Pension Benefit Guaranty Corporation

Office of Inspector General

Memorandum Report

Lessons Learned from the Fiscal Year 2006 Financial Statement Audit

March 30, 2007

2007-3/FA-0032

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

March 30, 2007

MEMORANDUM REPORT

TO: Vince Snowbarger
Interim Director

Theodore Winter
Acting Chief Financial Officer

FROM: Luther L. Atkins D. Sponton
for Assistant Inspector General for Audits

SUBJECT: Lessons Learned from the Fiscal Year 2006 Financial Statement Audit Process

INTRODUCTION

We are pleased to report that the Pension Benefit Guaranty Corporation (PBGC or the Corporation) continues to make improvements in its financial management activities. In 2006, the Corporation received its fourteenth consecutive unqualified opinion on its fiscal year (FY) 2006 financial statements, received its third consecutive unqualified opinion on management's assertion about the effectiveness of its internal controls, and met the government-wide financial statement audit reporting deadline of November 15. This continued success can be attributed to a strong commitment to the audit by PBGC's senior executives, department directors and managers.

RESULTS IN BRIEF

A more detailed synopsis of some of the most common observations made in relation to areas for improvement and best practices or activities and processes that worked well are included in the Results section of this report and in the attached document. Some of the key highlights are as follows:

Areas, activities, or processes that **worked well** included:

- Periodic audit status meetings
- Separate OIT and financial audit protocol/prepared by client (PBC) meetings to discuss the status of documentation requests on a weekly basis
- Designated Functional Area Representatives (FARs) for each key audit area
- Strong management commitment to the audit process

Areas, activities, or processes that **require improvement** included:

- Better communication and clarification of the timing and results of audit testing performed in relation to outstanding audit recommendations from prior years
- More open and frequent communications between PBGC management and the auditors in relation to items requested that are or are not on the PBC list
- More timely communication of potential audit findings to PBGC management, as well as more timely responses from management to the auditors

Some **key challenges** that could impact the FY07 audit included:

- Changes and updates to the auditing standards, such as lowering the threshold for reporting internal control weaknesses in the Report on Internal Control, and renaming "Reportable Conditions" as "Significant Deficiencies"
- Implementation of a new financial accounting and reporting system of record (CFS)
- Senior executives in key positions are in acting roles – PBGC Director, Chief Financial Officer (CFO), Chief Information Officer (CIO)

OBJECTIVES, SCOPE, AND METHODOLOGY

In January 2007, the Inspector General (IG), in cooperation with the CFO, conducted a survey to identify lessons learned from the audit of the FY 2006 financial statements, so that the results could be potentially incorporated into the FY07 financial statement audit process. We surveyed PBGC employees who were considered key stakeholders, and those who were involved in the financial statement audit process. The survey participants were asked to provide feedback on:

- Areas, activities, and processes that worked well and were successful;
- Areas, activities, and processes that could be improved upon or added for FY 2007;
- Audit status meetings and audit protocol (PBC) meetings;
- Performance of the auditors, PBGC management, contractors, and external third parties (i.e., Government Accountability Office); and
- Potential challenges that could impact the FY 2007 audit.

The OIG also sent the survey to Clifton Gunderson (CG), the financial statement auditors, as well as the PBGC contractors and their Contracting Officer's Technical Representatives (COTRs) who CG visited during the FY06 audit. These contractors included: PBGC's investment custodian and benefits disbursing agent, three investment managers, and two field benefit administrators (FBA).

The Office of Inspector General (OIG) sent the survey to 78 individuals, of which 40 responded. In some cases, PBGC management sent a combined response on behalf of a department or a number of individuals.

Once the OIG received and compiled the survey responses, key stakeholders that included each of the senior executives, department directors, the OIG staff, and the CG partners and managers, held meetings during February and March 2007 to discuss the survey results. The OIG and Acting CFO made a final presentation to the Executive Management Committee (EMC) members on March 16, 2007. This presentation incorporated the survey results and feedback received during our meetings with the key stakeholders. During the presentation, each of the EMC members highlighted their key suggestions to be incorporated into the FY 2007 financial statement audit, as well as their commitment to the audit process.

RESULTS

What worked well and should be continued for FY07

The majority of the survey participants stated that the following worked well and should be continued during the FY07 audit:

- *Periodic audit status meetings* – Survey participants thought that these meetings, which became more frequent as the due date for PBGC's Annual Management Report (AMR) approached, were both an efficient and effective means of ongoing communications between and among PBGC management, the OIG and CG.

- *Weekly audit protocol (PBC) meetings* – The Contracts and Control Review Department (CCRD) held separate OIT and "other" financial audit meetings to discuss the status of audit documentation requests from both PBGC and the auditors. Everyone agreed that these meetings should continue for FY07 and remain separate (OIT and other), given the nature and number of requests to be discussed during the meetings. Everyone applauded CCRD's efforts in coordinating, facilitating, and performing the preparation for these meetings.

- *Functional Area Representatives* – During the FY06 audit, management designated FARs for each of the key areas having an impact on the financial statements and the audit of these statements. The FARs met periodically with CCRD and the auditors, as part of the audit protocol process, which helped to facilitate the coordination of documentation requests, meetings between the auditors and PBGC staff and management, and the notification of potential audit findings.

- *Strong Commitment to the Audit Process* – To meet the Office of Management and Budget's (OMB) November 15 deadline to submit the AMR, a strong commitment to the audit process is crucial. For the FY06 audit, there was a strong commitment on the part of the Senior Executives and Department Directors to facilitate the audit process and cooperate with the Financial Operations Department (FOD), CCRD, and the auditors. PBGC management communicated their commitment to their staff and contractors at all levels and enforced this commitment, whenever necessary. This in turn helped the OIG and the CG staff to complete their audit work on-time.

Other items noted included:
- Quarterly financial statement close-out meetings
- Pilot testing of the AMR compilation/electronic reporting process for submission to OMB and others
- Open communication between CG's actuaries and PBGC
- CG testing not intrusive to ongoing work of the FBAs and investment managers
- Objectives and results of CG's testing communicated in a timely manner
- Professionalism, efficiency, responsiveness and availability of the CG and OIG staff

What could be improved upon or added for FY07

The following are the key areas for improvement identified in the survey, as well as some of the suggested recommendations for the upcoming financial statement audit.

- *Audit Follow-up* – The overwhelming majority of survey participants stated that the process to follow up on and close outstanding prior audit recommendations needs improvement. Management stated that the Corporation needs clarification of what exactly needs to be done to correct or resolve a reported weakness, as well as more timely feedback from the auditors as to whether the Corporation has resolved the issue and implemented the recommendation or corrective action. Once the Corporation has a good understanding of what is needed to address the issues, management can incorporate the resolution of these issues within its strategic plan, and request or reallocate the funds necessary to implement the related recommendations. Even though the auditor has a responsibility to report the deficiency, management may decide to perform a cost-benefit analysis to determine whether it is willing to assume the risk associated with the deficiency, if they believe that the costs outweigh the benefits of resolving the issue.

- *Audit Protocol (PBC) Process* – Although implementation of the audit protocol process was a positive initiative, there is still room for improvement. The communication lines between the auditors and management can be more open. There was a feeling that sometimes the auditors did not fully understand PBGC processes, systems, and controls and that the Corporation had to "re-educate" the auditors. In addition, management sometimes did not understand why an auditor was requesting something and therefore could not always comply with the auditor's request in a timely manner. Finally, management stated that the auditors should also be required to meet their PBC deadlines for providing management with sample items, etc. The auditors felt the same frustration, when items were requested and not always provided in a timely manner – especially in cases where items have been on the PBC list for many years. For items requested that were not on the PBC list, both auditors and management felt frustration. Management was frustrated in that items had to be turned around to the auditors so quickly, and CG was frustrated that they were not receiving the requested items in an expeditious manner. Some also believed that once they had a meeting or provided documentation to an auditor, they could not go back to the auditor to clarify an issue or a prior statement made. Both management and the auditors agreed that communication lines should be opened even more than in prior years. Some also recommended that the PBC meetings begin during the earlier stages of the audit and that the auditors, together with management, review the PBC list at the onset of the audit, to identify changes or deletions in the list for FY07.

- *Notification of Potential Findings* – Many believed that the use of CG's Notice of Findings and Recommendations (NFR) forms was positive; however, management would prefer to receive feedback regarding potential findings in a more timely manner. In general, an NFR form is signed by the PBGC person directly involved in the particular process or control activity. This form should also be signed by the applicable department director and/or senior executive to help ensure that persons at all levels are informed of the issue when it is raised. In turn, the auditors would like to receive a more timely response regarding the issues raised. During the FY06 audit, the auditors did not receive some responses to reportable conditions and management letter issues until one month after the comment deadline. Since management stated that five working days to response to an NFR is not always sufficient, especially when multiple parties and contractors are involved, some recommended that management request an extension from CG to sign off on the NFR, on an exception basis. Finally, the department directors should remind their staff that audit findings are related to controls and processes, not to specific individuals.

Other items noted included:

- Improving communications between the auditors, PBGC (COTRs), and its off-site contractors;
- Combining the two legal representation letters into one letter;
- Involving the Office of General Counsel in more audit status and PBC meetings; and
- Finalizing the format and content of the management representation letter earlier in the audit (including holding OIG discussions with the GAO).

Potential challenges for the FY07 audit

Some of the potential challenges identified that could have an impact on the FY07 audit include:

- Changes and updates to the auditing standards, such as lowering the threshold for reporting internal control weaknesses in the Report on Internal Control, and renaming "Reportable Conditions" as "Significant Deficiencies"

- Implementation of a new financial accounting and reporting system of record (CFS)
- Mandatory premium e-filings and development of a new premiums system (PPS)
- Enactment and implementation of the Pension Protection Act of 2006
- Senior executives in key positions in acting roles – PBGC Director, CFO, CIO

CONCLUDING REMARKS

The OIG is committed to working with and supporting the Acting CFO, CCRD, CG, and the other PBGC senior executives, management, and staff who will be involved in the upcoming financial statement audit.

We thank the Acting CFO, CG, and the other stakeholders for their dedication in producing our third annual lessons learned report. In addition, we thank the EMC members for allowing us to present the results of the survey during their regularly scheduled meeting. We look forward to another successful financial statement audit process for FY07.

Attachment

cc: Judith Starr
Stephen Barber
Richard Macy
Terrance Deneen
Jon Baake
Marty Boehm
Walt Luiza
Wayne McKinnon
Ellis Tash
Joan Weiss

ATTACHMENT

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SURVEY RESULTS AND FEEDBACK

Some of the responses to this year's survey were similar to topics discussed in the Lessons Learned from FY 2005 Financial Statement Audit report (2006-10/FA-0023) including:

- ❖ Processes that continued to work well during FY 2006 audit
  - Communications: audit status meetings held with key stakeholders; notices of findings and recommendations (NFRs); and the CFO's quarterly close meetings.
  - Responsibility and commitment: management of the Prepared by Client (PBC) list. In fact, this process was greatly improved during the FY 2006 audit.
- ❖ Processes that need additional improvement during FY 2007 audit
  - Communications: correction, documentation of correction, and auditor follow-up on open audit recommendations; and clarification of the audit process and reasons why auditors need requested information.
  - Responsibility and commitment: management and delivery of PBC deliverables.

Processes that work well during the FY 2006 audit

1. Management of the Audit Protocol/PBC list

At the beginning of the FY 2006 audit, the CFO, with Contracts and Controls Review Department (CCRD) as coordinator, issued an audit information request, follow-up and reporting protocol for the financial statement audit. The document covers the processing of initial and follow-up on PBC requests, NFRs, and prior audit recommendations. Preparation and communication of this document to all key participants at the beginning of the audit contributed to the success of the PBC process. Other contributing factors included:

- PBGC, OIG, and CG commitment of resources to making the process work.
- Management's involvement in the oversight of this process throughout the audit.
- The assignment of a central contact for both CG and PBGC.
- The diligence, patience, and attention to detail by these central contacts.

- Identification of Functional Area Representatives (FAR) for each PBGC area.
- Consistent meetings scheduled and coordinated by CCRD with CG and the FARs to address the status and questions on information requests.
- Prompt attention by CCRD to overdue requests.

In addition, centralizing the open audit recommendation status and transfer of supporting documentation as part of the audit protocol improved communications in this area. Accountability for the updates and documentation being provided was also improved. The information was provided on a more timely and consistent basis than in the prior year's audit.

2. <u>Auditor's organization and communication</u>

The auditor's organization and communication contributed to a smooth audit process. Survey responders indicated that the auditors:

- Were readily available and quite responsive.
- Kept PBGC informed about important issues.
- Were much more aware of PBGC's needs, timing and constraints than last year.
- were well organized
- Provided initial information requests to contractors prior to their onsite fieldwork.
- Were non-intrusive to the functional workflows and respectful to contractors' line managers' time.
- Completed their fieldwork at contractors' sites in a timely manner.

3. <u>Strong Commitment to the Audit Process</u>

It was agreed that a strong commitment to the audit process, in order to meet the OMB-mandated November 15 deadline to submit the AMR was crucial. For the FY06 audit, there was strong commitment on the part of the Senior Executives and Department Managers to facilitating the audit process and cooperate with FOD, CCRD, and the auditors. This commitment was communicated to PBGC staff and contractors at all levels and enforced, whenever necessary. This in turn helped the OIG and the CG staff to complete their audit work on-time.

Processes that should be improved or added for FY 2007

1. <u>Audit follow-up and the process for closing outstanding audit recommendations</u>

Inclusion of the open audit recommendation process in the audit protocol improved communications in this area. However, several responders stated that more work needs to be done to address open audit recommendations in a timely manner. The OIG and CG auditors, as well as PBGC managers, share responsibility for improving this process. Issues encountered and suggested improvements include:

Issues

During FY 2006, PBGC made progress toward remedying the four reportable conditions included in the FY 2006 Internal Control Report (2007-1/FA-0024-1); however, three of the four conditions have been reported for several years. Responders suggested that a different approach for correcting the conditions may expedite their completion. Managers should determine, in consultation with OIG and CG, what outcomes PBGC wants to obtain from correction of the conditions. This more strategic approach would highlight the most critical areas and resources needed for successful outcomes.

While the reportable conditions are the area of PBGC's primary focus, addressing open audit recommendations included in the FY 2006 management letter is also important. The number of recommendations reported in the management letter has reached an historic high point and correction of these findings and recommendations may also help correct the reportable conditions. The two categories of issues are:

- ♦ Expectations regarding the accountability for addressing open audit recommendations
  - Procedures for addressing open recommendations in the management letter seemed to only be in place when this information was requested during the audit and not year round. Updates on the status of open recommendations weren't provided to CCRD on a monthly basis.
  - Documentation provided by the FARs to substantiate completion of recommendations did not in several cases demonstrate that the findings and recommendations had been adequately addressed. Indications of rigorous management review prior to management's acceptance of the completion of an open recommendation was sometimes lacking.

- ♦ Communications between the auditor and PBGC management
  - A better understanding of CG's plan of action and timeframe for testing recommendations that have been submitted for closure was needed.
  - CG auditors did not always provide timely and detailed responses to completion evidence submitted by management.
  - Management was not sure of the type of documentation to provide as evidence of completion of some audit recommendations. In many cases, several attempts were required before satisfactory evidence was provided.
  - Management would have liked to have time to review and clarify any results of testing completed on open recommendations prior to issuance of the management letter.

Suggestions for improvement

- PBGC should determine, in consultation with OIG and CG, the outcomes to be obtained from correction of the four FY 2006 reportable conditions. This approach should highlight the most critical areas and resources needed for successful outcomes.

- OIG, CG and management should meet regularly to make sure that the findings and recommendations are understood, that corrective actions appear reasonable, and that the process expectations of both management and the auditor are met.
- Updates on the status of open recommendations should be provided to CCRD on a monthly basis.
- An early joint (OIG, CG and management) meeting should be held to discuss the proper format for documentation of evidence of completion of recommendations.
- Additional training of the FARs to help assure a better understanding of the requirements for completion should be provided.
- More rigorous management review should be performed prior to management's acceptance of the completion of open recommendations.
- CG auditors should provide more timely and detailed responses to completion documentation submitted by management.

2. Audit Protocol (PBC) deliverables process

Although the new protocol process for initial and follow-up on PBC deliverables was very successful, several responses discussed issues encountered and suggested improvements to the process.

Issues

There was a number of deliverable requests from the auditors after the PBC list had been distributed that should have been known before the list was finalized.

The auditors did not always meet their commitments to their deadlines on the PBC list for supplying information and materials to PBGC.

On occasion, auditors went directly to PBGC staff for additional deliverable items, rather than following the PBC protocol process. In some cases, the auditors asked for responses within 48 to 72 hours after their deliverable requests.

Communication issues in the IT area, while better managed, still existed during the FY 2006 audit. Even though a process was in place, an extreme dedication of resources to address status and questions on PBC items related to IT matters was necessary. These discussions often occurred after the requested information was due.

Suggestions for improvement

Discussions between the auditors and responsible managers should be held to define and agree on various deliverables and expected due dates to ensure adequate time for responsible organizations to complete their work. These discussions need to take place before May. Deliverable dates should coincide with the auditors' planned testing schedule. The final PBC list should include all known deliverable items with due dates from May through the end of the financial statement audit.

Providing background or the reasoning for an audit request would be helpful in ensuring the documentation provided fulfills the auditors' request and that the request is being made to the correct department.

Requests, other than clarifying questions, which arise after the initial PBC list is approved, should follow the audit protocol process, rather than going directly to PBGC staff. In addition, one week should be the standard response time for such requests.

The OIT FAR should have the authority and time to perform the required duties. Management should reiterate the importance of the audit protocol process and specifically work with OIT to assure that the OIT FAR and responsible responders within OIT have an understanding of their roles in the process.

Posting the current PBC list on the portal or intranet would be a very helpful means of checking on the status of requests.

3. <u>Improvements needed in communications with PBGC contractors</u>

<u>Issues</u>

For one of the auditor's IT site visits, both CG auditors and contractor personnel indicated that communications needed to be improved.

The auditors had difficulty obtaining information from the contractor prior to the commencement of the site visit. Questions and follow-up requests which are a normal part of an audit were sometimes met with significant resistance and some response times to these matters were not reasonable. The contractor required a non-disclosure agreement before providing certain requested information to CG. This agreement was not anticipated and took time to coordinate amongst the parties, further delaying the process.

The contractor personnel stated that the auditors should have had a better understanding of PBGC processes prior to coming to the contractor's site. Clear and reasonable expectations of resources and time were needed and should have been agreed upon prior to the site visit. Information requests from the auditor should have been reviewed prior to acceptance so that all parties agreed that the information was understood.

<u>Suggestions for improvement</u>

Discussions between auditors, responsible managers, the contracting officer's technical representative (COTR), and the contractor should be held to define and agree on various deliverable items and expected due dates to ensure adequate time for the auditor and the contractor to complete their work. These discussions need to take place several weeks before the site visit.

The COTR and other PBGC representatives should be more involved during the entire process to assist in the contractor's understanding and acceptance of audit requests and adherence by the contractor to agreed-upon deliverable dates.

The PBGC managers and COTR should also work with the contractor to identify and address any required non-disclosure agreements several weeks before the site visit.

4. Other suggested improvements

Legal representation letters

Legal representation letters are requested at various times during the audit. For the FY 2006 audit, PBGC's Office of the General Counsel (OGC) and Office of Chief Counsel (OCC) prepared separate letters. The process would be simplified if the two offices combined their responses into one letter for each required submission. Responders also recommended that the auditors ensure that OGC and OCC are knowledgeable of the various due dates and required formats for the FY 2007 letters.

Management representation letters

The final formats for management's representation letters to the auditor need to be established earlier in the audit so that preparation and submission of the letters does not become a rush at the last minute. Also, discussions with GAO regarding the materiality thresholds included in the management representation letter need to take place during the initial stages of the FY07 audit.

Additional OGC participation in working groups

During the FY 2006 audit, OGC representatives were not participants in any of the groups working on various issues, including reportable events. While the resolution of many of the auditors' concerns rest with responsible department, there may be interpretative issues involving legal or procedural requirements for which OGC input would be helpful. In addition, the possibility of the auditor's issuance of an adverse finding, including its potential impact on PBGC's annual report, suggests that the agency's legal counsel should have first-hand knowledge regarding the decision-making that led to an adverse finding. OGC could provide useful input without delaying or compromising the issue resolution process existing in these working audit groups.

Potential challenges for the FY 2007 audit

Recent changes in auditing standards related to communication of internal control matters and dating of the audit report will impact the FY 2007 audit process.

In their FY 2006 Report on Internal Control, the auditors reported four reportable conditions with none considered material weaknesses. New auditing standards require auditors to communicate *significant control deficiencies* and *material weaknesses* in internal control, instead of reportable conditions and material weaknesses. A *significant control deficiency* is more comprehensive than a reportable condition. As a result, it is possible that the auditors will be reporting more internal control-related matters than were reported in FY 2006.

The new standards have changed the requirement for dating of the auditor's report. Previously the audit report date was the date the audit work at PBGC's premises was completed, i.e. the "end of fieldwork" date. While the auditor's report date for the FY 2006 audit was fairly close to the date the financial statements were released by PBGC, these dates will have to be even closer for FY 2007. The audit report can not be dated prior to the date of final approval of the annual management report by PBGC's Board of Directors. Key areas of concern are synchronizing the signing of the management letter and updated legal representation letters from OGC and OCC with the date PBGC's financial statements are approved by the Board. This change increases the need for greater coordination and PBGC assistance during the final stage of the audit. PBGC's assistance in promptly resolving issues and finalizing the audit will help minimize the time and cost of performing additional updating procedures.

Other potential challenges include:

- PBGC implemented a new general ledger system, Consolidated Financial System (CFS), at the beginning of FY 2007. Auditors will test the controls surrounding CFS for the first time.
- Development of a new premium system during FY 2007 with planned implementation in FY 2008.
- Mandatory premium e-filings.
- Acting/interim persons in executive-level positions, including the Director, Chief Financial Officer, and the Chief Information Officer.