Under the multiemployer program, if a plan becomes insolvent, it receives financial assistance from the PBGC to allow the plan to continue to pay participants their guaranteed benefits. The PBGC recognizes assistance as a loss to the extent that the plan is not expected to be able to repay these amounts from future plan contributions, employer withdrawal liability or investment earnings.

Note 2 -- Significant Accounting Policies

Basis of Presentation: The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions may change over time as new information is obtained or subsequent developments occur. Actual results could differ from those estimates.

Valuation Method: A primary objective of the PBGC's financial statements is to provide information that is useful in assessing the PBGC's present and future ability to ensure that its plan beneficiaries receive benefits when due. Accordingly, the PBGC values its financial assets at estimated fair value, consistent with the standards for pension plans contained in Statement of Financial Accounting Standards (FAS) No. 35 ("Accounting and Reporting by Defined Benefit Pension Plans"). The PBGC values its liabilities for the present value of future benefits and present value of nonrecoverable future financial assistance using assumptions derived from annuity prices from insurance companies, as described in the Statement of Actuarial Opinion. As described in Paragraph 21 of FAS No. 35, the assumptions are "those assumptions that are inherent in the estimated cost at the (valuation) date to obtain a contract with an insurance company to provide participants with their accumulated plan benefits." Also, in accordance with Paragraph 21 of FAS No. 35, the PBGC selects assumptions for expected retirement ages and the cost of administrative expenses in accordance with its best estimate of anticipated experience.

Revolving and Trust Funds: The PBGC accounts for its single-employer and multiemployer programs' revolving and trust funds on an accrual basis. Each fund is charged its portion of the benefits paid each year. The PBGC presents totals that include both the revolving and trust funds for presentation purposes in the financial statements; however, the single-employer and multiemployer programs are separate programs by law and, therefore, the PBGC also reports them separately.

ERISA provides for the establishment of the revolving fund where premiums are collected and held. The assets in the revolving fund are used to cover deficits incurred by plans trusteed and to provide funds for financial assistance. The Pension Protection Act of 1987 created a single-employer revolving (7th) fund that is credited with all premiums in excess of $8.50 per participant, including all penalties and interest charged on these amounts, and its share of earnings from investments. This fund may not be used to pay the PBGC's administrative costs or the benefits of any plan terminated prior to October 1, 1988, unless no other amounts are available.

The trust funds include assets (e.g., pension plan investments) the PBGC assumes (or expects to assume) once a terminated plan has been trusteed, and related investment income. These assets generally are held by custodian banks. The trust funds support the operational functions of the PBGC.

The trust funds reflect accounting activity associated with: (1) trusteed plans -- plans for which the PBGC has legal responsibility–the assets and liabilities are reflected separately on the PBGC's Statements of Financial Condition, the income and expenses are included in the Statements of Operations and Changes in Net Position and the cash flows from these plans are included in the Statements of Cash Flows, and (2) plans pending termination and trusteeship -- plans for which the PBGC has begun the process for termination and trusteeship by fiscal year-end -- the assets and liabilities for these plans are reported as a net amount on the liability side of the Statements of Financial Condition under "Present value of future benefits, net." For these plans, the income and expenses are included in the Statements of Operations and Changes in Net Position, but the cash flows are not included in the Statements of Cash Flows, and (3) probable terminations -- plans that the PBGC determines are likely to terminate and be trusteed by the PBGC–the assets and liabilities for these plans are reported as a net amount on the liability side of the Statements of Financial Condition under "Present value of future benefits, net." The accrued loss from these plans is included in the Statements of Operations and Changes in Net Position as part of "Losses from completed and probable terminations." The cash flows from these plans are not included in the Statements of Cash Flows. The PBGC cannot exercise legal control over a plan's assets until it becomes trustee.

Allocation of Revolving and Trust Funds: The PBGC allocates assets, liabilities, income and expenses to each program's revolving and trust funds to the extent that such amounts are not directly attributable to a specific fund. Revolving fund investment income is allocated on the basis of each program's average cash and investments available during the year while the expenses are allocated on the basis of each program's present value of future benefits. Revolving fund assets and liabilities are allocated on the basis of the year-end equity of each program's revolving funds. Plan assets acquired by the PBGC and commingled at the PBGC's custodian bank are credited directly to the appropriate fund while the earnings and expenses on the commingled assets are allocated to each program's trust funds on the basis of each trust fund's value, relative to the total value of the commingled fund.

Cash and Cash Equivalents: Cash includes cash on hand and demand deposits. Cash equivalents are securities with a maturity of one business day.

Securities Lending Collateral: The PBGC participates in a securities lending program administered by its custodian bank. The custodian bank requires collateral that equals 102 percent to 105 percent of the securities lent. The collateral is held by the custodian bank. In addition to the lending program managed by the custodian bank, some of the PBGC's investment managers are authorized to invest in repurchase agreements (an agreement with a commitment by the seller to buy a security back from the purchaser at a specified price at a designated future date), and reverse repurchase agreements. The manager either receives cash as collateral or pays cash out to be used as collateral. Any cash collateral received is invested.

Investment Valuation and Income: The PBGC bases market values on the last sale of a listed security, on the mean of the "bid-and-ask" for nonlisted securities or on a valuation model in the case of fixed income securities that are not actively traded. These valuations are determined as of the end of each fiscal year. Purchases and sales of securities are recorded on the trade date. In addition, the PBGC invests in and discloses its derivative investments in accordance with the guidance contained in FAS No. 133 ("Accounting for Derivative Instruments and Hedging Activities"), as amended. Investment income is accrued as earned. Dividend income is recorded on the ex-dividend date. Realized gains and losses on sales of investments are calculated using first-in, first-out for the revolving fund and average cost for the trust fund. The PBGC marks the plan's assets to market and any increase or decrease in the market value of a plan's assets occurring after the date on which the plan is terminated must, by law, be credited to or suffered by the PBGC.

Sponsors of Terminated Plans, Receivables: The amounts due from sponsors of terminated plans or members of their controlled group represent the settled, but uncollected, claims for employer liability (underfunding as of date of plan termination) and for contributions due their plan less an allowance for estimated uncollectible amounts. The PBGC discounts any amounts expected to be received beyond one year for time and risk factors. Some agreements between the PBGC and plan sponsors provide for contingent payments based on future profits of the sponsors. The Corporation will report any such future amounts in the period they are realizable. Income and expenses related to amounts due from sponsors are reported in the underwriting section of the Statements of Operations and Changes in Net Position. Interest earned on settled claims for employer liability and due and unpaid employer contributions (DUEC) is reported as "Income: Other." The change in the allowances for uncollectible employer liability and DUEC is reported as "Expenses: Other."

Premiums: Premiums receivable represent the estimated earned but unpaid portion of the premiums for plans that have a plan year commencing before the end of the PBGC's fiscal year and past due premiums deemed collectible, including penalties and interest. The liability for unearned premiums represents an estimate of payments received during the fiscal year that cover the portion of a plan's year after the PBGC's fiscal year-end. Premium income represents actual and estimated revenue generated from self-assessments from defined benefit pension plans as required by Title IV of ERISA (see Note 9).

Capitalized Assets: Capitalized assets include furniture and fixtures, electronic processing equipment and internal-use software. This includes costs for internally developed software incurred during the application development stage (system design including software configuration and software interface, coding, testing including parallel processing phase). These costs are shown net of accumulated depreciation and amortization.

Present Value of Future Benefits (PVFB): The PVFB is the estimated liability for future pension benefits that the PBGC is or will be obligated to pay the participants of trusteed plans and the net liability for plans pending termination and trusteeship. The PVFB liability (including trusteed plans as well as plans pending termination and trusteeship) is stated as the actuarial present value of estimated future benefits less the present value of estimated recoveries from sponsors and members of their controlled group and the assets of plans pending termination and trusteeship as of the date of the financial statements. The PBGC also includes the estimated liabilities attributable to plans classified as probable terminations as a separate line item in the PVFB (net of estimated recoveries and plan assets). The PBGC uses assumptions to adjust the value of those future payments to reflect the time value of money (by discounting) and the probability of payment (by means of decrements, such as for death or retirement). The PBGC also includes anticipated expenses to settle the benefit obligation in the determination of the PVFB. The PBGC's benefit payments to participants reduces the PVFB liability.

The values of the PVFB are particularly sensitive to changes in underlying estimates and assumptions. These estimates and assumptions could change and the impact of these changes may be material to the PBGC's financial statements (see Note 4)

(1) Trusteed Plans--represents the present value of future benefit payments less the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans that have terminated and been trusteed by the PBGC prior to fiscal year-end. Assets are shown separately from liabilities for trusteed plans.

(2) Pending Termination and Trusteeship--represents the present value of future benefit payments less the plans' net assets (at fair value) anticipated to be received and the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans for which termination action has been initiated and/or completed prior to fiscal year-end. Unlike trusteed plans, the liability for plans pending termination and trusteeship is shown net of plan assets.

(3) Settlements and Judgments--represents estimated liabilities related to settled litigation.

(4) Net Claims for Probable Terminations--In accordance with Statement of Financial Accounting Standards No. 5 (Accounting for Contingencies) the PBGC recognizes net claims for probable terminations which represent the PBGC's best estimate of the losses, net of plan assets and the present value of expected recoveries (from sponsors and members of their controlled group) for plans that are likely to terminate within twelve months of the financial statement issuance date. These estimated losses are based on conditions that existed as of the PBGC's fiscal year-end. Management believes it is likely that one or more events subsequent to the PBGC's fiscal year-end will occur, confirming the loss. Criteria used for classifying a specific plan as a probable termination include, but are not limited to, one or more of the following conditions: the plan sponsor is in liquidation or comparable state insolvency proceeding with no known solvent controlled group member; sponsor has filed or intends to file for distress plan termination; or the PBGC seeks involuntary plan termination. In addition, management takes into account other economic events and factors in making judgments regarding the classification of a plan as a probable termination. These events and factors may include, but are not limited to: the plan sponsor is in bankruptcy or has indicated that a bankruptcy filing is imminent; the plan sponsor has stated that plan termination is likely; the plan sponsor has received a going concern opinion from its independent auditors; or the plan sponsor is in default under existing credit agreement(s).

In addition, a reserve for small unidentified probable losses and incurred but not reported (IBNR) claims is recorded based on an actuarial loss development methodology (triangulation method) (see Note 4). For FY 2007, a comparable reserve for large unidentified probable losses was discontinued due to PBGC's comprehensive probables identification process.

(5) The PBGC identifies certain plans as high risk if the plan sponsor is in Chapter 11 proceedings or sponsor's unsecured debt is rated CCC+/Caa1 or lower by S&P or Moody's respectively. The PBGC specifically reviews each plan identified as high risk and classifies those plans as probable if, based on available evidence, the PBGC concludes that plan termination is likely. Otherwise, high risk plans are classified as reasonably possible.

(6) In accordance with Statement of Financial Accounting Standards No. 5 (Accounting for Contingencies), the PBGC's exposure to losses from plans of companies that are classified as reasonably possible is disclosed in the footnotes. In order for a plan sponsor to be specifically classified as reasonably possible, it must first have $5 million or more of underfunding, as well as meet additional criteria. Criteria used for classifying a company as reasonably possible include, but are not limited to, one or more of the following conditions: the plan sponsor is in Chapter 11 reorganization; funding waiver pending or outstanding with the Internal Revenue Service (IRS); sponsor missed minimum funding contribution; sponsor's bond rating is below-investment-grade for Standard & Poor's (BB+) or Moody's (Ba1); sponsor has no bond rating but unsecured debt is below investment grade; or sponsor has no bond rating but the ratio of long-term debt plus unfunded benefit liability to market value of shares is 1.5 or greater (see Note 7).

Present Value of Nonrecoverable Future Financial Assistance: In accordance with Title IV of ERISA, the PBGC provides financial assistance to multiemployer plans, in the form of loans, to enable the plans to pay guaranteed benefits to participants and reasonable administrative expenses. These loans, issued in exchange for interest-bearing promissory notes, constitute an obligation of each plan.

The present value of nonrecoverable future financial assistance represents the estimated nonrecoverable payments to be provided by the PBGC in the future to multiemployer plans that will not be able to meet their benefit obligations. The present value of nonrecoverable future financial assistance is based on the difference between the present value of future guaranteed benefits and expenses and the market value of plan assets, including the present value of future amounts expected to be paid by employers, for those plans that are expected to require future assistance. The amount reflects the rates at which, in the opinion of management, these liabilities (net of expenses) could be settled in the market for single-premium nonparticipating group annuities issued by private insurers (see Note 5).

A liability for a particular plan is included in the "Present Value of Nonrecoverable Future Financial Assistance" when it is determined that the plan is currently, or will likely become in the future, insolvent and will require assistance to pay the participants their guaranteed benefit. Determining insolvency requires considering several complex factors, such as an estimate of future cash flows, future mortality rates, and age of participants not in pay status.

Each year, the PBGC analyzes insured multiemployer plans to identify those plans that are at risk of becoming claims on the insurance program. Regulatory filings with the PBGC and the other ERISA agencies are important to this analysis and determination of risk. For example, a multiemployer plan that no longer has contributing employers files a notice of termination with the PBGC. In general, if a terminated plan's assets are less than the present value of its liabilities, the PBGC considers the plan a probable risk of requiring financial assistance in the future. During FY 2007, eleven underfunded multiemployer plans terminated, and thus the PBGC recorded a loss representing the present value of estimated future financial assistance payments to those plans.

The PBGC also analyzes ongoing multiemployer plans (i.e., plans that continue to have employers making regular contributions for covered work) to determine whether any such plans may be probable or possible claims on the insurance program. In conducting this analysis each year, the PBGC examines plans that are chronically underfunded, have poor cash flow trends, a falling contribution base, and plans that may lack a sufficient asset cushion to weather temporarily income losses. A combination of these factors, or any one factor that is of sufficient concern, leads to a more detailed analysis of the plan's funding and the likelihood that the contributing employers will be able maintain the plan.

<u>Other Expenses:</u> These expenses represent an estimate of the net amount of receivables deemed to be uncollectible during the period (e.g., reserve for disputed or doubtful termination premiums, write-off of unpaid premiums from recent large plan terminations). The estimate is based on the most recent status of the debtor (e.g., sponsor), the age of the receivables and other factors that indicate the element of uncollectibility in the receivables outstanding.

<u>Losses from Completed and Probable Terminations:</u> Amounts reported as losses from completed and probable terminations represent the difference as of the actual or expected date of plan termination (DOPT) between the present value of future benefits (including amounts owed under Section 4022(c) of ERISA) assumed, or expected to be assumed, by the PBGC, less related plan assets and the present value of expected recoveries from sponsors and members of their controlled group (see Note 10). When a plan terminates, the previously recorded probable Net claim is reversed and newly estimated DOPT plan assets, recoveries and PVFB are netted and reported on the line PVFB - Plans pending termination and trusteeship (this value is usually different than the amount previously reported), with any change in the estimate being recorded in the Statements of Operations and Changes in Net Position. In addition, the plan's net income from date of plan termination to the beginning of the PBGC's fiscal year is included as a component of losses from completed and probable terminations for plans with termination dates prior to the year in which they were added to the PBGC's inventory of terminated plans.

Actuarial Adjustments and Charges (Credits): The PBGC classifies actuarial adjustments related to changes in method and the effect of experience as underwriting activity; actuarial adjustments are the result of the movement of plans from one valuation methodology to another, e.g., nonseriatim (calculating the liability for the group) to seriatim (calculating separate liability for each person), and of new data (e.g., deaths, revised participant data). Actuarial charges (credits) related to changes in interest rates and passage of time is classified as financial activity. These adjustments and charges (credits) represent the change in the PVFB that results from applying actuarial assumptions in the calculation of future benefit liabilities (see Note 4).

Depreciation and Amortization: The PBGC calculates depreciation on the straight-line basis over estimated useful lives of 5 years for equipment and 10 years for furniture and fixtures. The PBGC calculates amortization for capitalized software, which includes certain costs incurred for purchasing and developing software for internal use, on the straight-line basis over estimated useful lives not to exceed 5 years, commencing on the date that the Corporation determines that the internal-use software is implemented. Routine maintenance and leasehold improvements (the amounts of which are not material) are charged to operations as incurred.

Note 3 -- Investments

Premium receipts are invested through the revolving fund in U.S. Treasury securities. The trust funds include assets the PBGC assumes or expects to assume with respect to terminated plans (e.g., recoveries from sponsors) and investment income thereon. These assets generally are held by custodian banks. The basis and market value of the investments by type are detailed below as well as related investment profile data. The basis indicated is cost of the asset if assumed after the date of plan termination or the market value at date of plan termination if the asset was assumed as a result of a plan's termination. The PBGC marks the plan's assets to market and any increase or decrease in the market value of a plan's assets occurring after the date on which the plan is terminated must, by law, be credited to or suffered by the PBGC. Investment securities denominated in foreign currency are translated into U.S. dollars at the prevailing exchange rates at period end. Purchases and sales of investment securities, income, and expenses are translated into U.S. dollars at the prevailing exchange rates on the respective dates of the transactions. The portfolio does not isolate that portion of the results of operations resulting from changes in foreign exchange rates of investments from the fluctuations arising from changes in market prices of securities held. Such fluctuations are included with the net realized and unrealized gain or loss on investments. For the PBGC's securities, unrealized holding gains and losses are both recognized by including them in earnings. Unrealized holding gains and losses measure the total change in fair value – consisting of unpaid interest income earned or unpaid accrued dividend and the remaining change in fair value from holding the security.

As the table below illustrates, the market value of investments of the single-employer program increased significantly from September 30, 2006, to September 30, 2007.

INVESTMENTS OF SINGLE-EMPLOYER REVOLVING FUNDS AND SINGLE-EMPLOYER TRUSTEED PLANS

	September 30, 2007		September 30, 2006	
(Dollars in millions)	**Basis**	**Market Value**	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	**$17,658**	**$17,558**	$20,195	$19,838
Commercial paper	**1,188**	**1,188**	1,591	1,591
Asset backed securities	**4,544**	**4,494**	3,714	3,692
Corporate and other bonds	**13,250**	**13,210**	10,516	10,382
Subtotal	**36,640**	**36,450**	36,016	35,503
Equity securities	**10,729**	**17,386**	9,127	13,730
Real estate and real estate investment trusts	**4**	**3**	6	4
Insurance contracts and other investments	**45**	**37**	12	1
Total *	**$47,418**	**$53,876**	$45,161	$49,238

* This includes securities on loan at September 30, 2007 and September 30, 2006, with a market value of $4.939 billion and $6.352 billion, respectively.

INVESTMENTS OF MULTIEMPLOYER REVOLVING FUNDS AND MULTIEMPLOYER TRUSTEED PLANS

	September 30, 2007		September 30, 2006	
(Dollars in millions)	**Basis**	**Market Value**	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	**$1,199**	**$1,189**	$1,191	$1,159
Equity securities	**0**	**0**	0	0
Total	**$1,199**	**$1,189**	$1,191	$1,159

INVESTMENT PROFILE

	September 30, 2007	2006
Fixed Income Assets		
Average Quality	**AA**	AA
Average Maturity (years)	**16.7**	18.6
Duration (years)	**13.4**	13.9
Yield to Maturity (%)	**5.4**	5.3
Equity Assets		
Average Price/Earnings Ratio	**18.3**	18.7
Dividend Yield (%)	**1.8**	1.7
Beta	**1.03**	1.02

In addition, the PBGC's trusteed liability return was 0.7% and the duration (years) of these liabilities was 9.6 at the end of 2007.

Derivative Instruments: Derivatives are accounted for at market value in accordance with the Statement of Financial Accounting Standards No. 133, as amended. Derivatives are marked to market with changes in value reported within financial income. These instruments are used to (1) mitigate risk (e.g., adjust duration or currency exposures), (2) enhance investment returns, and/or (3) as liquid and cost efficient substitutes for positions in physical securities. The standard requires disclosure of fair value on these instruments. During fiscal years 2006 and 2007, the PBGC invested in investment products that used various U.S. and non-U.S. derivative instruments including but not limited to: money market, futures, options, government bond futures, forward contracts, interest rate and credit default swaps and swaption contracts, stock warrants and rights, debt option contracts, and foreign currency forward and option contracts. Some of these derivatives are traded on organized exchanges and thus bear minimal counterparty risk. The counterparties to the PBGC's non-exchange-traded derivative contracts are major financial institutions. The PBGC monitors its counterparty risk and has never experienced non-performance by any of its counterparties.

A futures contract is an agreement between a buyer or seller and an established futures exchange or clearinghouse in which the buyer or seller agrees to take or make a delivery of a specific amount of a financial instrument at a specified price on a specific date (settlement date). The futures exchange clearinghouses clear, settle, and guarantee transactions occurring through its facilities. Upon entering into a futures contract, an "initial margin" amount (in cash or liquid securities) of generally one to six percent of the face value indicated in the futures contract is required to be deposited with the broker. Open futures positions are marked to market daily. Subsequent payments known as "variation margin" are made or received by the portfolio dependent upon the daily fluctuations in value of the underlying contract. The

PBGC maintains adequate liquidity in its portfolio to meet these margin calls. Futures contracts are valued at the most recent settlement price.

The PBGC also invests in forward contracts. A bond forward is an agreement whereby the short position agrees to deliver pre-specified bonds to the long at a set price and within a certain time window. A forward foreign currency exchange contract is a commitment to purchase or sell a foreign currency at the settlement date at a negotiated rate. Foreign currency forward and option contracts may be used as a substitute for cash currency holdings, in order to minimize currency risk exposure to changes in foreign currency exchange rates and to adjust overall currency exposure to reflect the investment views of the fixed income portfolio managers regarding relationships between currencies.

A swap is an agreement between two parties to exchange different financial returns on a notional investment amount. The two major forms of swaps traded are interest rate swaps and credit default swaps. The PBGC uses swap and swaption contracts to adjust exposure to interest rates, fixed income securities exposure, credit exposure, and to generate income based on the investment views of the portfolio managers regarding interest rates, indices and debt issues.

Interest rate swaps involve exchanges of fixed rate and floating rate interest. Interest rate swaps are often used to alter exposure to interest rate fluctuations, by swapping fixed rate obligations for floating rate obligations, or vice versa. The counterparties to the swap agree to exchange interest payments on specific dates, according to a predetermined formula.

A credit default swap is a contract between a buyer and seller of protection against a pre-defined credit event. The portfolio may buy or sell credit default swap contracts to seek to increase the portfolio's income or to mitigate the risk of default on portfolio securities.

An option contract is a contract in which the writer of the option grants the buyer of the option the right to purchase from (call option) or sell to (put option) the writer a designated instrument at a specified price within a specified period of time.

Stock warrants and rights allow the PBGC to purchase securities at a stipulated price within a specified time limit.

For the fiscal years ended September 30, 2007 and 2006, respectively, gains and losses from settled margin calls are reported in Investment income on the Statements of Operations and Changes in Net Position.

During FY 2007, PBGC's investment managers increased their utilization of derivative instruments. Changing market conditions in FY 2007, such as the significant increase in market volatility and the substantial decrease in market liquidity, created an environment in which derivative instruments represented a more cost efficient means for implementing portfolio strategies than in FY 2006

The following table summarizes the notional amounts and fair market values (FMV) of derivative financial instruments held or issued for trading as of September 30, 2007, and September 30, 2006. FY 2006 notional amounts for swaps and options have been revised. The notional (contractual) amount is used for computing the size of interest payments for swap agreements. It is not an amount actually at risk, nor is it an amount that is actually exchanged. Instead, it provides a basis for computing interest flows. These amounts have no impact on assets, liabilities or net position.

	Sept. 30, 2007		Sept. 30, 2006	
DERIVATIVE CONTRACTS	**Notional**	**FMV**	Notional	FMV
(Dollars in millions)				
Forwards	**$ 765**	**$ (3)**	$ 685	$ 2
Futures				
Contracts in a receivable position	**9,380**	**3**	2,940	0
Contracts in a payable position	**6,869**	**(14)**	7,970	(6)
Total futures	**16,249**	**(11)**	10,910	(6)
Swap agreements				
Interest rate swaps	**10,352**	**(76)**	3,116	(18)
Credit default swaps	**2,063**	**33**	130	7
Total swap agreements	**12,415**	**(43)**	3,246	(11)
Options purchased (long)	**6,425**	**76**	463	17
Options written (sold short)	**2,338**	**(49)**	704	(19)
Forwards – foreign exchange	**1,505**	**11**	1,767	1

Securities Lending: The PBGC participates in a securities lending program administered by its custodian bank whereby the custodian bank lends PBGC's securities to third parties. The custodian bank requires collateral from the borrower that equals 102 percent to 105 percent of the securities lent. The collateral is held by the custodian bank. In addition to the lending program managed by the custodian bank, some of the PBGC's investment managers are authorized to invest in repurchase agreements and reverse repurchase agreements. The manager either receives cash as collateral or pays cash out to be used as collateral. Any cash collateral received is invested. The total value of securities on loan at September 30, 2007, and September 30, 2006, was $4.939 billion and $6.352 billion, respectively.

Although securities on loan have decreased since September 30, 2006, there continues to be an ongoing demand for fixed income securities to lend.

The amount of cash collateral received for these loaned securities was $5.045 billion at September 30, 2007, and $6.491 billion at September 30, 2006. These amounts are recorded as assets and are offset with a corresponding liability. The PBGC had earned income from securities lending of $6.2 million as of September 30, 2007 and $5.2 million as of September 30, 2006. Net income from securities lending is included in "Investment income – Fixed" on the Statements of Operations and Changes in Net Position. As of September 30, 2007, the PBGC loaned out $4.939 billion in securities of approximately $18.210 billion of securities available for securities lending. At September 30, 2006, securities lending collateral was included in "Cash and cash equivalents"; beginning in FY 2007 securities lending collateral is shown separately on the Statements of Financial Condition. This change had no effect on net position.

Of the $4.939 billion market value of securities on loan at September 30, 2007, approximately 86% are invested in U.S. government securities and 13% in U.S. corporate securities.

Note 4 -- Present Value of Future Benefits

The following table summarizes the actuarial adjustments, charges and credits that explain how the Corporation's single-employer program liability for the present value of future benefits changed for the years ended September 30, 2007 and 2006.

For FY 2007, the PBGC used a 20-year select interest factor of 5.31% followed by an ultimate factor of 4.88% for the remaining years. In FY 2006, the PBGC used a 25-year select interest factor of 4.85% followed by an ultimate factor of 4.82% for the remaining years. These factors were determined to be those needed, given the mortality assumptions, to continue to match the survey of annuity prices provided by the American Council of Life Insurers (ACLI). Both the interest factor and the length of the select period may vary to produce the best fit with these prices. The prices reflect rates at which, in the opinion of management, the liabilities (net of administrative expenses) could be settled in the market at September 30, for the respective year, for single-premium nonparticipating group annuities issued by private insurers. Many factors, including Federal Reserve policy, changing expectations about longevity risk, and competitive market conditions may affect these rates.

For FY 2005, the surveys of annuity prices were used in conjunction with a Moody's bond index, averaged over the last five days of each month. Beginning in FY 2006, a Lehman's bond index is used instead; this index is as of only the last day of the month, and is applied to both the select and ultimate factors instead of the select factor only as had been prior practice. Finally, interest factors beginning in FY 2006 are now rounded to two decimal places instead of one so as to be able to state to the level of a single basis point. For FY 2005 and prior years, the select factor was rounded to ten basis points, and the ultimate factor was rounded to 25 basis points.

For September 30, 2007, the PBGC used the 1994 Group Annuity Mortality (GAM) 94 Static Table (with margins), set forward one year and projected 23 years to 2017 using Scale AA. For September 30, 2006, the PBGC used the same table set forward one year, projected 22 years to 2016 using scale AA. The number of years that the PBGC projects the mortality table reflects the number of years from the 1994 base year of the table to the end of the fiscal year (13 years in 2007 versus 12 years in 2006) plus the PBGC's calculated duration of its liabilities (10 years in both 2007 and 2006). The PBGC's procedure is based on the procedures recommended by the Society of Actuaries UP-94 Task Force (which developed the GAM94 table) for taking into account future mortality improvements.

The PBGC continues to utilize the results of its 2004 mortality study. The study showed that the mortality assumptions used in FY 2003 reflected higher mortality than was realized in the PBGC's seriatim population. Therefore, the PBGC adopted a base mortality table (i.e., GAM94 set forward one year instead of GAM94 set forward two years) that better reflects past mortality experience. The ACLI survey of annuity prices, when combined with the mortality table, provides the basis for determining the interest factors used in calculating the PVFB. The insurance annuity prices, when combined with the stronger mortality table, result in a higher interest factor.

The reserve for administrative expenses in the 2006 valuations was assumed to be 1.18 percent of benefit liabilities plus additional reserves for cases in which plan asset determinations, participant database audits and actuarial valuations were not yet complete. As the result of an updated study, the expense reserve factor for FY 2007 has changed to 1.37 percent. The factors to determine the additional reserves were also re-estimated and continue to be based on plan milestone completion as well as case size, number of participants and time since trusteeship.

The present values of future benefits for trusteed multiemployer plans for 2007 and 2006 reflect the payment of assistance and the changes in interest and mortality assumptions, the passage of time and the effect of experience.

The resulting liability represents the PBGC's best estimate of the measure of anticipated experience under these programs.

RECONCILIATION OF THE PRESENT VALUE OF FUTURE BENEFITS FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

	September 30,			
(Dollars in millions)	**2007**		2006	
Present value of future benefits, at beginning of year -- Single-Employer, net		**$ 69,143**		$ 69,737
Estimated recoveries, prior year		**62**		343
Assets of terminated plans pending trusteeship, net, prior year		**282**		3,039
Present value of future benefits at beginning of year, gross		**69,487**		73,119
Settlements and judgments, prior year		**(55)**		(58)
Net claims for probable terminations, prior year		**(4,862)**		(10,470)
Actuarial adjustments -- underwriting:				
Changes in method and assumptions	**$ (88)**		$ (609)	
Effect of experience	**(26)**		185	
Total actuarial adjustments -- underwriting	**(114)**		(424)	
Actuarial charges -- financial:				
Passage of time	**3,269**		3,206	
Change in interest rates	**(2,809)**		2,037	
Total actuarial charges -- financial	**460**		5,243	
Total actuarial charges, current year		**346**		4,819
Terminations:				
Current year	**5,548**		1,112	
Changes in prior year	**(109)**		130	
Total terminations		**5,439**		1,242
Benefit payments, current year*		**(4,266)**		(4,082)
Estimated recoveries, current year		**(155)**		(62)
Assets of terminated plans pending trusteeship, net, current year		**(540)**		(282)
Settlements and judgments, current year		**55**		55
Net claims for probable terminations:				
Future benefits**	**14,810**		17,430	
Estimated plan assets and recoveries from sponsors	**(11,024)**		(12,568)	
Total net claims, current year		**3,786**		4,862
Present value of future benefits, at end of year -- Single-Employer, net		**69,235**		69,143
Present value of future benefits, at end of year – Multiemployer		**2**		2
Total present value of future benefits, at end of year, net		**$ 69,237**		$ 69,145

* The benefit payments of $4,266 million and $4,082 million include $96 million in 2007 and $76 million in 2006 for benefits paid from plan assets by plans prior to trusteeship.

** The future benefits for probable terminations of $14,810 million and $17,430 million for fiscal years 2007 and 2006, respectively, include $71 million and $87 million, respectively, in net claims (future benefits less estimated plan assets and recoveries) for probable terminations not specifically identified and $14,739 million and $17,343 million, respectively, in net claims for specifically identified probables.

The following table details the assets that make up single-employer terminated plans pending termination and trusteeship:

ASSETS OF SINGLE-EMPLOYER PENDING TERMINATION AND TRUSTEESHIP, NET

	September 30, 2007		September 30, 2006	
(Dollars in millions)	**Basis**	**Market Value**	Basis	Market Value
U.S. Government securities	**$ 11**	**$ 11**	$ 0	$ 0
Corporate and other bonds	**151**	**155**	107	113
Equity securities	**172**	**187**	117	156
Insurance contracts	**1**	**0**	4	4
Other	**188**	**187**	9	9
Total, net	**$523**	**$540**	$237	$282

Net Claims for Probable Terminations: Factors that are presently not fully determinable may be responsible for these claim estimates differing from actual experience. Included in net claims for probable terminations is a provision for future benefit liabilities for plans not specifically identified.

The values recorded in the following reconciliation table have been adjusted to the expected dates of termination.

RECONCILIATION OF NET CLAIMS FOR PROBABLE TERMINATIONS

	September 30,			
(Dollars in millions)	**2007**		2006	
Net claims for probable terminations, at beginning of year		**$ 4,862**		$10,470
New claims	**$ 130**		$ 3,063	
Actual terminations	**(1,745)**		(288)	
Deleted probables	**(17)**		(8,035)	
Change in benefit liabilities	**1,189**		(867)	
Change in plan assets	**(633)**		519	
Loss (credit) on probables		**(1,076)**		(5,608)
Net claims for probable terminations, at end of year		**$ 3,786**		$ 4,862

The following table itemizes the probable exposure by industry:

PROBABLES EXPOSURE BY INDUSTRY (PRINCIPAL CATEGORIES)

(Dollars in millions)	**FY 2007**	FY 2006
Manufacturing	**$ 3,590**	$3,318
Services/Other	**150**	197
Wholesale and Retail Trade	**27**	7
Finance, Insurance, and Real Estate	**19**	20
Transportation, Communication and Utilities	**-**	1,279
Agriculture, Mining, and Construction	-	41
Total	**$3,786**	$4,862

For further detail, see Note 2 subpoint (4)

The following table shows what has happened to plans classified as probables. This table does not capture or include those plans that were not previously classified as probable before they terminated. This table incorporates the impact of the additional probable deletions of the Pension Protection Act (PPA). The second table below reflects results excluding the impact due to the PPA, which was an unpredictable factor impacting the PBGC's ability to predict probables as terminations.

ACTUAL PROBABLES EXPERIENCE
As Initially Recorded Beginning in 1987

(Dollars in millions)	Status of Probables from 1987-2006 at September 30, 2007			
Beginning in 1987, number of plans reported as Probable:	Number of Plans	Percent of Plans	Net Claim	Percent of Net Claim
Probables terminated	308	78%	$24,106	66%
Probables not yet terminated or deleted	6	2%	3,004	8%
Probables deleted *	80	20%	9,358	26%
Total	394	100%	$36,468	100%

* "Probables deleted" in the above table includes 5 plans deleted due to airline provisions pursuant PPA. Absent passage of PPA and had these 5 plans terminated, the following values in the above table would be adjusted:

ADJUSTED PROBABLES EXPERIENCE – excluding impact of Pension Protection Act of 2006
As Initially Recorded Beginning in 1987

(Dollars in millions)	Status of Probables from 1987-2006 at September 30, 2007			
Beginning in 1987, number of plans reported as Probable:	Number of Plans	Percent of Plans	Net Claim	Percent of Net Claim
Probables terminated	313	79%	$32,315	89%
Probables not yet terminated or deleted	6	2%	3,004	8%
Probables deleted *	75	19%	1,149	3%
Total	394	100%	$36,468	100%

Note 5 -- Multiemployer Financial Assistance

The PBGC provides financial assistance to multiemployer defined benefit pension plans in the form of loans. An allowance is set up to the extent that repayment of these loans is not expected.

NOTES RECEIVABLE MULTIEMPLOYER FINANCIAL ASSISTANCE

	September 30,	
(Dollars in millions)	**2007**	2006
Gross balance at beginning of year	**$ 155**	$ 85
Financial assistance payments - current year	**71**	70
Subtotal	**226**	155
Allowance for uncollectible amounts	**(226)**	(155)
Net balance at end of year	**$ 0**	$ 0

The losses from financial assistance reflected in the Statements of Operations and Changes in Net Position include period changes in the estimated present value of nonrecoverable future financial assistance.

As of September 30, 2007, the corporation expects 94 multiemployer plans will exhaust plan assets and need financial assistance from the PBGC to pay guaranteed benefits and plan administrative expenses. The present value of nonrecoverable future financial assistance for these 94 plans is $2.1 billion. The 94 plans fall into three categories - plans currently receiving financial assistance; plans that have terminated but have not yet started receiving financial assistance from the PBGC; and ongoing plans (not terminated) that the corporation expects will require financial assistance in the future.

Of the 94 plans:

- 34 have exhausted plan assets and are currently receiving financial assistance payments from the PBGC. The present value of future financial assistance payments for these insolvent 34 plans is $928 million.

- 49 plans have terminated but have not yet started receiving financial assistance payments from the PBGC. Terminated multiemployer plans no longer have employers making regular contributions for covered work, though some plans continue to receive withdrawal liability payments from withdrawn employers. In general, the PBGC records a loss for future financial assistance for any underfunded multiemployer plan that has terminated. The present value of future financial assistance payments to these 49 terminated plans is $625 million.
- 11 plans are ongoing (i.e., have not terminated), but the PBGC expects these plans will exhaust plan assets and need financial assistance within 10 years. In this analysis, the PBGC takes into account the current plan assets, future income to the plan, the statutory funding rules, and the possibility for future increases in contributions. The present value of future financial assistance payments for these 11 ongoing plans is $571 million.

PRESENT VALUE OF NONRECOVERABLE FUTURE FINANCIAL ASSISTANCE AND LOSSES FROM FINANCIAL ASSISTANCE

	September 30,	
(Dollars in millions)	**2007**	2006
Balance at beginning of year	**$1,876**	$1,485
Changes in allowance:		
Losses from financial assistance	**319**	461
Financial assistance granted (previously accrued)	**(71)**	(70)
Balance at end of year	**$2,124**	$1,876

Note 6 -- Accounts Payable and Accrued Expenses

The following table itemizes accounts payable and accrued expenses reported in the Statements of Financial Condition:

ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	September 30,	
(Dollars in millions)	**2007**	2006
Annual leave	**$ 6**	$ 5
Other payables and accrued expenses	**105**	88
Accounts payable and accrued expenses	**$111**	$93

Note 7 -- Contingencies

Single-employer plans sponsored by companies whose credit quality is below investment grade pose a greater risk of being terminated. In addition, there are some multiemployer plans that may require future financial assistance. The amounts disclosed below represent the Corporation's best estimates of the reasonably possible losses in these plans given the inherent uncertainties about these plans.

In accordance with Statement of Financial Accounting Standards No. 5, the PBGC classified a number of these companies as reasonably possible terminations as the sponsors' financial condition and other factors did not indicate that termination of their plans was likely as of year-end. The best estimate of aggregate unfunded vested benefits exposure to the PBGC for the companies' single-employer plans classified as reasonably possible as of September 30, 2007, was $66 billion. This is down from $73 billion in FY 2006.

The estimated unfunded vested benefits exposure has been calculated as of December 31, 2006, and is not based on the PBGC-guaranteed levels. The PBGC calculated this estimate as in previous years by using data obtained from filings and submissions to the government and from corporate annual reports for fiscal years ending in calendar 2006. The Corporation adjusted the value reported for liabilities to a December 31, 2006, PBGC select rate of 5.02% that was derived using the 1994 Group Annuity Mortality Static Table (with margins) projected to 2016 using Scale AA. When available, data were adjusted to a consistent set of mortality assumptions. The underfunding associated with these plans would generally tend to be smaller at September 30, 2007, because of the economic conditions that existed between December 31, 2006 and September 30, 2007. The Corporation did not adjust the estimate for events that occurred between December 31, 2006, and September 30, 2007.

The following table itemizes the reasonably possible exposure by industry:

REASONABLY POSSIBLE EXPOSURE BY INDUSTRY (PRINCIPAL CATEGORIES)

(Dollars in millions)	**FY 2007**	FY 2006
Manufacturing	**$31,364**	$37,634
Transportation, Communication and Utilities	**19,454**	20,509
Services/Other	**6,901**	6,969
Wholesale and Retail Trade	**5,808**	6,096
Finance, Insurance, and Real Estate	**1,153**	857
Agriculture, Mining, and Construction	**985**	1,220
Total	**$65,665**	$73,285

The PBGC included amounts in the liability for the present value of nonrecoverable future financial assistance (see Note 5) for multiemployer plans that the PBGC estimated may require future financial assistance. In addition, the PBGC currently estimates that it is reasonably possible that other multiemployer plans may require future financial assistance in the amount of $73 million.

The Corporation calculated the future financial assistance liability for each multiemployer plan identified as probable (see Note 5), or reasonably possible as the present value of guaranteed future benefit and expense payments net of any future contributions or withdrawal liability payments as of the later of September 30, 2007, or the projected (or actual, if known) date of plan insolvency, discounted back to September 30, 2007. The Corporation's identification of plans that are likely to require such assistance and estimation of related amounts required consideration of many complex factors, such as an estimate of future cash flows, future mortality rates, and age of participants not in pay status. These factors are affected by future events, including actions by plans and their sponsors, most of which are beyond the Corporation's control.

The PBGC used select and ultimate interest rate assumptions of 5.31% for the first 20 years after the valuation date and 4.88% thereafter. The Corporation also used the 1994 Group Annuity Mortality Static Table (with margins), set forward one year, and projected 23 years to 2017 using Scale AA.

Note 8 – Commitments

The PBGC leases its office facility under a new commitment that began on January 1, 2005, and expires December 10, 2018. The new lease agreement was entered into because of the need for additional office space. This lease provides for periodic rate increases based on increases in operating costs and real estate taxes over a base amount. In addition, the PBGC is leasing space for field benefit administrators. These leases began in 1996 and expire in 2013. The minimum future lease payments for office facilities having noncancellable terms in excess of one year as of September 30, 2007, are as follows:

COMMITMENTS: FUTURE LEASE PAYMENTS

(Dollars in millions)

Years Ending September 30,	Operating Leases
2008	$ 19.0
2009	18.3
2010	18.1
2011	19.2
2012	18.4
Thereafter	127.5
Minimum lease payments	$220.5

Lease expenses were $21.9 million in 2007 and $18.7 million in 2006.

Note 9 -- Premiums

For both the single-employer and multiemployer programs, ERISA provides that the PBGC shall continue to guarantee basic benefits despite the failure of a plan administrator to pay premiums when due. The PBGC assesses interest and penalties on the unpaid portion of or underpayment of premiums. Interest continues to accrue until the premium and the interest due are paid. For plan year 2006 the flat-rate premiums for single-employer pension plans was $30 per participant and the multiemployer plans yearly premium was $8 per participant. For plan year 2007, per participant rates were $31 for single-employer plans and $8 for multiemployer plans. The PBGC recorded premium income, excluding interest and penalty, of approximately $1.1 billion in flat-rate premiums, $358 million in variable-rate premiums, and $61 million in termination premiums for fiscal year 2007, and approximately $941 million in flat-rate premiums and $550 million in variable-rate premiums for fiscal year 2006. The termination premium is a new $1,250 per participant annual post-termination premium payable for three years that applies to certain plan terminations occurring after 2005.

Since premium income for FY 2007 primarily consists of plan year 2007 and 2006 premiums, and revenue recognition accounting principles require partial recognition of plan year 2007 premiums as of September 30, 2007, the 2007 increase in flat-rate premium income represents approximately 65% of the full impact to the plan year 2007 flat-rate premiums due for all plans.

Note 10 -- Losses from Completed and Probable Terminations

Amounts reported as losses are the present value of future benefits less related plan assets and the present value of expected recoveries from sponsors. The following table details the components that make up the losses:

LOSSES FROM COMPLETED AND PROBABLE TERMINATIONS -- SINGLE-EMPLOYER PROGRAM

	For the Years Ended September 30,					
	2007			2006		
(Dollars in millions)	**New Terminations**	**Changes in Prior Year Terminations**	**Total**	New Terminations	Changes in Prior Year Terminations	Total
Present value of future benefits	**$ 5,548**	**$(109)**	**$ 5,439**	$1,112	$ 130	$ 1,242
Less plan assets	**3,802**	**69**	**3,871**	582	1,370	1,952
Plan asset insufficiency	**1,746**	**(178)**	**1,568**	530	(1,240)	(710)
Less estimated recoveries	**0**	**94**	**94**	3	(165)	(162)
Subtotal	**1,746***	**(272)**	**1,474**	527*	(1,075)	(548)
Settlements and judgments		**1**	**1**		1	1
Loss (credit) on probables	**(1,745)**	**669**	**(1,076)****	(288)	(5,320)	(5,608)**
Total	**$ 1**	**$ 398**	**$ 399**	$ 239	$(6,394)	$(6,155)

* gross amounts for plans terminated during the year.

** see Note 4 – includes $1,745 million at September 30, 2007, and $288 million at September 30, 2006, previously recorded relating to plans that terminated during the period.

Note 11 -- Financial Income

The following table details the combined financial income by type of investment for both the single-employer and multiemployer programs:

INVESTMENT INCOME SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS

(Dollars in millions)	**Single-Employer Fund Sept. 30, 2007**	**Multiemployer Fund Sept. 30, 2007**	**Memorandum Total Sept. 30, 2007**	Single-Employer Fund Sept. 30, 2006	Multiemployer Fund Sept. 30, 2006	Memorandum Total Sept. 30, 2006
Fixed income securities:						
Interest earned	**$1,992**	**$ 60**	**$2,052**	$1,756	$ 56	$1,812
Realized loss	**(620)**	**(62)**	**(682)**	(815)	(44)	(859)
Unrealized gain (loss)	**358**	**25**	**383**	(547)	(13)	(560)
Total fixed income securities	**1,730**	**23**	**1,753**	394	(1)	393
Equity securities:						
Dividends earned	**88**	**0**	**88**	89	0	89
Realized gain	**801**	**0**	**801**	522	0	522
Unrealized gain	**2,099**	**0**	**2,099**	1,182	0	1,182
Total equity securities	**2,988**	**0**	**2,988**	1,793	0	1,793
Other income (loss)	**19**	**0**	**19**	(3)	0	(3)
Total investment income (loss)	**$4,737**	**$ 23**	**$4,760**	$2,184	$ (1)	$2,183

Note 12 -- Employee Benefit Plans

All permanent full-time and part-time PBGC employees are covered by the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Full-time and part-time employees with less than five years service under CSRS and hired after December 31, 1983, are automatically covered by both Social Security and FERS. Employees hired before January 1, 1984, participate in CSRS unless they elected and qualified to transfer to FERS.

The Corporation's contribution to the CSRS plan for both 2007 and 2006 was 7.0 percent of base pay for those employees covered by that system. For those employees covered by FERS, the Corporation's contribution was 11.2 percent of base pay for both 2007 and 2006. In addition, for FERS-covered employees, the PBGC automatically contributes one percent of base pay to the employee's Thrift Savings account, matches the first three percent contributed by the employee and matches one-half of the next two percent contributed by the employee. Total retirement plan expenses amounted to $14 million in 2007 and $13 million in 2006.

These financial statements do not reflect CSRS or FERS assets or accumulated plan benefits applicable to the PBGC employees. These amounts are reported by the U.S. Office of Personnel Management (OPM) and are not allocated to the individual employers. OPM accounts for federal health and life insurance programs for those eligible retired the PBGC employees who had selected federal government-sponsored plans. The PBGC does not offer other supplemental health and life insurance benefits to its employees.

Note 13 -- Cash Flows

The following two tables, one for Sales and one for Purchases, provide further details on cash flows from investment activity. Sales and purchases of investments are driven by the level of newly trusteed plans, the unique investment strategies implemented by the PBGC's investment managers, and the varying capital market conditions in which they invest during the year. These cash flow numbers can vary significantly from year to year based on the fluctuation in these three variables.

INVESTING ACTIVITIES (SINGLE-EMPLOYER AND MULTIEMPLOYER PROGRAMS COMBINED)

	September 30,	
(Dollars in millions)	**2007**	2006
Proceeds from sales of investments:		
Fixed maturity securities	**$107,251**	$84,901
Equity securities	**3,314**	2,622
Other/uncategorized	**15,093**	4,857
Memorandum total	**$125,658**	$92,380
Payments for purchases of investments:		
Fixed maturity securities	**$(108,530)**	$(88,655)
Equity securities	**(4,287)**	(2,942)
Other/uncategorized	**(11,627)**	(653)
Memorandum total	**$(124,444)**	$(92,250)

The following is a reconciliation between the net income as reported in the Statements of Operations and Changes in Net Position and net cash provided by operating activities as reported in the Statements of Cash Flows. Cash and cash equivalents at September 30, 2006, has been adjusted on the Statements of Financial Condition and "Cash and cash equivalents, beginning of year" on the Statements of Cash Flows due to the addition of a separate line for "Securities lending collateral" on the Statements of Financial Condition.

RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
(Dollars in millions)	**2007**	2006	**2007**	2006	**2007**	2006
Net income (loss)	**$ 5,031**	$4,634	**$(216)**	$(404)	**$ 4,815**	$4,230
Adjustments to reconcile net income to net cash provided by operating activities:						
Net (appreciation) decline in fair value of investments	**(2,716)**	(350)	**37**	61	**(2,679)**	(289)
Net gain (loss) of plans pending termination and trusteeship	**(159)**	19	**0**	0	**(159)**	19
Losses on completed and probable terminations	**399**	(6,155)	**0**	0	**399**	(6,155)
Actuarial charges	**346**	4,819	**0**	0	**346**	4,819
Benefit payments - trusteed plans	**(4,170)**	(4,006)	**0**	0	**(4,170)**	(4,006)
Settlements and judgments	**(2)**	(3)	**0**	0	**(2)**	(3)
Cash received from plans upon trusteeship	**165**	75	**0**	0	**165**	75
Receipts from sponsors/non-sponsors	**459**	886	**1**	0	**460**	886
Amortization of discounts/premiums	**(599)**	(319)	**(53)**	(28)	**(652)**	(347)
Changes in assets and liabilities, net of effects of trusteed and pending plans:						
Decrease in receivables	**197**	150	**1**	11	**198**	161
Increase in present value of nonrecoverable future financial assistance			**248**	391	**248**	391
Increase (decrease) in unearned premiums	**4**	88	**(1)**	19	**3**	107
Increase in accounts payable	**18**	23	**0**	0	**18**	23
Net cash provided (used) by operating activities	**$ (1,027)**	$ (139)	**$ 17**	$ 50	**$ (1,010)**	$ (89)

Note 14 – Litigation

Legal challenges to PBGC's policies and position continued in 2007. At the end of the fiscal year, the PBGC had 467 open, active bankruptcy cases and 82 active cases in state and federal courts (other than in bankruptcy court). The PBGC records as a liability on its financial statements an estimated cost for unresolved litigation to the extent that losses in such cases are probable and estimable in amount. In addition to such recorded cases, at September 30, 2007, the PBGC estimated that possible losses of up to $36 million could be incurred in the event that the PBGC does not prevail in these matters. These possible losses are not recognized in the financial statements.

Note 15 -- Subsequent Events

For the year ended September 30, 2007, there were no subsequent events to report on either the single-employer or multiemployer program.

Section III

Agency Comments

PBGC
Protecting America's Pensions
Pension Benefit Guaranty Corporation
1200 K Street, N.W., Washington, D.C. 20005-4026

Office of the Director

MEMORANDUM

To:	Deborah Stover-Springer Acting Inspector General	November 7, 2007
From:	Charles E. F. Millard Interim Director	
Subject:	Response to Draft Independent Auditor's Combined Report Issued in Connection with the FY 2007 Financial Statement Audit	

I value the work of the Office of Inspector General in overseeing the FY 2007 financial statement audit. In addition, I appreciate the opportunity to comment on the draft report containing the opinions on the agency's financial statements, management's assertion on the effectiveness of internal controls, and matters relating to compliance with laws and regulations. As a financial institution, it is noteworthy that PBGC has again received unqualified opinions on the Corporation's financial statements and its internal controls for FY 2007.

Progress in the internal controls area was commendable. In particular, I appreciate your recognition of the progress that PBGC has made in addressing last year's reportable condition relating to our preparedness for unanticipated incidences and disruptions of our business operations. In the uncertain world in which we live, the progress in this area is particularly gratifying.

The report also commendably highlights the data quality improvements made in the single-employer premium system. We look forward to working on the remaining premium system issues as part of the significant deficiency related to integrated financial management systems.

We agree with the three recommendations in the report and will work aggressively on the related areas of information security, access controls, and financial management systems integration. The Corporation is in the process of preparing formal Corrective Action Plans to address each of these conditions.

Again, the work of the OIG is sincerely appreciated, and I look forward to working with you in responding to the issues that you have called to our attention.

cc: Vincent K. Snowbarger
Stephen E. Barber
Terrence M. Deneen
Patsy A. Garnett
Richard H. Macy
Judith R. Starr
Theodore J. Winter, Jr.
Martin O. Boehm