



Pension Benefit Guaranty Corporation
Office of Inspector General
Audit Report

**Audit of the Pension Benefit Guaranty Corporation's
Fiscal Year 2008 and 2007 Financial Statements**

Independent Auditor's Report

Pension Benefit Guaranty Corporation's
Fiscal Year 2008 and 2007 Financial Statements

November 13, 2008

2009-1 / FA-0049-1



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

The Office of Inspector General 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, 2008 and 2007. 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*, as amended; and the *Government Accountability Office / President's Council Integrity and Efficiency Financial Audit Manual*.

In the audits 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, 2008, is fairly stated in all material respects. However, Clifton Gunderson 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 reportable noncompliance with tested laws and regulations.

Clifton Gunderson is responsible for the accompanying auditor's report dated November 12, 2008, 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 (2009-1/FA-0049-1) is also available on our website at <http://oig.pbgc.gov>.

Sincerely,

Rebecca Anne Batts
Inspector General

November 13, 2008

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Abbreviations

C&A	Certification and Accreditation
FIPS PUB	Federal Information Processing Standards Publication
FMFIA	Federal Managers' Financial Integrity Act of 1982
FY	Fiscal Year
IT	Information Technology
NIST SP	National Institute of Standards and Technology Special Publication
OIG	Office of Inspector General
OMB	Office of Management and Budget
PBGC	Pension Benefit Guaranty Corporation

Audit of the Pension Benefit Guaranty Corporation's
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Audit Report 2009-1 / FA-0049-1

Section I

Independent Auditor's Report

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 2008 and 2007, 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, 2008; and
- no reportable noncompliance in fiscal year 2008 with laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions, (2) our conclusions on other accompanying information, (3) our audit objectives, scope, and methodology, and (4) 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, 2008 and 2007, 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, 2008, PBGC reported in its financial statements net deficit positions (liabilities in excess of assets) in the Single-Employer and Multiemployer Program Funds of \$10,678 million and \$473 million, respectively. As discussed in Note 8 to the financial statements, loss exposure for the Single-Employer and Multiemployer Programs that are reasonably possible as a result of unfunded vested benefits are estimated to be \$46,732 million and \$30 million, respectively. Management based the Single-Employer Program estimate on data for fiscal years ending in calendar 2007 that was obtained from filings and submissions to the

government and from corporate annual reports. Subsequent adjustment for economic conditions through September 30, 2008 has not been made and as a result the exposure to loss for the Single-Employer Program as of September 30, 2008 could be substantially different. In addition, 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 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, 2008 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. Entity-wide Security Program Planning and Management
2. Access Controls
3. Integrated 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.

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.

Our review of IT controls covered general and selected application controls. General controls are the structure, policies, and procedures that apply to an entity's overall computer systems. They include entity-wide security management, access controls, system software controls, application software development and change controls, segregation of duties and service continuity controls. Application controls involve input, processing, and output controls related to specific IT applications.

Our review also included the integration of financial management systems to ensure effective and efficient interrelationships. These interrelationships include common data elements, common transaction processing, consistent internal controls, and transaction entry.

In fiscal year (FY) 2008, PBGC embarked on a concerted entity-wide security management program to correct systemic security control weaknesses at the root cause level. However, these efforts have not been completed and additional time will be needed to adequately implement the audit recommendations noted in the FY 2007 report. PBGC has initiated the reorganization and improvement of its security planning and management through the design and initial implementation of an entity-wide security management program. Our current year audit work found deficiencies in the areas of security 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. The process for effective entity-wide security management and access controls will require time to mature, but the framework that PBGC has developed should significantly improve its security posture, if properly implemented and monitored.

Based on our findings we are reporting as significant deficiencies for FY 2008, (1) entity-wide security program planning and management, (2) access controls and (3) integrated financial management systems. 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 12, 2008. A summary of the significant deficiencies and related recommendations follows.

1. Entity-wide Security Program Planning and Management

An entity-wide security management 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 reflect 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.

During FY 2008, PBGC made significant progress in strengthening the design and implementation of their entity-wide security management program. This program was designed to address previously identified security weaknesses at the root cause level. Management corrected four prior year's internal control weaknesses. First, they completed categorizing their general support systems and major applications in accordance with Federal Standards; second, PBGC identified and documented 65 common security controls; third, they completed a process to conduct certification and accreditation (C&A) procedures; and fourth, they completed security awareness training for employees and contractors.

PBGC made progress on other internal control weaknesses. PBGC has identified and documented 65 common security controls organized into the 17 security control families noted in the National Institute of Standards and Technology (NIST) Special Publication (SP) 800-53, *Recommended Security Controls for Federal Information Systems*. However, PBGC needs to fully implement and confirm the adequacy of design and operating effectiveness of the 65 common controls for all 17 families. PBGC completed the development and implementation of a formal C&A process, using it to complete a review of 13 major applications and general support systems. However, although PBGC conducted a quality control review of the C&A packages, the review did not identify issues with quality, accuracy, and consistency. Lastly, PBGC developed a role-based training program. However, this effort is still in process.

Despite progress in these areas, continued improvements are needed to resolve the control deficiencies. These deficiencies prevent PBGC from implementing effective security controls to protect its information from unauthorized access, modification, and disclosure.

Without a fully implemented security management program, there is increased risk that security controls are inadequate; responsibilities are unclear, misunderstood, and improperly implemented; and controls are inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

Recommendation:

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

2. Access Controls

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 and contractors 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. FIPS PUB 200 requires PBGC's information system owners to limit information system access to authorized users.

PBGC is in the process of implementing a program to address access control weaknesses at the root cause level. PBGC has acknowledged that this approach will require additional time to fully address access control weaknesses. The former approach of addressing specific access control findings did not adequately correct and/or mitigate known control weaknesses. PBGC implemented intensive manual controls in order to compensate for the access control deficiencies. Additionally, management stated that they are evaluating new technology to help enhance their access controls. We continue to find deficiencies in system configurations and user account management across many of PBGC's systems. Until PBGC consistently implements all key elements of its information security program, PBGC will not have sufficient assurance that financial information and financial assets are adequately safeguarded from inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction.

Recommendation:

PBGC management and information system owners should continue 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. Integrated Financial Management Systems

As reported in prior year audits, the risk of inaccurate, inconsistent, and redundant data is increased because PBGC lacks a single integrated financial management system. The current system 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.

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.

In the short term, PBGC's ability to accurately and efficiently record, 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 2008.

Recommendation:

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

Compliance with Laws and Regulations

Our tests of PBGC's compliance with selected provisions of laws and regulations for fiscal year 2008 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, 2008 based on management's assertion included in the accompanying 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 and performing limited procedures with respect to certain other information appearing in the accompanying Annual Management Report.

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 the entity and its operations, including its 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 fiscal year ended September 30, 2008; (6) considered the design of the process for evaluating and reporting on internal control and financial management systems under FMFIA; and (7) tested compliance for fiscal year 2008 with selected provisions of laws and regulations that have a direct and material effect on the financial statements.

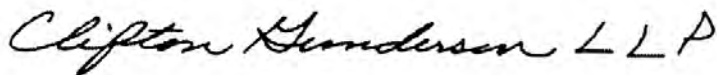
We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because 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 selected provisions of laws and regulations that have a direct and material effect on the financial statements and to those required by OMB audit guidance that we deemed applicable to the financial statements for the fiscal year ended September 30, 2008. 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 Section III of this 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.

A handwritten signature in cursive script that reads "Clifton Henderson LLP".

Calverton, Maryland
November 12, 2008

Audit of the Pension Benefit Guaranty Corporation's
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Section II

**Pension Benefit Guaranty Corporation's
Fiscal Year 2008 and 2007 Financial Statements**

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF FINANCIAL CONDITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	Sept 30, 2008	Sept 30, 2007	Sept 30, 2008	Sept 30, 2007	Sept 30, 2008	Sept 30, 2007
<i>(Dollars in millions)</i>						
ASSETS						
Cash and cash equivalents	\$ 1,906	\$ 2,201	\$ 20	\$ 7	\$ 1,926	\$ 2,208
Securities lending collateral (Note 3)	3,772	5,045	0	0	3,772	5,045
Investments, at market (Note 3):						
Fixed maturity securities	34,075	36,450	1,298	1,189	35,373	37,639
Equity securities	13,044	17,386	0	0	13,044	17,386
Real estate and real estate investment trusts	3	3	0	0	3	3
Other	23	37	0	0	23	37
Total investments	47,145	53,876	1,298	1,189	48,443	55,065
Receivables, net:						
Sponsors of terminated plans	19	68	0	0	19	68
Premiums (Note 10)	185	151	2	1	187	152
Sale of securities	1,357	937	0	0	1,357	937
Derivative contracts (Note 4)	6,831	4,634	0	0	6,831	4,634
Investment income	398	286	7	0	405	286
Other	3	2	0	0	3	2
Total receivables	8,793	6,078	9	1	8,802	6,079
Capitalized assets, net	32	41	0	0	32	41
Total assets	\$61,648	\$67,241	\$1,327	\$1,197	\$62,975	\$68,438

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

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF FINANCIAL CONDITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	Sept 30, 2008	Sept 30, 2007	Sept 30, 2008	Sept 30, 2007	Sept 30, 2008	Sept 30, 2007
<i>(Dollars in Millions)</i>						
LIABILITIES						
Present value of future benefits, net (Note 5):						
Trusteed plans	\$ 56,570	\$ 65,096	\$ 1	\$ 2	\$ 56,571	\$ 65,098
Plans pending termination and trusteeship	216	298	0	0	216	298
Settlements and judgments	56	55	0	0	56	55
Claims for probable terminations	3,154	3,786	0	0	3,154	3,786
Total present value of future benefits, net	<u>59,996</u>	<u>69,235</u>	<u>1</u>	<u>2</u>	<u>59,997</u>	<u>69,237</u>
Present value of nonrecoverable future						
financial assistance (Note 6)			1,768	2,124	1,768	2,124
Payable upon return of securities loaned	3,772	5,045	0	0	3,772	5,045
Unearned premiums	331	302	31	26	362	328
Due for purchases of securities	1,847	814	0	0	1,847	814
Derivative contracts (Note 4)	6,217	4,845	0	0	6,217	4,845
Accounts payable and accrued expenses (Note 7)	163	111	0	0	163	111
Total liabilities	<u>72,326</u>	<u>80,352</u>	<u>1,800</u>	<u>2,152</u>	<u>74,126</u>	<u>82,504</u>
Net position	<u>(10,678)</u>	<u>(13,111)</u>	<u>(473)</u>	<u>(955)</u>	<u>(11,151)</u>	<u>(14,066)</u>
Total liabilities and net position	<u>\$ 61,648</u>	<u>\$ 67,241</u>	<u>\$1,327</u>	<u>\$1,197</u>	<u>\$ 62,975</u>	<u>\$ 68,438</u>

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

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

<i>(Dollars in Millions)</i>	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,	
	2008	2007	2008	2007	2008	2007
UNDERWRITING						
Income:						
Premium (Note 10)	\$ 1,402	\$ 1,476	\$ 90	\$ 81	\$ 1,492	\$ 1,557
Other	23	55	0	0	23	55
Total	<u>1,425</u>	<u>1,531</u>	<u>90</u>	<u>81</u>	<u>1,515</u>	<u>1,612</u>
Expenses:						
Administrative	350	328	0	0	350	328
Other	67	114	1	1	68	115
Total	<u>417</u>	<u>442</u>	<u>1</u>	<u>1</u>	<u>418</u>	<u>443</u>
Other underwriting activity:						
Losses (credits) from completed and probable terminations (Note 11)	(826)	399	0	0	(826)	399
Losses (credits) from financial assistance (Note 6)			(271)	319	(271)	319
Actuarial adjustments (credits) (Note 5)	(649)	(114)	(1)	0	(650)	(114)
Total	<u>(1,475)</u>	<u>285</u>	<u>(272)</u>	<u>319</u>	<u>(1,747)</u>	<u>604</u>
Underwriting gain (loss)	<u>2,483</u>	<u>804</u>	<u>361</u>	<u>(239)</u>	<u>2,844</u>	<u>565</u>
FINANCIAL:						
Investment income (Note 12):						
Fixed	577	1,730	121	23	698	1,753
Equity	(4,788)	2,988	0	0	(4,788)	2,988
Other	47	19	0	0	47	19
Total	<u>(4,164)</u>	<u>4,737</u>	<u>121</u>	<u>23</u>	<u>(4,043)</u>	<u>4,760</u>
Expenses:						
Investment	50	50	0	0	50	50
Actuarial charges (credits) (Note 5):						
Due to passage of time	3,400	3,269	0	0	3,400	3,269
Due to change in interest rates	(7,564)	(2,809)	0	0	(7,564)	(2,809)
Total	<u>(4,114)</u>	<u>510</u>	<u>0</u>	<u>0</u>	<u>(4,114)</u>	<u>510</u>
Financial income (loss)	<u>(50)</u>	<u>4,227</u>	<u>121</u>	<u>23</u>	<u>71</u>	<u>4,250</u>
Net income (loss)	<u>2,433</u>	<u>5,031</u>	<u>482</u>	<u>(216)</u>	<u>2,915</u>	<u>4,815</u>
Net position, beginning of year	<u>(13,111)</u>	<u>(18,142)</u>	<u>(955)</u>	<u>(739)</u>	<u>(14,066)</u>	<u>(18,881)</u>
Net position, end of period	<u>\$ (10,678)</u>	<u>\$ (13,111)</u>	<u>\$ (473)</u>	<u>\$ (955)</u>	<u>\$ (11,151)</u>	<u>\$ (14,066)</u>

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

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF CASH FLOWS

<i>(Dollars in millions)</i>	Single-Employer Program		Multiemployer Program		Memorandum Total	
	For the Years Ended		For the Years Ended		For the Years Ended	
	September 30,		September 30,		September 30,	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
OPERATING ACTIVITIES:						
Premium receipts	\$ 1,336	\$ 1,598	\$ 93	\$ 81	\$ 1,429	\$ 1,679
Interest and dividends received	2,325	1,714	47	7	2,372	1,721
Cash received from plans upon trusteeship	155	165	0	0	155	165
Receipts from sponsors/non-sponsors	137	345	0	0	137	345
Receipts from the missing participant program	7	3	0	0	7	3
Other receipts	1	3	0	0	1	3
Benefit payments – trustee plans	(4,247)	(4,170)	0	0	(4,247)	(4,170)
Financial assistance payments			(85)	(71)	(85)	(71)
Settlements and judgments	(1)	(2)	0	0	(1)	(2)
Payments for administrative and other expenses	(372)	(377)	0	0	(372)	(377)
Accrued interest paid on securities purchased	(702)	(306)	(32)	0	(734)	(306)
Net cash provided (used) by operating activities (Note 14)	<u>(1,361)</u>	<u>(1,027)</u>	<u>23</u>	<u>17</u>	<u>(1,338)</u>	<u>(1,010)</u>
INVESTING ACTIVITIES:						
Proceeds from sales of investments	216,225	123,680	3,270	1,978	219,495	125,658
Payments for purchases of investments	(215,159)	(122,451)	(3,280)	(1,993)	(218,439)	(124,444)
Net change in investment of securities lending collateral	(1,274)	(1,446)	0	0	(1,274)	(1,446)
Net change in securities lending payable	1,274	1,446	0	0	1,274	1,446
Net cash provided (used) by investing activities	<u>1,066</u>	<u>1,229</u>	<u>(10)</u>	<u>(15)</u>	<u>1,056</u>	<u>1,214</u>
Net increase (decrease) in cash and cash equivalents	(295)	202	13	2	(282)	204
Cash and cash equivalents, beginning of year	2,201	1,999	7	5	2,208	2,004
Cash and cash equivalents, end of year	<u>\$ 1,906</u>	<u>\$ 2,201</u>	<u>\$ 20</u>	<u>\$ 7</u>	<u>\$ 1,926</u>	<u>\$ 2,208</u>

The accompanying notes are an integral part of these financial statements

NOTES TO FINANCIAL STATEMENTS

SEPTEMBER 30, 2008 AND 2007

Note 1 – Organization and Purpose

The Pension Benefit Guaranty Corporation (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 PBGC programs be self-financing. ERISA provides that the U.S. Government is not liable for any obligation or liability incurred by PBGC.

For financial statement purposes, PBGC divides its business activity into two broad areas – “Underwriting Activity” and “Financial Activity” – covering both single-employer and multiemployer program segments. 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 PBGC’s assets and liabilities. PBGC’s assets consist of premiums collected from defined benefit plan sponsors, assets from distress or involuntarily terminated plans that PBGC has insured, and recoveries from the former sponsors of those terminated plans. PBGC’s future benefit liabilities consist of those future benefits, under statutory limits, that PBGC has assumed following distress or involuntary terminations. Gains and losses on PBGC’s investments and changes in the value of 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, 2008, the single-employer and multiemployer programs reported deficits of \$10.7 billion and \$473 million, respectively. The single-employer program had assets of over \$61.6 billion offset by total liabilities of \$72.3 billion, which include a total present value of future benefits (PVFB) of approximately \$60.0 billion. As of September 30, 2008, the multiemployer program had assets over \$1.3 billion offset by approximately \$1.8 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 PBGC's long-term obligations to plan participants.

Single-Employer and Multiemployer Program Exposure

PBGC's best estimate of the total underfunding in plans sponsored by companies with credit ratings below investment grade, and classified by PBGC as reasonably possible of termination as of September 30, 2008, was \$47 billion. The comparable estimates of reasonably possible exposure for 2007 and 2006 were \$66 billion and \$73 billion, respectively. These estimates are measured as of December 31 of the previous year (see Note 8). For 2008, this exposure is concentrated in the following sectors: manufacturing (primarily automobile/auto parts, and primary and fabricated metals), transportation (primarily airlines), and wholesale and retail trade.

PBGC estimates that, as of September 30, 2008, it is reasonably possible that multiemployer plans may require future financial assistance in the amount of \$30 million. As of September 30, 2007 and 2006, these exposures were estimated at \$73 million and \$83 million, respectively.

There is significant volatility in plan underfunding and sponsor credit quality over time, which makes long-term estimation of PBGC's expected claims difficult. This volatility, and the concentration of claims in a relatively small number of terminated plans, have characterized PBGC's experience to date and will likely continue. Among the factors that will influence 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 of ERISA is the most current source of individual plan underfunding information; it has accounted for over 75% of the estimates of total underfunding reported in the recent past. Prior to PPA, section 4010 required that companies annually provide PBGC with information on their underfunded plans if the firm's aggregate underfunding exceeds \$50 million or there is an outstanding lien for missed contributions exceeding \$1 million or an outstanding funding waiver of more than \$1 million. 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, PBGC no longer publishes 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, PBGC is liable for the payment of guaranteed benefits with respect only to underfunded terminated plans. An underfunded plan may terminate only if PBGC or a bankruptcy court finds that one of the four conditions for a distress termination, as

defined in ERISA, is met or if PBGC involuntarily terminates a plan under one of five specified statutory tests. The net liability assumed by PBGC is generally equal to the present value of the future benefits payable by PBGC less amounts provided by the plan's assets and amounts recoverable by 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 PBGC to allow the plan to continue to pay participants their guaranteed benefits. 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 PBGC's financial statements is to provide information that is useful in assessing PBGC's present and future ability to ensure that its plan beneficiaries receive benefits when due. Accordingly, 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"). 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, PBGC selects assumptions for expected retirement ages and the cost of administrative expenses in accordance with its best estimate of anticipated experience.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands

disclosures about fair value measurements. SFAS No. 157 applies to accounting pronouncements that require or permit fair value measurements. Prior to SFAS No. 157, there were different definitions of fair value with limited guidance for applying those definitions in GAAP; additionally, the issuance for applying fair value was dispersed among many accounting pronouncements that require fair value measurement. SFAS No. 157 is effective for accounting periods beginning after November 15, 2007, which will be PBGC's FY 2009 financial statements. PBGC is currently evaluating the impact that the adoption of SFAS No. 157 will have on the financial statements.

Revolving and Trust Funds: 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. 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, 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 trusteeed 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 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) PBGC assumes (or expects to assume) once a terminated plan has been trusteeed, and related investment income. These assets generally are held by custodian banks. The trust funds support the operational functions of PBGC.

The trust funds reflect accounting activity associated with: (1) trusteeed plans – plans for which PBGC has legal responsibility – the assets and liabilities are reflected separately on 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 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 PBGC determines are likely to terminate and be trusteeed by 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. PBGC cannot exercise legal control over a plan’s assets until it becomes trustee.

Allocation of Revolving and Trust Funds: 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 according to the year-end balance of each program’s revolving funds. Plan assets acquired by PBGC and commingled at 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: 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 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 by PBGC’s investment agent.

Investment Valuation and Income: 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, 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. 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 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. PBGC discounts any amounts expected to be received beyond one year for time and risk factors. Some agreements between 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 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 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 10).

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 PBGC is or will be obligated to pay the participants of trustee plans and the net liability for plans pending termination and trusteeship. The PVFB liability (including trustee 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. 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). 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). PBGC also includes anticipated expenses to settle the benefit obligation in the determination of the PVFB. 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 PBGC's financial statements (see Note 5).

(1) **Trusted 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 trusted by PBGC prior to fiscal year-end. Assets are shown separately from liabilities for trusted 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 trusted 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) PBGC recognizes net claims for probable terminations which represent 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 in the future. These estimated losses are based on conditions that existed as of PBGC's fiscal year-end. Management believes it is likely that one or more events subsequent to 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 and the criteria will likely be met; or PBGC is considering the plan for involuntary 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 5).

(5) PBGC identifies certain plans as high risk if the plan sponsor is in Chapter 11 proceedings or the sponsor's senior unsecured debt is rated CCC+/Caa1 or lower by S&P or Moody's respectively. PBGC specifically reviews each plan identified as high risk and classifies those plans as probable if, based on available evidence, PBGC concludes that plan termination is likely (based on criteria described in (4) above). Otherwise, high risk plans are classified as reasonably possible.

(6) In accordance with Statement of Financial Accounting Standards No. 5 (Accounting for Contingencies), 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 8).

Present Value of Nonrecoverable Future Financial Assistance: In accordance with Title IV of ERISA, 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 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 6).

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, PBGC analyzes insured multiemployer plans to identify those plans that are at risk of becoming claims on the insurance program. Regulatory filings with 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 PBGC. In general, if a terminated plan’s assets are less than the present value of its liabilities, PBGC considers the plan a probable risk of requiring financial assistance in the future.

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, 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 to maintain the plan.

Other Expenses: 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.

Losses from Completed and Probable Terminations: 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 PBGC, less related plan assets and the present value of expected recoveries from sponsors and members of their controlled group (see Note 11). 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 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 PBGC's inventory of terminated plans.

Actuarial Adjustments and Charges (Credits): 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 5).

Depreciation and Amortization: PBGC calculates depreciation on the straight-line basis over estimated useful lives of 5 years for equipment and 10 years for furniture and fixtures. 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 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. 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 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 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 following table illustrates, the market value of investments of the single-employer program decreased significantly from September 30, 2007, to September 30, 2008.

<i>(Dollars in millions)</i>	September 30, 2008		September 30, 2007	
	Basis	Market Value	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	\$17,509	\$17,587	\$17,658	\$17,558
Commercial paper	636	636	1,188	1,188
Repo/ reverse repo*	(865)	(865)	0	0
Asset backed securities	3,683	3,330	4,544	4,494
Corporate and other bonds	16,037	13,387	13,250	13,210
Subtotal	37,000	34,075	36,640	36,450
Equity securities:				
Public equity	9,410	12,130	9,662	16,310
Private equity	955	914	1,067	1,076
Subtotal	10,365	13,044	10,729	17,386
Real estate and real estate investment trusts	4	3	4	3
Insurance contracts and other investments	18	23	45	37
Total**	\$47,387	\$47,145 ***	\$47,418	\$53,876

*A repo is a contract in which the seller of securities, such as Treasury Bills, agrees to buy them back at a specified time and price.

A reverse repo is a purchase of securities with an agreement to resell them at a higher price at a specific future date. As of September 30, 2008, PBGC investment manager positions in reverse repos exceeded the amounts invested in repurchased agreements, thereby creating a credit balance in the above table for the net overall value of repo and reverse repo positions. Reverse repurchase agreements provide a means for PBGC to maintain ownership rights to specific mortgage pass-through securities, at times when cash is required and the manager believes alternative means of funding (e.g., the sale of other portfolio holdings or deferral of a purchased security's settlement date) are less favorable.

**Total includes securities on loan at September 30, 2008, and September 30, 2007, with a market value of \$3.623 billion and \$4.939 billion, respectively.

***This total of \$47,145 million of investments at market value represents the Single-Employer assets only. It differs from the total investments of \$50.77 billion shown on page 16 of this report which includes investments of the Multiemployer Program, cash and accrued investment income.

<i>(Dollars in millions)</i>	September 30, 2008		September 30, 2007	
	Basis	Market Value	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	\$1,296	\$1,298	\$1,199	\$1,189
Equity securities	0	0	0	0
Total	\$1,296	\$1,298	\$1,199	\$1,189

INVESTMENT PROFILE

	September 30,	
	2008	2007
Fixed Income Assets		
Average Quality	AA	AA
Average Maturity (years)	13.3	16.7
Duration (years)	9.5	13.4
Yield to Maturity (%)	6.3	5.4
Equity Assets		
Average Price/Earnings Ratio	15.4	18.3
Dividend Yield (%)	2.4	1.8
Beta	1.04	1.03

Derivative Instruments: PBGC assigns investment discretion to all of its investment managers. These investment managers, who act as fiduciaries to PBGC, determine when it may or may not be appropriate to utilize derivatives in the portfolios for which they are responsible. Investments in derivatives carry many of the same risks of the underlying instruments and carry additional risks that are not associated with direct investments in the securities underlying the derivatives. Furthermore, risks may arise from the potential inability to terminate or sell derivative positions, although derivative instruments are generally more liquid than physical market instruments. A liquid secondary market may not always exist for certain derivative positions at any time. Over-the-counter derivative instruments also involve counterparty risk that the other party to the derivative instrument will not meet its obligations.

The use of derivatives by PBGC investment managers is restricted in so far as portfolios cannot utilize derivatives to create leverage in the portfolios for which they are responsible. That is, the portfolios shall not utilize derivatives to leverage the portfolio beyond the maximum risk level associated with a fully invested portfolio of physical securities. Such controls are necessary because the use of leverage can magnify the effects of changes in the value of the portfolio's investments, and would make such investments more volatile.

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 2007 and 2008, 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, credit default and total return 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 PBGC's non-exchange-traded derivative contracts are major financial institutions. PBGC monitors its counterparty risk and exchanges collateral to further support performance by 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. PBGC maintains adequate liquidity in its portfolio to meet these margin calls. Futures contracts are valued at the most recent settlement price.

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 position at a set price and within a certain time window. A TBA ("to be announced") forward instrument is an underlying contract on a mortgage backed security (MBS) to buy or sell a MBS which will be delivered at an agreed-upon date in the future. The pool of actual securities is to be announced 48 hours prior to the established trade settlement date. 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 payment flows are usually netted against each other, with one party paying the difference to the other. The major forms of swaps traded are interest rate swaps, credit default swaps, and total return swaps. PBGC uses swap and swaption (an option on a swap) contracts to adjust exposure to interest rates, fixed income securities exposure, credit exposure, equity 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.

A total return swap is a contract between a buyer and seller of exposures to certain asset classes such as equities. The portfolio may buy or sell total return contracts to seek to increase or reduce the portfolio's exposure to certain asset classes.

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 PBGC to purchase securities at a stipulated price within a specified time limit.

For the fiscal years ended September 30, 2008 and 2007, respectively, gains and losses from settled margin calls are reported in Investment income on the Statements of Operations and Changes in Net Position. Securities pledged by PBGC as collateral for derivative contracts, e.g., futures and swaps, are recorded in investments by PBGC's custodian bank.

During FY 2008, PBGC's investment managers increased their utilization of derivative instruments. Changing market conditions in FY 2008, 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 2007.

The following table summarizes the notional amounts and fair market values (FMV) of all derivative financial instruments held or issued for trading as of September 30, 2008, and September 30, 2007.

DERIVATIVE CONTRACTS	Sept. 30, 2008		Sept. 30, 2007	
	Notional	FMV	Notional	FMV
<i>(Dollars in millions)</i>				
Futures				
Contracts in a receivable position	\$ 7,756	\$ 155	\$ 9,380	\$ 3
Contracts in a payable position	<u>7,626</u>	<u>(34)</u>	<u>6,869</u>	<u>(14)</u>
Total futures	15,382	121	16,249	(11)
Swap agreements				
Interest rate swaps	11,211	10	10,352	(76)
Credit default swaps	<u>6,370</u>	<u>(90)</u>	<u>2,063</u>	<u>33</u>
Total swap agreements	17,581	(80)	12,415	(43)
Option contracts				
Options purchased (long)	5,501	51	6,425	76
Options written (sold short)	<u>1,438</u>	<u>(31)</u>	<u>2,338</u>	<u>(49)</u>
Total option contracts	6,939	20	8,763	27
Forward contracts				
Forwards – foreign exchange	1,790	(6)	1,505	11
Forwards – bonds/TBA's	<u>2,657</u>	<u>(21)</u>	<u>765</u>	<u>(3)</u>
Total forward contracts	4,447	(27)	2,270	8

Securities Lending: 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 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, 2008, and September 30, 2007, was \$3.623 billion and \$4.939 billion, respectively. Although securities on loan have decreased since September 30, 2007, there continues to be an ongoing demand for fixed income securities to lend.

The amount of cash collateral received for these loaned securities was \$3.772 billion at September 30, 2008, and \$5.045 billion at September 30, 2007. These amounts are recorded as assets and are offset with a corresponding liability. PBGC had earned income from securities lending of

\$34.6 million and \$6.2 million for the years ending September 30, 2008, and September 30, 2007, respectively. 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, 2008, PBGC loaned out \$3.623 billion in securities of approximately \$17.913 billion of securities available for securities lending.

Of the \$3.623 billion market value of securities on loan at September 30, 2008, approximately 84% are invested in U.S. government securities and 16% in U.S. corporate securities.

Note 4 – Derivative Contracts

PBGC’s derivative financial instruments are recorded at fair value and are included on the Statements of Financial Condition as investments and derivative contracts. Amounts in the table below represent the derivative contracts in a receivable position at financial statement date. Included in the total of \$6,831 million is \$4,577 million representing trades sold and removed from the market value of investments (i.e., bond forwards, TBA’s, interest rate swaps, credit default swaps) on the Statements of Financial Condition and shown below as derivative contracts receivable. The balance of \$2,254 million represents contracts sold which have longer settlement dates to maturity.

DERIVATIVE CONTRACTS

<i>(Dollars in millions)</i>	September 30, 2008	September 30, 2007
Open trades on derivatives:		
Futures contracts	\$ 155	\$ 8
Foreign exchange forwards	2,099	1,770
Bond forwards	855	243
To be announced (TBA) forwards *	2,969	2,169
Interest rate swaps	79	380
Credit default swaps	674	64
Total	\$6,831	\$4,634

* TBA (to be announced) is a contract for the purchase or sale of mortgage-backed securities to be delivered on a future date. The term TBA is derived from the fact that the actual mortgage-backed security that will be delivered to fulfill a TBA trade is not designated at the time the trade is made. The securities are to be announced 48 hours prior to the established trade settlement date. TBA’s are issued by FHLMC, FNMA and GNMA.

Amounts in the Derivative Contracts table below represent derivative contracts in a payable position at financial statement date which PBGC reflects as a contracts liability. Included in this total payable of \$6,217 million is \$4,078 million representing the market value of investments (i.e., bond forwards, TBA’s, interest rate swaps, credit default swaps) which are included in amounts shown as investments at

market on the Statements of Financial Condition. The balance of \$2,139 million reflects the market value of investments purchased with settlement dates in the future and are shown below as derivative contracts payable.

DERIVATIVE CONTRACTS

<i>(Dollars in millions)</i>	September 30, 2008	September 30, 2007
Open trades on derivatives:		
Futures contracts	\$ 34	\$ 19
Foreign exchange forwards	2,105	1,759
Bond forwards	823	283
To be announced (TBA) forwards	2,461	2,340
Interest rate swaps	80	378
Credit default swaps	714	66
Total	\$6,217	\$4,845

Note 5 – 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, 2008 and 2007.

For FY 2008, PBGC used a 20-year select interest factor of 6.66% followed by an ultimate factor of 6.47% for the remaining years. In FY 2007, PBGC used a 20-year select interest factor of 5.31% followed by an ultimate factor of 4.88% 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.

Beginning in FY 2006, a Lehman Long Corporate A and Higher bond index as of the last trading day of the month is used 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 September 30, 2008, PBGC used the 1994 Group Annuity Mortality (GAM) 94 Static

Table (with margins), set forward one year and projected 24 years to 2018 using Scale AA. For September 30, 2007, PBGC used the same table set forward one year, projected 23 years to 2017 using scale AA. The number of years that 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 (14 years in 2008 versus 13 years in 2007) plus PBGC's calculated duration of its liabilities (10 years in both 2008 and 2007). 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.

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 PBGC's seriatim population. Therefore, 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 and carried forward to FY 2008. 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 trustee multiemployer plans for 2008 and 2007 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 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, 2008 AND 2007

September 30,

<i>(Dollars in millions)</i>	2008	2007
Present value of future benefits, at beginning of year -- Single-Employer, net	\$69,235	\$69,143
Estimated recoveries, prior year	155	62
Assets of terminated plans pending trusteeship, net, prior year	540	282
Present value of future benefits at beginning of year, gross	69,930	69,487
Settlements and judgments, prior year	(55)	(55)
Net claims for probable terminations, prior year	(3,786)	(4,862)
Actuarial adjustments -- underwriting:		
Changes in method and assumptions	\$ (715)	\$ (88)
Effect of experience	66	(26)
Total actuarial adjustments -- underwriting	(649)	(114)
Actuarial charges -- financial:		
Passage of time	3,400	3,269
Change in interest rates	(7,564)	(2,809)
Total actuarial charges -- financial	(4,164)	460
Total actuarial charges, current year	(4,813)	346
Terminations:		
Current year	662	5,548
Changes in prior year	(382)	(109)
Total terminations	280	5,439
Benefit payments, current year*	(4,292)	(4,266)
Estimated recoveries, current year	(165)	(155)
Assets of terminated plans pending trusteeship, net, current year	(313)	(540)
Settlements and judgments, current year	56	55
Net claims for probable terminations:		
Future benefits**	12,606	14,810
Estimated plan assets and recoveries from sponsors	(9,452)	(11,024)
Total net claims, current year	3,154	3,786
Present value of future benefits, at end of year -- Single-Employer, net	59,996	69,235
Present value of future benefits, at end of year -- Multiemployer	1	2
Total present value of future benefits, at end of year, net	\$59,997	\$69,237

* The benefit payments of \$4,292 million and \$4,266 million include \$45 million in 2008 and \$96 million in 2007 for benefits paid from plan assets by plans prior to trusteeship.

** The future benefits for probable terminations of \$12,606 million and \$14,810 million for fiscal years 2008 and 2007, respectively, include \$59 million and \$71 million, respectively, for probable terminations not specifically identified and \$12,547 million and \$14,739 million, respectively, 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 PLANS PENDING TERMINATION AND TRUSTEESHIP, NET

<i>(Dollars in millions)</i>	September 30, 2008		September 30, 2007	
	Basis	Market Value	Basis	Market Value
U.S. Government securities	\$ 10	\$ 11	\$ 11	\$ 11
Corporate and other bonds	101	101	151	155
Equity securities	117	120	172	187
Insurance contracts	0	0	1	0
Other	82	81	188	187
Total, net	\$310	\$313	\$523	\$540

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

<i>(Dollars in millions)</i>	September 30,	
	2008	2007
Net claims for probable terminations, at beginning of year	\$3,786	\$ 4,862
New claims	\$ 233	\$ 130
Actual terminations	(148)	(1,745)
Deleted probables	0	(17)
Change in benefit liabilities	(3,400)	1,189
Change in plan assets	<u>2,683</u>	<u>(633)</u>
Loss (credit) on probables	<u>(632)</u>	<u>(1,076)</u>
Net claims for probable terminations, at end of year	<u>\$3,154</u>	<u>\$ 3,786</u>

The following table itemizes the probable exposure by industry:

PROBABLES EXPOSURE BY INDUSTRY (PRINCIPAL CATEGORIES)

<i>(Dollars in millions)</i>	FY 2008	FY 2007
Manufacturing	\$2,964	\$3,590
Services	90	71
Wholesale and Retail Trade	49	27
Finance, Insurance, and Real Estate	46	19
Health Care	5	79
Total	<u>\$3,154</u>	<u>\$3,786</u>

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 PBGC's ability to predict probables as terminations.

ACTUAL PROBABLES EXPERIENCE

As Initially Recorded Beginning in 1987

<i>(Dollars in millions)</i>	Status of Probables from 1987-2007 at September 30, 2008			
	Number of Plans	Percent of Plans	Net Claim	Percent of Net Claim
Beginning in 1987, number of plans reported as Probable:				
Probables terminated	318	78%	\$24,251	66%
Probables not yet terminated or deleted	7	2	2,990	8
Probables deleted *	80	20	9,358	26
Total	<u>405</u>	<u>100%</u>	<u>\$36,599</u>	<u>100%</u>

*"Probables deleted" in the above table includes five plans deleted due to airline relief provisions pursuant PPA. Absent passage of PPA and had these five 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**

<i>(Dollars in millions)</i>	Status of Probables from 1987-2007 at September 30, 2008			
	Number of Plans	Percent of Plans	Net Claim	Percent of Net Claim
Beginning in 1987, number of plans reported as Probable:				
Probables terminated	323	80%	\$32,461	89%
Probables not yet terminated or deleted	7	2	2,990	8
Probables deleted *	75	18	1,148	3
Total	405	100%	\$36,599	100%

Note 6 – Multiemployer Financial Assistance

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

<i>(Dollars in millions)</i>	September 30, 2008	September 30, 2007
Gross balance at beginning of year	\$226	\$155
Financial assistance payments - current year	85	71
Subtotal	311	226
Allowance for uncollectible amounts	(311)	(226)
Net balance at end of period	\$ 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, 2008, the corporation expects 90 multiemployer plans will exhaust plan assets and need financial assistance from PBGC to pay guaranteed benefits and plan administrative expenses. The present value of nonrecoverable future financial assistance for these 90 plans is \$1.8 billion. The 90 plans fall into three categories – plans currently receiving financial assistance; plans that have terminated but have not yet started receiving financial assistance from PBGC; and ongoing plans (not terminated) that the corporation expects will require financial assistance in the future.

Of the 90 plans:

- 37 have exhausted plan assets and are currently receiving financial assistance payments from PBGC. The present value of future financial assistance payments for these insolvent 37 plans is \$841 million.

- 47 plans have terminated but have not yet started receiving financial assistance payments from 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, 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 47 terminated plans is \$639 million.
- 6 plans are ongoing (i.e., have not terminated), but PBGC expects these plans will exhaust plan assets and need financial assistance within 10 years. In this analysis, 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 6 ongoing plans is \$289 million.

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

<i>(Dollars in millions)</i>	September 30, 2008	September 30, 2007
Balance at beginning of year	\$2,124	\$1,876
Changes in allowance:		
Losses (credits) from financial assistance	(271)	319
Financial assistance granted (previously accrued)	(85)	(71)
Balance at end of period	<u>\$1,768</u>	<u>\$2,124</u>

Note 7 – 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

<i>(Dollars in millions)</i>	September 30, 2008	September 30, 2007
Annual leave	\$ 6	\$ 6
Other payables and accrued expenses	157	105
Accounts payable and accrued expenses	<u>\$ 163</u>	<u>\$111</u>

Note 8 – 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 estimated unfunded vested benefits exposure amounts disclosed below represent the Corporation's best estimates of the reasonably possible exposure to loss in these plans given the inherent uncertainties about these plans.

In accordance with Statement of Financial Accounting Standards No. 5, PBGC classified a number of these companies as reasonably possible rather than probable terminations as the sponsors' financial condition and other factors did not indicate that termination of their plans was likely. This classification was done based upon information about the companies as of September 30, 2008.

The best estimate of unfunded vested benefits exposure to loss for the single-employer plans of these companies was measured as of December 31, 2007. The reasonably possible exposure to loss in these plans was \$47 billion for FY 2008. This is down from \$66 billion in FY 2007. This reasonably possible exposure to loss declined primarily due to a net reduction in the unfunded vested benefit liabilities of the plans whose sponsors remained at risk and improved credit ratings and/or other measures of risk for others.

The best estimate of unfunded vested benefits exposure to loss is not based on PBGC-guaranteed benefit levels. 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 2007. The Corporation adjusted the value reported for liabilities to December 31, 2007, PBGC select rate of 5.37% that was derived using the 1994 Group Annuity Mortality Static Table (with margins) projected to 2017 using Scale AA. When available, data were adjusted to a consistent set of mortality assumptions. The underfunding associated with these plans could be substantially different at September 30, 2008, because of the economic conditions that existed between December 31, 2007 and September 30, 2008. The Corporation did not adjust the estimate for events that occurred between December 31, 2007, and September 30, 2008.

The following table by industry itemizes the reasonably possible exposure to loss:

REASONABLY POSSIBLE EXPOSURE TO LOSS BY INDUSTRY (PRINCIPAL CATEGORIES)

<i>(Dollars in millions)</i>	FY 2008	FY 2007
Manufacturing *	\$20,995	\$31,364
Transportation, Communication and Utilities **	16,161	19,454
Wholesale and Retail Trade	4,495	5,808
Services	2,412	4,273
Health Care	1,531	2,628
Agriculture, Mining, and Construction	700	985
Finance, Insurance, and Real Estate	438	1,153
Total	<u>\$46,732</u>	<u>\$65,665</u>

* For FY 2008, primarily automobile/auto parts and primary and fabricated metals

** For FY 2008, primarily airline

PBGC included amounts in the liability for the present value of nonrecoverable future financial assistance (see Note 6) for multiemployer plans that PBGC estimated may require future financial assistance. In addition, PBGC currently estimates that it is reasonably possible that other multiemployer plans may require future financial assistance in the amount of \$30 million.

The Corporation calculated the future financial assistance liability for each multiemployer plan identified as probable (see Note 6), 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, 2008, or the projected (or actual, if known) date of plan insolvency, discounted back to September 30, 2008. 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.

Note 9 – Commitments

PBGC leases its office facility under a commitment that began on January 1, 2005, and expires December 10, 2018. This lease provides for periodic rate increases based on increases in operating costs and real estate taxes over a base amount. In addition, 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, 2008, are as follows:

COMMITMENTS: FUTURE LEASE PAYMENTS

<i>(Dollars in millions)</i>	
Years Ending September 30,	Operating Leases
2009	\$ 19.9
2010	18.9
2011	19.8
2012	18.4
2013	19.1
Thereafter	108.4
Minimum lease payments	<u>\$204.5</u>

Lease expenses were \$21.5 million in 2008 and \$21.9 million in 2007.

Note 10 – Premiums

For both the single-employer and multiemployer programs, ERISA provides that PBGC shall continue to guarantee basic benefits despite the failure of a plan administrator to pay premiums when due. 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 2007 the flat-rate premiums for single-employer pension plans was \$31 per participant and for multiemployer plans, \$8 per participant. For plan year 2008, per participant rates were \$33 for single-employer plans and \$9 for multiemployer plans. PBGC recorded premium income, excluding interest and penalty, of approximately \$1.171 billion in flat-rate premiums, \$241 million in variable-rate premiums, and \$57 million in termination premiums for fiscal year 2008, and approximately \$1.117 billion in flat-rate premiums, \$358 million in variable-rate premiums, and \$61 million in terminated premiums for fiscal year 2007. The termination premium is a \$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 2008 primarily consists of plan year 2008 and 2007 premiums, and revenue recognition accounting principles require partial recognition of plan year 2008 premiums as of September 30, 2008, the 2008 increase in flat-rate premium income represents approximately 66% of the full impact to the plan year 2008 flat-rate premiums due for all plans.

Note 11 – 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

	2008			2007		
	New Terminations	Changes in Prior Year Terminations	Total	New Terminations	Changes in Prior Year Terminations	Total
<i>(Dollars in millions)</i>						
Present value of future benefits	\$ 662	\$(382)	\$ 280	\$ 5,548	\$(109)	\$ 5,439
Less plan assets	391	74	465	3,802	69	3,871
Plan asset insufficiency	271	(456)	(185)	1,746	(178)	1,568
Less estimated recoveries	0	10	10	0	94	94
Subtotal	271*	(466)	(195)	1,746*	(272)	1,474
Settlements and judgments		1	1		1	1
Loss (credit) on probables	(148)	(484)	(632)**	(1,745)	669	(1,076)**
Total	\$ 123	\$(949)	\$(826)	\$ 1	\$ 398	\$ 399

* gross amounts for plans terminated during the year

** see Note 5 – includes \$148 million at September 30, 2008, and \$1,745 million at September 30, 2007, previously recorded relating to plans that terminated during the period

Note 12 – 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

	Single-Employer Program Sept. 30, 2008	Multiemployer Program Sept. 30, 2008	Memorandum Total Sept. 30, 2008	Single-Employer Program Sept. 30, 2007	Multiemployer Program Sept. 30, 2007	Memorandum Total Sept. 30, 2007
<i>(Dollars in millions)</i>						
Fixed income securities:						
Interest earned	\$ 2,071	\$ 63	\$ 2,134	\$ 1,992	\$ 60	\$2,052
Realized gain (loss)	1,268	45	1,313	(620)	(62)	(682)
Unrealized gain (loss)	<u>(2,762)</u>	<u>13</u>	<u>(2,749)</u>	<u>358</u>	<u>25</u>	<u>383</u>
Total fixed income securities	<u>577</u>	<u>121</u>	<u>698</u>	<u>1,730</u>	<u>23</u>	<u>1,753</u>
Equity securities:						
Dividends earned	72	0	72	88	0	88
Realized gain (loss)	(835)	0	(835)	801	0	801
Unrealized gain (loss)	<u>(4,025)</u>	<u>0</u>	<u>(4,025)</u>	<u>2,099</u>	<u>0</u>	<u>2,099</u>
Total equity securities	<u>(4,788)</u>	<u>0</u>	<u>(4,788)</u>	<u>2,988</u>	<u>0</u>	<u>2,988</u>
Other income	<u>47</u>	<u>0</u>	<u>47</u>	<u>19</u>	<u>0</u>	<u>19</u>
Total investment income (loss)	<u>\$ (4,164)</u>	<u>\$ 121</u>	<u>\$ (4,043)</u>	<u>\$ 4,737</u>	<u>\$ 23</u>	<u>\$4,760</u>

Note 13 – 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 2008 and 2007 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 2008 and 2007. In addition, for FERS-covered employees, 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 \$15 million in 2008 and \$14 million in 2007.

These financial statements do not reflect CSRS or FERS assets or accumulated plan benefits applicable to 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 PBGC employees who had selected federal government-sponsored plans. PBGC does not offer other supplemental health and life insurance benefits to its employees.

Note 14 – 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 trustee plans, the unique investment strategies implemented by 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)

<i>(Dollars in millions)</i>	September 30,	
	2008	2007
Proceeds from sales of investments:		
Fixed maturity securities	\$198,230	\$107,251
Equity securities	462	3,314
Other/uncategorized	20,803	15,093
Memorandum total	<u>\$219,495</u>	<u>\$125,658</u>
Payments for purchases of investments:		
Fixed maturity securities	\$(197,197)	\$(108,530)
Equity securities	(459)	(4,287)
Other/uncategorized	(20,783)	(11,627)
Memorandum total	<u>\$(218,439)</u>	<u>\$(124,444)</u>

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.

RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

<i>(Dollars in millions)</i>	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
	2008	2007	2008	2007	2008	2007
Net income (loss)	\$ 2,433	\$ 5,031	\$ 482	\$(216)	\$ 2,915	\$ 4,815
Adjustments to reconcile net income to net cash provided by operating activities:						
Net (appreciation) decline in fair value of investments	6,268	(2,658)	(58)	38	6,210	(2,620)
Net gain (loss) of plans pending termination and trusteeship	25	(107)	0	0	25	(107)
Losses (credits) on completed and probable terminations	(826)	399	0	0	(826)	399
Actuarial charges (credits)	(4,813)	346	(1)	0	(4,814)	346
Benefit payments - trustee plans	(4,247)	(4,170)	0	0	(4,247)	(4,170)
Settlements and judgments	(1)	(2)	0	0	(1)	(2)
Cash received from plans upon trusteeship	155	165	0	0	155	165
Receipts from sponsors/non-sponsors	142	349	0	0	142	349
Amortization of discounts/premiums	(429)	(599)	(41)	(53)	(470)	(652)
Changes in assets and liabilities, net of effects of trustee and pending plans:						
(Increase) decrease in receivables	(149)	197	(8)	1	(157)	198
Increase (decrease) in present value of nonrecoverable future financial assistance			(356)	248	(356)	248
Increase (decrease) in unearned premiums	29	4	5	(1)	34	3
Increase in accounts payable	52	18	0	0	52	18
Net cash provided (used) by operating activities	<u>\$(1,361)</u>	<u>\$(1,027)</u>	<u>\$ 23</u>	<u>\$ 17</u>	<u>\$(1,338)</u>	<u>\$(1,010)</u>

Note 15 – Litigation

Legal challenges to PBGC's policies and position continued in 2008. At the end of the fiscal year, PBGC had 561 open, active bankruptcy cases and 80 active cases in state and federal courts (other than in bankruptcy court). 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, 2008, PBGC estimated with a degree of certainty that possible losses of up to \$104 million could be incurred in the event that PBGC does not prevail in these matters. These possible losses are not recognized in the financial statements.

Note 16 – Subsequent Events

PBGC's financial statements are as of September 30, 2008. Since the close of the fiscal year, there continue to be significant events in the economy and financial markets that may impact the financial statement measurements going forward.

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Audit of the Pension Benefit Guaranty Corporation's
Fiscal Year 2008 and 2007 Financial Statements

Audit Report 2009-1 / FA-0049-1

Section III

Agency Comments




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

Office of the Director

MEMORANDUM

November 5, 2008

To: Rebecca Anne Batts
Inspector General

From: Charles E.F. Millard 
Director

Subject: Response to Draft Independent Auditor's Combined Report Issued in
Connection with the FY 2008 Financial Statement Audit

I welcome the opportunity to comment on the Office of Inspector General's FY 2008 combined report, which includes the opinions on PBGC's financial statements, management's assertion on the effectiveness of internal controls, and matters relating to compliance with laws and regulations.

Management sincerely appreciates the work of your office in overseeing this audit. As PBGC has become an increasingly important financial institution, it is worthy of note that the Corporation has once again received unqualified opinions on our financial statements and internal controls for FY 2008.

We appreciate the report's acknowledgement of the progress we have made over the past year in addressing our significant deficiencies. We concur with the three related recommendations in the areas of information security, access controls, and financial management systems integration. These represent issues that need to be addressed in a measured, rational way, and we look forward to working with you as we update and work through our Corrective Action Plans.

Again, I value the work of the OIG, and PBGC management stands ready to work with your office in fully addressing the issues that you have called to our attention.

cc: Vincent K. Snowbarger
Stephen E. Barber
Terrence M. Deneen
Patsy A. Garnett
Patricia Kelly
Richard H. Macy
Judith R. Starr
Martin O. Boehm