United States General Accounting Office

GAO

Report to the Congress

March 1995

FINANCIAL AUDIT

Pension Benefit Guaranty Corporation's 1994 and 1993 Financial Statements

GAO/AIMD-95-83

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-259540

March 8, 1995

To the President of the Senate and the
Speaker of the House of Representatives

This report presents our opinion on the financial statements of the Pension Benefit Guaranty Corporation's Single-Employer Fund and Multiemployer Fund for the fiscal years ended September 30, 1994 and 1993, and our evaluation of internal controls and compliance with laws and regulations. We conducted our audit pursuant to the provisions of 31 U.S.C. 9105, as amended, and in accordance with generally accepted government auditing standards.

Our opinion on the Funds' financial statements is unqualified. During fiscal year 1994, the Corporation continued making progress in improving its internal controls; however, material internal control weaknesses continue to affect both funds. This report also discusses our continuing concerns about the long-term viability of the Single-Employer Fund and weaknesses in employee benefit plan audits and reports.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs; the House Committee on Government Reform and Oversight; and the Subcommittee on Oversight, House Committee on Ways and Means. We are also sending copies to the Secretaries of Labor, the Treasury, and Commerce in their capacities as Chairman and members of the Board of Directors of the Pension Benefit Guaranty Corporation; the Corporation's Executive Director; the Director of the Office of Management and Budget; and other interested parties.

This report was prepared under the direction of Robert W. Gramling, Director of Corporate Financial Audits, Accounting and Information Management Division, who may be reached at (202) 512-9406, if you have any questions. Other major contributors are listed in appendix V.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

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Abbreviations

ERISA	Employee Retirement Income Security Act
FMFIA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
GATT	General Agreement on Tariffs and Trade
PBGC	Pension Benefit Guaranty Corporation
PC	personal computer
PLUS	Pension and Lump Sum

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To the Board of Directors
Pension Benefit Guaranty Corporation

We have audited the accompanying statements of financial condition as of September 30, 1994 and 1993, of the Single-Employer and Multiemployer Funds administered by the Pension Benefit Guaranty Corporation (PBGC), and the related statements of operations and changes in net position and statements of cash flows for the fiscal years then ended. We found the following:

- The Corporation's financial statements referred to above were reliable in all material respects.
- In its 1994 report on internal controls, management fairly stated that internal controls in place on September 30, 1994, were not effective in assuring that transactions were properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles and to maintain accountability for assets among funds. However, through additional audit procedures, we were able to satisfy ourselves that these weaknesses did not have a material effect on the Corporation's financial statements. In contrast, internal controls in place on September 30, 1994, did provide reasonable assurance that assets were safeguarded from material loss and that transactions were executed in accordance with management authority and significant provisions of selected laws and regulations.
- There was no reportable noncompliance with laws and regulations we tested.

The following sections outline each of these conclusions in more detail and discuss significant matters considered in performing our audit and forming our opinions. Appendix I discusses the scope of our audit, including one area for which we reviewed and relied on the work of an independent public accountant under contract to the Corporation's Inspector General. Appendix II presents the financial statements of the funds; appendix III presents the Corporation's assertion about the effectiveness of its internal controls; and appendix IV contains the Corporation's written comments on a draft of this report.

Significant Matters

The following information discusses our continuing concerns about

- the long-term viability of the Single-Employer Fund and
- weaknesses in employee benefit plan audits and reporting.

In addition, significant matters involving material weaknesses in internal controls are discussed in a separate section below.

Concerns About the Long-term Viability of the Single-Employer Fund

The Single-Employer Fund is able to meet its near-term benefit obligations because premium receipts presently exceed benefit payments and the Fund held investments having a market value of $7.2 billion and cash of $627 million at September 30, 1994. The Single-Employer Fund also reported a significant gain for the year, largely as a result of the effect of rising interest rates on the program's benefit liabilities.

However, the Fund's unfunded $1.2 billion deficit, which represents a shortfall in assets needed to satisfy the Corporation's benefit liabilities for terminated plans and for those plans considered likely to terminate, still constitutes a threat to the Fund's long-term viability. In addition to the losses recorded in the financial statements and reflected in the unfunded deficit as of September 30, 1994, the Corporation disclosed $18 billion in estimated unfunded liabilities in single-employer plans that represent reasonably possible future losses.

The Employee Retirement Income Security Act of 1974 (ERISA), which created the pension insurance program, established funding standards for insured plans but allowed benefits to become guaranteed before being funded by plan sponsors. The resulting timing difference has contributed, in large measure, to the Corporation's exposure should a financially troubled plan sponsor be unable to meet its pension obligations.

Moreover, the premium structure of the Single-Employer Fund has limited the Corporation's ability to manage the exposure posed by underfunded plans because premiums paid by those plans have not fully covered the risks.

In 1987, the Congress modified the Single-Employer Fund's basic flat-rate premium structure by adding a supplemental variable rate premium which, for the first time, established a link between premiums and plan underfunding. The variable rate premium was based on the unfunded vested liability as calculated by the plan, after adjusting for a common interest rate, rather than the specific unfunded liability the Fund assumes should a plan actually terminate. However, as previously reported,[1] the

[1]Pension Plans: Hidden Liabilities Increase Claims Against Government Insurance Program (GAO/HRD-93-7, December 30, 1992).

Single-Employer Fund often assumes a substantially larger liability upon termination than the last one calculated and reported by a plan.

Also, the variable rate premium was subject to a maximum dollar amount that, when reached, effectively limited the risk-based linkage between premiums and plan underfunding. In addition, the Single-Employer Fund's premium structure did not take into account the added risk of termination posed by underfunded plans sponsored by financially troubled companies.

To address these concerns, the administration supported legislation proposed in the 103rd Congress to strengthen minimum funding standards by requiring sponsors to increase their contributions to underfunded defined benefit pension plans and phasing out the cap on variable rate premiums paid by underfunded plans. A modified version of this proposal, the Retirement Protection Act of 1994, became law on December 8, 1994, as part of legislation implementing the General Agreement on Tariffs and Trade (GATT). The Corporation anticipates that this legislation will significantly reduce underfunding in the plans that it insures and improve its financial condition. We have not assessed the long-term effects of this legislation on the Corporation's deficit. However, the Corporation will need to monitor whether the legislation achieves the desired results.

Weaknesses in Employee Benefit Plan Audits and Reporting

As we previously reported,[2] weaknesses in the scope and quality of audits of employee benefit plans and the lack of plan reporting on internal controls reduce their effectiveness in safeguarding the interests of plan participants and the government. Under ERISA, the Department of Labor is responsible for establishing reporting and disclosure requirements and monitoring ongoing employee benefit plans, which include defined benefit pension plans insured by the Corporation.

In past reviews of independent public accountants' audits of employee benefit plans we found severe weaknesses in both the quality and scope of plan audits that made their reliability and usefulness questionable.[3] ERISA allows plan administrators to limit the scope of plan audits by excluding plan assets held by certain regulated institutions from the scope of the auditor's work. Thus, in cases where the scope is limited, the auditor

[2] Financial Audit: Pension Benefit Guaranty Corporation's 1993 and 1992 Financial Statements (GAO/AIMD-94-109, May 4, 1994).

[3] These reviews are discussed in Employee Benefits: Improved Plan Reporting and CPA Audits Can Increase Protection Under ERISA (GAO/AFMD-92-14, April 9, 1992) and Changes Are Needed in the ERISA Audit Process To Increase Protection for Employee Benefit Plan Participants, U.S. Department of Labor, Office of Inspector General, 09-90-001-12-001 (Washington, D.C.: November 9, 1989).

provides little or no assurance about the existence, ownership, or value of assets that may be material to the financial condition of those plans. In addition, plan auditors are not required to check the accuracy and completeness of pension insurance premium filings applicable to insured plans or related premium payments made to the Corporation. Finally, while plan administrators are responsible for establishing sound internal controls and for complying with applicable laws and regulations, ERISA does not require that either plan administrators or plan auditors report to regulators and participants on the effectiveness of internal controls.

In our April 1992 report (GAO/AFMD-92-14), we recommended that the Congress eliminate ERISA's limited scope audit provision and require plan administrators and auditors to report on internal controls. Legislation was introduced late in the 103rd Congress that would have eliminated limited scope audits, required peer review of auditors conducting plan audits, and required plan administrators and auditors to report irregularities. This proposed legislation would not have required plan administrators and auditors to report on internal controls. The legislation was not enacted, and as of February 15, 1995, the 104th Congress had not taken up similar legislation.

Material Internal Control Weaknesses

Our work disclosed that the Corporation has continued to make progress in improving internal controls affecting its financial reporting. However, as of September 30, 1994, material weaknesses[4] continued to exist in the Corporation's internal control structure in the three areas reported in our previous audits:

- weaknesses in financial systems and related internal controls,
- inadequate controls over the assessment of the Multiemployer Fund's liability for future financial assistance, and
- inadequate controls over nonfinancial participant data.

Through substantive audit procedures,[5] we were able to satisfy ourselves that the weaknesses discussed below did not have a material effect on the fiscal year 1994 and 1993 financial statements of the Single-Employer and

[4]A material weakness is a reportable condition in which the design or operation of the internal controls does not reduce to a relatively low level the risk that losses, noncompliance, or misstatements in amounts that would be material in relation to the financial statements may occur and not be detected within a timely period by employees in the normal course of their assigned duties.

[5]Substantive audit procedures are detailed tests and analytical procedures performed to detect material misstatements in the classification of transactions, account balances, and disclosure components of financial statements.

Multiemployer Funds. However, these weaknesses could result in misstatements in future financial statements and other financial information if not corrected by management. These weaknesses could also have an adverse impact on management decisions based, in whole or in part, on information whose accuracy is affected by the deficiencies. Unaudited financial information, including budget information, reported by the Corporation or used as a basis for management's operational decisions also may contain inaccuracies resulting from these weaknesses.

Weaknesses in Financial Systems and Related Internal Controls

We reported for fiscal years 1992 and 1993[6] that weaknesses in financial systems and related internal controls presented an unacceptable risk to the Corporation that material misstatements might occur in the Corporation's financial information and not be detected promptly by the Corporation.

During fiscal year 1994, the Corporation continued to take steps to strengthen internal controls and to address weaknesses in financial and management information systems. For example, the Corporation began testing the data supporting multiemployer plan requests for financial assistance to ensure that they were valid and adequately supported prior to providing the assistance, updated certain computer operations procedures, and began detail system design for a new core financial system incorporating the standard general ledger.

However, as of September 30, 1994, the Corporation had not implemented sufficient financial reporting controls to compensate fully for its lack of financial system integration. Deficiencies in automated management and financial information systems continued to inhibit management's ability to promptly and accurately accumulate and summarize the information needed for internal and external reports. Overall, the Corporation's cumbersome and nonintegrated processes for preparing the financial and other management information needed to support operations and financial/budgetary reporting were time-consuming and labor-intensive. These conditions were due, in part, to shortcomings in systems development and operations, including the absence of a proven systems development methodology. Thus, system and control weaknesses exposed the Corporation to a significant risk that the information could be materially misstated. These weaknesses were discussed in greater detail in our previous reports.

[6] Financial Audit: Pension Benefit Guaranty Corporation's 1992 and 1991 Financial Statements (GAO/AIMD-93-21, September 29, 1993); and Financial Audit: Pension Benefit Guaranty Corporation's 1993 and 1992 Financial Statements (GAO/AIMD-94-109, May 4, 1994).

Inadequate Controls Over the Assessment of the Multiemployer Fund's Liability for Future Financial Assistance

During fiscal year 1994, the Corporation placed into operation a new computer system to determine the multiemployer plan universe and identify financially troubled plans as part of its assessment of the Multiemployer Fund's liability for future financial assistance. However, the new system's security controls were not designed to effectively restrict access to program source code, executable programs, and data tables. Additionally, during system implementation, the Corporation did not maintain evidence to document that key financial and nonfinancial plan data were accurately and completely transferred into the new multiemployer system.

In addition, as reported for fiscal year 1993, the Corporation did not review or properly supervise the process for determining which plans should be included in the universe of multiemployer plans, or address the accuracy of certain data utilized in identifying and assessing financially troubled multiemployer plans.

Inadequate Controls Over Nonfinancial Participant Data

As previously reported, the Corporation's controls did not ensure the accuracy of nonfinancial participant data entered into the Pension and Lump Sum (PLUS) system. In processing a terminated pension plan, the Corporation obtains nonfinancial participant data (such as social security numbers and dates of birth and employment) and uses the data, in conjunction with other information, to initially determine participants' guaranteed benefits. After the nonfinancial data are obtained and initial benefits are determined, the data are entered into the PLUS system automated database, which is used to respond to participant inquiries and administer other benefit services. The Corporation uses these data annually to value its benefit liability for participants whose data have been entered in PLUS. Inaccurate nonfinancial data can reduce the precision of the Corporation's fiscal year-end liability valuation and delay the final calculation of participant benefits.

Weaknesses in controls over nonfinancial participant data and related recommendations are discussed in the Pension Benefit Guaranty Corporation Inspector General Report No. 94-6/23079-1 and as updated in its report No. 95-5/23083-1. In our report (GAO/AIMD-94-109), we concurred with the Inspector General's recommendations, which are designed primarily to strengthen the verification of participant data and the input and edit controls over participant data maintained in PLUS.

During fiscal year 1993, the Corporation initiated efforts designed to improve the accuracy of certain aspects of nonfinancial participant data entered into the PLUS system. However, control weaknesses involving these data continued to exist for fiscal year 1994 because the Corporation had not made significant progress in improving procedures for obtaining and documenting participant data in a timely manner. Also, weaknesses existed in the Corporation's verifying and editing of the nonfinancial participant data entered and maintained in the Corporation's records and its PLUS database.

We previously made recommendations for addressing each of the material internal control weaknesses discussed in this report.[7] These recommendations called for strengthening internal controls over systems development/modification and integration, financial reporting, multiemployer financial assistance, and participant data. While the Corporation made progress during fiscal year 1994 in addressing these recommendations, these efforts have not been completed. The Corporation has stated its commitment to fully addressing the weaknesses disclosed in these reports.

Opinion on Financial Statements

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Single-Employer and Multiemployer Funds administered by the Pension Benefit Guaranty Corporation as of September 30, 1994 and 1993, and the results of their operations and cash flows for the fiscal years then ended, in accordance with generally accepted accounting principles.

However, misstatements may nevertheless occur in other financial information reported by the Corporation as a result of the internal control weaknesses previously described. Furthermore, the Corporation's assessment of the Multiemployer Fund's exposure to liabilities for future financial assistance is subject to material uncertainties, whose eventual effects cannot be reasonably determined at present. Many complex factors must be considered to identify multiemployer plans which are likely to require future assistance and to estimate the amount of such assistance. These factors, which include the financial condition of the plans and their

[7]Financial Audit: Pension Benefit Guaranty Corporation's 1992 and 1991 Financial Statements (GAO/AIMD-93-21, September 29, 1993); Financial Audit: Pension Benefit Guaranty Corporation's 1993 and 1992 Financial Statements (GAO/AIMD-94-109, May 4, 1994); Pension Benefit Guaranty Corporation Inspector General Report No. 93-6/23069-1, September 29, 1993; and Pension Benefit Guaranty Corporation Inspector General Report No. 94-6/23079-1, May 4, 1994.

multiple sponsors, will be affected by future events, most of which are beyond the Corporation's control.

Opinion on Internal Controls

We evaluated management's assertion about the effectiveness of its internal controls designed to:

- safeguard assets against loss from unauthorized use or disposition;
- assure the execution of transactions in accordance with management authority and with laws and regulations that have a direct and material effect on the financial statements or that are listed by OMB and could have a material effect; and
- properly record, process, and summarize transactions to permit the preparation of reliable financial statements in accordance with generally accepted accounting principles and to maintain accountability for assets.

In its 1994 report on internal controls, the Corporation's management fairly stated that internal controls in effect on September 30, 1994, did not provide reasonable assurance that the Corporation properly recorded, processed, and summarized transactions to permit the preparation of financial statements in accordance with generally accepted accounting principles. However, controls in effect on September 30, 1994, provided reasonable assurance that assets were safeguarded against loss from unauthorized use or disposition and that transactions were executed in accordance with management's authority and significant provisions of selected laws and regulations. Management made this assertion, which is included in appendix III, using the internal control and reporting criteria set forth in the Federal Managers' Financial Integrity Act (FMFIA) and implementing guidance. In making this assertion, management considered the material weaknesses we found.

Reportable Condition

While the Corporation made progress in addressing the reportable conditions identified and discussed with the Corporation during our fiscal year 1993 audit, our audit for fiscal year 1994 found that one of these reportable conditions continued to exist. Although this reportable condition is not considered a material weakness, it represents a significant deficiency in the design or operation of the Corporation's internal controls and should be corrected.

The Corporation's controls over documentation supporting participant data maintained on PLUS were inadequate. In many cases, the Corporation was unable to provide documentation supporting the nonfinancial participant data entered on PLUS. In addition, the Corporation was not always able to demonstrate that procedures designed to support the accuracy of PLUS data were performed. Without proper supporting documentation, the Corporation may be unable to demonstrate the accuracy of PLUS data used to value the Corporation's liability for terminated plans.

This reportable condition and related recommendations are discussed further in the Pension Benefit Guaranty Corporation Inspector General Report No. 94-6/23079-1 and as updated in its report No. 95-5/23083-1. In our report (GAO/AIMD-94-109), we concurred with the Inspector General's recommendations and recommended that the Corporation implement them. The Corporation agreed with the recommendations but its intended corrective actions had not progressed sufficiently to prevent the documentation weakness identified by the audit.

In addition to the material weaknesses and reportable condition described in this report, we noted other less significant matters involving the Corporation's internal control structure and its operations which we will be reporting separately to the Corporation's management. Similarly, in addition to the material weakness and reportable condition described in Pension Benefit Guaranty Corporation Inspector General Report No. 95-5/23083-1, other less significant matters related to the Corporation's internal control structure over its liability for future benefits on terminated plans will be reported separately to management by the Corporation's Inspector General.

Compliance With Laws and Regulations

Our tests of compliance with significant provisions of selected laws and regulations disclosed no material instances of noncompliance.

Agency Comments and Our Evaluation

Commenting on a draft of this report, the Corporation's Executive Director agreed with our findings. The Executive Director's written comments, provided in appendix IV, discuss the Corporation's ongoing efforts to address the internal control weaknesses and respond to our previous recommendations. We plan to monitor the adequacy and effectiveness of these efforts as part of follow-up audits of the Corporation's financial statements.

Charles A. Bowsher
Comptroller General
of the United States

February 15, 1995

Objectives, Scope, and Methodology

The Corporation's management is responsible for

- preparing the annual financial statements of the two funds in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing the internal control structure to provide reasonable assurance that the broad control objectives of FMFIA are met; and
- complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the Corporation's financial statements are reliable (free of material misstatement and presented fairly in conformity with generally accepted accounting principles) and (2) management's assertion about the effectiveness of internal controls is fairly stated in all material respects based upon the control criteria in GAO's Standards for Internal Controls in the Federal Government required by the Federal Managers' Financial Integrity Act. We are also responsible for testing compliance with significant provisions of selected laws and regulations and for performing limited procedures with respect to certain other information appearing in this financial statement.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements of each of the two funds;
- assessed the accounting principles used and significant estimates made by the Corporation's management;
- evaluated the overall presentation of the financial statements;
- obtained an understanding of the internal control structure related to safeguarding assets, compliance with laws and regulations including execution of transactions in accordance with budget authority, financial reporting, and assessed control risk;
- tested relevant internal controls and evaluated management's assertion about the effectiveness of internal controls;
- tested compliance with selected provisions of the following laws and regulations: the Employee Retirement Income Security Act of 1974, as amended, and the Chief Financial Officers Act of 1990. The provisions selected for testing included, but were not limited to, those relating to
  - benefit guarantees and financial assistance;
  - the availability of, accounting for, and use of funds;

- the preparation and issuance of financial statements and management reports; and
- premiums and the assessment of related interest and penalties.

We also conducted tests of compliance with the Anti-Deficiency Act that were limited to comparing the Corporation's recorded payments to related authorized limitations on certain payments and apportionments.

In fulfilling our responsibilities, we have relied on audit work performed by an independent public accounting firm under the direction of the Corporation's Inspector General. The scope of this work, performed in conjunction with our audit, included an audit of the Corporation's liabilities for future benefits on terminated plans and related losses, expenses, and cash flows, as well as related internal controls and compliance. We worked with the Inspector General to establish the scope of the work. We reviewed the work and concur with its scope, opinions, conclusions, and recommendations, which are presented in Pension Benefit Guaranty Corporation Inspector General Report No. 95-5/23083-1.

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 accounting and other controls necessary to achieve the objectives outlined in our opinion on management's assertion about the effectiveness of internal controls. Because of inherent limitations in any internal control structure, losses, noncompliance, or misstatements may nevertheless occur and not be detected. We also caution that projecting our evaluation of controls to future periods is subject to the risk that controls may become inadequate because of changes in conditions or the degree of compliance with controls may deteriorate.

Our audit was conducted pursuant to provisions of 31 U.S.C. 9105, as amended, and in accordance with generally accepted government auditing standards. We believe our audit provides a reasonable basis for our opinions.

Financial Statements

Statements of Financial Condition

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF FINANCIAL CONDITION

(*Dollars in millions*)	Single-Employer Program September 30, 1994	1993	Multiemployer Program September 30, 1994	1993	Memorandum Total September 30, 1994	1993
Assets						
Cash and cash equivalents	**$ 627**	$ 313	**$ 22**	$ 19	**$ 649**	$ 332
Investments, at market (Note 3):						
Fixed maturity securities	**4,690**	5,844	**349**	384	**5,039**	6,228
Equity securities	**2,418**	1,412	**3**	2	**2,421**	1,414
Real estate	**66**	88	**0**	0	**66**	88
Other	**56**	209	**0**	0	**56**	209
Total investments	**7,230**	7,553	**352**	386	**7,582**	7,939
Receivables, net:						
Sponsors of terminated plans	**172**	65	**0**	0	**172**	65
Premiums	**37**	32	**0**	0	**37**	32
Sale of securities	**32**	29	**0**	0	**32**	29
Lease receivable	**80**	75	**0**	0	**80**	75
Insurance companies	**0**	6	**0**	0	**0**	6
Investment income	**60**	45	**4**	2	**64**	47
Other	**40**	53	**0**	0	**40**	53
Total receivables	**421**	305	**4**	2	**425**	307
Furniture and fixtures, net	**3**	1	**0**	0	**3**	1
Restricted assets (Note 7)	**0**	95	**0**	0	**0**	95
Total assets	**$8,281**	$8,267	**$378**	$407	**$8,659**	$8,674

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)	**1994**	1993	**1994**	1993	**1994**	1993
Liabilities						
Present value of future benefits, net (Note 4):						
Trusteed plans	**$ 7,874**	$ 8,655	**$ 10**	$ 13	**$ 7,884**	$ 8,668
Terminated plans pending trusteeship	**175**	411	**0**	0	**175**	411
Claims for probable terminations	**1,166**	1,627	**0**	0	**1,166**	1,627
Total present value of future benefits, net	**9,215**	10,693	**10**	13	**9,225**	10,706
Present value of nonrecoverable future financial assistance (Note 5)			**164**	110	**164**	110
Claim on contingent valuation rights (Note 7)	**0**	96	**0**	0	**0**	96
Unearned premiums	**229**	207	**7**	8	**236**	215
Accounts payable and accrued expenses (Note 6)	**77**	168	**0**	0	**77**	168
Commitments and contingencies (Notes 7, 8, and 17)						
Total liabilities	**9,521**	11,164	**181**	131	**9,702**	11,295
Net position	**(1,240)**	(2,897)	**197**	276	**(1,043)**	(2,621)
Total liabilities and net position	**$ 8,281**	$ 8,267	**$378**	$407	**$ 8,659**	$ 8,674

The accompanying notes are an integral part of these financial statements

Statements of Operations and Changes in Net Position

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

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
(Dollars in millions)	**1994**	1993	**1994**	1993	**1994**	1993
Underwriting:						
Income:						
Premium income (Note 10)	**$ 955**	$ 890	**$ 23**	$ 23	**$ 978**	$ 913
Other income (Note 11)	**42**	38	**0**	(1)	**42**	37
Total	**997**	928	**23**	22	**1,020**	950
Expenses:						
Administrative expenses	**125**	97	**0**	0	**125**	97
Loss on contingent valuation rights (Note 7)	**0**	96	**0**	0	**0**	96
Total	**125**	193	**0**	0	**125**	193
Other underwriting activity:						
Losses from completed and probable terminations (Note 12)	**(249)**	743	**0**	0	**(249)**	743
Losses from financial assistance (Note 5)			**57**	20	**57**	20
Actuarial adjustments (Note 4)	**(115)**	7	**(1)**	0	**(116)**	7
Total	**(364)**	750	**56**	20	**(308)**	770
Underwriting income (loss)	**1,236**	(15)	**(33)**	2	**1,203**	(13)
Financial:						
Investment income (loss) (Note 13):						
Fixed	**(490)**	1,465	**(46)**	107	**(536)**	1,572
Equity	**74**	150	**0**	0	**74**	150
Other	**36**	(77)	**0**	0	**36**	(77)
Total	**(380)**	1,538	**(46)**	107	**(426)**	1,645
Expenses:						
Investment expenses	**10**	10	**0**	0	**10**	10
Actuarial charges (credits) (Note 4):						
Due to passage of time	**560**	549	**1**	1	**561**	550
Due to change in interest rates	**(1,371)**	1,124	**(1)**	1	**(1,372)**	1,125
Total	**(801)**	1,683	**0**	2	**(801)**	1,685
Financial income (loss)	**421**	(145)	**(46)**	105	**375**	(40)
Net income (loss)	**1,657**	(160)	**(79)**	107	**1,578**	(53)
Net position, beginning of year	**(2,897)**	(2,737)	**276**	169	**(2,621)**	(2,568)
Net position, end of year	**$(1,240)**	$(2,897)	**$197**	$276	**$(1,043)**	$(2,621)

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

Statements of Cash Flows

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF CASH FLOWS

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
(Dollars in millions)	**1994**	1993	**1994**	1993	**1994**	1993
Operating Activities:						
Premium receipts	**$ 1,008**	$ 907	**$ 23**	$23	**$ 1,031**	$ 930
Interest and dividends received, net	**347**	266	**8**	12	**355**	278
Cash received from plans upon trusteeship	**66**	9	**0**	0	**66**	9
Receipts from sponsors	**33**	66	**0**	0	**33**	66
Other receipts	**25**	0	**0**	0	**25**	0
Receipts of lease receivable	**5**	130	**0**	0	**5**	130
Benefit payments—trusteed plans	**(693)**	(657)	**(2)**	(2)	**(695)**	(659)
Purchase LTV stock rights	**0**	(50)	**0**	0	**0**	(50)
Payment of LTV Contingent Valuation Rights	**(96)**	0	**0**	0	**(96)**	0
Financial assistance payments			**(4)**	(4)	**(4)**	(4)
Payments for administrative and other expenses	**(124)**	(105)	**0**	0	**(124)**	(105)
Net cash provided by operating activities (Note 16)	**571**	566	**25**	29	**596**	595
Investing Activities:						
Proceeds from sales of investments	**11,024**	2,972	**270**	25	**11,294**	2,997
Payments for purchases of investments	**(11,281)**	(3,463)	**(292)**	(44)	**(11,573)**	(3,507)
Net cash used in investing activities	**(257)**	(491)	**(22)**	(19)	**(279)**	(510)
Net increase in cash and cash equivalents	**314**	75	**3**	10	**317**	85
Cash and cash equivalents, beginning of year	**313**	238	**19**	9	**332**	247
Cash and cash equivalents, end of year	**$ 627**	$ 313	**$ 22**	$19	**$ 649**	$ 332

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

Notes to Financial Statements

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 1994 AND 1993

NOTE 1 — ORGANIZATION AND PURPOSE

The Pension Benefit Guaranty Corporation (PBGC) is a federal corporation created by Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) and 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, and the Pension Protection Act of 1987. The Corporation insures pensions, within statutory limits, of participants in covered single-employer and multiemployer defined benefit pension plans that meet the criteria specified in Section 4021 of ERISA. Subsequent to fiscal year 1994, the Retirement Protection Act became law. The act contains provisions to strengthen minimum funding standards and phases out the cap on variable-rate premiums paid by underfunded defined benefit pension plans.

ERISA requires that the PBGC programs be self-financing. The Corporation finances its operations through premiums collected from covered plans, assets assumed from terminated plans, collection of employer liability payments due under ERISA as amended, and investment income. In addition, PBGC may borrow up to $100 million from the U.S. Treasury to finance its operations. The Corporation did not use this borrowing authority during the years ended September 30, 1994, or September 30, 1993, nor is use of this authority currently planned. ERISA provides that the U.S. Government is not liable for any obligation or liability incurred by PBGC.

Under the single-employer program, PBGC is liable for the payment of guaranteed benefits with respect only to underfunded terminated plans. An underfunded plan may terminate only if PBGC finds that one of the four conditions for a distress termination, as defined in ERISA, is met or if PBGC involuntarily terminates a plan under one of five specified statutory tests. The net liability assumed by PBGC is generally equal to the present value of the future benefits (including amounts owed under Section 4022(c) of ERISA) less (1) the amounts that are provided by the plan's assets and (2) the amounts that are recoverable by PBGC from the plan sponsor and members of the plan sponsor's controlled group, as defined by ERISA.

Under the multiemployer program, if a plan becomes insolvent, it receives financial assistance from PBGC to allow the plan to continue to pay participants their guaranteed benefits. Such assistance is recognized as a loss to the extent that the plan is expected to be unable to repay these amounts from future plan contributions, employer withdrawal liability, or investment earnings.

NOTE 2 — SIGNIFICANT ACCOUNTING POLICIES

Revolving and Trust Funds: PBGC accounts for its single-employer and multiemployer program revolving and trust funds on an accrual basis. Each fund is charged a pro rata portion of the benefits paid each year. The revolving and trust funds have been combined for presentation purposes in the financial statements. The single-employer and multiemployer programs are separate entities by law and, therefore, are reported separately.

ERISA provides for the establishment of revolving funds to be used by PBGC "in carrying out its duties." The revolving funds support the administrative functions of PBGC and fund any deficits incurred by PBGC in trusteeing plans or providing financial assistance. Premiums collected from ongoing plans are accounted for through the revolving funds. The Pension Protection Act of 1987 created a single-employer revolving fund that is credited with all premiums in excess of $8.50 per participant, including all penalties and interest charged on these amounts, and investment income. This fund may not be used to pay PBGC's administrative costs or the benefits of any plan terminated prior to October 1, 1988, unless no other amounts are available.

The trust funds reflect accounting activity associated with: (1) trusteed plans—plans for which PBGC has legal responsibility, (2) plans pending trusteeship—terminated plans for which PBGC has not become legal trustee by fiscal yearend, and (3) probable terminations—plans that PBGC determines are likely to terminate and be trusteed by PBGC. PBGC cannot exercise legal control over a plan's assets until PBGC becomes trustee, which may be several years after the date of plan termination.

Allocation of Revolving and Trust Funds: Revolving and trust fund assets, liabilities, earnings, and expenses are allocated to each program's revolving and trust funds to the extent that such amounts are not directly attributable to a specific fund. Revolving fund earnings are allocated on the basis of each program's average cash available for investment 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 yearend equity of each program's revolving funds. The plan assets acquired by PBGC and commingled at PBGC's custodian bank are credited directly to the appropriate fund while the earnings and expenses on the commingled assets are allocated to each program's trust funds on the basis of each trust fund's value, relative to the total value of the commingled fund.

Valuation Method: Consistent with generally accepted accounting principles outlined in Statements of Financial Accounting Standards Nos. 35 and 60, PBGC reports its assets and liabilities at fair market value. A primary objective of PBGC's financial statements is to provide financial information that is useful in assessing PBGC's present and future ability to ensure that defined benefit beneficiaries receive benefits when due. PBGC believes that measuring its assets and liabilities at fair market value provides the most relevant information to the reader.

Investment Valuation and Income: Fair market values are based on the last sale of a listed security, on the mean of the "bid-and-asked" 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. 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 an average cost basis. Any increase or decrease in the market value of a plan's assets occurring after the date on which the plan is terminated must, by law, be credited to or suffered by PBGC (see Notes 3, 4 and 13).

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

Sponsors of Terminated Plans, Receivables: The amounts due from sponsors of terminated plans or members of their controlled group represent the settled claims for employer liability (underfunding as of date of plan termination) and for contributions due their plan less an allowance for uncollectible amounts. Any amounts expected to be received beyond one year are discounted for time and risk factors. Some agreements between PBGC and plan sponsors provide for contingent payments based on future profits of the sponsors. Any such future amounts realized will be reported in the period in which they accrue or are received.

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

Present Value of Future Benefits (PVFB): The PVFB is the estimated liability for future pension benefits that PBGC is or will be obligated to pay with respect to trusteed plans and terminated plans pending trusteeship. This liability is stated as the actuarial present value of estimated future benefits less the present value of estimated recoveries from sponsors and the assets of terminated plans pending trusteeship. For financial statement purposes, the estimated liabilities (net of estimated recoveries and assets) attributable to probable future plan terminations are also included in the PVFB. To measure the actuarial present value, PBGC used assumptions to adjust the value of those future payments to reflect the time value of money (by discounting) and the probability of payment (by means of decrements, such as for death or retirement). PBGC also included anticipated expenses to settle the benefit obligation in the determination of the PVFB.

(1) ***Trusteed Plans***—represents the present value of future payments of benefits less the present value of expected recoveries, for which an agreement has not been reached, from sponsors of plans that have terminated and been trusteed by PBGC prior to fiscal yearend.

(2) ***Terminated Plans Pending Trusteeship***—represents the present value of future payments of benefits less the plans' net assets at fair market value anticipated to be received and the present value of expected recoveries, for which an agreement has not been reached, from sponsors of plans that have terminated but have not been trusteed by PBGC prior to fiscal yearend.

(3) ***Net Claims for Probable Terminations***—includes estimates of the losses, net of plan assets and the present value of expected recoveries from sponsors, from plans that were expected to terminate based on the occurrence of an identifiable event by fiscal yearend and the expectation that the distress tests will be met or PBGC itself will seek termination of the plan.

Benefit payments to participants of pension plans trusteed by PBGC, or that are terminated and pending trusteeship, represent a reduction to the PVFB (see Note 4).

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

The present value of nonrecoverable future financial assistance represents the estimated nonrecoverable payments to be provided by PBGC in the future to multiemployer plans that will not be able to meet their future benefit obligations. The present value of nonrecoverable future financial assistance is based on the difference between the present value of future benefits 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 these liabilities could be settled in the market for single-premium nonparticipating annuities issued by private insurers (see Note 5).

Losses from Completed and Probable Terminations: Amounts reported as losses from completed and probable terminations in the Statements of Operations and Changes in Net Position represent the difference as of the date of plan termination between the present value of future benefits (including amounts owed under Section 4022(c) of ERISA) assumed, or expected to be assumed, by PBGC, less related plan assets and the present value of expected recoveries from sponsors (see Note 12).

Actuarial Adjustments and Charges: Actuarial adjustments related to changes in method and the effect of experience are classified as underwriting activity. Actuarial charges related to changes in interest rates and passage of time are classified as financial activity. These adjustments and charges represent the change in the PVFB that results from applying actuarial assumptions in the calculation of future benefit liabilities (see Note 4).

Depreciation: Depreciation of PBGC's furniture and equipment is calculated on a straight-line basis over the estimated useful lives of the assets. The useful lives range from 5 to 10 years. Routine maintenance repairs and leasehold improvements (the amounts of which are not material) are charged to operations as incurred.

Other: Certain items on the 1993 financial statements have been reclassified to conform with present year classifications.

NOTE 3 — INVESTMENTS

Premium receipts are invested in securities issued by the U.S. Government.

The trust funds include assets PBGC acquires or expects to acquire with respect to terminated plans 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. The basis indicated is cost of the asset if acquired after the date of plan termination or the market value at date of plan termination if the asset was acquired as a result of a plan's termination.

INVESTMENTS OF SINGLE-EMPLOYER REVOLVING FUNDS AND SINGLE-EMPLOYER TRUSTEED PLANS
(Dollars in millions)

	September 30, 1994		September 30, 1993	
	Basis	**Market Value**	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	**$4,764**	**$4,609**	$4,104	$5,353
Commercial paper	**1**	**1**	1	1
Corporate bonds	**93**	**80**	451	490
Subtotal	**4,858**	**4,690**	4,556	5,844
Equity securities	**2,114**	**2,418**	1,068	1,412
Real estate	**71**	**66**	100	88
Other:				
Insurance contracts	**26**	**25**	25	29
Mortgages	**6**	**6**	126	135
Foreign securities	**25**	**25**	42	45
Total	**$7,100**	**$7,230**	$5,917	$7,553

INVESTMENTS OF MULTIEMPLOYER REVOLVING FUNDS AND MULTIEMPLOYER TRUSTEED PLANS
(Dollars in millions)

	September 30, 1994		September 30, 1993	
	Basis	**Market Value**	Basis	Market Value
Fixed maturity securities:				
U.S. Government securities	**$359**	**$349**	$279	$383
Corporate bonds	**0**	**0**	1	1
Subtotal	**359**	**349**	280	384
Equity securities	**3**	**3**	2	2
Total	**$362**	**$352**	$282	$386

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, 1994 and 1993.

PBGC used a 20-year select interest rate of 7.9% followed by an ultimate rate of 6% for 1994 and a 20-year select interest rate of 6% followed by an ultimate rate of 5.5% for 1993. These rates were determined as those needed to continue to match the survey of insurance company prices provided by the American Council of Life Insurance (ACLI).

In both years, PBGC used the 83GAM mortality table with margins, projected to 1993 by Scale H. PBGC has found that this table is generally consistent with its experience.

For 1994 and 1993, the administrative expense assumption consists of (1) an initial case processing cost of $10,800 per plan plus $270 per plan participant, both of which costs are to be phased out over four years following the date of trusteeship; and (2) a flat 1.35 percent of total benefit liability. PBGC derived this formula from its own experience.

The present values of future benefits for trusteed multiemployer plans for 1994 and 1993 reflect changes due to benefit payments, change in interest assumption, passage of time, and effect of experience.

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

RECONCILIATION OF THE PRESENT VALUE OF FUTURE BENEFITS FOR THE YEARS ENDED SEPTEMBER 30, 1994 AND 1993
(Dollars in millions)

	September 30, 1994		1993	
Present value of future benefits, at beginning of year — Single-Employer, net		**$10,693**		$ 8,717
Estimated recoveries		**115**		188
Investments of terminated plans pending trusteeship, net		**154**		73
PVFB at beginning of year, gross		**10,962**		8,978
Net claims for probable terminations, prior year		**(1,627)**		(1,027)
Actuarial adjustments — underwriting:				
Changes in method and assumptions	**$ (83)**		$ (4)	
Effect of experience	**(32)**		11	
Total actuarial adjustments — underwriting	**(115)**		7	
Actuarial charges (credits) — financial:				
Passage of time	**560**		549	
Changes in interest rate	**(1,371)**		1,124	
Total actuarial charges (credits) — financial	**(811)**		1,673	
Total actuarial charges (credits)		**(926)**		1,680
Terminations:				
Current year	**564**		571	
Changes in prior year	**(23)**		(147)	
Total terminations		**541**		424
Benefit payments*		**(719)**		(720)
Estimated recoveries		**(74)**		(115)
Investments of terminated plans pending trusteeship, net		**(108)**		(154)
Net claims for probable terminations:				
Future benefits**	**2,699**		3,645	
Estimated plan assets and recoveries from sponsors	**(1,533)**		(2,018)	
Total net claims, current year		**1,166**		1,627
Present value of future benefits, at end of year — Single-Employer, net		**9,215**		10,693
Present value of future benefits, at end of year — Multiemployer		**10**		13
Total present value of future benefits, at end of year, net		**$ 9,225**		$10,706

* The benefit payments of $719 million and $720 million include $26 million in 1994 and $63 million in 1993 for benefits paid from plan assets by plans prior to trusteeship.

** The future benefits for probable terminations of $2,699 million and $3,645 million for fiscal years 1994 and 1993, respectively, include $121 million and $175 million, respectively, in net claims (future benefits less estimated plan assets and recoveries) for probables not specifically identified.

INVESTMENTS (ASSETS) OF SINGLE-EMPLOYER TERMINATED PLANS PENDING TRUSTEESHIP, NET
(*Dollars in millions*)

	September 30, 1994		September 30, 1993	
	Basis	**Market Value**	Basis	Market Value
U. S. Government securities	**$ 16**	**$ 15**	$ 26	$ 26
Corporate bonds	**28**	**28**	45	46
Equity securities	**14**	**15**	25	25
Insurance contracts	**28**	**17**	26	15
Other	**2**	**3**	10	11
Cash and cash equivalents	**30**	**30**	31	31
Total, net	**$118**	**$108**	$163	$154

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 associated with certain previously terminated plans.

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

RECONCILIATION OF NET CLAIMS FOR PROBABLE TERMINATIONS
(*Dollars in millions*)

	September 30, 1994		September 30, 1993	
Net claims for probable terminations, at beginning of year		**$1,627**		$1,027
New claims	**$ 82**		$ 487	
Actual terminations	**(149)**		(220)	
Eliminated probables	**(164)**		(12)	
Change in benefit liabilities	**(263)**		429	
Change in plan assets	**58**		36	
Change in expected recoveries	**(25)**		(120)	
Loss on probables		**(461)***		600*
Net claims for probable terminations, at end of year		**$1,166**		$1,627

* See Note 12

NOTE 5 — MULTIEMPLOYER FINANCIAL ASSISTANCE

Financial assistance is granted 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
(Dollars in millions)

	September 30, 1994	1993
Gross balance at beginning of year	**$ 18**	$ 14
Financial assistance payments— current year	**4**	4
Subtotal	**22**	18
Allowance for uncollectible amounts	**(22)**	(18)
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 annual changes in the estimated present value of nonrecoverable future financial assistance and assistance granted that was not previously accrued.

PRESENT VALUE OF NONRECOVERABLE FUTURE FINANCIAL ASSISTANCE AND LOSSES FROM FINANCIAL ASSISTANCE
(Dollars in millions)

	September 30, 1994	1993
Balance at beginning of year	**$110**	$ 94
Changes in allowance:		
Losses from financial assistance	**57**	20
Financial assistance granted (previously accrued)	**(3)**	(4)
Balance at end of year	**$164**	$110

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
(Dollars in millions)

	September 30, 1994	1993
Due for purchase of securities	**$22**	$144
Annual leave	**3**	2
Other payables and accrued expenses	**52**	22
Accounts payable and accrued expenses	**$77**	$168

NOTE 7 — THE LTV CORPORATION

On January 1, 1991, the restoration of three LTV Steel Company, Inc., plans that were the subject of a 1990 Supreme Court case was finally implemented, following a district court order enforcing the Supreme Court's decision.

On June 28, 1993, LTV emerged from bankruptcy. PBGC's settlement with LTV and LTV's major creditor groups provided for an initial $2 billion infusion of funding by LTV to its restored pension plans and elimination of the remaining underfunding over 28 years. In the settlement, PBGC agreed to provide contingent value rights (CVRs) to all creditors of LTV Steel who received common stock of the reorganized entity. Under these CVRs, PBGC agreed to pay the CVR holders up to $96.25 million, depending on the average market price of LTV's common stock during the 20 trading days immediately preceding December 23, 1993. As anticipated in last year's annual report, the actual average trading price was such that PBGC was required to pay the full $96.25 million, of which $13.75 million went to the restored plans. The full $96.25 million had been accrued as a loss as of September 30, 1993. PBGC had purchased an equivalent face amount of government obligations, with a carrying amount of $95 million, which were reflected as restricted assets at September 30, 1993. These restricted assets were used to pay the CVR holders during fiscal year 1994.

In return for the CVRs, LTV provided PBGC with stock appreciation rights (SARs), under which PBGC was to receive shares of LTV common stock with an aggregate value equal to the amount by which the average price of LTV's common stock over the 20 trading days immediately preceding June 28, 1994, exceeded $18.00. Because this average trading price did not exceed $18.00, PBGC received no payment with respect to the SARs. PBGC also received two 28-year zero coupon bonds, with face amounts of $454 million and $270 million, respectively, in settlement of its claims with respect to receivables from the restored plans and the underfunding in the Republic Retirement Plan.

In addition, on June 28, 1993, PBGC paid LTV $50 million for the right to receive $54.3 million of LTV common stock one year later. LTV contributed the $50 million proceeds to the restored pension plans. On June 28, 1994, PBGC received 3.3 million shares of LTV common stock worth $54.3 million at the then-current market price. As of September 30, 1994, PBGC had sold 3 million of these shares for $58 million.

NOTE 8 — CONTINGENCIES

There are a number of large single-employer plans that may terminate. In addition, there are some multiemployer plans that may require future financial assistance. The amounts disclosed below represent the Corporation's best estimates given the inherent uncertainties about these plans.

PBGC estimates that total unfunded vested benefits on termination of single-employer plans that represent reasonably possible losses as of September 30, 1994, is approximately $18 billion. The estimate has been calculated as in previous years by using data obtained from corporate annual reports for fiscal years ending in calendar 1993. The value reported for liabilities has been adjusted to the December 31, 1993, PBGC select interest rate of 5.65%. When available, data has been adjusted to a consistent set of mortality assumptions. Plans not insured by PBGC have been eliminated from the data. Since these figures are generally based on the reporting requirements in the Financial Accounting Standards Board's Statement of Financial Accounting Standard #87 ("Employers' Accounting for Pensions"), no provision has been made for the possible failure of the plan sponsor to make subsequent contributions or for plan liabilities that would be incurred after that date. The total underfunding in single-employer plans is estimated at $71 billion as of December 31, 1993.

PBGC has included amounts in the liability for the present value of nonrecoverable future financial assistance (see Note 5) for multiemployer plans that PBGC estimates may require future financial assistance. In addition, PBGC currently estimates that it is reasonably possible that other multiemployer plans may require future financial assistance ranging from $45 million to $145 million.

The future financial assistance liability for each multiemployer plan identified as probable or reasonably possible was calculated as the present value of future benefit and expense payments as of the later of September 30, 1994, or the projected (or actual, if known) date of plan insolvency, discounted back to September 30, 1994, using interest only. The Corporation's identification of plans that are likely to require such assistance and estimation of related amounts require consideration of many complex factors. These factors are affected by future events, including actions by plans and their sponsors, most of which are beyond the Corporation's control.

A select and ultimate interest rate assumption of 7.9% for the first 20 years after October 1, 1994, and 6% thereafter was used. The 83GAM loaded mortality table projected to 1993 using Scale H also was used.

NOTE 9 — COMMITMENTS

PBGC leases its office facility under a commitment that began on December 11, 1993, and expires December 10, 2008. The lease provides for periodic rate increases based on increases in operating costs and real estate taxes over a base amount. The minimum future lease payments for office facilities having noncancellable terms in excess of one year at September 30, 1994, are as follows:

COMMITMENTS: FUTURE LEASE PAYMENTS
(Dollars in millions)

Year Ending September 30,	Operating Leases
1995	$ 9.8
1996	10.2
1997	10.5
1998	11.0
1999	11.5
Thereafter	134.3
Minimum lease payments	$187.3

Lease expenditures were $9.2 million in 1994 and $5.6 million in 1993.

NOTE 10 — PREMIUMS

For both the single-employer and multiemployer programs, ERISA provides that PBGC shall continue to guarantee basic benefits despite the failure of a plan administrator to pay premiums when due. PBGC assesses interest and penalties up to 100 percent for late payment or underpayment (see Note 11). Premiums for the single-employer program are $19 per participant for a fully funded plan, with an underfunded plan paying an additional variable-rate charge of up to $53 per participant based on funding levels. On December 8, 1994, the Retirement Protection Act was signed into law. This act provides for the phase-out of the $53 cap on the variable-rate charge over three plan years, effective for plan years commencing on or after July 1, 1994. The multiemployer premium is $2.60 per participant.

NOTE 11 — UNDERWRITING: OTHER INCOME

UNDERWRITING: OTHER INCOME
(Dollars in millions)

	For the Years Ended September 30, 1994	1993
Interest income—premiums	**$ 1**	$ 1
Penalty income—premiums	**17**	(2)
Interest income—employer liability	**13**	5
Interest income—due and unpaid contributions	**11**	22
Other	**0**	11
Total	**$42**	$37

NOTE 12 — LOSSES FROM COMPLETED AND PROBABLE TERMINATIONS

Amounts reported as losses are the present value of future benefits (including amounts owed under Section 4022(c)) 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
(*Dollars in millions*)

	For the Years Ended September 30, 1994			1993		
	New Terminations	**Changes in Prior Year Terminations**	**Total**	New Terminations	Changes in Prior Year Terminations	Total
Present value of future benefits	**$564**	**$ (23)**	**$ 541**	$571	$(147)	$424
Less plan assets	**239**	**129**	**368**	203	113	316
Plan asset insufficiency	**325**	**(152)**	**173**	368	(260)	108
Less estimated recoveries	**6**	**(45)**	**(39)**	20	(55)	(35)
Subtotal	**$319**	**$(107)**	**212**	$348	$(205)	143
Probables			**(461)***			600*
Total			**$(249)**			$743

* See Note 4

NOTE 13 — FINANCIAL INCOME

FINANCIAL INCOME
(*Dollars in millions*)

	For the Years Ended September 30, 1994			1993		
	Terminated Plans Pending Trusteeship	**Revolving Funds and Trusteed Plans**	**Total**	Terminated Plans Pending Trusteeship	Revolving Funds and Trusteed Plans	Total
Fixed-income securities:						
Interest earned	**$3**	**$ 359**	**$ 362**	$ 8	$ 218	$ 226
Realized gains (losses)	**3**	**688**	**691**	(1)	226	225
Unrealized gains (losses)	**(2)**	**(1,587)**	**(1,589)**	3	1,118	1,121
Total fixed-income securities	**4**	**(540)**	**(536)**	10	1,562	1,572
Equity securities:						
Dividends earned	**0**	**42**	**42**	0	19	19
Realized gains	**1**	**64**	**65**	0	119	119
Unrealized gains (losses)	**1**	**(34)**	**(33)**	1	11	12
Total equity securities	**2**	**72**	**74**	1	149	150
Other income (losses)	**0**	**36**	**36**	(1)	(76)	(77)
Total financial income (loss)	**$6**	**$ (432)**	**$ (426)**	$10	$1,635	$1,645

NOTE 14 — PRESIDENT'S BUDGET

The Chief Financial Officer's Act of 1990 mandates the preparation of a reconciliation to the Budget. The reconciliation adjusts the operating expenses as reported in the Fiscal Year 1994 Statements of Operations and Changes in Net Position to selected budgetary accounts — obligations, budget authority, and outlays — reported in the program and financing accounts as actual for Fiscal Year 1994 in the President's Fiscal Year 1996 Budget.

RECONCILIATION OF OPERATING EXPENSES TO THE BUDGET FOR THE YEARS ENDED SEPTEMBER 30, 1994 AND 1993
(Dollars in millions)

	September 30, 1994	1993
Underwriting expenses	**$ (183)**	$ 963
Financial expenses	**(801)**	1,685
Total operating expenses as reported in Statements of Operations and Changes in Net Position	**(984)**	2,648
Add adjustments for:		
Current year benefit payments	**721**	657
Prior year benefit payments	**43**	42
Financial assistance payments	**4**	4
Adjustments added	**768**	703
Less adjustments for:		
Loss from completed terminations	**212**	143
Loss from probable terminations	**(461)**	600
Loss from financial assistance	**57**	20
Loss on contingent valuation rights	**0**	96
Loss on U.S. Government securities	**(143)**	0
Actuarial adjustments—underwriting	**(116)**	7
Actuarial charges (credits) due to:		
Passage of time	**561**	550
Changes in interest rate	**(1,372)**	1,125
Prior year adjusting entries	**29**	(23)
Adjustments subtracted	**(1,233)**	2,518
Total obligations per the budget	**$ 1,017**	$ 833
Total obligations per the budget	**$ 1,017**	$ 833
Plus: Obligated balance, start of year	**150**	149
Adjustments in unexpired accounts	**0**	(17)
Less: Obligated balance, end of year	**106**	150
Outlays (gross)	**1,061**	815
Adjustments to gross budget authority from offsetting collections:		
U.S. securities	**59**	1,054
Premium income	**996**	911
Other income	**1**	10
Reimbursements from trust funds	**390**	348
Total offsetting collections	**1,446**	2,323
Outlays (net)	**$ (385)**	$(1,508)

NOTE 15 — EMPLOYEE BENEFIT PLANS

All permanent full-time and part-time PBGC employees are covered by the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Full-time and part-time employees with less than five years service under CSRS and hired after December 31, 1983, are automatically covered by both Social Security and FERS. Employees hired before January 1, 1984, participate in CSRS unless they elected to transfer to FERS by June 30, 1988.

The Corporation's contribution to the CSRS plan equals the 7 percent of base pay contributed by employees covered by that system. For those employees covered by FERS, the Corporation's contribution was 13.7 percent of base pay for 1994 and 1993. In addition, for FERS-covered employees, PBGC automatically contributes 1 percent of base pay to the employee's Thrift Savings account, matches the first 3 percent contributed by the employee, and matches one-half of the next 2 percent contributed by the employee. Total retirement plan expenses amounted to $5 million and $4 million in 1994 and 1993, respectively.

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

NOTE 16 — CASH FLOWS

The following is a reconciliation between the net income (loss) 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 (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES
FOR THE YEARS ENDED SEPTEMBER 30, 1994 AND 1993
(Dollars in millions)

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	1994	1993	**1994**	1993	**1994**	1993
Net income (loss)	**$1,657**	$ (160)	**$(79)**	$107	**$1,578**	$ (53)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:						
Net (appreciation) decline in fair value of investments	**750**	(1,247)	**56**	(97)	**806**	(1,344)
Net income of terminated plans pending trusteeship	**(5)**	(8)	**0**	0	**(5)**	(8)
Loss on completed and probable terminations	**(249)**	743	**0**	0	**(249)**	743
Loss on contingent valuation rights	**0**	96	**0**	0	**0**	96
Actuarial charges (credits)	**(926)**	1,680	**(1)**	2	**(927)**	1,682
Benefit payments—trusteed plans	**(693)**	(657)	**(2)**	(2)	**(695)**	(659)
Cash received from plans upon trusteeship	**66**	9	**0**	0	**66**	9
Changes in assets and liabilities, net of effects of trusteed and pending plans:						
(Increase) decrease in receivables	**30**	105	**(2)**	2	**28**	107
Increase in present value of nonrecoverable future financial assistance			**54**	16	**54**	16
Decrease in contingent valuation rights	**(96)**	0	**0**	0	**(96)**	0
Increase (decrease) in unearned premiums	**22**	3	**(1)**	1	**21**	4
Increase in accounts payable	**15**	2	**0**	0	**15**	2
Net cash provided by operating activities	**$ 571**	$ 566	**$ 25**	$ 29	**$ 596**	$ 595

NOTE 17 — LITIGATION

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. PBGC estimates that reasonably possible losses of up to $300 million could be incurred in the event PBGC does not prevail in such matters.

Management's Report on Internal Controls

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

1994 MANAGEMENT REPORT ON INTERNAL CONTROLS

Corporate Internal Control Objective

PBGC maintains an internal control system designed to provide reasonable assurance that: assets are safeguarded against loss, unauthorized use, or misappropriation; transactions are properly recorded, processed, and summarized in accordance with generally accepted accounting principles and in a way that maintains accountability for assets; and programs are carried out in accordance with applicable law and management policy.

The internal control system includes a documented organizational structure, division of responsibility, and established policies and procedures. The corporate policy on internal controls sets a positive tone for the Corporation and is intended to strengthen the PBGC staff's knowledge of and adherence to the internal controls.

Internal Control Program

PBGC has an ongoing internal control program that maintains accounting and administrative controls, and ensures that PBGC management is involved in assessing the adequacy of systems of internal control in accordance with the Office of Management and Budget (OMB) guidance. The Corporation uses an audit follow-up program for tracking audit findings and recommendations by the General Accounting Office (GAO) and PBGC's Office of Inspector General (OIG). This audit follow-up program requires PBGC management to respond promptly to all recommendations contained in reports issued by both internal and external auditors. Additionally, PBGC has an active contract audit program.

PBGC's Management Control Committee is a body of senior departmental representatives that considers and makes recommendations to Deputy Executive Directors and the Executive Director on policy, corporate-wide issues, identified internal control weaknesses, and critical priority and resource determinations affecting PBGC programs. The Committee develops and forwards recommendations to Deputy Executive Directors and the Executive Director on policy and operational matters relative to corporate financial management systems in accordance with OMB Circulars A-123, A-127 and A-130, the Chief Financial Officers Act, and the FMFIA.

Internal Control and Operations Reviews

In 1994, the Corporation aggressively pursued its internal control review program. PBGC management completed 8 internal control and program compliance reviews and performed 78 vulnerability assessments covering the major programs and financial management systems. The reviews were used to monitor compliance with Corporate policies and the adequacy of internal controls and techniques. PBGC executive management actively participated in these internal control and program compliance reviews, and the PBGC Executive Information Report was used to monitor performance against management goals and objectives.

Noteworthy achievements in 1994 included a significant reduction in the average age of audit recommendations and the preparation of a Compendium of Legal Authority Applicable to PBGC, which was used to document and monitor the Corporation's compliance with all laws, rules, and regulations. In 1994, PBGC management worked closely with the OIG to achieve resolution on audit recommendations at the point of final audit report publication. This rapid concurrence was well within the parameters of the 6 month standard allowed for resolution in OMB Circular A-50. In addition, this enabled the Corporation, on average, to implement audit recommendations within 6 months.

In his semiannual reports to the Congress, PBGC's Inspector General (IG) noted the close cooperation between his office and PBGC management in identifying and correcting weaknesses. The IG also noted that his access to information was not restricted and that there were no unresolved audit reports (i.e., no reports requiring additional management decisions). During 1994 PBGC closed 45 open audit recommendations and expects to complete 35 of the remaining 43 by the end of 1995.

Management's Assertion

Management acknowledges its responsibility for establishing and maintaining the internal control structure. During the year, management evaluated the Corporation's internal controls for safeguarding assets against loss, unauthorized use, and misappropriation; assuring that transactions are properly recorded, processed, and summarized in accordance with generally accepted accounting principles and in a manner that maintains accountability for assets; ensuring that programs are carried out in accordance with applicable laws and management policy; and, maintaining accountability for assets using the control criteria described in FMFIA and other selective laws, as well as federal directives. Based on that evaluation, management believes that the Corporation's internal controls in effect on September 30, 1994, did provide reasonable assurance for safeguarding of assets against loss and executing transactions in accordance with management authority and significant provisions of selected laws and regulations. However, internal controls did not provide reasonable assurance that transactions were properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles and to maintain accountability for assets among funds. Although the Corporation is continuing to make progress in improving its internal controls, management acknowledges that material weaknesses remain, in particular:

- weaknesses in financial systems and related controls such as a lack of integration between the Corporation's primary and subsidiary financial systems,
- inadequate controls over the assessment of the multiemployer program's liability for future financial assistance, and
- inadequate controls over nonfinancial participant data.

The management of the Corporation is not aware of any other material weaknesses in the design or operation of the internal control structure. Management is not aware of any changes in the internal control structure or other factors that might significantly affect the internal controls structure as of the date of this report.

Management believes the weaknesses identified above did not materially affect PBGC's financial statements and the Corporation is currently implementing corrective actions to address these weaknesses. There are, however, inherent limitations in the effectiveness of any internal control system, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even the most effective internal control system can provide only reasonable assurance with respect to safeguarding of assets against loss, unauthorized use or misappropriation, compliance with laws and regulations, and financial statement preparation.

Martin Slate
Executive Director

N. Anthony Calhoun
Deputy Executive Director
and Chief Financial Officer

Comments From the Pension Benefit Guaranty Corporation

Pension Benefit Guaranty Corporation
1200 K Street, N.W., Washington, D.C. 20005-4026
(202) 326-4010

Office of the Executive Director

MAR 1 1995

The Honorable Charles A. Bowsher
Comptroller General of the United States
United States General Accounting Office
Washington, D.C. 20548

Re: Financial Audit - Pension Benefit Guaranty Corporation's 1994 and 1993 Financial Statements

Dear Mr. Bowsher:

Thank you for the opportunity to comment on your report on the audit of the Pension Benefit Guaranty Corporation's 1994 and 1993 financial statements.

We are gratified that, for the second consecutive year, PBGC has received a "clean" opinion on its financial statements. We are also gratified that PBGC was recently removed from the General Accounting Office's "high risk" program.

The report cites PBGC's efforts to strengthen minimum funding standards with passage of the Retirement Protection Act of 1994 and recommends further improvements in our internal controls. We concur in these recommendations with the following comments.

Pension Deficit

Heeding the warnings from the Congress, GAO, and others, this Administration made it a priority to address the growing problem of pension underfunding. The Retirement Protection Act of 1994, enacted last December, addresses these problems.

The Honorable Charles A. Bowsher
March 1, 1995
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The Retirement Protection Act strengthens pension funding requirements, requires companies with underfunded plans to pay their fair share for the risk they pose to the insurance system, gives PBGC stronger enforcement tools, and ensures that workers and retirees are informed about their underfunded pension plans and PBGC's guarantees.

The Retirement Protection Act should eliminate PBGC's deficit within 10 years and raise the funding ratio of pension plans from 60% to well over 85% in 15 years. Millions of American workers can rest easy as a result of this legislation.

GAO's input and interest in this legislation was invaluable. We will actively monitor the Retirement Protection Act's effect on pension underfunding.

Employee Plan Audits and Reporting

Your report cites the quality of employee plan audits and plan reporting on internal controls. These matters are within the purview of the Department of Labor, Pension and Welfare Benefits Administration. At the behest of the Department, legislation was introduced in the 103rd Congress to address certain issues involving audits. We understand that the Department intends to introduce legislation addressing these issues during the current session.

PBGC Internal Controls

The report states that PBGC has continued to make progress in improving its internal controls, but that there are continuing concerns in three areas: financial systems and related internal controls, assessment of the multiemployer fund's liability for future financial assistance, and inadequate controls over nonfinancial participant data. The report states that these matters did not have a material effect on PBGC's financial statements, but do need attention. We are committed to taking the

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necessary steps to detect and address weaknesses that remain and cite progress in a number of areas.

Financial Systems. We now have a quarterly financial reporting system. We are in the final stages of implementing a state-of-the-art premium collection system. By the end of this fiscal year, we will implement a new Standard General Ledger/Financial Reporting System to integrate our financial systems. We are moving ahead with developing and implementing a computer systems architecture that will ensure that PBGC's various information systems are properly linked.

Multiemployer Fund. We are establishing a new financial database system for multiemployer plans that will improve the quality of our data and enable PBGC to better assess multiemployer trends. We should complete work on security matters and procedures for making changes to the database by this summer. We established a Multiemployer Working Group to coordinate and monitor operational activities, including contacting administrators of high-risk plans to update financial information. We now receive copies of Form 5500 directly from the IRS for high-risk plans. And we have implemented an audit program for multiemployer plans currently receiving financial assistance.

Nonfinancial Participant Data. PBGC is completing a reorganization of its Insurance Operations Department to implement team case processing which will ensure that we acquire and update plan and participant data at the earliest stages. We have implemented a new computerized system for calculating the present value of future benefits which eliminates manual processes used in prior years. Continued improvements are being made to the controls on the entry of data on our basic system for benefit payments. By the end of the year, all participant records will be computer-imaged. Imaging of plan records will be completed shortly thereafter. This will protect PBGC records against loss. Also, it will make them readily available to PBGC personnel on their desktop computers. Finally, we have begun work on a state-of-the-art system to create a PBGC participant database that will be integrated with other PBGC systems. These efforts

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will greatly strengthen our internal controls on nonfinancial participant data.

We salute the GAO's contributions in strengthening the pension insurance system on which 41 million Americans rely. With your help, we have come a long way. I look forward to continued cooperative efforts with your office.

Sincerely,

Martin Slate
Executive Director

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