Pension Benefit Guaranty Corporation

Office of Inspector General

Audit Report

Audit of the Pension Benefit Guaranty Corporation's Fiscal Year 2006 and 2005 Financial Statements

Independent Auditor's Report

Independent Auditor's Report on Internal Control

Report of Independent Auditors on Compliance and Other Matters

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Pension Benefit Guaranty Corporation's
Fiscal Year 2006 and 2005 Financial Statements

November 15, 2006

2007-1/FA-0024-1

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

To the Board of Directors
Pension Benefit Guaranty Corporation

We contracted with Clifton Gunderson LLP, an independent certified public accounting firm, to audit the financial statements of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC) as of and for the years ended September 30, 2006 and 2005. The audits were performed 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, OMB's Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements,* and the *GAO/PCIE Financial Audit Manual.*

In its 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, 2006, is fairly stated in all material respects. However, four reportable conditions were repeated from Fiscal Year 2005 regarding the lack of integrated financial management systems, improvements needed in PBGC's information security program, weaknesses related to single-employer premiums, and PBGC's need to strengthen its preparedness for unanticipated incidences and disruptions;
- No instances of noncompliance with tested laws and regulations.

Clifton Gunderson is responsible for the accompanying auditor's report dated November 9, 2006, 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 reports (2007-1/FA-0024-1) are also available on our website at http://oig.pbgc.gov.

Sincerely,

Robert L. Emmons
Inspector General

November 9, 2006

Audit of the Pension Benefit Guaranty Corporation's Fiscal Year 2006 and 2005 Financial Statements Audit Report 2007-1/FA-0024-1

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Abbreviations

BIA	Business impact analysis
C&A	Certification and accreditation
CFS	Consolidated Financial System
CIO	Chief Information Officer
COOP	Continuity of Operations Plan
CTO	Chief Technology Officer
FASD	Facilities and Services Department
FISMA	Federal Information Security Management Act of 2002
FMFIA	Federal Managers' Financial Integrity Act of 1982
FOD	Financial Operations Department
FRS	Financial Reporting System
FY	Fiscal Year
IPVFB	Integrated Present Value of Future Benefits
ISSO	Information Systems Security Officer
NIST	National Institute of Standards and Technology
OFFM	Office of Federal Financial Management
OIG	Office of Inspector General
OIT	Office of Information Technology
OMB	Office of Management and Budget
PA	Performance Accounting
PAS	Premium Accounting System
PBGC	Pension Benefit Guaranty Corporation
PCIE	President's Council on Integrity and Efficiency
PDFN	Past Due Filing Notices
PPS	Premium Payment System
SOA	Statement of Account
TAS	Trust Accounting System
U.S.C.	United States Code

Section I

Independent Auditor's Report

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

To the Inspector General of the
Pension Benefit Guaranty Corporation

We have audited the accompanying statements of financial condition of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC) as of September 30, 2006 and 2005, and the related statements of operations and changes in net position and cash flows for the years then ended. These financial statements are the responsibility of PBGC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Single-Employer and Multiemployer Program Funds administered by PBGC as of September 30, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

By law, PBGC's Single-Employer and Multiemployer Program Funds must be self-sustaining. As of September 30, 2006, PBGC reported in its financial statements net deficit positions (liabilities in excess of assets) in the Single-Employer and Multiemployer Program Funds of $18,142 million and $739 million, respectively. As discussed in Note 7 to the financial

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statements, losses as of September 30, 2006 for the Single-Employer and Multiemployer Programs that are reasonably possible as a result of unfunded vested benefits are estimated to be $73,000 million and $83 million, respectively. The 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.

In accordance with *Government Auditing Standards,* we have also issued our reports dated November 9, 2006 on our consideration of PBGC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Clifton Gunderson LLP

Calverton, Maryland
November 9, 2006

Section II

Pension Benefit Guaranty Corporation's Fiscal Year 2006 and 2005 Financial Statements

PENSION BENEFIT GUARANTY CORPORATION

STATEMENTS OF FINANCIAL CONDITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
(Dollars in millions)	**2006**	2005	**2006**	2005	**2006**	2005
ASSETS						
Cash and cash equivalents	**$ 8,490**	$ 8,889	**$ 5**	$ 13	**$ 8,495**	$ 8,902
Investments, at market (Note 3):						
Fixed maturity securities	**35,503**	33,160	**1,159**	1,134	**36,662**	34,294
Equity securities	**13,730**	12,284	**0**	0	**13,730**	12,284
Real estate and real estate investment trusts	**4**	29	**0**	0	**4**	29
Other	**1**	25	**0**	0	**1**	25
Total investments	**49,238**	45,498	**1,159**	1,134	**50,397**	46,632
Receivables, net:						
Sponsors of terminated plans	**130**	146	**0**	0	**130**	146
Premiums (Note 9)	**374**	425	**1**	0	**375**	425
Sale of securities	**1,440**	1,124	**0**	0	**1,440**	1,124
Investment income	**259**	359	**1**	13	**260**	372
Other	**3**	2	**0**	0	**3**	2
Total receivables	**2,206**	2,056	**2**	13	**2,208**	2,069
Capitalized assets, net	**38**	27	**0**	0	**38**	27
Total assets	**$59,972**	$56,470	**$1,166**	$1,160	**$61,138**	$57,630

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	
	September 30,		September 30,		September 30,	
(Dollars in millions)	**2006**	2005	**2006**	2005	**2006**	2005
LIABILITIES						
Present value of future benefits, net (Note 4):						
Trusteed plans	**$ 63,949**	$ 57,291	**$ 2**	$ 2	**$ 63,951**	$ 57,293
Plans pending termination and trusteeship	**277**	1,918	**0**	0	**277**	1,918
Settlements and judgments	**55**	58	**0**	0	**55**	58
Claims for probable terminations	**4,862**	10,470	**0**	0	**4,862**	10,470
Total present value of future benefits, net	**69,143**	69,737	**2**	2	**69,145**	69,739
Present value of nonrecoverable future financial assistance (Note 5)			**1,876**	1,485	**1,876**	1,485
Payable upon return of securities loaned	**6,491**	6,939	**0**	0	**6,491**	6,939
Unearned premiums	**298**	210	**27**	8	**325**	218
Due for purchases of securities	**2,089**	2,290	**0**	0	**2,089**	2,290
Accounts payable and accrued expenses (Note 6)	**93**	70	**0**	0	**93**	70
Total liabilities	**78,114**	79,246	**1,905**	1,495	**80,019**	80,741
Net position	**(18,142)**	(22,776)	**(739)**	(335)	**(18,881)**	(23,111)
Total liabilities and net position	**$ 59,972**	$ 56,470	**$1,166**	$1,160	**$ 61,138**	$ 57,630

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

Commitments and contingencies are discussed in the following:
Notes 7, 8, 14, and 15.

PENSION BENEFIT GUARANTY CORPORATION

STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	For the Years Ended September 30,		For the Years Ended September 30,		For the Years Ended September 30,	
(Dollars in millions)	**2006**	2005	**2006**	2005	**2006**	2005
UNDERWRITING						
Income:						
Premium (Note 9)	**$ 1,442**	$ 1,451	**$ 58**	$ 26	**$ 1,500**	$ 1,477
Other	**79**	44	**0**	0	**79**	44
Total	**1,521**	1,495	**58**	26	**1,579**	1,521
Expenses:						
Administrative	**352**	311	**0**	0	**352**	311
Other	**2**	77	**0**	0	**2**	77
Total	**354**	388	**0**	0	**354**	388
Other underwriting activity:						
Losses (credits) from completed and probable terminations (Note 10)	**(6,155)**	3,954	**0**	0	**(6,155)**	3,954
Losses from financial assistance (Note 5)			**461**	204	**461**	204
Actuarial adjustments (Note 4)	**(424)**	220	**0**	0	**(424)**	220
Total	**(6,579)**	4,174	**461**	204	**(6,118)**	4,378
Underwriting gain (loss)	**7,746**	(3,067)	**(403)**	(178)	**7,343**	(3,245)
FINANCIAL:						
Investment income (Note 11):						
Fixed	**394**	1,755	**(1)**	79	**393**	1,834
Equity	**1,793**	2,114	**0**	0	**1,793**	2,114
Other	**(3)**	28	**0**	0	**(3)**	28
Total	**2,184**	3,897	**(1)**	79	**2,183**	3,976
Expenses:						
Investment	**53**	31	**0**	0	**53**	31
Actuarial charges (Note 4):						
Due to passage of time	**3,206**	2,618	**0**	0	**3,206**	2,618
Due to change in interest rates	**2,037**	(2,348)	**0**	0	**2,037**	(2,348)
Total	**5,296**	301	**0**	0	**5,296**	301
Financial income (loss)	**(3,112)**	3,596	**(1)**	79	**(3,113)**	3,675
Net income (loss)	**4,634**	529	**(404)**	(99)	**4,230**	430
Net position, beginning of year	**(22,776)**	(23,305)	**(335)**	(236)	**(23,111)**	(23,541)
Net position, end of year	**$(18,142)**	$(22,776)	**$(739)**	$(335)	**$(18,881)**	$(23,111)

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

PENSION BENEFIT GUARANTY CORPORATION

STATEMENTS OF CASH FLOWS

(Dollars in millions)	Single-Employer Program For the Years Ended September 30, **2006**	2005	Multiemployer Program For the Years Ended September 30, **2006**	2005	Memorandum Total For the Years Ended September 30, **2006**	2005
OPERATING ACTIVITIES:						
Premium receipts	**$ 1,579**	$ 1,595	**$ 76**	$ 26	**$ 1,655**	$ 1,621
Interest and dividends received, net	**1,689**	1,344	**44**	64	**1,733**	1,408
Cash received from plans upon trusteeship	**75**	218	**0**	0	**75**	218
Receipts from sponsors/non-sponsors	**884**	139	**0**	0	**884**	139
Receipts from the missing participant program	**7**	8	**0**	0	**7**	8
Other receipts	**9**	137	**0**	0	**9**	137
Benefit payments - trusteed plans	**(4,006)**	(3,301)	**0**	(1)	**(4,006)**	(3,302)
Financial assistance payments			**(70)**	(14)	**(70)**	(14)
Settlements and judgments	**(3)**	(5)	**0**	0	**(3)**	(5)
Payments for administrative and other expenses	**(373)**	(324)	**0**	0	**(373)**	(324)
Net cash provided (used) by operating activities (Note 13)	**(139)**	(189)	**50**	75	**(89)**	(114)
INVESTING ACTIVITIES:						
Proceeds from sales of investments	**90,261**	131,442	**2,119**	5,114	**92,380**	136,556
Payments for purchases of investments	**(90,073)**	(136,357)	**(2,177)**	(5,190)	**(92,250)**	(141,547)
Change in security lending collateral	**(448)**	6,301	**0**	0	**(448)**	6,301
Net cash provided (used) by investing activities	**(260)**	1,386	**(58)**	(76)	**(318)**	1,310
Net increase (decrease) in cash and cash equivalents	**(399)**	1,197	**(8)**	(1)	**(407)**	1,196
Cash and cash equivalents, beginning of year	**8,889**	7,692	**13**	14	**8,902**	7,706
Cash and cash equivalents, end of year	**$ 8,490**	$ 8,889	**$ 5**	$ 13	**$ 8,495**	$ 8,902

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

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2006 AND 2005

Note 1 -- Organization and Purpose

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

ERISA requires that the PBGC programs be self-financing. The Corporation's principal operational resources are premiums collected from covered plans, assets assumed from terminated plans, collection of employer liability payments due under ERISA, and investment income. ERISA provides that the U.S. Government is not liable for any obligation or liability incurred by the PBGC.

As of September 30, 2006, the single-employer and multiemployer programs reported deficits of \$18.142 billion and \$739 million, respectively. The single-employer program had assets of nearly \$60.0 billion which is offset by total liabilities of \$78.1 billion, which includes a total present value of future benefits (PVFB) of approximately \$69.1 billion. As of September 30, 2006, the multiemployer program had assets of approximately \$1.2 billion offset by approximately \$1.9 billion in present value of nonrecoverable future financial assistance.

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

<u>Single-Employer and Multiemployer Program Exposure</u>

Measures of risk in the PBGC's insured base of plan sponsors suggest that the single-employer deficit may begin to abate in the short term. The PBGC's best estimate of the total underfunding in plans sponsored by companies with credit ratings below investment grade, and classified by the PBGC as reasonably possible of termination as of September 30, 2006, was $73 billion. The comparable estimates of reasonably possible exposure for 2005 and 2004 were $108 billion and $96 billion, respectively. These estimates are measured as of December 31 of the previous year (see Note 7). For 2006, this exposure is concentrated in the following sectors: manufacturing; transportation, communication and utilities; services/other; and wholesale and retail trade.

The PBGC estimates that the total underfunding in single-employer plans was approximately $350 billion (unaudited), as of September 30, 2006, and exceeded $450 billion (unaudited), as of September 30, 2005. The PBGC's exposure to loss is less than these amounts because of the statutory limits on insured pensions. For single-employer plans sponsored by employers that do not file with the PBGC under section 4010 of ERISA, the PBGC's estimates are based on data obtained from other filings and submissions with the government and from corporate annual reports for fiscal years ended in calendar 2005.

Total underfunding of multiemployer plans is estimated to exceed $150 billion (unaudited) at September 30, 2006. In 2005, the PBGC estimated that multiemployer underfunding exceeded $200 billion (unaudited). Multiemployer plan data is much less current and complete than single-employer data--it is generally two years older and in some cases three years older than single-employer data and comes only from Form 5500 filings.

The PBGC estimates that, as of September 30, 2006, it is reasonably possible that multiemployer plans may require future financial assistance in the amount of $83 million. As of September 30, 2005 and 2004, this exposure was estimated at $418 million and $108 million, respectively.

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

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

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

Note 2 -- Significant Accounting Policies

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

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

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

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

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

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

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

Cash and Cash Equivalents: Cash includes cash on hand and demand deposits as well as cash collateral retained as security for securities lent. Cash equivalents are securities with a maturity of one business day.

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

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

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

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

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

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

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

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

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

(4) Net Claims for Probable Terminations--In accordance with Statement of Financial Accounting Standards No. 5 (Accounting for Contingencies) the PBGC recognizes net claims for probable terminations which represent the PBGC's best estimate of the losses, net of plan assets and the present value of expected recoveries (from sponsors and member controlled group) for plans that are likely to terminate within twelve months of the financial statement issuance date. These estimated losses are based on conditions that existed as of the PBGC's fiscal year-end. Management believes it is likely that one or more events subsequent to the PBGC's fiscal year-end will occur, confirming the loss. Criteria used for classifying a specific plan as a probable termination include, but are not limited to, one or more of the following conditions: the plan sponsor is in liquidation or comparable state insolvency proceeding with no known solvent controlled group

member; sponsor has filed or intends to file for distress plan termination; or the PBGC seeks involuntary plan termination. In addition, management takes into account other economic events and factors in making judgments regarding the classification of a plan as a probable termination. These events and factors may include, but are not limited to: the plan sponsor is in bankruptcy or has indicated that a bankruptcy filing is imminent; the plan sponsor has stated that plan termination is likely; the plan sponsor has received a going concern opinion from its independent auditors; or the plan sponsor is in default under existing credit agreement(s).

In addition, a reserve for large unidentified probable losses is recorded based on actual PBGC experience, as well as the historical industry bond default rates. This reserve has been developed by segregating plan sponsors listed on the contingency list, with plan funding ratios less than or equal to 80%, with aggregate underfunding equal to or greater than $50 million into risk bands that reflect their level of credit risk. A reserve for small unidentified probable losses and incurred but not reported (IBNR) claims is also recorded based on an actuarial loss development methodology (triangulation method) (see Note 4).

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

(6) In accordance with Statement of Financial Accounting Standards No. 5 (Accounting for Contingencies), the PBGC's exposure to losses from plans of companies that are classified as reasonably possible is disclosed in footnotes. In order for a plan sponsor to be specifically classified as reasonably possible, it must first have $5 million or more of underfunding, as well as meet additional criteria. Criteria used for classifying a company as reasonably possible include, but are not limited to, one or more of the following conditions: the plan sponsor is in Chapter 11 reorganization; funding waiver pending or outstanding with the Internal Revenue Service (IRS); sponsor missed minimum funding

contribution; sponsor's bond rating is below-investment-grade for Standard & Poor's (BB+) or Moody's (Ba1); sponsor has no bond rating but unsecured debt is below investment grade; or sponsor has no bond rating but the ratio of long-term debt plus unfunded benefit liability to market value of shares is 1.5 or greater (see Note 7).

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

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

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

Other Expenses: These expenses represent an estimate of the net amount of receivables deemed to be uncollectible during the period. 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 the PBGC, less related plan assets and the present value of expected recoveries from sponsors and members of their controlled group (see Note 10). When a plan terminates, the previously recorded probable Net claim is reversed and newly estimated DOPT plan assets, recoveries and PVFB are netted and reported on the line PVFB - Plans pending termination and trusteeship (this value is usually different from the amount previously reported), with any change in the estimate being recorded in the Statements of Operations and Changes in Net Position. In addition, the plan's net income from date of plan termination to the beginning of the PBGC's fiscal year is included as a component of losses from completed and probable terminations for plans with termination dates prior to the year in which they were added to the PBGC's inventory of terminated plans.

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

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

Note 3 -- Investments

Premium receipts are invested through the revolving fund in U.S. Treasury securities. The trust funds include assets the PBGC assumes or expects to assume with respect to terminated plans (e.g., recoveries from sponsors) and investment income thereon. These assets generally are held by custodian banks. The basis and market value of the investments by type are detailed below as well as related investment profile data. The basis indicated is cost of the asset if assumed after the date of plan termination or the market value at date of plan termination if the asset was assumed as a result of a plan's termination. The PBGC marks the plan's assets to market and any increase or decrease in the market value of a plan's assets occurring after the date on which the plan is terminated must, by law, be credited to or suffered by the PBGC. For the PBGC's securities, unrealized holding gains and losses are both recognized by including them in earnings. Unrealized holding gains and losses measure the total change in fair value--consisting of unpaid interest income earned or unpaid accrued dividend and the remaining change in fair value from holding the security. As the table below illustrates, the market value of investments of the single-employer program increased significantly from September 30, 2005, to September 30, 2006.

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

	September 30, 2006		September 30, 2005	
(Dollars in millions)	**Basis**	**Market Value**	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	**$20,195**	**$19,838**	$21,562	$21,417
Commercial paper	**1,591**	**1,591**	336	336
Asset backed securities	**3,714**	**3,692**	3,286	3,265
Corporate and other bonds	**10,516**	**10,382**	8,194	8,142
Subtotal	**36,016**	**35,503**	33,378	33,160
Equity securities	**9,127**	**13,730**	8,565	12,284
Real estate and real estate investment trusts	**6**	**4**	33	29
Insurance contracts and other investments	**12**	**1**	32	25
Total *	**$45,161**	**$49,238**	$42,008	$45,498

* This includes securities on loan at September 30, 2006, and September 30, 2005, with a market value of $6.352 billion and $6.769 billion, respectively.

INVESTMENTS OF MULTIEMPLOYER REVOLVING FUNDS AND MULTIEMPLOYER TRUSTEED PLANS

	September 30, 2006		September 30, 2005	
(Dollars in millions)	**Basis**	**Market Value**	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	**$1,191**	**$1,159**	$1,151	$1,134
Equity securities	**0**	**0**	0	0
Total	**$1,191**	**$1,159**	$1,151	$1,134

INVESTMENT PROFILE

	September 30, 2006	2005
Fixed Income Assets		
Average Quality	**AA**	AAA
Average Maturity (years)	**18.6**	16.6
Duration (years)	**13.9**	10.4
Yield to Maturity (%)	**5.3**	4.8
Equity Assets		
Average Price/Earnings Ratio	**18.7**	20.2
Dividend Yield (%)	**1.7**	1.6
Beta	**1.02**	1.03

In addition, the PBGC's trusteed liability return was 9.0% and the duration (years) of these liabilities was 9.95 at the end of 2006.

Derivative Instruments: Derivatives are accounted for at market value in accordance with 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 mitigate risk and/or enhance the PBGC's investment returns. The standard requires disclosure of fair value of these instruments. During fiscal years 2005 and 2006, the PBGC invested in investment products that used various U.S. and non-U.S. derivative instruments including but not limited to: money market and government bond futures and forward contracts, swap contracts, swaption contracts, stock warrants and rights, debt option contracts and foreign currency forward and option contracts. Some of these derivatives are traded on organized exchanges and thus bear minimal counterparty risk. The counterparties to the PBGC's non-exchange-traded derivative contracts are major financial institutions. The PBGC monitors its counterparty risk and has never experienced non-performance by any of its counterparties.

Futures are exchange-traded contracts specifying a future date of delivery or receipt of a certain amount of a specific tangible or intangible product. The futures exchange's clearinghouses clear, settle, and guarantee transactions occurring through its facilities. Futures contracts are held as efficient and liquid substitutes for purchases and sales of financial market indices and securities. Open futures positions are marked to market daily. An initial margin of generally 1 to 6 percent is maintained with the broker in Treasury bills or similar instruments. In addition, futures contracts require daily settlement of variation margin resulting from the marks to market. In periods of extreme volatility, margin calls may create a high liquidity demand on the underlying portfolio. To mitigate this, the PBGC maintains adequate liquidity in its portfolio to meet these margin calls.

Foreign currency forward and option contracts are used to hedge currency exposure (i.e., minimize currency risk) of certain assets and to adjust overall currency exposure to reflect the investment views of the portfolio managers regarding relationships between currencies. Other investments held by the Corporation include swap contracts and swaption (i.e., option on swap) contracts. A swap is an agreement between two parties to exchange different financial returns on a notional investment amount. For example, an interest rate swap involves exchanges of fixed rate and floating rate interest. There is no exchange of the underlying principal. The PBGC uses swap and swaption contracts to adjust exposure to interest rates, fixed income securities exposure and credit exposure, and to generate income based on the investment views of the portfolio managers regarding interest rates, indices and debt issues. Stock warrants and rights allow the PBGC to purchase securities at a stipulated price within a specified time limit. For the fiscal years ended September 30, 2005 and 2006, respectively, gains and losses from settled margin calls are reported in Investment income on the Statements of Operations and Changes in Net Position.

The following table summarizes the notional amounts and fair market values of derivative financial instruments held or issued for trading as of September 30, 2006, and September 30, 2005.

INTEREST RATE CONTRACTS (IRC)	Sept. 30, 2006 Notional	Sept. 30, 2006 FMV	Sept. 30, 2005 Notional	Sept. 30, 2005 FMV
(Dollars in millions)				
Forwards	$ 685	$ 2	$ 149	$ 0
Futures	10,910	(6)	5,098	6
Contracts in a receivable position	2,940	0	1,645	15
Contracts in a payable position	7,970	(6)	3,453	(9)
Swap Agreements	5,440	(11)	4,385	38
Options purchased (long)	110	17		2
			0	
Options written (sold short)	651	(19)	80	0

FOREIGN EXCHANGE CONTRACTS (FEC)	Sept. 30,2006 Notional	Sept. 30,2006 FMV	Sept. 30, 2005 Notional	Sept. 30, 2005 FMV
(Dollars in millions)				
Forwards	$1,767	$ 1	$ 1,129	$ (3)

Security Lending: The PBGC participates in a security lending program administered by its custodian bank. The custodian bank requires collateral that equals 102 percent to 105 percent of the securities lent. The collateral is held by the custodian bank. In addition to the lending program managed by the custodian bank, some of the PBGC's investment managers are authorized to invest in repurchase agreements 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, 2006, and September 30, 2005, was $6.352 billion and $6.769 billion, respectively. Although securities on loan have decreased slightly since September 30, 2005, there continues to be an ongoing demand for fixed income securities to lend.

The amount of cash collateral received for these loaned securities was $6.491 billion at September 30, 2006, and $6.939 billion at September 30, 2005. These amounts are recorded in cash and are offset with a corresponding liability. The PBGC had earned income from securities lending of $5.2 million as of September 30, 2006 and $4.0 million as of September 30, 2005.

Of the $6.352 billion market value of securities on loan at September 30, 2006, approximately 88% are invested in U.S. government securities and 9% in U.S. corporate securities. The PBGC had approximately $16.588 billion of securities available for securities lending at September 30, 2006.

Note 4 -- Present Value of Future Benefits

The following table summarizes the actuarial adjustments, charges and credits that explain how the Corporation's single-employer program liability for the present value of future benefits changed for the years ended September 30, 2006 and 2005.

For FY 2006, the PBGC used a 25-year select interest factor of 4.85% followed by an ultimate factor of 4.82% for the remaining years. For FY 2005, the PBGC used a 25-year select interest factor of 5.2% followed by an ultimate factor of 4.5% for the remaining years. These factors were determined to be those needed, given the mortality assumptions, to continue to match the survey of annuity prices provided by the American Council of Life Insurers (ACLI). Both the interest factor and the length of the select period may vary to produce the best fit with these prices. The prices reflect rates at which, in the opinion of management, the liabilities (net of administrative expenses) could be settled in the market at September 30, for the respective year, for single-premium nonparticipating group annuities issued by private insurers. Many factors, including Federal Reserve policy, changing expectations about longevity risk, and competitive market conditions may affect these rates.

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

For September 30, 2006, the PBGC used the 1994 Group Annuity Mortality (GAM) 94 Static Table (with margins), set forward one year and projected 22 years to 2016 using Scale AA, the same as the table used in the September 30, 2005 valuation. The number of years that the PBGC projects the mortality table reflects the number of years from the 1994 base year of the table to the end of the fiscal year (12 years in 2006 versus 11 years in 2005) plus the PBGC's calculated duration of its liabilities (10 years in 2006 versus 11 years in 2005). The PBGC's procedure is based on the procedures recommended by the Society of Actuaries UP-94 Task Force (which developed the GAM94 table) for taking into account future mortality improvements.

The PBGC continues to utilize the results of its 2004 mortality study. The study showed that the mortality assumptions used in FY 2003 reflected higher mortality than was realized in the PBGC's seriatim population. Therefore, the PBGC adopted a base mortality table (i.e., GAM94 set forward one year instead of GAM94 set forward two years) that better reflects past mortality experience. The ACLI survey of annuity prices, when combined with that 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 and 2005 valuations were assumed to be 1.18 percent of benefit liabilities plus additional reserves for cases whose plan asset determinations, participant database audits and actuarial valuations were not yet complete. The expense assumption was based on a study performed for the PBGC in 2000 by a major accounting firm. The factors to determine the additional reserves were based on case size, number of participants and time since trusteeship.

The present values of future benefits for trusteed multiemployer plans for 2006 and 2005 reflect the payment of assistance and the changes in interest and mortality assumptions, the passage of time and the effect of experience.

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

RECONCILIATION OF THE PRESENT VALUE OF FUTURE BENEFITS FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	September 30,			
(Dollars in millions)		**2006**		2005
Present value of future benefits, at beginning of year -- Single-Employer, net		**$ 69,737**		$ 60,836
Estimated recoveries, prior year		**343**		364
Assets of terminated plans pending trusteeship, net, prior year		**3,039**		678
Present value of future benefits at beginning of year, gross		**73,119**		61,878
Settlements and judgments, prior year		**(58)**		(65)
Net claims for probable terminations, prior year		**(10,470)**		(16,926)
Actuarial adjustments -- underwriting:				
Changes in method and assumptions	**$ (609)**		$ 17	
Effect of experience	**185**		203	
Total actuarial adjustments -- underwriting	**(424)**		220	
Actuarial charges -- financial:				
Passage of time	**3,206**		2,618	
Change in interest rates	**2,037**		(2,348)	
Total actuarial charges -- financial	**5,243**		270	
Total actuarial charges, current year		**4,819**		490
Terminations:				
Current year	**1,112**		21,191	
Changes in prior year	**130**		(292)	
Total terminations		**1,242**		20,899
Benefit payments, current year*		**(4,082)**		(3,685)
Estimated recoveries, current year		**(62)**		(343)
Assets of terminated plans pending trusteeship, net, current year		**(282)**		(3,039)
Settlements and judgments, current year		**55**		58
Net claims for probable terminations:				
Future benefits**	**17,430**		23,918	
Estimated plan assets and recoveries from sponsors	**(12,568)**		(13,448)	
Total net claims, current year		**4,862**		10,470
Present value of future benefits, at end of year -- Single-Employer, net		**69,143**		69,737
Present value of future benefits, at end of year -- Multiemployer		**2**		2
Total present value of future benefits, at end of year, net		**$ 69,145**		$ 69,739

* The benefit payments of $4,082 million and $3,685 million include $76 million in 2006 and $384 million in 2005 for benefits paid from plan assets by plans prior to trusteeship.

** The future benefits for probable terminations of $17,430 million and $23,918 million for fiscal years 2006 and 2005, respectively, include $87 million and $137 million, respectively, in net claims (future benefits less estimated plan assets and recoveries) for probable terminations not specifically identified and $17,343 million and $23,781 million, respectively, in net claims for specifically identified probables.

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

ASSETS OF SINGLE-EMPLOYER PLANS PENDING TERMINATION AND TRUSTEESHIP, NET

	September 30, 2006		September 30, 2005	
(Dollars in millions)	**Basis**	**Market Value**	Basis	Market Value
Corporate and other bonds	**$107**	**$113**	$1,043	$1,053
Equity securities	**117**	**156**	1,968	1,992
Insurance contracts	**4**	**4**	2	2
Other	**9**	**9**	(7)	(8)
Total, net	**$237**	**$282**	$3,006	$3,039

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

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

RECONCILIATION OF NET CLAIMS FOR PROBABLE TERMINATIONS

	September 30,			
(Dollars in millions)	**2006**		2005	
Net claims for probable terminations, at beginning of year		**$10,470**		$16,926
New claims	**$ 3,063**		$ 4,738	
Actual terminations	**(288)**		(10,637)	
Deleted probables	**(8,035)**		(83)	
Change in benefit liabilities	**(867)**		(205)	
Change in plan assets	**519**		(269)	
Loss (credit) on probables		**(5,608)**		(6,456)
Net claims for probable terminations, at end of year		**$ 4,862**		$10,470

The following table itemizes the probable exposure by industry:

PROBABLES EXPOSURE BY INDUSTRY (PRINCIPAL CATEGORIES)

(Dollars in millions)	**FY 2006**	FY 2005
Manufacturing	**$3,318**	$ 612
Transportation, Communication and Utilities	**1,279**	9,570
Services/Other	**197**	233
Agriculture, Mining, and Construction	**41**	37
Finance, Insurance, and Real Estate	**20**	-
Wholesale and Retail Trade	**7**	18
Total	**$4,862**	$10,470

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 PPA legislation which was an unpredictable factor impacting the PBGC's ability to predict probables as terminations.

PROBABLES EXPERIENCE - Actual
As Initially Recorded Beginning in 1987

(Dollars in millions)	Status of Probables from 1987-2005 at September 30, 2006			
Beginning in 1987, number of plans reported as Probable:	Number of Plans	Percent of Plans	Net Claim	Percent of Net Claim
Probables terminated	290	76%	$22,057	66%
Probables not yet terminated or deleted	15	4	2,004	6
Probables deleted *	77	20	9,344	28
Total	382	100%	$33,405	100%

* "Probables deleted" in the above table includes 5 plans deleted due to airline relief provisions pursuant to PPA, causing the percent of plans to increase from 19% to 20% and the percent of net claims to increase from 3% to 28%.

Note 5 -- Multiemployer Financial Assistance

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

NOTES RECEIVABLE
MULTIEMPLOYER FINANCIAL ASSISTANCE

	September 30,	
(Dollars in millions)	**2006**	2005
Gross balance at beginning of year	**$ 85**	$ 71
Financial assistance payments-current year	**70**	14
Subtotal	**155**	85
Allowance for uncollectible amounts	**(155)**	(85)
Net balance at end of year	**$ 0**	$ 0

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

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

	September 30,	
(Dollars in millions)	**2006**	2005
Balance at beginning of year	**$1,485**	$1,295
Changes in allowance:		
Losses from financial assistance	**461**	204
Financial assistance granted (previously accrued)	**(70)**	(14)
Balance at end of year	**$1,876**	$1,485

Note 6 -- Accounts Payable and Accrued Expenses

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

ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	September 30,	
(Dollars in millions)	**2006**	2005
Annual leave	**$ 5**	$ 5
Other payables and accrued expenses	**88**	65
Accounts payable and accrued expenses	**$93**	$70

Note 7 -- Contingencies

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

In accordance with Statement of Financial Accounting Standards No. 5, the PBGC classified a number of these companies as reasonably possible terminations as the sponsors' financial condition and other factors did not indicate that termination of their plans was likely as of year-end. The best estimate of aggregate unfunded vested benefits exposure to the PBGC for the companies' single-employer plans classified as reasonably possible as of September 30, 2006, was $73 billion. The drop from $108 billion in FY 2005 to $73 billion in FY 2006 is primarily attributable to a net reduction in the unfunded vested benefit liabilities of the plans whose sponsors remained at risk.

The estimated unfunded vested benefits exposure has been calculated as of December 31, 2005, and is not based on the PBGC guaranteed levels. The PBGC calculated this estimate as in previous years by using data obtained from filings and submissions to the government and from corporate annual reports for fiscal years ending in calendar 2005. The Corporation adjusted the value reported for liabilities to a December 31, 2005, PBGC select rate of 4.5% that was derived using 83 GAM mortality. When available, data were adjusted to a consistent set of mortality assumptions. The underfunding associated with these plans would generally tend to be greater at September 30, 2006, because of the economic conditions that existed between December 31, 2005, and September 30, 2006. During this nine month period, the PBGC estimates that the aggregate Unfunded Vested Benefits increased approximately within a range of 15% to 25%. The Corporation did not adjust the estimate for events that occurred between December 31, 2005, and September 30, 2006.

The following table itemizes the reasonably possible exposure by industry:

REASONABLY POSSIBLE EXPOSURE BY INDUSTRY (PRINCIPAL CATEGORIES)

(Dollars in millions)	**FY 2006**	FY 2005
Manufacturing	**$37,634**	$ 71,332
Transportation, Communication and Utilities	**20,509**	17,567
Services/Other	**6,969**	8,623
Wholesale and Retail Trade	**6,096**	7,296
Agriculture, Mining and Construction	**1,220**	1,731
Finance, Insurance, and Real Estate	**857**	1,490
Total	**$73,285**	$108,039

The PBGC included amounts in the liability for the present value of nonrecoverable future financial assistance (see Note 5) for multiemployer plans that the PBGC estimated may require future financial assistance. In addition, the PBGC currently estimates that it is reasonably possible that other multiemployer plans may require future financial assistance in the amount of $83 million.

The Corporation calculated the future financial assistance liability for each multiemployer plan identified as probable (see Note 5), or reasonably possible as the present value of guaranteed future benefit and expense payments net of any future contributions or withdrawal liability payments as of the later of September 30, 2006, or the projected (or actual, if known) date of plan insolvency, discounted back to September 30, 2006. The Corporation's identification of plans that are likely to require such assistance and estimation of related amounts required consideration of many complex factors, such as an estimate of future cash flows, future mortality rates, and age of participants not in pay status. These factors are affected by future events, including actions by plans and their sponsors, most of which are beyond the Corporation's control.

The PBGC used select and ultimate interest rate assumptions of 4.85% for the first 25 years after the valuation date and 4.82% thereafter. The Corporation also used the 1994 Group Annuity Mortality Static Table (with margins), set forward one year, projected 22 years to 2016 using Scale AA.

Note 8 -- Commitments

The PBGC leases its office facility under a new commitment that began on January 1, 2005, and expires December 10, 2018. The new lease agreement was entered into because of the need for additional office space. This lease provides for periodic rate increases based on increases in operating costs and real estate taxes over a base amount. In addition, the PBGC is leasing space for field benefit administrators. These leases began in 1996 and expire in 2013. The minimum future lease payments for office facilities having noncancellable terms in excess of one year as of September 30, 2006, are as follows:

COMMITMENTS: FUTURE LEASE PAYMENTS
(Dollars in millions)

Years Ending September 30,	Operating Leases
2007	$ 19.4
2008	19.0
2009	18.3
2010	18.1
2011	19.2
Thereafter	145.9
Minimum lease payments	$239.9

Lease expenses were $18.7 million in 2006 and $18.0 million in 2005.

Note 9 -- Premiums

For both the single-employer and multiemployer programs, ERISA provides that the PBGC shall continue to guarantee basic benefits despite the failure of a plan administrator to pay premiums when due. The PBGC assesses interest and penalties on the unpaid portion of or underpayment of premiums. Interest continues to accrue until the premium and the interest due are paid. Due to the enactment of the Deficit Reduction Act of 2005, flat-rate premiums for single-employer pension plans increased from $19 to $30 per participant and the multiemployer plans yearly premium increased from $2.60 to $8 per participant. The new rates are effective for plan year 2006, and will be indexed for wage inflation beginning in plan year 2007. The PBGC recorded premium income, excluding interest and penalty, of approximately $941 million in flat-rate premiums and $550 million in variable-rate premiums for fiscal year 2006, and approximately $670 million in flat-rate premiums and $787 million in variable-rate premiums for fiscal year 2005.

Since premium income for FY 2006 primarily consists of plan year 2006 and 2005 premiums, and revenue recognition accounting principles require partial recognition of plan year 2006 premiums as of September 30, 2006, the 2006 increase in flat-rate premium income represents approximately 65% of the full impact to the plan year 2006 flat-rate premiums due for all plans.

Note 10 -- Losses from Completed and Probable Terminations

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

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

	For the Years Ended September 30,					
	2006			2005		
(Dollars in millions)	**New Terminations**	**Changes in Prior Year Terminations**	**Total**	New Terminations	Changes in Prior Year Terminations	Total
Present value of future benefits	**$1,112**	**$ 130**	**$ 1,242**	$ 21,191	$ (292)	$20,899
Less plan assets	**582**	**1,370**	**1,952**	10,516	0	10,516
Plan asset insufficiency	**530**	**(1,240)**	**(710)**	10,675	(292)	10,383
Less estimated recoveries	**3**	**(165)**	**(162)**	9	(37)	(28)
Subtotal terminated plans	**527***	**(1,075)**	**(548)**	10,666 *	(255)	10,411
Settlements and judgments		**1**	**1**		(1)	(1)
Loss (credit) on probables	**(288)**	**(5,320)**	**(5,608)****	(10,637)	4,181	(6,456)**
Total	**$ 239**	**$(6,394)**	**$(6,155)**	$ 29	$3,925	$ 3,954

* gross amounts for plans terminated during the year
** see Note 4 - includes $288 million at September 30, 2006, and $10,637 million at September 30, 2005, previously recorded relating to plans that terminated during the period

Note 11 -- Financial Income

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

Investment Income - Single-Employer and Multiemployer Programs

(Dollars in millions)	**Single-Employer Program Sept 30, 2006**	**Multiemployer Program Sept 30, 2006**	**Memorandum Total Sept 30, 2006**	Single-Employer Program Sept 30, 2005	Multiemployer Program Sept 30, 2005	Memorandum Total Sept 30, 2005
Fixed income securities:						
Interest earned	**$1,756**	**$ 56**	**$1,812**	$1,270	$ 53	$1,323
Realized gain (loss)	**(815)**	**(44)**	**(859)**	1,361	82	1,443
Unrealized loss	**(547)**	**(13)**	**(560)**	(876)	(56)	(932)
Total fixed income securities	**394**	**(1)**	**393**	1,755	79	1,834
Equity securities:						
Dividends earned	**89**	**0**	**89**	81	0	81
Realized gain	**522**	**0**	**522**	1,540	0	1,540
Unrealized gain	**1,182**	**0**	**1,182**	493	0	493
Total equity securities	**1,793**	**0**	**1,793**	2,114	0	2,114
Other income	**(3)**	**0**	**(3)**	28	0	28
Total investment income (loss)	**$2,184**	**$ (1)**	**$2,183**	$3,897	$ 79	$3,976

Note 12 -- Employee Benefit Plans

All permanent full-time and part-time the 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 2006 and 2005 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 10.7 percent of base pay for both 2006 and 2005. In addition, for FERS-covered employees, the PBGC automatically contributes one percent of base pay to the employee's Thrift Savings account, matches the first three percent contributed by the employee and matches one-half of the next two percent contributed by the employee. Total retirement plan expenses amounted to $13 million in 2006 and $11 million in 2005.

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

Note 13 -- Cash Flows

The following two tables, one for Sales and one for Purchases, provide further details on cash flows from investment activity. Sales and purchases of investments are driven by the level of newly trusteed plans, the unique investment strategies implemented by the PBGC's investment managers, and the varying capital market conditions in which they invest during the year. Several investment strategies in use in 2006 involved higher volume short term investments, particularly in the fixed income area, as shown in the Investing Activities table below. These cash flow numbers can vary significantly from year to year based on the fluctuation in these three variables.

INVESTING ACTIVITIES

	September 30,	
(Dollars in millions)	**2006**	2005
Proceeds from sales of investments:		
Fixed maturity securities	**$84,901**	$125,646
Equity securities	**2,622**	8,515
Other/uncategorized	**4,857**	2,395
Total	**$92,380**	$136,556
Payments for purchases of investments:		
Fixed maturity securities	**$(88,655)**	$(139,681)
Equity securities	**(2,942)**	(7,022)
Other/uncategorized	**(653)**	5,156
Total	**$(92,250)**	$(141,547)

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

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
(Dollars in millions)	**2006**	2005	**2006**	2005	**2006**	2005
Net income (loss)	**$ 4,634**	$ 529	**$(404)**	$(99)	**$ 4,230**	$ 430
Adjustments to reconcile net income to net cash provided by operating activities:						
Net (appreciation) decline in fair value of investments	**(350)**	(2,481)	**61**	(26)	**(289)**	(2,507)
Net gain of plans pending termination and trusteeship	**19**	46	**0**	0	**19**	46
Losses on completed and probable terminations	**(6,155)**	3,954	**0**	0	**(6,155)**	3,954
Actuarial charges	**4,819**	490	**0**	0	**4,819**	490
Benefit payments - trusteed plans	**(4,006)**	(3,301)	**0**	(1)	**(4,006)**	(3,302)
Settlements and judgments	**(3)**	(5)	**0**	0	**(3)**	(5)
Cash received from plans upon trusteeship	**75**	218	**0**	0	**75**	218
Receipts from sponsors/non-sponsors	**886**	216	**0**	0	**886**	216
Amortization of discounts/premiums	**(319)**	128	**(28)**	11	**(347)**	139
Changes in assets and liabilities, net of effects of trusteed and pending plans:						
Decrease in receivables	**150**	31	**11**	0	**161**	31
Increase in present value of nonrecoverable future financial assistance			**391**	190	**391**	190
Increase (decrease) in unearned premiums	**88**	(13)	**19**	0	**107**	(13)
Increase (decrease) in accounts payable	**23**	(1)	**0**	0	**23**	(1)
Net cash provided (used) by operating activities	**$ (139)**	$ (189)	**$ 50**	$ 75	**$ (89)**	$ (114)

Note 14 -- Litigation

The PBGC was involved in numerous litigation matters in 2006. At the end of the fiscal year, the PBGC had 487 open, active bankruptcy cases and 64 active litigation matters (other than in bankruptcy court). The PBGC records as a liability on its financial statements an estimated cost for unresolved litigation to the extent that losses in such cases are probable and estimable in amount. At September 30, 2006, the PBGC estimated that possible losses of up to $269.2 million could be incurred in the event that the PBGC does not prevail in these matters. In October 2006, the PBGC received a favorable decision in one of these litigation matters in the amount of $84.2 million. These possible losses are not recognized in the financial statements.

Note 15 -- Subsequent Events

For the year ended September 30, 2006, there were no subsequent events to report on either the single-employer or multiemployer program.

Section III

Independent Auditor's Report on Internal Control

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Internal Control

To the Inspector General of the
Pension Benefit Guaranty Corporation

We have examined management's assertion included in the Annual Management Report, that the Pension Benefit Guaranty Corporation (PBGC) maintained effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations as of September 30, 2006, based on the criteria contained in the Federal Managers' Financial Integrity Act of 1982 (FMFIA) (31 U.S.C. 3512). PBGC's management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants; *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*, and, accordingly, included obtaining an understanding of the internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations, testing and evaluating the design and operating effectiveness of the internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

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 any internal control, misstatements due to error, fraud, losses, or noncompliance may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that PBGC maintained effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations as of September 30, 2006 is fairly stated, in all material respects, based on criteria contained in FMFIA.

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However, we noted certain matters involving the internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations that, in our judgment, could adversely affect PBGC's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions we noted are as follows:

1. PBGC needs to integrate its financial management systems (Repeat Condition).
2. PBGC needs to complete its efforts to fully implement and enforce an effective information security program (Repeat Condition).
3. PBGC needs to improve controls related to single-employer premiums (Repeat Condition).
4. PBGC needs to strengthen its preparedness for unanticipated incidences and disruptions (Repeat Condition).

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe that none of the reportable conditions described in this report are material weaknesses.

****

REPORTABLE CONDITIONS

1. PBGC Needs to Integrate Its Financial Management Systems (Repeat Condition)

A lack of integration of PBGC's significant financial management systems was identified in prior year audits. These systems include: Financial Reporting System (FRS), Performance Accounting (PA) System, Trust Accounting System (TAS), Participant Records Information System Management (PRISM), Premium Accounting System (PAS), Integrated Present Value of Future Benefits (IPVFB), and Pension and Lump Sum System (PLUS).

OMB Circular A-127, *Financial Management System*, requires that financial management systems should be designed to provide for effective and efficient interrelationships between systems. This Circular states the following:

> "The term "single, integrated financial management system" means a unified set of financial systems and the financial portions of mixed systems encompassing the software, hardware, personnel, processes (manual and automated), procedures, controls and data necessary to carry out financial management functions, manage financial operations of the

> agency and report on the agency's financial status to central agencies, Congress and the public. Unified means that the systems are planned for and managed together, operated in an integrated fashion, and linked together electronically in an efficient and effective manner to provide agency-wide financial system support necessary to carry out the agency's mission and support the agency's financial management needs."

OMB's Office of Federal Financial Management's (OFFM – formerly the Joint Financial Management Improvement Program – JFMIP) *Core Financial System Requirements* document, lists the following integrated financial management system attributes:

- Standard data classifications (definition and formats) established and used for recording financial events.
- Common processes used for processing similar kinds of transactions.
- Internal controls over data entry, transaction processing, and reporting applied consistently.
- A system design that eliminates unnecessary duplication of transaction entry.

PBGC has manual controls related to its significant financial management systems and is making progress to further improve data integrity controls and promote further integration of systems, as evidenced by the following:

- The system interface controls, used to reconcile data transmitted to and from the three general ledger applications, TAS, PA, and FRS, appear to be operating effectively.
- The manual interface controls, used to reconcile data between IPVFB and FRS, appear to be operating effectively.

Additionally, management stated that:

- PBGC performed testing of its commercially based general ledger system, Consolidated Financial System (CFS), which integrates the three previously separate ledger systems (TAS, PA and FRS), and incorporates full budget execution and administrative payment processes. This Oracle Enterprise Resources Planning software system allows organizations to be compliant with OFFM's *Core Financial System Requirements*. PBGC will make CFS its system of record, effective October 1, 2006.
- PBGC also integrated the design of its premium system upgrade, Premium Payment System (PPS), into the design of CFS. During FY 2006 a contract was awarded for the design and implementation of that critical element as a sub-ledger with an anticipated completion date of October 2007.

Despite the above, we believe more needs to be done to integrate PBGC's existing significant financial management systems. We identified the following factors relevant to the integration of systems:

Lack of standard data classifications and common data elements:

- PBGC management has indicated that a logical database model is being developed. Therefore, no centralized data catalog defining data elements or data access method was available for current databases.
- The current decentralized database structure may lead to erroneous financial and participant data. For example, the same data elements are required to be reformatted or are used for different purposes across PBGC's various applications.
- The current decentralized database structure may lead to untimely financial or participant data. Participant data must be reformatted and distributed to multiple PBGC systems; therefore, users may be relying on outdated information to make business decisions.

Duplication of transaction entry:

- PBGC uses three general ledger systems, TAS, PA, and FRS, to track and record trust, revolving, and consolidated transactions, respectively, rather than one system to track and record all three. Therefore, manual processes and adjustments are required to synchronize the data from TAS and PA to FRS; however, it is anticipated by management that CFS will address these issues for FY 2007.
- Probable and multiemployer plan data initially entered into IPVFB must be manually re-entered into a spreadsheet and then manually entered into FRS as adjusting journal entries.
- Plan data initially entered into the Case Administration System (CAS) application must be re-entered into the TAS application's portfolio header.
- Plan contingency listings are determined using data extracted from PAS. However, plans with multiple filings must be manually aggregated before the plans can be classified.
- Plan sponsor data initially entered into PAS to process receivables must also be entered into PA to process refunds. Management stated that this has been addressed in the design of the new CFS/PPS system.

Poor data integrity:

- The data in PAS requires significant manual review and adjustment before it can be used for the purpose of reporting the premium income and receivables in PBGC's financial statements.

In the short term, PBGC's ability to accurately and efficiently accumulate and summarize information required for internal and external financial reporting may be impacted. For this reason, this issue remains a reportable condition for fiscal year (FY) 2006.

Recommendation:

We are encouraged by the improvement made and direction taken by PBGC in the areas noted above. However, we recommend that PBGC continue its efforts in this area by doing the following:

- Integrate its financial management systems, in accordance with OMB Circular A-127. **(OIG Control Number FOD-268)**

2. PBGC Needs to Complete its Efforts to Fully Implement and Enforce an Effective Information Security Program (Repeat Condition)

Improvement is needed in PBGC's enterprise-wide security management program as indicated in prior year audits. During our FY 2006 review of PBGC's existing security program, we noted that PBGC made the following progress:

- PBGC has developed and granted interim approval for its Enterprise Information Security Policy in June 2006, pending (a) review of other existing directives for possible conflict and overlaps, and (b) circulation for comments by PBGC offices. The purpose of PBGC's information security policy document is to identify and disseminate the principles and framework that guide the secure usage of information at PBGC.

Our review of PBGC's existing security program revealed continuing weaknesses in controls that expose PBGC's significant financial management systems and data to unauthorized access and/or modification. Weaknesses included the following:

- Weaknesses in PBGC's certification and accreditation (C&A) program impact the reporting of accurate and complete information required for PBGC to make credible, risk-based decisions related to production system operations. These weaknesses compromise PBGC's ability to accept and manage the risk to PBGC's operations, agency assets, and personnel. Without an effective C&A program, there will be no reasonable assurance that PBGC's information systems are able to meet both their functional requirements and provide adequate security to protect PBGC's operations, assets, and personnel. For example, PBGC had not completed effective security plans, risk assessments, and testing as part of its C&A program. The National Institute of Standards and Technology (NIST) Special Publication 800-37, *Guide for the Security Certification and Accreditation of Federal Information Systems*, provides the framework under the Federal Information Security Management Act (FISMA) of 2002, Public Law 107-347, for how PBGC's C&A program is to be implemented.
- PBGC's current information security policy and plan do not comply with standards and guidance issued by NIST in furtherance of its statutory responsibilities under FISMA. NIST has developed standards and guidelines, including minimum requirements for providing adequate information security for all agency operations and assets.

- The 2006 reorganization of the Office of Information Technology (OIT) has severely impacted the Information System Security Officer's (ISSO) ability to ensure appropriate operational security for PBGC's information system security program. The change in organizational structure further demotes the ISSO function in establishing security policies and procedures and reduces clarity on the ISSO's responsibility and accountability. The ISSO function at PBGC has not been placed organizationally in a position to effectively carry out PBGC's responsibilities under FISMA.
- OIT's process for reviewing, approving and disseminating policies and procedures needs improvement. Certain policies presented as approved referenced outdated or non-existent policies and procedures. In some cases, PBGC policies and procedures were not implemented and enforced because responsible officials were not aware of their existence.
- PBGC has not consistently deployed security configurations across its significant financial management applications and general support systems.
- PBGC has not formalized effective processes for granting, removing, and recertifying user access to significant financial management applications and general support systems.
- Application owners or administrators do not perform periodic auditing and monitoring of user access and sensitive transactions for significant financial management systems.
- OIT management's, application owners', and application administrators' duties are not clearly defined regarding user and security administration for significant financial management systems.
- PBGC has granted developers inappropriate access to the production environment.
- OIT has not developed a process that would allow the ISSO to manage and monitor the effectiveness of the entity-wide security program.

Until PBGC implements a complete and effective enterprise-wide information security program that complies with FISMA and NIST standards and guidance, its ability to mitigate and appropriately manage the risk of unauthorized access to, and/or modification or disclosure of sensitive PBGC financial information will be impaired.

Recommendations:

We recommend that PBGC management perform the following:

- Assign specific resources to 1) update the general security plan and associated security policies to reflect the current operating environment, and 2) complete the implementation of a fully functional and integrated enterprise-wide information security program, with priority given to implementation and monitoring of technical security standards. **(OIG Control Number CTO-5)**
- Develop enforcement mechanisms to ensure that all departments comply with the enterprise-wide information security program, as well as consistently enforce

policies and procedures for logical access to information resources that are based on the concepts of "least possible privilege". **(OIG Control Number CTO-6)**

- Implement an organization structure that promotes independence and reporting with regard to PBGC's information security program. **(OIG Control Number CIO-1)**
- Implement a certification and accreditation program that is in full compliance with NIST Special Publication 800-37, *Guide for the Security Certification and Accreditation of Federal Information Systems*. **(OIG Control Number OIT-86)**
- Strengthen the OIT process for reviewing, approving and disseminating policies and procedures to ensure documents are 1) accurate, consistent, and properly approved, and 2) properly disseminated to the officials and responsible parties for their implementation and enforcement. **(OIG Control Number OIT-87)**

3. PBGC Needs to Improve Controls Related to Single-Employer Premiums (Repeat Condition)

Management has acknowledged the weaknesses associated with the single-employer premiums and has taken steps to improve the internal controls for premiums including the FY 2006 award of a contract for the design and implementation of a new premium accounting system with an anticipated completion date of October 2007. However, we noted continued internal control weaknesses in our 2006 audit.

The control weaknesses we identified relate to the following internal control objectives:

- Safeguarding of Assets - Ensuring PBGC collects all premiums due under statute. OMB Circular A-123, *Management's Responsibility for Internal Control*, requires that: "The agency head must establish controls that reasonably ensure that: i) obligations and costs are in compliance with applicable law; (ii) funds, property, and other assets are safeguarded against waste, loss, unauthorized use or misappropriation."
- Financial Reporting - Ensuring PBGC reports complete and reliable premium revenue and receivables in the financial statements. OMB Circular A-123 states that: "The agency head must establish controls that reasonably ensure that: … iii) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets."

<u>Data quality weaknesses</u>:

During PAS conversion from the legacy Premium Processing System, PBGC experienced difficulty in migrating data. In addition, errors due to incorrect data entry, adjustments, and system-generated balances while not identified as an ongoing issue during the FY 2006 audit were noted as issues in the FY 2004 audit and prior years. These difficulties are the underlying cause of several of the control weaknesses noted during our testing.

PBGC's ability to identify plans that have a premium filing requirement and to collect premiums owed is limited because the Audit and Enforcement module within PAS to compare Form 1 (premium filing form) filings to pension plan Form 5500 filings with the Department of Labor is not currently functional and will not be until the new premium system is implemented. A match of this data was performed outside of PAS during FY 2006; however, the results of this process have not yet been analyzed. Completing this analysis would enable PBGC to potentially identify plans which had not filed or paid their associated premiums.

Impact of data quality weaknesses:

Because of the data quality issues noted, PBGC is unable to efficiently utilize two of its primary tools, Past Due Filing Notices (PDFN) and Statements of Account (SOA), to ensure the accuracy and completeness of premium data. The PDFN is a PAS-generated notice mailed to plans that have not submitted premium filings. The SOA is also a PAS-generated notice used to ensure that underpaid or overpaid premiums from a plan sponsor are effectively rectified. We noted during the audit that PDFNs and SOAs are not mailed timely in accordance with PBGC policy because significant resources must be expended prior to mailing each notice to validate the information. Because these notices are not mailed in a timely manner, the potential exists that premiums will not be collected or that errors in amounts reflected in PAS will not be detected.

Other control matters:

Finally, we noted that all of the pertinent policies and procedures related to the premium accounting cycle have not been documented, communicated, or implemented throughout PBGC.

Recommendations:

While we acknowledge that PBGC is currently working toward the implementation of a new premium system with an implementation date currently scheduled for October 2007, we continue to recommend that PBGC:

- Implement controls to reconcile Form 1 information received by PBGC to Form 5500 information received by the Department of Labor as a means of identifying plans that have not filed or paid their associated premiums. **(OIG Control Number FOD-334)**
- Compile a comprehensive polices and procedures manual for processing and accounting for premium revenue. **(OIG Control Number FOD-335)**

4. PBGC Needs to Strengthen Its Preparedness for Unanticipated Incidences and Disruptions (Repeat Condition)

PBGC has developed a Continuity of Operations Plan (COOP) that identifies and exercises its ability to respond to a limited number and type of incidents that impact operations. However the COOP is just one component of a full spectrum of service continuity controls that would allow PBGC to reduce the impact on its operations due to unexpected events. For example, just as losing the capability to process and protect information maintained on PBGC's computer systems can significantly impact PBGC's ability to accomplish its mission, maintain productivity, and ensure financial integrity, so would safely evacuating staff from a building due to a fire or similar emergency and relocating operations or dealing with a pandemic flu outbreak have a comparable impact.

Strong service continuity controls should identify and address adequate procedures to minimize the risk of unplanned interruptions and be included in a plan to recover critical operations should such interruptions occur. This plan should consider the impact on and recovery of all facilities, personnel, and information systems as they relate to PBGC's mission and business objectives. These procedures and plan should be tested periodically to ensure they will work as intended, and if not, timely corrections can be made before the next test.

During our FY 2006 review of PBGC's ability to develop and implement a contingency plan, we noted that PBGC made the following progress:

- PBGC has drafted its contingency planning policy statement which is in the process of being approved, disseminated and implemented. The contingency planning policy statement will be effective in FY 2007. The policy addresses a comprehensive set of objectives for the establishment of the organizational framework and responsibilities for comprehensive contingency planning at PBGC, of which COOP is one component.
- PBGC is in the process of conducting a business impact analysis (BIA) that will address a comprehensive set of contingency planning scenarios to further direct its development and implementation of a more robust contingency planning process.

We identified the following service continuity control deficiencies in PBGC's completion of key elements required in establishing a comprehensive contingency plan:

- PBGC's current BIA addressed items necessary to develop its COOP. The BIA did not address all significant recovery issues related to contingency planning.
- PBGC's COOP policy statement was too narrow to meet the needs of PBGC. This was the only contingency related policy statement in effect during FY 2006. It only establishes one objective (e.g. to continue to perform certain critical functions of PBGC in the event that an emergency renders or threatens to render the PBGC sites unusable). PBGC did not have an approved contingency planning policy statement in FY 2006 that addresses a comprehensive set of objectives for the establishment of the organizational framework and responsibilities for comprehensive contingency planning of which COOP is one component.
- PBGC's recovery strategies do not address prioritized recovery scenarios based on disruption impacts and allowable outage times for the failure and/or

degradation of critical system components at headquarters. The current strategy does not include a combination of methods that complement one another to provide recovery capability over the full spectrum of incidents.

- Although PBGC conducts at least two (2) tests of its COOP annually, PBGC has not demonstrated its ability to successfully recover its major business processes. For example, PBGC could not recover and process several major applications during its August 2006 COOP test. The COOP test did not meet intended objectives and did not achieve the level of recovery envisaged in the COOP test plan. PBGC's participation in the federal "Forward Challenge" exercise also did not demonstrate PBGC's ability to successfully operate from an alternative site.

Recommendations:

- First, establish and implement a contingency planning policy statement that addresses a comprehensive set of objectives for the establishment of the organizational framework and responsibilities for comprehensive contingency planning. **(OIG Control Number FASD-130)**
- Second, conduct a BIA that addresses a full set of contingencies, including system outages and degradation issues at headquarters. **(OIG Control Number FASD-131)**
- Finally, develop, document, implement, and test recovery strategies as part of PBGC's COOP to achieve the comprehensive set of objectives in PBGC's contingency planning policy statement and address the disruption impacts and allowable outage times identified in PBGC's comprehensive BIA. **(OIG Control Number FASD-132)**

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In addition to the reportable conditions described above, we noted certain matters involving internal control and its operation that we reported to the management of PBGC in a separate letter dated November 9, 2006.

This report 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.

Clifton Gunderson LLP

Calverton, Maryland
November 9, 2006

Section IV

Independent Auditor's Report on Compliance and Other Matters

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Compliance and Other Matters

To the Inspector General of the
Pension Benefit Guaranty Corporation

We have audited the financial statements of the Single-Employer and Multiemployer Program Funds administered by the Pension Benefit Guaranty Corporation (PBGC) as of and for the year ended September 30, 2006, and have issued our report thereon dated November 9, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*.

The management of PBGC is responsible for complying with laws and regulations applicable to PBGC. As part of obtaining reasonable assurance about whether PBGC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to PBGC. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests of compliance disclosed no instances of noncompliance with laws and regulations discussed in the preceding paragraph or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 06-03.

This report 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.

Clifton Gunderson LLP

Calverton, Maryland
November 9, 2006

Section V

Agency Comments

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

Office of the Director

TO: Robert L. Emmons, Inspector General

FROM: Vincent K. Snowbarger, Interim Director Vincent K. Snowbarger

SUBJECT: PBGC's Response to the FY 2006 Financial Statement Audit Reports

DATE: November 13, 2006

Thank you for the opportunity to respond to the three reports issued in connection with the FY 2006 financial statement audit, by Clifton Gunderson, LLP, with the oversight of the PBGC Office of Inspector General (OIG). We are pleased to have received our 14th consecutive unqualified audit opinion on our financial statements, and again to have received an unqualified opinion regarding the effectiveness of PBGC's internal controls.

The Report on Internal Control does identify four reportable conditions, and PBGC is committed to addressing these issues in a timely manner. While we have made progress, we understand that more remains to be done, and concur with the recommendations contained in the report. We discuss the current status of corrective actions for each reportable condition and provide estimated completion dates below:

- **Systems Integration –** In FY 2006, PBGC completed the first phase of a multiyear effort to consolidate and improve core financial management systems. On October 1, 2006, the Consolidated Financial System (CFS) became the new system of record, consolidating three general ledger systems and our budget execution and administrative payment system into a single integrated environment. The passing of this major milestone positions PBGC closer to the resolution of this reportable condition. The second phase will focus on Business Process Re-engineering (BPR) to identify process improvements and increased integration between CFS and other systems that provide input to PBGC's financial statements. PBGC plans to complete corrective action on this major effort by FY 2009.

- **System Security** – PBGC has added resources to develop an enterprise-wide system security program. Significant progress has been made in developing the Enterprise Information Security Policies and an Enterprise-wide Security Plan with implementation in the final stages. Through the internal controls program, deficiencies in critical processes across the agency are being corrected or mitigated. Risk assessment and system security plans for all significant financial management applications and general support systems have either been completed or initiated. PBGC is working on a comprehensive framework to formalize its progress under the Certification and Accreditation program to ensure compliance with NIST Special

Publication 800-37, Guide for the Security Certification and Accreditation of Federal Information Systems. PBGC expects to complete Certification and Accreditation on two of its significant financial management applications (including the consolidated general ledger and budget system) as well as on its most critical general support systems in FY 2007, with Certification and Accreditation to follow on its two other primary significant financial systems when they are placed into operation in early FY 2008.

- **Premiums –** PBGC's Financial Operations Department has made considerable progress by implementing a new data capture process, improved image capture systems, a new e-filing system, and additional manual controls. For example, in the past, a significant number of premium payment transactions were suspended because the payments could not be initially associated with an existing customer account or failed other validation tests. As a result of an increased emphasis in this area and process improvements, the backlog of unresolved suspended transactions that existed at the end of FY 2004 has been eliminated, and the time required resolving such transactions has been greatly reduced. As of October 31, 2004, there were $66.5 million in suspended transactions, and two years later, these amounts have been reduced to $3.3 million (a 95% reduction). As of the same time periods, the dollar value associated with suspended transactions which were not resolved within a 60-day window has been reduced from $5.2 million to $41,000 (a 99% reduction). A new system, the Premium and Practitioner System (PPS), which will be the receivable module for the revolving set of books and will be fully integrated in CFS, has been designed to further improve timeliness and accuracy in premium operations. The new system will strengthen financial management and customer service capabilities, and will include a User's Manual and updated procedures for estimating premiums. The contract to implement PPS was awarded at the end of FY 2006, and implementation will occur in FY 2008.

- **Continuity of Operations Plan –** PBGC's Facilities and Services Department, along with the Office of Information Technology, worked to address this reportable condition by conducting an internal review of the causes of a disruption in the availability of PBGC computer network at the end of FY 2005. A contingency planning policy statement that addresses a comprehensive set of objectives for the establishment of the organizational framework and responsibilities for comprehensive contingency planning was established and implemented. The policy's objectives are comprised of ten components. PBGC has completed its efforts on the Continuity of Operations, Occupant Emergency, and Pandemic Influenza Plans. Work continues on the remaining components which include, but are not limited to, a Business Impact Analysis (BIA), an IT Risk Assessment, and various other recovery/communication plans. In addition, PBGC has a testing and exercise plan, which includes participation in government-wide Forward Challenge COOP exercises. Management plans to complete work on this effort in FY 2007.

We appreciate the professionalism that the OIG and Clifton Gunderson, LLP, demonstrated in completing a complex audit in such a timely manner. Again, thank you for the opportunity to respond.