Pension Benefit Guaranty Corporation

Office of Inspector General

EVALUATION REPORT

PBGC PROCESSING OF TERMINATED UNITED AIRLINES PENSION PLANS WAS SERIOUSLY DEFICIENT

November 30, 2011

EVAL-2012-05/ PA-10-72

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

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Pension Benefit Guaranty Corporation

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SUBJECT: PBGC Processing of Terminated United Airlines Pension Plans Was Seriously Deficient - OIG Report No. EVAL 2012-5/ PA-10-72

This report describes findings identified during our evaluation of PBGC's actions in terminating certain United Airlines defined pension plans. We initiated this evaluation in response to a request from then Chairman George Miller of the House Committee on Education and Labor.

Our objectives were to determine (1) whether the United Airlines plan asset audits and participant data audits met applicable professional standards; (2) whether the audits were conducted in accordance with PBGC's established protocols; and (3) the effectiveness of PBGC's oversight and quality control processes for the subject audits.

Our review identified serious flaws in each of the original plan asset audits intended to establish the fair market value of United Airlines plans assets of the four terminated pension plans at the date of plan termination. Additionally, our review showed that each of the audits failed to meet applicable professional standards, contained myriad obvious errors and omissions as well as unsupported conclusions. In response to our initial findings, PBGC contracted with a Certified Public Accountant (CPA) firm to perform a re-valuation of the plan assets for the four United Airlines plans. As described in the attached report, to date PBGC's ongoing efforts to correct errors and omissions have been unsuccessful in determining the fair market value of United Airlines plans' assets.

The attached report also describes concerns with PBGC's participant data, source document, and electronic source document audits for the terminated United Airlines plans. In addition, other findings address the systemic nature of errors and omissions in PBGC's audits of terminated pension plans. We made fifteen specific recommendations that, if implemented, will enhance PBGC's ability to value United Airlines plan assets at fair market value and strengthen PBGC's post-termination audit and evaluation processes in the future.

In responding to the report, PBGC noted general agreement with the report's findings and recommendations. The Corporation reports that it has already implemented some of the needed corrective actions and commits to developing and implementing a Corrective Action Plan for the remaining items. PBGC's response is included, in its entirety, as Appendix B to this report.

We appreciate the cooperation we received while performing this evaluation and PBGC's expressed commitment to fundamental change.

Executive Summary

PBGC did not follow its own established protocols or ensure compliance with applicable professional standards for audits of terminated United Airlines pension plans. To date, PBGC's ongoing efforts to correct errors and omissions have been unsuccessful in determining the fair market value of plan assets. OIG had previously reported to then-Chairman George Miller of the House Committee on Education and Labor that PBGC had failed to protect the interests of United Airlines workers and retirees when it contracted for and accepted a series of poor quality and mistake-ridden audits. Serious errors and omissions plagued PBGC's determination of (1) the fair market value of plan assets and (2) the reliability of data used to calculate participants' benefits for four terminated United Airlines pension plans. Neither the PBGC leadership responsible for providing oversight nor the employees of Integrated Management Resources Group, Inc. (IMRG), a PBGC contractor, demonstrated the requisite skills and understanding to perform the audits in accordance with applicable professional standards. As a result, neither PBGC nor the plan participants had reasonable assurance with regard to the accuracy of retirement benefits. Based on the systemic nature of the issues identified, we concluded that the $26 million, expended over a six year period by PBGC on its audit services contract with IMRG, were "funds to be put to better use."

When the Office of Inspector General (OIG) brought the errors and omissions in PBGC's audits of United Airlines (UAL) plans to the attention of the Corporation, PBGC leadership instructed BAPD management to initiate efforts at corrective action. The Corporation contracted with a Certified Public Accounting (CPA) firm for a re-valuation of UAL plan assets, an engagement that would provide less assurance than a properly completed audit performed consistent with government auditing standards. Our review of PBGC's corrective action shows that efforts to date have not yet been effective in providing a reasonable level of assurance about the value of plan assets.

In accordance with the Employee Retirement Income Security Act of 1974 (ERISA), as amended, the value of a plan's assets is used in calculating retirement benefits, given that a participant's benefit is the greater of the guaranteed benefit or the amount funded by plan assets. For some plans, including the United Airlines' plans, increases in the calculated value of plan assets at the date of plan termination may result in increased benefits for some plan participants. However, for other plans, even relatively large increases in the value of plan assets may not translate into additional benefits for retirees. PBGC regulations call for plan assets to be valued "at their fair market value, based on the method of valuation that most accurately reflects such fair market value."

Plan Asset Audits Were Seriously Flawed

PBGC's contractor, IMRG, completed the initial four plan asset audits intended to establish the fair market value of United Airlines plan assets at the dates of plan termination. PBGC employees signed the four reports, indicating their acceptance of the reports and the supporting workpapers. However, our review showed that each of the four plan asset audits failed to meet applicable professional standards, containing myriad obvious errors and omissions, as well as a number of critical unsupported conclusions. We concluded that neither PBGC nor its contractor exercised due professional care in the conduct of the initial four UAL plan asset audits. Further, PBGC did not provide effective oversight for the contractor and accepted and paid for sub-standard and obviously flawed audit work. As a result, neither PBGC nor the plan participants had reasonable assurance that plan assets were identified, correctly valued, and properly allocated to the individual United Airlines pension plans.

In response to our initial findings about the first four plan asset audits, PBGC contracted with a CPA firm to perform a re-valuation of plan assets for the four UAL plans. However, PBGC agreed to the CPA firm's use of a flawed methodology that was inconsistent with federal regulations requiring plan assets be valued based on the method that most accurately reflects fair market value. Further, we found that PBGC employees had not performed an effective review of the CPA firm's reports and supporting workpapers. Some errors and omissions could have been identified and corrected if a more critical and professional review had been made of the reports and supporting workpapers. As a result of inadequate reviews, PBGC once again accepted and paid for UAL plan asset valuation work that did not accurately value plan assets as of the date of plan termination.

PBGC booked adjusting entries to its financial records, based on the results of these flawed reports. After OIG expressed concerns with the validity of the April 2011 CPA firm reports, PBGC reversed the entries in its financial records, pending PBGC leadership's decision with regard to appropriate asset valuations.

Readers of this report should be aware that both the initial audit reports prepared by IMRG and the April 2011 re-valuation reports prepared by the CPA firm relied heavily on the valuations provided by the Trustee, often deferring to the Trustee value even in instances where supporting workpapers documented a different price. Thus, some of the errors and omissions addressed in this report were documented in the supporting workpapers, but did not flow through to the final valuation presented in the IMRG reports and the CPA firm's April 2011 reports. That is, a reader should not assume that a "correct" value could be obtained by adjusting reported values to accommodate the errors and omissions described in this report. Further, while examples of the types of errors and omissions have been provided as an aid to understanding, these examples are not all-inclusive. Our testing was extensive enough to confirm the existence and degree of the problems reported, but was not intended to identify each and every error or to determine the fair market value of plan assets.

As of the date of our report, the CPA firm has made no changes to April 2011 plan asset valuation reports although they report having made modifications and improvement to the supporting workpapers. PBGC has recently implemented a more detailed and in-depth review procedure for the re-valuations of UAL and National Steel plan assets; if carefully and professionally implemented, the new procedures are likely to result in PBGC conducting a more effective review of future plan asset valuation reports. The first or primary stage of PBGC's review of the UAL plan asset valuations is currently nearing completion.

Participant Data Audits Contain Errors and Omissions

Participant data audits are intended (in part) to verify participants' records to ensure the reliability of data obtained to calculate participants' benefits. IMRG issued five separate participant data audit reports relating to the United Airlines plans, one for each of the four plans as well as a comprehensive participant data audit report to address United Airlines participant data overall. Additionally, PBGC paid the audit contractor for work on four source document audits and an electronic source document audit, all related to one or more of the four United Airlines pension plans. Our review showed that each of these ten audit reports contained obvious errors, omissions, and failures of logic. For four of the five participant data audit reports, major factual errors further limited the usefulness and reliability of the reports. We concluded that neither PBGC nor its contractor exercised due professional care in the conduct of the audits. Further, PBGC did not provide effective oversight for the contractor and accepted and paid for sub-standard and obviously flawed audit work.

We did note that PBGC actuaries identified and corrected numerous errors in the database, subsequent to IMRG's completion of the various participant data audits. Although we were unable to determine whether these actions fully mitigated the issues identified, PBGC officials have concluded that there is no additional value to PBGC or the UAL plan participants in pursuing additional work, based on a number of factors, including the opportunity for participants to have their data "trued up" when they go into pay status.

PBGC did not obtain manual source records in accordance with established PBGC protocols, and drew conclusions in the various participant data audits based on a small sub-sample of data that was not representative of participant records. That is, PBGC inappropriately drew conclusions about data for United Airlines participants based on a review of files for retirees and without analyzing manual source documentation for active and separated vested participants. Active and separated vested participants comprise more than 85,000 participants – over two-thirds of the total. The impact of the scope limitation that arose from UAL's purported denial of access to certain source documents was referenced in four of the five participant data audits and in three of five source document audits.

PBGC's Re-Valuation of UAL Plan Assets

When the OIG brought the errors and omissions in PBGC's audits of United Airlines plans to the attention of the Corporation, PBGC contracted with a CPA firm[1] to perform a re-valuation of UAL plan assets.[2] However, PBGC did not provide adequate oversight and review for the new UAL plan asset re-valuation work. As a result, in April 2011, PBGC accepted and paid for four additional valuation reports containing errors in fact and in logic that fell short of compliance with key contract terms and applicable federal regulations. That is, the four reports that were intended to replace the seriously flawed plan asset audits performed by IMRG were also themselves significantly flawed.

After we brought examples of the errors and omissions included in the re-valuation work to PBGC's attention, the Corporation issued a request for proposal to the CPA firm, asking that they provide a plan for re-work and a proposed cost for correcting some of the errors and shortcomings that OIG had identified. The CPA firm provided a plan and a bid for the additional work and PBGC advised OIG that a new call order would be issued. However, after OIG explained that the additional work called for in the new contract vehicle would still not provide necessary assurance about key elements needed to ensure that plan assets are valued at fair market value, in accordance with PBGC's regulations, PBGC decided to hold the CPA firm accountable for correcting identified errors and omissions. The CPA firm has now provided revised supporting workpapers to PBGC. These documents are currently undergoing review by PBGC.

Systemic Errors and Omissions in Audits of Terminated Pension Plans

In our March 30, 2011, Evaluation Report No. 2011-10/PA-09-66-1, entitled *PBGC's Plan Asset Audit of National Steel Pension Plans Was Seriously Flawed*, we identified similar omissions and errors related to the plan asset audit for National Steel plans, another audit performed by IMRG.. Further, we noted that PBGC used the same contractor to perform hundreds of plan asset and participant data audits during the last decade. While PBGC does not have a definitive listing showing the specific plan terminations for which IMRG provided audit services, our review of available evidence showed that IMRG had worked on at least eight of the ten largest pension plan terminations in PBGC's history.

PBGC's own reviews provided an indication of problems with PBGC's plan asset audits and with IMRG, its audit contractor. A PBGC-commissioned assessment of its trusteeship of large defined benefit plans completed by Hewitt Associates in September of 2007 concluded, in part, that Benefits Administration and Payment Department (BAPD) auditors (both Federal and contract employees) lacked the audit skills necessary

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[1] IMRG, PBGC's prior contract auditor, was not a CPA firm but a provider of "audit services."

[2] PBGC's contract calls for a re-valuation, not an audit. The engagement for which PBGC contracted provides a lesser level of assurance than a properly completed audit performed consistent with Government Auditing Standards. However, due to the length of time that has elapsed since the original UAL plan asset audits, it is now unlikely that any firm could complete an audit in accordance with applicable standards to determine the fair market value of plan assets.

to adequately perform their roles. An internal PBGC review of plan asset audits, completed late in 2010 after OIG's initial briefings on United Airlines issues, identified errors and omissions in the audits tested throughout BAPD.

Based on our work – the prior evaluation of the plan asset audit for National Steel; this evaluation of four plan asset audits, five participant data audits, four source document audits, and an electronic source document audit for United Airlines; and our review of the practices and procedures in place at PBGC's audit contractor - we concluded that none of the audits performed by IMRG during the course of the audit services contract had been performed "consistent with the Government Auditing Standards" as required by IMRG's contract with PBGC. In addition to the shortcomings in its audit reports, we noted that IMRG did not have the infrastructure in place necessary for its audit work to meet the minimum applicable standards. That is, IMRG did not have an effective quality control system, an external peer review of compliance with its system of quality controls, or documentation that its audit staff met minimum requirements for continuing professional education. As a result of IMRG's failure to provide work consistent with government auditing standards, as required in its contract with PBGC, we concluded that the $26 million expended by PBGC over a six year period on IMRG's audit services were "funds to be put to better use." That is, using PBGC's funds on professional audit services in compliance with applicable standards would be better than expenditure of funds on audits that fell far short of those standards.

PBGC should be acknowledged for beginning to take action to address the systemic issues that contributed to the serious errors and omissions in PBGC's audits of terminated pension plans. The PBGC Director has shown his commitment to corrective action by contracting for a comprehensive analysis of the appropriateness of BAPD's current organizational structure and operations to meet its mission challenges. The analysis will also propose alternatives for an organizational structure that is better aligned with BAPD mission responsibilities. Initiated in April 2011, the first phase of the strategic review has been completed and includes a current-state assessment report addressing many of the factors that contributed to the problems described in this report, including workforce, contracting, business processes, and quality control practices. The second phase, also complete, includes options for a future state operating model.

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Background

UAL Corporation is a holding company whose principal subsidiary is United Airlines, a firm that engages in commercial air transportation of people, property and mail. UAL sponsored four defined pension plans covering approximately 126,000[3] participants. These plans were terminated by PBGC in 2004 and 2005:

- United Airlines Pilot Benefit Pension Plan (Pilots) terminated December 30, 2004;
- United Airlines Ground Employees' Retirement Plan (Ground Employees) terminated March 11, 2005;
- United Airlines Flight Attendant Defined Benefit Pension Plan (Flight Attendants) terminated June 30, 2005; and
- United Airlines Management, Administrative, and Public Contact Employee Defined Benefit Pension Plan (MAPC) terminated June 30, 2005.

The assets of these plans were held in the United Airlines Inc. Group Investment Trust, a master trust established for the investment of assets. Each of the four plans owned an undivided interest in the trust.

The following table shows the Net Asset Value as reported by IMRG in each of the four original plan asset audits. These dollar values are included so that a reader of this report can place our findings in perspective. However, as noted throughout this report, because these dollar values were based on IMRG's incorrect and unsupported work, they should not be relied upon.

	Date of Plan Termination	**Cumulative Net Assets per IMRG Report (millions)**	**Asset Allocation Percentage per IMRG**
Pilot Defined Benefit Pension Plan	12/30/04	$2,845.8	40.36
Ground Employees Retirement Plan	3/11/05	$1,637.0	17.81
Management, Administrative, and Public Contact Employees Defined Benefit Pension Plan	6/30/05	$2,000.5	21.79
Flight Attendant Defined Benefit Pension Plan	6/30/05	$1,569.7	20.40
Total		$8,053.0	

3 This is the number reported by PBGC as of 2011. It differs from the 123,000 reported in the various participant data audits.

The CPA firm hired to perform re-valuation of the UAL plan assets issued reports in April 2011, concluding that the value of certain assets was greater than originally determined, primarily because of stale dated pricing in partnership funds. Consistent with standard industry practice, the trustee may not obtain updated valuations from some partnerships for one to six months after the statement date. Based on the results of the initial CPA firm reviews, PBGC's actuarial contractor estimated that, of more than 126,000 participants in the four UAL plans, approximately 23,000 could see a benefit increase. They estimate that about 4,400 current retirees would see an increase and that these benefit increases would be small, ranging from $0.10 to $25.00 per month. Readers are cautioned that, as of the date of this report, the actual impact of revised plan asset values on UAL participants has yet to be determined by PBGC.

Under various sections of ERISA, PBGC is required to determine the sufficiency of a terminated pension plan's assets to pay guaranteed benefits and to determine the total benefit liabilities. One part of that determination is the plan asset audit performed by BAPD. A plan asset audit is conducted to identify and establish the fair market value of the terminated defined benefit plan's assets and liabilities as of the date of plan termination. By regulation (29 CFR § 4044.41(b)) plan assets are to be valued "at their fair market value, based on the method of valuation that most accurately reflects such fair market value."

BAPD has established detailed data gathering and analysis steps that, if thoughtfully conducted as part of an audit performed consistent with Government Auditing Standards,[4] could yield an appropriate plan asset audit. These procedures include:

- steps to validate the fair market value of assets, such as comparing the stated value of an asset with the value as reported by an independent source, e.g., Bloomberg or the Wall Street Journal; and
- a variety of activities intended to ensure that all plan assets are accounted for, and that all potential claims against (liabilities of) the plan are identified.

Failure to properly determine the fair market value of plan assets as of the date of plan termination or to properly allocate trust assets among the plans could result in incorrect calculation of benefits payments to retirees. Further, additional plan assets, if any, that exist but are not identified as part of the plan asset audit, are not available to PBGC to pay future benefits and unnecessarily increase PBGC's deficit position.

PBGC protocols require BAPD to perform several other audits in their plan termination process. The participant data audit is conducted to determine whether the participant database prepared by PBGC accurately reflects information contained in source documents of the plan sponsor. The participant database forms the basis for determining participant benefits. The source document audit is performed to identify and determine the accuracy of the source documents used in building the database for computation of participant benefits. The objective of the electronic source document audit is to determine whether the data contained in the electronic sources obtained from the plan

[4] In responding to a draft of this report, officials noted that BAPD "does not use these standards, but applies them as a guide on conducting its work."

sponsor can be accepted as a source to construct the valuation databases for terminated pension plans.

During the time the UAL pension plans were being terminated and trusteed, PBGC had an on-going labor-hour contract with IMRG to conduct audits related to terminated pension plans. PBGC has a long-standing and close relationship with IMRG. PBGC recognized IMRG personnel for their work by providing them with PBGC awards, including the names of IMRG employees in the awards program book for PBGC's annual awards ceremony. While PBGC did not retain records documenting how many audits IMRG had completed, the contractor reported as an "immense accomplishment" the completion of 430 plan asset audits, 350 participant data audits, 100 plan document audits, and 225 source document audits over a period of years. Further, the contractor reported that PBGC has hired more than twenty-five of IMRG's staff. Prior OIG audit work addressed issues with the qualifications of staff provided by IMRG and with PBGC's oversight of IMRG's audit services contract.[5]

IMRG staff conducted plan asset, participant data, source document, and electronic source document audits for four UAL defined benefit plans – a total of 14 audit reports. PBGC's contract with IMRG specified that IMRG work products were to be consistent with Government Auditing Standards, the American Institute of Certified Public Accountants (AICPA) Accounting Guide entitled *Audits of Employee Benefit Plan*, PBGC regulations, PBGC policies, and the Insurance Operations Department Online Manual.[6] Each of the audit reports were on PBGC letterhead, accepted by PBGC, and signed by an IMRG project manager and an IMRG audit supervisor.

In pension plans, participants can be classified into a number of categories based on retirement status. PBGC classifications included retired, active vested, and separated vested. According to PBGC's participant data audits, the four UAL plans had almost 124,000 participants. Active and separated vested participants comprise more than two-thirds of the total number of United Airlines participants.

Objectives

Our objectives were to determine (1) whether the UAL plan asset audits and participant data audits met applicable professional standards; (2) whether the audits were conducted in accordance with PBGC's established protocols; and (3) the effectiveness of PBGC's oversight and quality control processes for the subject audits.

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[5] *Report on PBGC's Contract Administration of the IMRG Contract CT-03-0652*, No.: 2008-4/CA-0033-2 (December 7, 2007); *Report for costs incurred by IMRG under contract PBGC01-CT-03-0652 for Fiscal Years ending September 30, 2003, 2004, 2005, and 2006*, No.: 2007-8/CA-0033-1 (September 26, 2007).

[6] Currently the BAPD Operations Manual. BAPD replaced the Insurance Operations Department.

Findings and Recommendations

I. Plan Asset Audits Contained Obvious Errors and Omissions

Each of the four UAL plan asset audit reports issued in 2007 and 2008 contained serious errors and omissions, an indication that the audits were not conducted with due professional care or diligence.[7] PBGC's audit contractors reached conclusions on the value of assets that were unsupported by their work and omitted tests of key assertions required by applicable auditing standards. Further, PBGC's audit contractors omitted required testing designed to identify missing assets or unusual transactions. As a result, the four plan asset audits performed by IMRG and accepted by PBGC did not provide credible or reliable support for the fair market value of plan assets at the date of plan termination.

Inadequate Confirmation of Plan Asset Valuations

PBGC reviewers did not identify obvious shortcomings in work done to confirm the value of securities held by the United Airlines plans. Although audit work performed by IMRG gave the appearance that asset values were validated, in every instance where substantive audit tests produced a result at odds with the trustee's[8] records, the auditors merely accepted the trustee's valuation and did not identify the reasons for apparent differences. That is, PBGC's audit contractors attempted to validate the fair market value of assets by comparing the value of a sample of those assets, as noted by the plan trustee (called "the Bank" in IMRG's reports) to independent financial market data services such as Bloomberg. However, when auditors concluded that independent data was not available from Bloomberg or when the auditors' calculations did not agree with the balances as reported by the trustee, the IMRG auditors did not attempt to resolve or further research the differences, but merely accepted the trustee's valuation. As a result, the audit work performed to independently confirm the value of plan assets was of no value in providing assurance about the accuracy or validity of the trustee's valuation.

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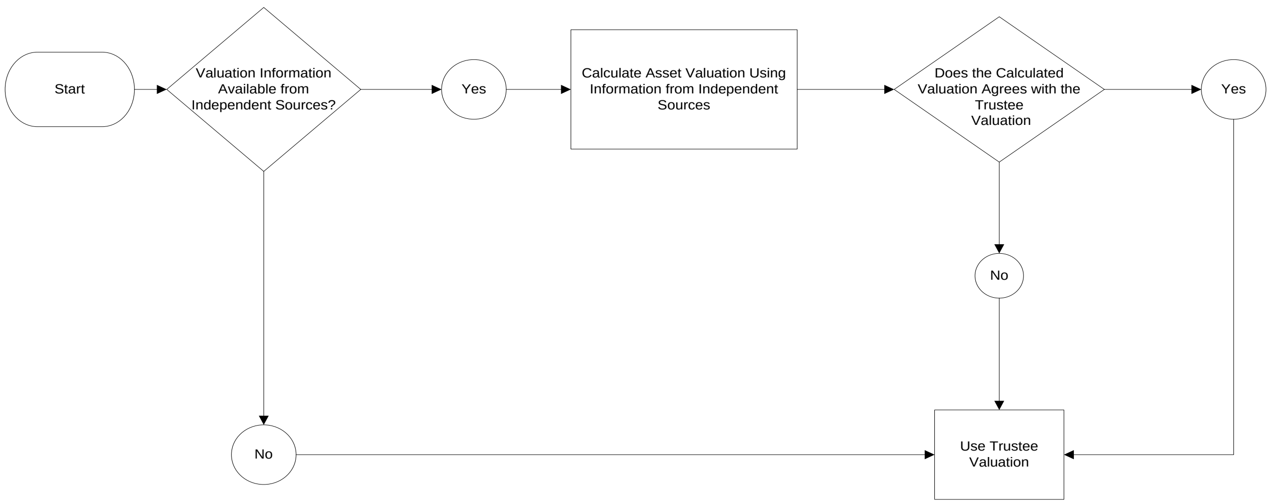
7 Government Auditing Standards § 3.34 requires auditors to exercise reasonable care and diligence in performing engagements. Standard §3.36 requires auditors to exercise professional skepticism which includes the objective evaluation of evidence for sufficiency, competency and relevancy.

8 Trustee, as used in this report, refers to the custodian bank that held the assets of the UAL master trust.

The following flow chart demonstrates how the methodology used by PBGC and IMRG in the initial plan asset audits resulted in reliance on trustee values, without regard to whether those values were supported or correct. As shown below, there were no circumstances under which IMRG would not accept the trustee's valuation.

How IMRG
Determined Asset Values



The failure to independently valídate asset values affected all four of the United Airlines plan asset audits. For example:

- Pilots Plan Asset Audit. In describing tests performed "to validate the correctness of the Fixed Income Funds valuation made by the bank,[9]" IMRG's audit report concluded, in part, that "The trust assets held in the Fixed Income Funds were **stated at fair value** [emphasis added] as determined by market prices quoted on U.S. Securities Exchanges." However, the tests performed by IMRG did not support this assertion. PBGC's audit contractors simply accepted the figures provided by the trustee, noting in the report that "When valuing Fixed Income funds, there is always a problem of getting prices from Bloomberg and **therefore we have used the bank prices in the course of performing the audit**" [emphasis added]. In other words, the auditors used the trustee's pricing as the basis for determining the "correctness" of the trustee's valuation, a questionable and illogical practice that did not provide valid support for the audit conclusion.

[9] IMRG referred to the trustee/custodian that held the master trust as "the bank."

- MAPC Plan Asset Audit. The audit report states that tests were performed "to validate the correctness of the Fixed Income valuation made by the Bank" and includes the following audit test results:

  > "We found 100.00% error rate on prices on Foreign Bonds, 100.00% error rate on US Government Bonds, 100.00% error rate on US Government Agency [sic], 100.00% error rate on US Municipal Bonds, 100.00% error rate on Foreign Corporate Bonds, 100.00% error rate on US Corporate Bonds, 100.00% error rate on US Govt. Mortgage backed securities."

  That is, the auditor's workpapers indicated errors in every price tested for the specified securities. Further, the workpapers do not show any efforts to resolve or research the identified errors. Nevertheless, despite these exceptionally high error rates, the IMRG auditors concluded "the audit revealed that Domestic Investment Prices and Market Values reflected in statements **were in agreement** with our findings" [emphasis added].

- Ground Employees Plan Asset Audit. Regarding tests performed "to validate the correctness of the valuation made by the bank" for (1) Foreign Corporate Bonds, (2) US Corporate Bonds, and (3) US Government Mortgage-backed securities, PBGC's audit contractors calculated error rate percentages of 89%, 100% and 100% respectively. The IMRG auditors then concluded that "these errors were due to conversion rate differences." However, the supporting work-papers did not provide any analysis as to how conversion rate differences would affect a dollar-denominated security such as a US corporate bond or a US government mortgage-backed security. PBGC's audit contractors accepted the trustee's valuation, despite their own work showing high error rates.

- Flight Attendants Plan. Like the MAPC plan, despite test results that showed error rates of 100.00% for U.S. Government Bonds, U.S. Government Agency [sic], U.S. Municipal Bonds, U.S. Corporate Bonds, and U.S. Government Mortgage-backed Securities, PBGC's audit contractor concluded that "domestic investment prices and market values reflected in statements **were in agreement** [emphasis added] with our findings." Based on this work, IMRG accepted the trustee's valuation for these assets, as well as the other assets held within the master trust.

For three of the four plan asset audit reports, both a PBGC division manager and a team leader signed off in acceptance of the audit and supporting workpapers. Only the PBGC team leader signed off in acceptance of the plan asset audit for the Pilots Plan. When OIG interviewed the team leader about the obvious errors and omissions in IMRG's audit work, he expressed his confidence in the high quality of IMRG work, stating that this level of confidence rendered detailed review unnecessary.

Our interview of the PBGC division manager disclosed that he relied on the review of the team leader and did not evaluate the validity of the audit reports' conclusions. Because his background was in actuarial science and not in auditing, the division manager stated that he deferred to the team leader's audit expertise. BAPD's senior leadership advised OIG that no member of BAPD's senior leadership had reviewed or even read any of the United Airlines plan asset audits prior to the time that OIG raised questions about the quality of the audits.

Inadequate Valuations of Interest Earnings

PBGC accepted audit work containing errors and omissions in the calculation of interest earnings. The IMRG auditors did not gather sufficient evidence or properly calculate interest earned on securities owned by the UAL master trust. Missing evidence and inaccurate and inconsistent interest calculations resulted in incorrect interest calculations for numerous securities. As a result, plan participants did not have assurance that interest earned on assets was properly valued before allocation to the various plans. For example, in the MAPC plan asset audit, PBGC's audit contractors concluded, "Based on our samples, the interest calculations on Bonds have somea lot [sic] of differences when compared with the Bank figures." OIG's review of the supporting workpaper showed a basic lack of understanding about how to calculate bond interest on the part of the audit contractors and on the part of the PBGC team leader who accepted the work. That is, PBGC's audit contractors incorrectly used the market value of the bond instead of the face value in their calculation of accrued interest. When this result produced differences between the trustee's calculation and the auditors' calculation, the auditors merely accepted the "Bank figures," a practice that provided no assurance about the accuracy of accrued bond interest. The same error occurred in calculation of accrued bond interest for the Flight Attendants Plan.

Failure to Perform Tests to Identify Fraud, Waste, or Abuse

Many of the mandatory steps omitted by PBGC's audit contractors were intended to identify potential indicators of fraud, waste, or abuse and to ensure that all plan assets were identified and valued. BAPD has established data gathering and analysis steps to search for unidentified assets and indications of potential fraud or abuse, including reviewing statements from each asset manager who manages assets of the master trust; comparing data from Federal Forms 5500;[10] and reviewing the audited financial statements of each pension plan. PBGC accepted plan asset audits and audit workpapers that failed to address these important areas.

> <u>Identification of missing assets.</u> The Corporation provided no evidence that PBGC or its audit contractors performed audit procedures to ensure that all plan assets had been located or to identify and value additional assets, if any, beyond those listed in the custodian bank statements. The audit services contract required the IMRG auditors to contact likely sources such as insurance companies, investment

[10] Federal Form 5500 Annual Return/Report of Employee Benefit Plan.

managers, accountants, and the plan administrator with the purpose of identifying assets not listed on custodian bank statements. However, the contractor's audit workpapers showed no evidence that this occurred and IMRG did not provide such evidence in response to our inquiries. As a result of the auditors' failure to contact sources independent of the trustee, PBGC and the United Airlines plan participants do not have reasonable assurance that all plan assets were identified and included in the total value of plan assets reported in the audit reports.

<u>Assessment of unusual transfers and transactions.</u> Review and analysis of information from asset managers and other sources can identify assets that may not be reflected on trustee statements. Despite the audit report assertion that PBGC and its audit contractors had reviewed "all documents and statements for evidence of improper transactions," we found no supporting documentation that the auditors had verified the legitimacy of transfers from the pension plans. PBGC policy required the auditor to contact banks and insurance companies to obtain statements for one year prior to the date of plan termination (DOPT) and one year subsequent to DOPT, with the purpose of verifying that all transfers are "legitimate." The trustee statements included transactions that should have been subject to review. For example, a transaction appeared on the monthly portfolio statement for the Barclay's Equity Account. The trustee's explanation for this item was limited, noting only that the purpose of this $272 million transaction was "to reflect transfer from 501506 to 617489." Trustee records showed that the market value of this account dropped from $438 million on July 1 to $182 million at the end of the month. Workpapers contained no evidence that this transaction, or any other unusual transfer or transaction, was reviewed.

No Audit Testing Performed to Validate Bank Asset Allocations

The assets of the four UAL plans are included in a commingled master trust. As part of plan asset audit, assets of the master trust must be allocated among the participating plans. The auditors calculated the fair market value of plan assets for each of the four individual plans by distributing the "audited" values of assets and liabilities using a set of allocation percentages. These percentages were vital to the accuracy of the resulting numbers.

Nevertheless, neither PBGC nor its audit contractors did any work to ensure that the allocation percentages were reliable or to validate the source and use of the percentages. IMRG did not provide workpapers to explain the method or rationale for the allocation percentages and dollar values attributed to each plan. BAPD officials confirmed that the ratios were taken directly from the trustee statement and that no validation procedures were performed. Further, they stated that PBGC protocols did not require validation work on the allocation ratios.

Because the allocation percentages are so important to the calculated fair market value of plan assets at the date of plan termination, regardless of the lack of BAPD protocols, any audit done consistent with Government Auditing Standards, which incorporate by reference AICPA standards, would necessarily include tests to validate the allocation percentages. Without audit work on this key assertion, none of UAL plan participants can be sure that their plan received its proper share of the commingled assets.

The UAL plan asset audits are not unique in the auditors' failure to validate allocation percentages. In our March 30, 2011, Evaluation Report No. 2011-10/PA-09-66-1, entitled *PBGC's Plan Asset Audit of National Steel Pension Plans Was Seriously Flawed*, we identified the same lack of testing of the allocation percentages. We recommended that PBGC develop and implement specific audit procedures to ensure the integrity and fairness of allocation percentages used in situations where plan assets have been commingled. In responding to our report, PBGC agreed to update the procedures manual and train staff on how to audit plans where an allocation of assets is needed.

II. PBGC Bypassed Established Protocols for Validation of Participant Data

PBGC failed to follow established protocols for validation of UAL participant data. These protocols include a detailed audit-based methodology for testing and validating participant information at several different levels. Although PBGC's contractors completed (and PBGC accepted) ten different audit reports intended to provide assurance about the accuracy of the information that would be used to calculate benefits for UAL retirees, the scope of the work excluded more than two-thirds of the participants. Instead, the report focused only on retirees and omitted review of manual source documentation for active and separated vested participants, a category that included more than 85,000 workers. Further, the audit reports contained pervasive errors in analysis and unsupported conclusions. As a result, the audit work performed by PBGC's audit contractors did not provide reasonable assurance of the validity of participant data.

PBGC protocols require a series of audits to address the accuracy of participant data. Objectives of the three types of audits are closely related. As described in the various, UAL audits, the electronic source document audit determines whether electronic data provided by the plan sponsor can be accepted as a source of data. Source document audits determine the accuracy of the source documents themselves and participant data audits are performed to ensure the reliability of data. Taken together, the three types of audits are intended to provide assurance about the accuracy and completeness of the participant database.

The participant database is a critical component for determining participant benefits. UAL provided PBGC with automated information to construct the participant database from its Total Administrative Benefits System (TABS). TABS pulled the information needed to calculate a participant's pension from UAL's payroll system as well as the People Soft System (human resources information). PBGC and its contractors used this data to create PBGC's participant database, comprising detailed records of almost 124,000 UAL workers, retirees and beneficiaries.

PBGC Documented UAL Denial of Access to Records

PBGC asserted in various audit reports that UAL denied access to certain records that were necessary to complete the participant data and source document audits, creating a scope limitation. The comprehensive participant data audit report notes that there was "inadequate manual source documentation for active and separated vested participants" and concludes that the auditors were "not able to validate electronic records of these employees to their manual source documents." According to the final audit report, United Airlines had "denied PBGC's request … to review personnel records of its active and separated vested employees." A supporting memo signed by the PBGC division manager and specifically referenced in the audit report stated "The Legal Department at United denied PBGC permission to copy the personnel files with the exception of a sample of twenty-five to fifty files from the Ground plan. … The files obtained were for retired participants only." Three of the four plan participant data audits report similar denials of access.

Available documentation shows that PBGC took little action in response to UAL's purported denial of access to pension records. When questioned about the basis for his memo describing United Airlines' denial of records, the division manager asserted that he did not have documentation showing who denied the records, did not remember who denied the records, and noted that he did not seek a subpoena or contact PBGC's legal staff to obtain assistance at the time the records were denied. In his view, his concern with the relationship between PBGC and United Airlines, which was assisting in the trusteeship transition, outweighed the need to subpoena participant records or take other steps to obtain necessary data.

Based on our interviews with PBGC personnel, PBGC has authority to take action, including issuing a subpoena, when a plan sponsor denies access to necessary records. Established protocols detail specific tests to be performed on representative samples of participant data. However, by failing to obtain records, the PBGC division manager by-passed protocols with respect to validating electronic records of active and separated vested participants to manual source records. He explained his decision, noting that he had a high level of confidence in the data based on 1) the lack of issues in retiree files, which comprised almost one-third of the participant population;[11] 2) the paucity of questions at PBGC's meetings with participants; and 3) UAL participant access to records in UAL systems prior to PBGC trusteeship. We noted that this rationale was not documented in any of the audit reports, in the audit workpapers, or in any other information provided by PBGC. Further, we found no evidence that any member of BAPD management or PBGC senior leadership had concurred in this material deviation from established protocols.

[11] IMRG reported that UAL "audits" retiree records before placing them into pay status. Accordingly, the results regarding this segment of the participant population cannot validly be applied to remainder of the participants with records that have not been subject to the same level of review and scrutiny.

If UAL denied PBGC access to records needed to process the termination of UAL pension plans, the PBGC division manager should have taken several important steps, including documenting PBGC's request to UAL, documenting the identity of the UAL personnel denying access and the rationale for the denial, and consulting with PBGC leadership, including the PBGC General Counsel about ways to obtain the necessary records. Further, at least one member of PBGC senior leadership (e.g., the Chief Operating Officer) should be aware of audit results and read or review any audits describing the purported denial of access, especially when that denial of access has a potential effect on thousands of participants. At a minimum, PBGC's senior leadership should have evaluated the wisdom of forgoing records on 85,000 participants in order to maintain a positive relationship with a plan sponsor. Based on our interviews, no member of senior leadership read any of the participant data, source document, or electronic source document audits relating to the UAL termination, prior to OIG raising concerns about the quality of the audit work.

PBGC's Audit Conclusions for 85,000 Employees Were Unsupported

PBGC failed to follow its protocols, reaching conclusions that were not based on a representative sample of participants. For each of the participant data audits, conclusions were inappropriately drawn about data for United Airlines participants based on a review of files for retirees and without analyzing data for participants in other pay statuses. Additionally, the audits concluded that the constructed database was accurate and complete, even though sampling error rates greatly exceeded the acceptable threshold specified in PBGC's protocols.

Participants can be classified into a number of categories based on retirement status. PBGC classifications include retired, active vested, and separated vested. Active and separated vested participants comprise more than 68% of the total number of United Airlines participants.

The PBGC manager that accepted the audits informed OIG of his opinion that, based on the testing of retired participants and participants subject to qualified domestic relation orders (QDRO), as well as the lack of inquiries resulting from PBGC trusteeship notification letters to plan participants, he determined that the work that had been completed was sufficient to assess the accuracy of the databases.

The evidence collected and sampling work completed do not support the reported conclusions or assertions. IMRG reported that UAL "audits" retiree records before placing them into pay status. Accordingly, the results regarding this segment of the participant population cannot be viewed as representative of the remaining participants with records that have not been subject to the same level of review and scrutiny.

Four of the audits also sampled participants with QDROs to determine whether the participant database accurately reflected source document information. BAPD Operations Manual Section 12.7 established the acceptable error rate at 2% for significant errors – i.e., errors that could affect benefit calculation. IMRG identified QDRO error rates that far exceeded the acceptable level for three of the UAL participant data audits but still asserted that the resulting databases were reliable because corrections had been made. For example:

- The Pilots plan participant data audit report included the statement: "The statistical participant data audit of the sampled participants revealed an overall error rate of 24% and 37% Sub-Population A and Sub-Population B respectively. Since Sub-Population A and Sub-Population B failed, the sample size was expanded to 100% of the QDRO population. Based on the results of the audit work performed we conclude that the valuation database, as constructed, **may be relied upon** [emphasis added] to produce a valid valuation and accurate individual benefit calculations…"

- The Ground Employees Participant Data Audit has a similar statement, with error rates of 10.43% and 9.57% for Sub-Population A and Sub-Population B, respectively. We noted that these error rates are 4 to 5 times PBGC's established acceptable error rate of 2%.

While PBGC's audit contractors asserted that necessary corrective actions were completed, audit workpapers do not provide any evidence to corroborate the assertion. Auditing standards require documentation in sufficient detail to enable an experienced auditor, having no previous connection to the engagement, to understand conclusions reached.[12] Most significantly, the high error rates found in the samples indicate that segments of the UAL population that have not been subject to previous scrutiny are likely to have significant errors in data elements that could affect a participant's benefits. While not definitive, the results reflect a higher risk of error, a risk that should have been addressed through a corresponding increase in testing. This did not occur in the UAL participant data audits.

III. Inadequate PBGC Oversight of Audit Services Contractor

PBGC did not provide effective oversight of the audit contractors' deliverables, including the four UAL plan asset audit reports, the five participant data audit reports, the four source document audit reports, the electronic source document audit report, and all supporting workpapers. A BAPD team leader signed in concurrence with each of the plan asset audits. When interviewed, he advised that he relied heavily on IMRG's experience and reputation; he did not review workpapers or independently consider the judgment and accuracy of the decisions made by the IMRG auditors. His analysis was limited to a review of the summary of plan assets and a comparison of the figures reported by the IMRG auditors with the figures shown on the trustee's statement. As noted above, this approach was certain to be ineffective in discovering errors, given that the IMRG auditors accepted the trustee's numbers in all instances in which differences were identified. Due to the limited review and ineffective approach, the PBGC team leader did not identify the errors, omissions, and unsupported conclusions in the four UAL plan asset audits.

[12] Government Auditing Standards, Section 6.21

Our interview of the PBGC division manager with responsibility for oversight of the team leader and the UAL plan asset audits disclosed that he did not review workpapers or assess the internal logic of the four UAL plan asset audit reports. He advised that his review, similar to the review conducted by the PBGC team leader, focused on the relationship between the final schedule of plan assets as set forth by the IMRG auditors and the trustee's statements. We noted that this approach, like the team leader's review, was ineffective in identifying the types of errors, omissions, and unsupported conclusions included in the four UAL plan asset audits.

At our request, the PBGC division manager provided notes documenting his review of two of the four plan asset audits. We noted that he requested editorial changes (e.g., make certain items bold) and noted a minor error involving a few cents, but did not identify obvious errors or question IMRG's judgment to accept the trustee's records, despite high error rates identified by the auditors.

Our review of the plan asset audit reports and supporting workpapers caused us to question the professional skills of the auditors who performed the work. Spreadsheets contained in the workpapers contain obvious errors, omissions, and inconsistencies that should have been evident to both the preparer and to any reviewer.

For example:

- In numerous instances, the auditors made mathematical errors or used the spreadsheet functions inexpertly. We identified instances where the audited valuation varied from the trustee value because the auditors failed to enter a share price value in the spreadsheet before completing the calculation.

- In some instances, the audit contractor's calculated value differed from the trustee's value – even though the number of shares and the price were identical – an indication of a simple math error.

If the audit contractors and reviewers or the PBGC reviewers had researched these apparent differences, the auditors' mistakes would have been readily apparent.

We interviewed IMRG officials regarding the deficiencies in the audits and questioned them about IMRG's responsibility for compliance with audit standards. In response, IMRG explained that more than half of the instructions that they received from PBGC were verbal, rendering the contract and its terms only "science fiction." IMRG personnel were integrated into teams with PBGC staff and, in their view:

> [A]uthorized PBGC personnel gave instructions as to how IMRG, Inc. was to perform the Contract and IRMG, Inc. followed those instructions. PBGC controlled the „how', „when' and „where' of these plan audits. IMRG, Inc. was providing personnel to PBGC to assist the PBGC in performing the tasks PBGC wanted performed the way PBGC wanted them performed.

In responding to a draft of this report, PBGC disagreed with IMRG's assertion, as noted above. However, as noted in the Scope and Methodology section of this report, our review was limited due to PBGC's failure to maintain important information; the TPD auditor, the COTR, and the Contracting Officer each failed to maintain complete records of contract oversight for the IMRG contract, impeding our ability to determine exactly how PBGC interacted with IMRG. Other information developed as part of our review tended to corroborate IMRG's assertions. For example, while each of the four audit reports was signed by an IMRG lead auditor, an IMRG project manager, and (for the Pilots plan audit only) an IMRG audit supervisor, the reports were issued on PBGC letterhead - an indication that PBGC accepted and took responsibility for the content of the plan asset audits. Further, BAPD officials concurred with the contractor's view that IMRG staff had been integrated into PBGC teams; the Deputy Director of BAPD noted that, whether it was right or wrong, BAPD and IMRG auditors worked as a team – "hand and hand."

BAPD has established standards[13] that state: "The report should be complete, accurate and as clear and as concise as the subject permits.… The information presented should be sufficient to convince the report users to recognize the validity of the findings, the reasonableness of the conclusions." Further the standards state: "Evidence is sufficient if there is enough of it to support the auditors' finding (i.e. is there enough evidence to persuade a reasonable person of the validity of the findings)."

Based on the information identified in Findings I and II, we concluded that the UAL plan asset, participant data, source document, and electronic source document audits were not performed consistent with *Government Auditing Standards* or with PBGC's own established protocols. Based on the obvious errors and omissions in the reports, the limited documentation of BAPD's review, and the explanations provided by PBGC personnel, we concluded that PBGC did not provide adequate oversight for the audit work.

IV. *Systemic Errors and Omissions in Audits of Terminated Pension Plans*

Errors and omissions in the audits performed to process terminated pension plans are not limited to the United Airlines pension plans. PBGC used the same contractor to perform hundreds of plan asset and participant data audits during the last decade, including eight of the ten largest pension plan terminations in PBGC's history. In our March 30, 2011, Evaluation Report, No. 2011-10/PA-09-66-1, entitled *PBGC's Plan Asset Audit of National Steel Pension Plans Was Seriously Flawed,* we identified similar omissions and errors related to the National Steel plan asset audit, which was performed by the same contractor.

Previously, OIG had issued reports and recommended corrective actions regarding the (1) education and experience of employees provided by IMRG and (2) PBGC oversight of the contractor. A PBGC commissioned assessment of its trusteeship of large defined

[13] BAPD Operations Manual, Auditor's Technical Reference Manual,, BAPD Auditing Standards.

benefit plans completed by Hewitt Associates in September of 2007 concluded, in part that BAPD[14] auditors (both Federal and contract employees) lacked the audit skills necessary to adequately perform their roles. An internal PBGC review of plan asset audits, completed after OIG briefings, identified errors and omissions in the audits tested throughout BAPD.

Prior OIG Reports

During the period that IMRG completed the UAL audits, OIG issued two audit reports addressing concerns with IMRG. In a report issued in September 2007, we noted that IMRG had provided employees to PBGC who did not meet the minimum education and/or experience requirements for the position of senior auditor. PBGC paid IMRG for the work of two senior auditors for whom there was no documentation demonstrating completion of an accounting degree or 24 semester hours in accounting – the minimum educational requirements established in the contract. For three other IMRG employees, PBGC paid for the work of experienced auditors even though IMRG did not provide evidence that the employees met the minimum experience requirements set forth in the contract.

In December 2007, OIG issued a report describing the need for PBGC to improve its administration of the IMRG contract by holding the contractor accountable for complying with contract terms and providing better monitoring of performance. In response to our audit, PBGC committed to issuing Technical Monitoring delegation letters that would detail the technical monitor's responsibility for ensuring compliance with the terms and provisions of the specific contract. Six of IRMG's fourteen substandard audit reports dealing with UAL terminations were issued after OIG had placed the Corporation on notice of the poor quality of oversight accorded this important audit services contract.

Hewitt Associates Assessment

A PBGC commissioned assessment of its trusteeship of large defined benefit plans completed by Hewitt Associates in September of 2007 concluded, in part, that BAPD auditors (both Federal and contract employees) lacked the audit skills necessary to adequately perform their roles. The Hewitt Associates report noted the following cross-cutting issues and weaknesses within BAPD:

- "BAPD auditors (both Federal and contractor employees) lack many of the traditional audit skills necessary to adequately perform their roles…."
- "Teams comprised of both federal Full Time Employees (FTEs) and contractors cause confusion over responsibility and accountability for work products."
- "Audit contractors do not appear to be held to stated contractual requirements, and audits are not performed in accordance with generally accepted auditing standards."
- "Inconsistent or inadequate monitoring of contractor activities or work products."

[14] PBGC's Benefits Administration and Payment Department (BAPD) has responsibility for performing the asset valuation.

Additionally, with respect to the plan asset audits, Hewitt concluded:

- "Observed weakness bring the overall added value of the plan asset audit process, as it is currently performed, into question."
- "Auditors in general do not have the necessary skill set, and have not been provided sufficient training to know how to value complex assets."
- "Use of contract auditors can cause weaknesses, including, but not limited to:
  - Contractors do not appear to perform audit procedures to identify and value additional assets beyond those listed in bank statements.
  - Existing category requirements, in terms of qualifications or experience, may not be sufficient to address more complex audit requirements.
  - Work products prepared by contractor staff may not be subject to sufficient review by contractor management."

OIG review of current work shows that many of these same conditions continue to exist, unabated since the 2007 report. PBGC corrective actions in response to the Hewitt report were minimal at best. Neither the Chief Operating Officer nor any BAPD official was held accountable for implementation of Hewitt's recommendations or for addressing the serious shortcomings identified in this PBGC commissioned report. BAPD officials assert that this failure to assign responsibility was "a clear senior management decision to address a few of the important items, given the competing priorities that BAPD faced at the time, such as the move from Ariel back to ACT and the FBA contract recompete."

Risks Associated with a Poorly Executed Asset Audits

In 2007, the Hewitt Report also warned PBGC of some of the risks associated with poorly executed plan asset audits. The report noted, in part, that accurately valuing a terminated pension plan's assets is one of the most important and fundamental aspects of PBGC's post-trusteeship process. Carelessness in this area exposes PBGC to a variety of risks, including, but not limited to the following:

- Incorrect value of plan assets;
- Failure to identify all plan assets;
- Incorrect value of plan liabilities;
- Insufficient documentation to support valuation;
- Incorrect benefit payments;
- Increased exposure to PBGC's insurance program;
- Increased benefit processing time; and
- Litigation against PBGC.

PBGC Internal Assessment

PBGC initiated an internal assessment of BAPD –Trusteeship Processing Division (TPD) operations in response to our National Steel evaluation and the preliminary results of this review. The PBGC review, conducted during the first quarter of FY 2011, was led by a BAPD senior level manager and the initial scope of the planned review consisted of a sample of over 60 recently completed plan asset audits from each of the eight TPD groups. However, after completing an assessment of the first 20 audits, sample results were consistent with the observations reported by OIG and by Hewitt Associates. The review work was terminated, based on PBGC's assessment that sufficient information had been obtained to show the existence and extent of the issues, including the same types of issues identified in our review of UAL audit work:

- Comparison of Federal Forms 5500s and trustee asset statements was often not done for the required three year period, and significant variances are not explained. This comparison is performed to test for unidentified assets.
- Limited testing performed to identify fiduciary breaches. Fiduciary breaches could result in misuse of plan assets.
- Differences in asset values determined by the plan asset audits and the Financial Operations Department were not researched. This comparison may identify errors in asset valuations allocated to plans.
- Asset figures in work plans, plan asset audit reports, and forms to document the reconciliation between BAPD and the Financial Operations Department did not agree.
- Uncharacteristically large plan expenditures were not always investigated.
- Testing of plan expenses, while specified in the procedure, is not being done.
- Electronically imaged records are often not complete.
- Workpapers are not signed by reviewer on a consistent basis.

PBGC Analysis of Other Potentially Affected Plans

In April 2011, PBGC initiated a review to begin identifying and prioritizing other plans where errors and omissions in plan asset audits have a potential impact on participants. The initial analysis is focusing on plans where actuarial valuations were finalized between October 1, 2001 and September 30, 2010 and where IMRG had involvement in the plan asset audits. PBGC's current approach emphasizes analysis of the plan's funding status. However, a more comprehensive and reliable analysis would also include more in-depth consideration of the potential effects of any errors in allocation percentages. Additionally, consideration should be given to assessing risk higher for those plan asset audits approved by BAPD managers who have acknowledged completing only limited reviews and for plans where private partnerships or other assets subject to stale price dating comprise a significant portion of the investment portfolio.

When we shared our concerns about PBGC's approach to identifying any additional plans where errors and omissions in plan assets audits may affect participants, PBGC officials referred to a template that had been developed to document the review process, noting their belief that the template provided adequate guidance for the review. However, our assessment of the template identified several inadequacies. First, the template was only applicable to plans initially rated as "medium;" no such template was developed to document the assessment of plans rated either "high" or "low." Second, the template seems to demonstrate a very casual approach to valuation of the plan assets, with a final question asking whether documents provide reasonable assurance that "asset values are in line." No definition is provided of what is meant by asset values being "in line." Further, some template instructions seem to be illogical, e.g., if there is any evidence that DISC (another PBGC department) was involved in valuing the assets, the template directs the reviewer to "stop and take no further action. This case will be re-categorized as low." If PBGC plans to rely on the template for documenting its review, a careful assessment should be made of its adequacy, to include consideration of how plans initially rated "high" and "low" will be reviewed. Additionally, senior PBGC officials should carefully consider and document whether the appropriate standard for the review is that "asset values are in line."

Strategic Review of BAPD Operations

PBGC should be acknowledged for beginning to take action to address the systemic issues that contributed to the serious errors and omissions in PBGC's audits of terminated pension plans. The PBGC Director has shown his commitment to corrective action by contracting for a comprehensive analysis of the appropriateness of BAPD's current organizational structure and operations to meet its mission challenges. The analysis will also propose alternatives for an organizational structure that is better aligned with BAPD mission responsibilities. Initiated in April 2011, the first phase of the strategic review has been completed and includes a current-state assessment report addressing many of the factors that contributed to the problems described in this report, including workforce, contracting, business processes, and quality control practices. The second phase, also complete, includes options for a future state operating model.

V. *PBGC's Effort to Correct UAL Asset Valuations*

When the Office of Inspector General brought the errors and omissions in PBGC's audits of United Airlines plans to the attention of the Corporation, PBGC leadership initiated efforts at corrective action, including contracting with a CPA firm for a re-valuation of UAL plan assets. Our review of PBGC's corrective actions shows that efforts to date have not yet been effective in providing a reasonable level of assurance about the value of plan assets.

The re-valuation work done by the CPA firm and documented in workpapers and reports issued in April 2011 does not provide reasonable assurance about the value of plan assets for terminated United Airlines plans as of the date of plan termination. Some issues occurred because PBGC's agreement with the CPA firm called for valuing plan assets in a manner different from the method required by Federal regulation. Other issues arose because PBGC did not provide adequate oversight and review for the UAL plan asset re-valuation work provided by the CPA, with the result that undetected errors occurred and were not corrected before PBGC's acceptance of the work. Additionally, the CPA firm, with PBGC's concurrence, did not perform a credible validation of the allocation percentages used to divide the plan assets among the four UAL pension plans. As a result of these issues, the four reports completed by the CPA firm that were intended to replace the seriously flawed plan asset audits performed by IMRG were also themselves significantly flawed.

Issues Resulting from Use of an Incorrect Methodology

PBGC regulations call for plan assets to be valued "at their fair market value, **based on the method of valuation that most accurately reflects such fair market value**" [emphasis added]. However, the 2011 agreement between PBGC and the CPA firm called for the firm to determine "the fair market value of plan assets as of the date of plan termination, **using custodian statements as of the dates of plan termination and any monthly statements for the preceding year**" [emphasis added]. The difference between the two approaches is important, as the CPA firm's methodology leads to tremendous reliance on the values reported by the custodian/trustee. That is, instead of using the method that most accurately reflects fair market value, as required by Federal regulation, the CPA firm's valuation were based on a far more limited approach and, in some cases, did not make use of credible, reliable information, even when such information was readily available.

Based on our discussions with BAPD leaders responsible for oversight of the re-valuation work, we concluded that BAPD officials were apparently unaware of the regulatory requirement to value plan assets in the manner that most accurately reflects fair market value. In response to a draft of this report, PBGC disagreed with our conclusion. However, throughout the course of our review, we found no evidence in interviews, PBGC meeting notes, or other documentation of PBGC's oversight of the CPA firm to indicate an awareness on the part of any BAPD official of the need to value plan assets in the manner that most accurately reflects fair market value. As further evidence of this apparent lack of awareness, BAPD officials did not identify the impact of the CPA's proposed alternative approach, when that approach was accepted and made a part of the contract. Prior to OIG bringing the issue to their attention, we found no documentary evidence that BAPD officials had considered the regulatory requirement for determination of fair market value of plan assets based on the method that most accurately reflects such fair market value or noted the ways in which the CPA firm's proposal differed from that requirement.

> Use of an Arbitrary Threshold for Adjustment. One impact of the flawed agreement between PBCG and the CPA firm was the firm's failure to recommend adjusting the value of certain assets despite credible evidence that the fair market value at the date of plan termination was greater than reported by the trustee. This occurred because the CPA firm, with PBGC's concurrence, used a 10% threshold as part of its analysis of certain assets.i[15] Because values of certain individual assets were not adjusted unless they exceeded 110% of the value recorded by the Trustee, in many instances the CPA firm and PBGC had evidence of an increased fair market value that was not reflected in the total adjustment recommended in their report. These amounts were significant and likely to affect the calculated benefits for some UAL participants.

[15] Different thresholds were used for different asset classes. Valuations of Liquidity Group V assets -- comprising, preferred stock, right/warrants, unit trust equity, swaps, options, partnerships, and collective funds – were not adjusted unless the difference varied from the trustee's value by at least 10%. Established thresholds for other asset classes were lower.

The following example demonstrates how the methodology that PBGC and the CPA firm agreed to understated the value of a particular plan asset. The UAL master trust owned an investment in the Huff Alternative Fund, a limited partnership. As of 12/30/04, the custodian valued the assets at $24,761,864. However, the CPA firm's workpapers included a copy of an audited financial statement for the partnership, showing that the UAL Group Investment Trust held assets valued at $26,179,981 as of 12/31/04. While the CPA firm's workpapers noted the increase in value totaling $1,418,117, the firm's report did not recommend that the value of the asset be adjusted. That is, because the increased amount totaled only 5.73% of the amount recorded by the trustee (less than the 10% threshold), the CPA firm valued the asset at the trustee's lower value, despite having credible evidence of a higher fair market value. In other similar instances, the CPA firm did recommend adjustment of asset values, based on audited financial statements or other credible evidence of value, as long as the amount of the difference totaled at least 10% of the trustee's valuation.

Based on our review of the CPA firm's workpapers for the Pilots plan, increases in asset value totaling about $9.2 million were not adjusted because the amount of the change was less than the 10% threshold.[16] The CPA firm's practice is inconsistent with the Federal regulation requiring that plan assets be valued by the method that most accurately reflects the fair market value. However, the CPA firm reports that it deferred to PBGC on matters of policy, noting "the choice on the thresholds to be used, however, is ultimately one of policy, and here the thresholds were approved by BAPD." In response to a draft of this report, PBGC agreed that the method in which the contractor applied thresholds produced a result that was inconsistent with the regulation. Further, the Corporation agreed to make the necessary adjustments to reflect the fair market value as of the date of plan termination.

<u>Inconsistent Treatment of Increases in Asset Value</u>. Because the CPA firm, with PBGC's concurrence, did not attempt to value plan assets based on the method that most accurately reflects fair market value, the different UAL plans were treated inconsistently with respect to valuation of certain assets. Three of the plans had a date of plan termination at or near the end of a calendar quarter; that is, for the Pilots, Flight Attendants, and MAPC plans, quarterly statements were often available to support the value of particular investments on or near the DOPT. However, for the Ground Employees Plan, with a date of plan termination of March 11, 2005, supporting documentation was rarely available for those assets that were not priced on a daily basis. Thus, the CPA firm was able to obtain evidence supporting certain prices at or near the date of plan termination for only three of the four plans.

[16] The $9.2 million reflects a combination of increases and decreases, with an increased value for 20 investments and a decreased value for 4 investments.

Under the method chosen by the CPA firm and agreed to by PBGC, the CPA firm deferred to the trustee's value as of 3/11/05 for non-public assets (a component valued at almost $2 billion) and did not attempt to estimate or interpolate a more accurate fair market value. Because the general price trend in these assets was upward at this time, the effect of this decision was to deprive the Ground Employees plan of increases in value occurring between 12/31/04 and the date of plan termination.

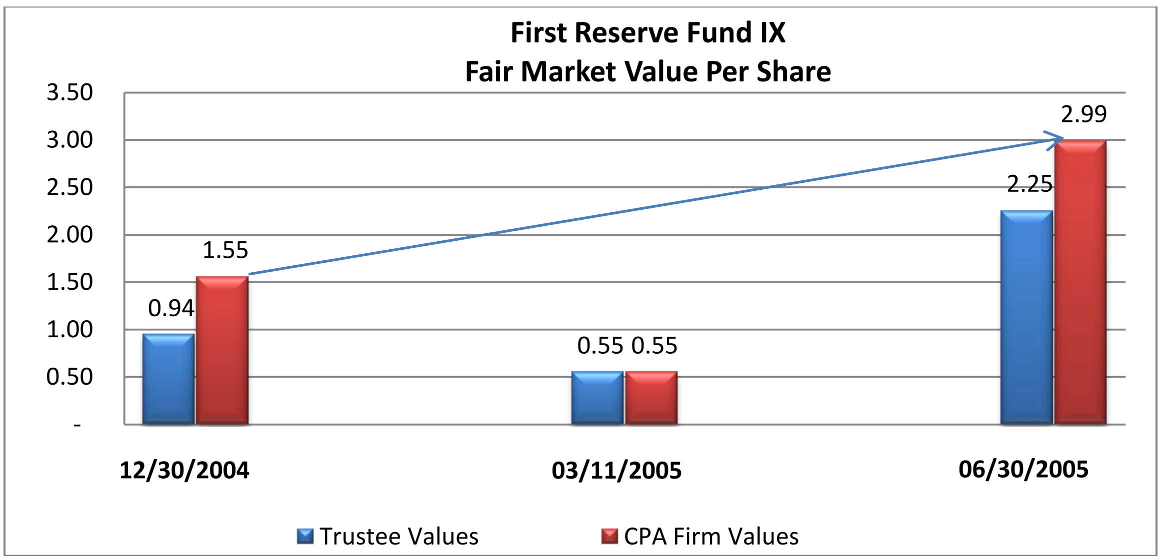
The following example shows the impact of the methodology chosen by the CPA firm and approved by PBGC. Looking at the valuation treatment of the master trust's investment in the First Reserve Fund IX for each of the plans:

- As of 12/31/04, the date of plan termination for the Pilot's plan, the UAL master trust's investment in this fund was valued by the Trustee at $0.94 per share or $17,379,549. The CPA firm made a correct determination that resulted in a value per share of $1.55 and a total value of $28,695,000. As a result, the CPA firm's report recommended increasing the value of this investment by $11,315,451.

- As of 6/30/05, the date of plan termination for the Flight Attendants and the MAPC plans, the UAL master trust's investment in this fund was valued by the Trustee at $2.25 per share or $28,875,588. (The number of shares fluctuated throughout the six month period, so comparisons should be based on the per share price.) The CPA firm made a correct determination that resulted in a value per share of $2.99 and a total value of $38,284,000. As a result, the CPA firm's reports on the two plans recommended increasing the value of this investment by $9,408,412.

- Nevertheless, because the CPA firm did not have information about the value of this fund as of 3/11/05, no adjustment was made to the value of this asset for the Ground Employees plan. Trustee documentation showing a per share value of $1.26 as of 3/31/05, an indication that the $0.55 per share value at 3/11/05 was likely understated. Thus, even though we know the asset was undervalued at 12/30/04 and 6/30/05 and the additional value was credited to the Pilots, Flight Attendants, and MAPC plans, the Ground Employees plan did not receive any adjustment. PBGC concurred with the CPA firm's actions and the methodology was consistent with the CPA firm's written agreement. However, this method systematically understated the value of plan assets for the Ground Employees, simply because their date of plan termination did not occur at or near a quarter's end.

The following chart graphically represents the impact of the CPA firm's methodology. The Pilots plan, represented by the two bars on the left and with a DOPT of 12/30/04, benefitted from the $0.61 per share increase in value ($1.55 - $0.94), with the result that the CPA firm recommended an increase in asset value of $11,315,451. The Flight Attendants and MAPC plans, represented by the two bars on the right and with a DOPT of 6/30/05, benefitted from a $0.74 per share increase in value ($2.99 – $2.25), with a resulting increase in asset value of $9,408,412. Only one plan - the Ground Employees plan - does not benefit from an upward adjustment in asset value. Estimating the value as of the DOPT would provide a more accurate reflection of the fair market value of this asset than does the CPA firm's practice of deferring to the trustee's value, a value that has been shown to be consistently understated for this particular asset.



While the impact of a single investment may have been small, the accumulated effect is more significant. The following table, with information taken from the CPA firm's April 2011 reports, demonstrates the impact of the inconsistent treatment between plans. Forty-one of the forty-two partnership investments tested were identical for all four plans. As shown below, supporting documentation provided by the trustee showed an increase in value for the group of assets as of 12/30/04 and as of 6/30/2005. It is reasonable to assume, based on the results shown below and absent information to the contrary, that the value of these partnership investments had a generally positive trend during the six month period. Given the effect of stale date pricing on the investments, the method chosen by the CPA firm and agreed to by PBGC systematically understated the value of tested partnership investments as of 3/11/2005 – the date of plan termination for the Ground Employees plan. PBGC should consider methods that will more accurately reflect fair market value as of 3/11/2005, including interpolation between quarterly values or other methods of estimation. While such estimates might not be a perfect reflection of fair market value at the date of plan termination, they will be more accurate than the result achieved by arbitrarily holding to a trustee's value, when that value is known to be affected by stale date pricing.

Plan Name	DOPT	Number of Partnership Investments Tested	Market Value of Tested Investments as Reflected in Trustee Statements as of DOPT	Market Value of Tested Investments Based on Report[17]	Increase in Value
Pilots	12/30/2004	42	$329,613,927	$367,374,677[18]	$37,760,750
Ground Employees	03/11/2005	42	$333,653,290	Not reported[19]	-0-
Flight Attendants	06/30/2005	41	$353,147,005	$380,880,401	$27,733,396
MAPC	06/30/2005	41	$353,147,005	$380,880,401	$27,733,396

<u>Failure to Utilize Easily Available Evidence of Asset Values</u>. In many instances and with PBGC's concurrence, the CPA firm did not seek out evidence of asset values from other sources when the trustee could not provide supporting documentation for the value. While this was consistent with the written agreement between PBCG and the CPA firm -- that fair market value would be determined "using custodian statements" -- this approach did not comply with the Federal regulation requiring use of the method that most accurately reflects fair market value. As a result, the CPA firm's work did not provide assurance about many of the assets, including assets where determination of the fair market value was relatively simple.

Examples of asset values where the CPA firm used the trustee's values, despite the easy availability of more accurate valuations include two limited partnerships, Menlo Ventures VII and Menlo Ventures VIII. For the CPA firm's reports on each of the four plans, the value of these investments was recorded at the value reported by the trustee, e.g., $2,132,297 and $5,962,007, respectively, as of 12/30/04. For the two subject Menlo Ventures investments, workpapers supporting each of the reports state, in part, "We requested supporting documentation … however, PBGC/Northern Trust was unable to provide the necessary data. Therefore, we were not able to obtain a value for these securities."

[17] As noted previously, this amount does not reflect the entire increase in value, as only those increases exceeding 110%of the Trustee value were accumulated in the CPA firm's report. The CPA firm omitted from its reports increases and decreases that did not reach the threshold.

[18] The CPA firm proposed increased valuations for 20 of the 42 investments. The adjustments included both increases and decreases in value.

[19] The CPA firm's report noted "we were not provided the DOPT partnership supporting documentation and could not conclude on the valuation."

As part of our review, OIG obtained credible evidence about the value of these investments, in the form of Statements of Changes in Individual Partners' Capital Accounts. Through a simple internet search, OIG found a phone listing for a California company with a similar name. A phone call to the company's Comptroller resulted in assurance that the information was available. However, it was not necessary for OIG to obtain the information directly from Menlo Ventures because the Comptroller was aware of a PBGC financial analyst who already had the information. We contacted PBGC's financial analyst, who had the information readily available and provided it upon request. It is notable that, in contrast to many of the other examples in this report, supporting documentation showed that the fair market value of these two assets was actually lower than reported by the trustee, an indication that correction of the errors and omissions in PBGC's valuation process will include both increases and decreases in value.

Issues Arising Because PBGC Did Not Provide Adequate Oversight and Review of the CPA Firm's Work

In some instances, the CPA firm's report and supporting workpapers included errors and omissions that were not identified by PBGC prior to the Corporation's acceptance of the April 2011 re-valuation reports. Although BAPD leadership asserted that a careful review had been made of the CPA firm's reports and workpapers prior to PBGC's acceptance of the work and payment to the contractor, we identified several different types of errors and omissions of which the PBGC reviewers were unaware. For example:

<u>Incorrect Assessment of Evidence</u>. We identified instances where the CPA firm's workpapers included credible evidence of an increase in value exceeding the established 10% threshold but no adjustment to the valuation was recommended because the CPA firm had not properly evaluated the evidence included in its own workpapers.

In one example contained in the CPA firm's workpapers supporting the report on valuation of the Flight Attendants pension plan, the CPA noted that the trustee had valued an investment in Welsh, Carson, Anderson & Stowe VIII, LP at $17,245,496 as of 6/30/05. The CPA firm's workpaper showed a value of $19,396,793 for this asset, but did not recommend an increase in the valuation. Instead, the CPA firm's workpaper stated "We were provided the partnership support for 9/3/2005, but our DOPT is 6/30/2005. Since our valuation date is 6/30/2005, these valuations may not be accurate given the 3 months timing difference. Since **we were not provided the 6/30/2005 partnership supporting documentation**, [emphasis added] this is a scope limitation for our valuation."

We noted that this analysis was incorrect, as the CPA firm's workpapers contained a copy of a quarterly capital account statement showing the capital account balance for UAL's group investment trust to be $19,767,502 as of 6/30/2005, the date of plan termination. Apparently, CPA firm staff had not correctly analyzed supporting documentation, with the result that value of the asset was not adjusted to reflect the

$2,522,006 increase in value. That is, the resulting valuation understated the value of the asset by more than $2.5 million and was not in compliance with the applicable Federal regulation requiring that assets be valued based on the method that most accurately reflects fair market value.

In another example, the workpapers supporting the CPA firm's report on the MAPC plan included information about an investment in the Thomas H. Lee Equity Fund IV, LP, valued by the Trustee at $7,733,680, as of 6/30/05, the date of plan termination. The CPA firm's workpapers included a Statement of Partners' Equity showing that the UAL group Investment Trust held partners' equity valued at $8,710,952 as of 6/30/05, an increase in value of $977,272. Nevertheless, the CPA firm's workpapers incorrectly stated, in part "… we were not provided the 6/30/2005 partnership supporting documentation." As a result, the Trustee's valuation was not adjusted and the value of the asset was understated by $977,272 as of the date of plan termination. In a manner similar to the prior example, CPA firm staff had not correctly analyzed supporting documents, with the result that the value of the asset was not adjusted to reflect the $977,272 increase in value.

PBGC reviewers did not identify either of the errors provided as examples. Neither did they find the other instances of similar mistakes that we identified as part of our review. Additionally, as of the date of our exit conference, BAPD officials persisted in their incorrect assertion that "increases and decreases in asset value were proposed for ALL assets [emphasis in original] where evidence (which met the criteria established in the audit program) [20] supported the increase and decrease."

<u>Misidentification of Assets</u>. Many securities have names that seem similar, often representing different investment products offered by a single company. Thus, correct identification of a particular security or fund is critical in correctly establishing its fair market value. Our review found at least 10 instances in which the CPA firm incorrectly traced bond funds to investments with similar names. Surprisingly, some of the same assets were affected as were incorrectly valued as part of the prior IMRG work. The example shown in the following table demonstrates PBGC's recent acceptance of the CPA firm's workpapers with errors in valuing one of the same funds that was incorrectly valued as part of the prior IMRG audit work. It is notable that, despite the apparent large differences in value reflected in workpapers prepared by the two different contractors, OIG's review showed that the trustee's valuation was, indeed, correct. Because neither IMRG nor the CPA firm had attempted to resolve the apparent difference, and because both contractors deferred to the trustee's value, the workpaper errors did not impact the overall valuation of plan assets in this instance. Nevertheless, this demonstrates that neither the work of IMRG nor the work of the CPA firm provided assurance about the accuracy of the value of this $404 million plan asset.

[20] While BAPD referred to an "audit program," the CPA firm was engaged to perform an evaluation, not an audit.

JPMorgan Chase Bank Public Bond Fund	Per IMRG Plan Asset Workpapers	Per April 2011 CPA Firm Valuation Workpapers	Per OIG, Based on JPMorgan Valuation	Per Trustee Statements
Number of Units	20,727,550.54	20,727,550.54	20,727,550.54	20,727,550.54
Net Asset Value per Unit	$19.51	$15.90	$19.51	$19.51
Computed Fair Market Value of Assets as of 6/30/2005	$4,043,945	$329,568,054	$404,394,511	$404,394,511
Apparent Understatement of Value	$400,350,566[21]	$74,826,457[22]		

In the example shown above, the UAL master trust held more than 20 million units in a JPMorgan Chase Bank Public Bond Fund that was part of a commingled pension trust fund. As of the date of plan termination for the MAPC plan, the investment was valued at $404,394,511 by the trustee, based on a net asset value per unit of $19.51. With minimal effort, OIG confirmed the net asset value of JPMorgan Chase Bank Public Bond Fund to be $19.51 per unit and the total value of the asset to be $404,394,511 – the same fair market value assigned by the trustee. According to information provided by JPMorgan, the investment is valued on a daily basis. Though not a publicly-traded bond fund, OIG concluded that investments of this nature should not present significant valuation difficulties for PBGC's contractors.

The workpapers of both of PBGC's contractors, IMRG and the recently hired CPA firm, showed significant errors in the valuation of this relatively easy to value investment.

- OIG's review of IMRG workpapers showed that the contractor obtained the correct unit price and number of shares for the investment, but used a spreadsheet formula that incorrectly divided the result by 100. As a result, IMRG calculated a value that was only 1% of the actual fair market value. The workpapers do not show any effort to resolve this apparent error or include any indication that a calculated difference of more than $400 million should be the subject of further review. Even though such a large difference was documented in their workpapers, PBGC and its audit contractors either ignored the difference or did not understand the calculation.

- OIG's review of the CPA firm's workpapers relating to the same asset showed that the CPA firm traced the investment to an incorrect bond fund. JPMorgan Chase Bank has a number of similarly named commingled pension trust funds. The CPA firm's workpapers incorrectly concluded that the JPMorgan Chase Bank fixed income fund listed by the trustee as "Pub BD FD" was the "Long Duration Public Bond Fund" instead of the similarly named "Public Bond Fund." As a result, workpapers showed a unit value of $15.90 instead of the correct $19.51 –

[21] $404,394,511 - $4,043,945

[22] $404,394,511 -$329,568,054

producing an error of almost $75 million. Workpapers do not show any effort to resolve this apparent error. Further, until OIG brought this error to PBGC's attention, there was no indication that PBGC reviewers had noted the misidentification of this bond fund.

Workpapers supporting each of the four April 2011 CPA firm's valuation reports contained similar errors in which CPA firm staff traced investments to incorrect bond funds and associated prices. Although these mis-identifications occurred in the relevant supporting workpapers for each of the four reports, there was no indication that the PBGC reviewers identified the errors or noted that the work performed provided no assurance about the fair market values of these erroneously identified assets.

Issues Related to the Need to Validate Allocation Percentages

The April 2011 CPA firm's reports and supporting workpapers do not demonstrate performance of a credible validation of the allocation percentages used to divide the plan assets among the four UAL pension plans. The CPA firm performed analytical review procedures including reviewing the master trust agreement, trustee's statements, Forms 5500 and audited financial statements of the plans. PBGC's contracted CPA firm also reconciled assets per the trustee's allocation schedule to assets per the master trust's portfolio statements. These procedures provide some limited assurance about the allocation percentages and are consistent with the technical proposal submitted by the CPA firm and agreed to by PBGC. However, the limited steps taken to validate these key percentages do not go far enough toward meeting the intent of the regulation requiring that fair market value be determined by the method that most accurately reflects such fair market value. PBGC should require its contractors to do more, given the importance of these key percentages.

Validation of allocation percentages is difficult, but important. Each individual plan holds a percentage interest in assets of the trust. Investment earnings are distributed to each plan based on the allocation percentage ownership, which is adjusted by the time-weighted holding period of plan contributions and withdrawals. For those items that are time-weighted, the effective date of the transaction determines the "weight" that the entry carries in the allocation. Transactions that post earlier in the month have a greater impact on the time-weighted percentage than those that post later in the month. We noted that a difference as small as 0.1% can have an impact of more than $6 million on a UAL plan. Given that changes in asset values can affect the benefits of some UAL retirees, the accuracy and precision of allocation percentages are a key element of any plan asset valuation.

The CPA firm's reports provide clear documentation of the limitations on their work to validate the allocation of assets. Procedures that were not performed due to the lack of information include:

- Comparing the unit value of the master trust across the plans to ensure consistency;
- Determining whether the master trust units were properly valued; and
- Reconciling the Forms 5500 to the audited financial statements as of the DOPT.

Other limitations in the work performed to evaluate the allocation percentages occurred because the Form 5500 filings for three of the UAL plans indicate zero ending assets at these periods as the custody of the plans had transferred to PBGC. Additionally, master trust level and plan level reporting for the DOPT was not provided by the trustee, only year-end reporting. The year-end reporting did not include detail sufficient to break out the earnings, fees, and distributions for each period.

PBGC leadership has not yet determined whether the Corporation will undertake additional work to validate allocation percentages. PBGC's BAPD Director prepared a memorandum describing his conclusions with regard to this issue, stating, "I believe that the work that was performed by [CPA firm] appropriately met the objective of the Call Order to „Validate the allocation of assets in the Master Trust to ensure that each plan was allocated the appropriate amount as of DOPT.' … I also took into account fact [sic] that the DOPT date for these plans is 7 plus years old and the availability of data." In responding to a draft of this report, PBGC reported that, based on input from industry experts, PBGC will determine if the work conducted by the independent CPA firm is adequate and, if necessary, will supplement the work performed through some additional substantive testing of the allocation percentages related to the UAL plans.

Overall, we found that PBGC employees charged with review of the CPA firm's April 2011 reports did not perform an effective review of the CPA's reports and supporting workpapers. As a result, PBGC once again accepted and paid for UAL plan asset valuation work that included obvious errors and omissions. These errors and omissions could have been identified if a more critical and professional review had been made of the reports and supporting workpapers.

After we brought examples of the errors and omissions included in the re-valuation work to PBGC's attention, the Corporation issued a request for proposal to the CPA firm, asking that they provide a plan for re-work and a proposed cost for correcting some of the errors and shortcomings that OIG had identified. The CPA firm provided a plan and a bid for the additional work and PBGC advised OIG that a new call order would be issued. OIG then explained that the additional work called for in the new contract vehicle would still not provide necessary assurance about key elements needed to ensure that plan assets are valued at fair market value, in accordance with PBGC's regulations. OIG also noted that much of the "additional work" for which the CPA firm was going to be paid should have been performed as part of the original agreement. Subsequently, PBGC decided to hold the CPA firm accountable for correcting identified errors and omissions.

PBGC has recently implemented a more detailed and in-depth review procedure for re-valuations of UAL and National Steel; if carefully and professionally implemented, the new procedures are likely to result in PBGC conducting a more effective review of future plan asset valuation reports. PBGC's new process includes a three-stage review. In the primary asset valuation report review, BAPD auditors will follow a detailed review program designed to ensure that the contractor's work meets the terms of the contract and all applicable standards. The review program calls for documentation of the review procedures performed, any issues identified by the primary reviewer and the resolution of such issues. After completion of the primary review, BAPD audit managers will perform substantive reviews of the primary reviewer's work. The review program will incorporate documentation of any issues identified by the secondary reviewer and the resolution of such issues. Once the secondary reviewer is satisfied that the work meets contract specifications and applicable standards, a review committee comprising both subject matter experts outside BAPD and BAPD staff unaffiliated with the primary or secondary reviews will perform a substantive review of both the contractor's work product and the primary and secondary reviews of the contractor's work product. The review committee will report to the Deputy Director of Operations. According to PBGC, the contractor's work will not be accepted unless and until all issues identified by the review committee are resolved. PBGC asserts the process is going to be implemented going forward starting with the CPA firm's revised re-valuation. As of September 30, 2011, the CPA firm's revisions to their April 2011 UAL work was undergoing the primary review.

VI. Further Work to Address Flaws in Post-termination Participant Audits

Regarding the various participant data audits, source document audits, and the electronic source document audit, PBGC has reached the conclusion that any further testing of data used to support the benefit calculations for the active and deferred vested participants in the UAL Plans will not provide additional value to the PBGC or the plan participants. The Corporation bases this conclusion on the following:

(1) Prior to termination of the plans, PBGC notes that UAL participants had the opportunity to go online and use UAL's web calculator to review their benefits. The information provided to the participants through this web calculator is the same as the TABS data obtained by PBGC. Any discrepancies in the information would have been communicated by the participant to UAL and would have been validated.

(2) PBGC reports that, shortly after the plans were terminated, a series of participant meetings were held for the various plans. Prior to the meetings, PBGC provided (via mail) to each participant a copy of an estimated benefit statement. Participants were encouraged to bring their statement or contact PBGC if they had any questions regarding the information provided. According to PBGC, this provided the participant with the opportunity to correct any inconsistencies in their data.

(3) As part of the participant data audits, BAPD provided a detailed write-up on the TABS system and why the TPD relied so heavily on the electronic data.

(4) BAPD has issued more than 95% of the benefit determinations associated with these plans. PBGC asserts that, based on data from the Appeals Division, very few requests for data corrections have been received from participants.

(5) As for the deferred vested and active participants, when they go into pay status, PBGC notes that there is an opportunity for their information to be "trued-up."

(6) PBGC leadership asserts that there is no reason to believe that the TABS system was not reliable, based on a thorough write-up of how the TABS data was collected by PBGC.

Based on the passage of years since the completion of the various participant data, source document, and electronic source document audits for the UAL plans, OIG concurred with PBGC's conclusion regarding further testing of data used to support the benefit calculations for the active and deferred vested participants in the UAL plans. As part of the ongoing strategic review, PBGC should ensure careful consideration of the various activities performed as part of the participant data, source document, and electronic source document audits with a focus on determining whether the current practices add value for the Corporation or for the participants.

Recommendations

Recommendation No. 1. **(OIG Control No. PBGC-06)**

Ensure that PBGC policies, procedures, and protocols consistently require plan assets to be valued based on the method that most accurately reflects fair market value.

PBGC Response:

BAPD plan asset procedures clearly indicate that plan assets are to be valued at Fair Market Value.

OIG Evaluation:

PBGC's response does not address our recommendation. While PBGC regulations require using the method that most accurately reflects fair market value, our review found that neither BAPD's plan asset procedures nor PBGC's established practices specifically address the need to ensure that the method of valuation chosen for determining fair market value is the method that most accurately reflects such value. As described in this report, PBGC has historically used methods of determining fair market value that do not provide the most accurate reflection of that value, as in the agreement with the CPA firm.

To achieve an agreed-to management decision for this recommendation, PBGC should revise its policies, procedures, and protocols to reflect the requirement that fair market value be determined using the method that most accurately reflects such value and provide details of how management will ensure consistent implementation of the regulatory requirement.

Recommendation No. 2 (OIG Control No. PBGC-07)

For plan asset audits or valuations of very large plans, plans with significant valuation challenges, and plans where error rates exceed allowable thresholds, ensure that a member of senior leadership with an understanding of asset valuation issues is briefed on audit or valuation results and documents concurrence in deviations, if any, from established protocols.

PBGC Response:

BAPD under the direction of the DDO will establish a process in which large plan asset evaluations or plans with significant plan asset valuation challenges are vetted through senior leadership for concurrence. BAPD will update its manual to reflect this new process.

OIG Evaluation:

OIG concurs with the management response.

Recommendation No. 3 (OIG Control No. PBGC-08)

Clarify BAPD procedures to require documentation of the resolution of variances identified as part of plan asset valuations and post-termination participant audits.

PBGC Response:

BAPD will update its procedures manual to properly reflect the requirement for documentation to support the resolution of variances found in the plan asset evaluations and the participant data reviews.

OIG Evaluation:

OIG concurs with the management response.

Recommendation No. 4 (OIG Control No. PBGC-09)

Develop specific procedures for the audit or validation of allocation percentages, when plan assets are held in a master trust or otherwise commingled. Ensure that the procedures produce sufficient, competent, and reliable evidence of the accuracy of allocation percentages.

PBGC Response:

BAPD currently has procedures in its manual that address how to audit the allocation of assets in a plan that is in a Master Trust. The procedures outlined are reflective of those prescribed by the AICPA (American Institute of Certified Public Accountants) for Auditing Employee Benefit Plans. In consultation with others outside of PBGC, BAPD will evaluate the existing procedures and make adjustments to ensure that the procedures meet PBGC's need to provide a high level of confidence that the allocation of assets is appropriate and accurate.

OIG Evaluation:

It is unclear how the Corporation will evaluate and make adjustments to the recently established protocols and procedures for the allocation of assets. Additional detail about the Corporation's approach is needed for us to determine whether we can agree with PBGC's management decision.

Recommendation No. 5 (OIG Control No. PBGC-010)

Develop procedures to be followed in the event that a plan sponsor denies access to records. These procedures should include requirements that the denial of access be documented and that the General Counsel be consulted concerning the need for a subpoena or other action.

PBGC Response:

BAPD will update appropriate sections of its procedures manual to identify the specific steps that are needed when plan sponsors or other parties deny access to records pertaining to PBGC's trusteeship of their plan(s), and will have these updates reviewed by the Office of the General Counsel. BAPD will obtain legal assistance to subpoena records where needed.

OIG Evaluation:

OIG concurs with the management response.

Recommendation No. 6 (OIG Control No. PBGC-11)

Clarify BAPD procedures and establish controls to ensure that conclusions are not based on non-representative samples.

PBGC Response:

BAPD will update its procedure manual and sampling methodology to ensure that sample data tested in the participant data reviews are representative of the population of participants tested to ensure that the proper conclusions are reached. This will also be added to the Audit Technical Reviewers' Checklist as an element to check during their review of the work.

OIG Evaluation:

OIG concurs with the management response.

Recommendation No. 7 (OIG Control No. PBGC-12)

Ensure that PBGC employees and contract personnel who conduct and review post-termination audits and evaluations have the necessary knowledge, skills, and abilities by requiring continuing professional education and that at least some team leaders and managers have enhanced qualifications, such as a CPA designation or credible audit experience gained outside of BAPD.

PBGC Response:

As one of BAPD's FY 2012 goals for its Audit Program, more emphasis will be placed on developing the core competencies for its audit staff. To address this issue, BAPD has worked with an outside consultant to develop core competencies for auditors at various grades that are in line with the OPM requirements. As part of BAPD's Strategic Review, BAPD's management has identified a number of competency gaps in the audit staff. BAPD, in coordination with HRD will develop training to address these deficiencies. BAPD will also implement and track continuing education requirements for its audit staff. BAPD is committed to encouraging its audit staff to acquire professional designations such as a CPA, CIA, etc. As BAPD seeks to fill some management positions, it will look to candidates with audit experience outside of BAPD and professional designations. Currently, BAPD has openings for staff auditors and is actively seeking to fill some of these positions at the mid-career level with candidates with outside experience and professional designations.

OIG Evaluation:

We do not concur with PBGC's management decision for this recommendation. While PBGC's response is positive, it does not include a commitment to require continuing professional education for PBGC employees and contractor personnel who conduct and review post-termination audits and evaluations. Instead, the response addresses only "audit staff" and does not include the other PBGC employees and managers with audit related responsibilities. Further, we requested BAPD's FY 2012 goals for its audit program and noted that the goals do not directly address developing core competencies. Concerning the work performed by the outside consultant, we noted that it was not performed to address the finding in this report as the consultant's final report was issued in May 2010.

Recommendation No. 8 (OIG Control No. PBGC-13)

Develop a quality event tracking tool to address the risk that training needs are being overlooked, system issues are undocumented or unaddressed, and that performance issues are unaddressed. The tool should include a statement of the issue, population affected, root cause analysis of why the error or issue occurred, event resolution, and appropriate remedial action to limit or reduce recurrence of the event.

PBGC Response:

PBGC agrees and will create a process and related tool to evaluate quality issues and if determined to be of a systematic nature (i.e., that it is not linked to a specific individual's performance, but rather to a process, system, or general training weakness), we will capture the quality issue, determine the root cause, identify an owner, develop a corrective action plan, monitor the plan until completion, and validate the plan's instantiation. We have created and hired for each TPD a new position of Audit Technical Reviewer; this was put in place in December 2010. The duties of the position include identifying training needs and auditor adherence to procedures. PBGC has implemented a Process and Product Quality Assurance (PPQA) program during the past fiscal year over the audit activities.

OIG Evaluation:

PBGC's response does not provide enough information about the PPQA tool to allow us to determine whether we can agree to PBGC's management decision. In order for OIG to make a determination, we need details concerning the proposed process and PPQA tool.

Recommendation No. 9 (OIG Control No. PBGC-14)

Elevate the compliance function for post-termination audits and evaluations to promote objectivity and provide a greater emphasis on compliance with standards and audit/evaluation quality. The unit's organizational placement should encourage independence of thought and action for the compliance unit; until quality issues in BAPD have been resolved, the compliance function should report directly to the highest levels of PBGC management.

PBGC Response:

PBGC Management is committed to the quality of the post-termination audit/review work conducted by BAPD. As such, organizational placement of the compliance/quality assurance reviews will be addressed as part of BAPD's Strategic Review. In the interim, we have developed the PPQA Program which evaluates BAPD's compliance with procedures in both the Plan Asset Evaluation and the Participant Data Reviews. PPQA is housed in the Business Process Management Unit, which reports directly to the DDO outside of BAPD. Additionally, we will capture interim remediation measures as appropriate.

OIG Evaluation:

PBGC's interim actions are positive. However, the final placement and operation of the quality control process is dependent upon the ongoing BAPD Strategic Review. Accordingly PBGC management has not made final decisions about the quality control process. In order for OIG to make a determination, we need details of the PBGC management decisions made based on the BAPD Strategic Review

Recommendation No. 10 (OIG Control No. PBGC-15)

For UAL plan asset valuations, value plan assets at fair market value based on the method that most accurately reflects the fair market value. For assets where the only evidence of fair market value is the trustee's valuation, document the efforts to obtain an alternative or independent source for the value.

PBGC Response:

To ensure that assets are valued in a manner that most accurately reflects fair market value, BAPD will supplement the independent CPAs work by contacting investment managers and others to obtain additional pricing data for securities in which the CPA relied solely on the Trustee values. Efforts to obtain additional information will be documented.

OIG Evaluation:

OIG concurs with the management response.

Recommendation No. 11 (OIG Control No. PBGC-16)

For UAL plan asset valuations, adjust the value of plan assets for increases and decreases in value, even in instances where those increases and decreases do not meet the arbitrary 10% threshold.

PBGC Response:

PBGC acknowledges that the method, in which the contractor applied the thresholds, as a means of recommending adjustments to the plan asset values, produced a result that was inconsistent with PBGC's regulation. PBGC will make the necessary adjustments to reflect the fair market value as of the date of plan termination.

In order to comply with the fair market value requirement in PBGC's regulation, PBGC will to develop a policy approved by PBGC's Director to address the use of thresholds. The use of thresholds will serve as a basis for determining when additional investigation will be needed to validate pricing differences between values reported by the prior plan Trustees and the independent pricing obtained through Bllomberg or some other source. For securities that are publicly traded, thresholds will not apply, since these should be exact with the exception of rounding differences. However, because non-public securities are not exact, established thresholds shall be applied. Variances in prices outside the established thresholds will be investigated and documented. PBGC believes that the application of thresholds will not be inconsistent with the requirement to apply "the fair market value, based on a method of valuation that most accurately reflects such fair market value".

OIG Evaluation:

The PBGC response states a policy regarding the use of thresholds will be developed. However, no details regarding the policy were provided and OIG has insufficient information to assess the sufficiency of the PBGC management decision. Additional detail about the Corporation's approach will allow us to determine whether we can agree with the management decision.

Recommendation No. 12 (OIG Control No. PBGC-17)

For UAL plan asset valuations, ensure that the Ground Employees plan is treated consistently with the other UAL plans and receive the benefit of increases in asset value by developing and implementing a method to estimate or interpolate more accurate values for partnership assets as of 3/11/05.

PBGC Response:

PBGC is in the process of developing a methodology that will to apply alternative investments in plans where the DOPT falls between pricing periods for the security. This methodology will be applied to the Ground Plan to more accurately reflect the value of the partnerships as of the plan's DOPT of March 11, 2005.

OIG Evaluation:

OIG concurs with the management response.

Recommendation No. 13 (OIG Control No. PBGC-18)

For UAL plan asset valuations, carefully review the CPA firm's workpapers and require necessary adjustments.

PBGC Response:

PBGC has implemented a three-tier review process for UAL that will ensure that work submitted by the CPA Firm is adequately reviewed and the proper adjustments to asset valuation amounts are made. PBGC will assess the process and make adjustments as needed.

OIG Evaluation:

OIG concurs with the management response.

Recommendation No. 14 (OIG Control No. PBGC-19)

For UAL plan asset valuations, consult with industry experts to determine how to obtain sufficient, competent and reliable evidence about the accuracy of allocation percentages when they have been determined using a time-weighted methodology.

PBGC Response:

PBGC is in initial conversations with two large independent CPA firms (which were not involved with the UAL plan asset evaluation), and we are also reaching out to DOL/EBSA, to determine appropriate audit steps that should be applied to plans in which a time-weighted allocation methodology is used. PBGC management will then determine the appropriate action based on this input. BAPD will update its procedures to reflect recommendations made.

OIG Evaluation:

OIG concurs with the management response.

Recommendation No. 15 (OIG Control No. PBGC-20)

As part of the on-going strategic review, develop and implement processes to ensure that post-termination participant audits are done in accordance with applicable standards and in a manner that provides the appropriate level of assurance.

PBGC Response:

PBGC Management is committed to the quality of its post termination review work. Management will ensure that the Strategic Review addresses process issues surrounding the participant data reviews.

OIG Evaluation:

OIG concurs with the management response.

Appendix A – Scope and Methodology

The Office of Inspector General received a request from then Chairman George Miller of the House Committee on Education and Labor requesting that OIG review the circumstances surrounding the PBGC's handling of the termination of United Airlines pension plans. The Chairman requested that OIG (1) determine whether worker and retiree interests were protected to the extent practical and (2) verify that PBGC properly executed its own protocols and that those protocols remain sufficient to protect the interests of current and future beneficiaries. In an effort to address this area of concern, the OIG reviewed selected aspects of PBGC's benefit termination process for terminated UAL plans.

Fieldwork for this evaluation was performed from August 2010 through November 2011. The evaluation was conducted in accordance with the *Quality Standards for Inspections* established by the Council of the Inspectors General on Integrity and Efficiency, as well as applicable OIG policies and procedures. These standards require that we plan and perform the evaluation to obtain sufficient, competent, and relevant evidence to provide a reasonable basis for our conclusions based on our evaluation objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our evaluation objectives.

To achieve our evaluation objectives, we performed a detailed review of the plan asset, participant data, source document, and electronic source document audits of the four terminated United Airlines pension plans. These audits were conducted by audit contractors, under PBGC oversight, and were intended, collectively, to determine the fair market value of plan assets of each of the plans at the date of plan termination and to ensure the reliability of the participants' records obtained to calculate participants' benefits. In addition to performing a detailed review of the issued plan asset and participant data audit reports and supporting workpapers and attachments, the OIG evaluation team:

1.) Identified and analyzed the laws, regulations, professional standards (including Government Auditing Standards and standards promulgated by the AICPA), and PBGC policy and guidance applicable to the post-termination audit process and to oversight of contractors.

2.) Obtained and analyzed PBGC's contract with IMRG for audit services to be provided between 2002 and 2008, as well as key documentation, progress reports, and other correspondence and documentation pertaining to the conduct of the United Airlines post-termination audits.

3.) Obtained and analyzed PBGC's agreement (call order) with the CPA firm for re-valuation work, as well as key documentation, progress reports, minutes of progress meetings, and other correspondence and documentation pertaining to the conduct of the April 2011 UAL valuation reports.

4.) Interviewed the BAPD Director, BAPD Deputy Director, various BAPD managers, the COTRs as of the date of contract closeout , various PBGC personnel, IMRG leadership and staff, and partners and staff of the CPA firm.

5.) Performed evaluation work at IMRG offices to obtain the contractor's perspective on the conduct of the United Airlines audits as well as other audit work performed under the auditing services contract, and evaluated the contractor's processes for ensuring that work was consistent with Government Auditing Standards.

6.) Reviewed and evaluated trustee statements, to the extent available, to identify assets or income that may have been omitted from the plan asset audit and to identify unusual transactions, if any.

7.) Conducted detailed testing of the IMRG's workpapers supporting post-termination audits, with emphasis on tests of completeness and valuation. We recalculated spreadsheets, tested equity and fixed income valuations against publicly available sources such as Yahoo! Finance, and compared the inventory of plan assets to other available information including Forms 5500.

8) Performed detail testing of CPA firm's workpapers supporting the re-valuation of plan assets, with emphasis on the asset value, completeness testing and asset allocation.

9.) Reviewed previously issued OIG Audit Reports Number 2007-8/CA-0033-1 and 2008-4/CA-0033-2, *Report for Costs Incurred by IMRG under Contract PBGC01-CT-03-0652 for Fiscal Years ended September 30, 2003, 2004, 2005, and 200,6* and *Report on PBGC's Contract Administration of the IMRG Contract CT-03-0652*, respectively. These audits had been performed to evaluate IMRG's compliance with selected contract terms and to assess PBGC's oversight of IMRG. Our current review placed special emphasis on the open audit recommendations where PBGC has yet to implement corrective action.

10.) Reviewed a report commissioned by PBGC and performed by the Hewitt Corporation to evaluate BAPD's post-trusteeship activities, including the plan asset audit process. Additionally, we requested PBGC to provide the status of actions taken to address recommendations included in the Hewitt report. We adapted some of the Hewitt recommendations for use in this report.

Our evaluation was limited in several ways due to PBGC's failure to maintain important information about the UAL post-termination audits. Additionally, the TPD auditor, the COTR, and the Contracting Officer each failed to maintain complete records of contract oversight for the IMRG contract, impeding our ability to determine exactly why PBGC accepted and issued the various flawed audit reports. In some instances, we used information obtained directly from IMRG.

An additional scope limitation occurred because we were unable to corroborate PBGC's assertion, repeated in several different audit reports, that UAL had denied PBGC's request to review personnel records for its active and separated vested participants. The only available support for the assertion was a one paragraph memo signed by a PBGC manager. Because he asserted that he did not remember details surrounding the denial of access, we were unable to gain assurance about the circumstances of the purported denial of records.

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

November 23, 2011

To: Rebecca Anne Batts
Inspector General

From: Vincent K. Snowbarger
Deputy Director for Operations

Subject: **2007 and 2008 Asset and Participant Data Audits for United Airlines**

Four United Airlines (UAL) Pension Plans terminated some five to six years ago during United's bankruptcy, affecting the lives of many of the 126,000 participants and their families. As a result of the termination, PBGC assumed responsibility for the plans and began paying benefits. To do this, PBGC took over both the assets and liabilities associated with the Plans. Part of PBGC's task in the termination process is to perform a number of reviews, including: (1) ensure that participants are properly accounted for; and (2) ensure that all plan assets have been identified, valued, and allocated to the appropriate plans.

A primary finding of your report was that the original plan asset audits performed by PBGC's contractor were poor, and that PBGC failed to correct, or even to detect, that. We have recognized the correctness of these findings, which confirm your earlier work beginning in 2010, for over a year.

Since that time, we have been working on a number of fronts to establish procedures to correct or avoid similar mistakes. First, we are conducting a review of the plan asset evaluation for the various plans, including the UAL Plans, which has been contracted out to independent CPA firms. Second, within PBGC, we implemented a three-tier review of this work, to ensure the completed work is both accurate and complete. And finally, we initiated a Strategic Review of BAPD operations and procedures to identify any structural problems and to address noted deficiencies. All of this work is ongoing[1].

We generally agree with the recommendations in the report[2]. We have already implemented some, have begun implementing others, and will develop and implement a Corrective Action Plan for the remainder.

PBGC's mission -- to provide security to those whose pensions have ended -- is one we take seriously. We have acknowledged our mistakes in UAL and, as you acknowledge in your report, are currently in the

[1] The OIG report notes that "PBGC's corrective action…efforts to date have not yet been effective in providing a reasonable level of assurance about the value of plan assets." We appreciate the benefits of ongoing OIG review but believe the right time to judge the effectiveness of these processes is when they have been completed.

[2] There are some assertions in the report with which we do not agree. We do not agree with statements attributed to the contractor, IMRG, in the report or believe the statement claiming that BAPD's leaders were not aware of the regulatory requirement to value plan assets at fair market value is accurate.

process of correcting them. Our review work may or may not lead to changes in the results of the initial work and these, in turn, may or may not have affected anyone's benefits. Because the review of the work at this stage does not reflect the outcome of the corrective actions put in place, it is too early to know the final result -- which in the end is what matters to our beneficiaries.

We do wish to caution the readers of the report not to presume that lack of documented reviews means that any assets are actually missing from the UAL Plans. All of the required procedures are being performed, and PBGC will not approve a final asset evaluation until we are confident that we have accounted for all assets appropriately.

Once that is accomplished, we will find and correct any errors. **If people have been underpaid, we will correct the error and pay the overdue amount with interest and an apology.** If they have been overpaid, we will adjust their payments gradually, without either interest or penalty.

Current Evaluation of Assets for United Airlines Plans

PBGC has contracted with an independent CPA Firm to perform an evaluation of the assets in the UAL Plans. Although the Office of Inspector General identified deficiencies in the initial submission of the work, the CPA Firm has committed to provide PBGC and its participants with a work product follows our procedures and meets our standards. A submission of the most recent contractor work is currently undergoing the three-tier review described below. The results of this work will enable us to determine whether any of the 126,000 participants in the UAL Plans received more or less than the benefits to which they are entitled.

Three-Tier Review Process

PBGC has recently implemented a three-tier review process to ensure the accuracy and quality of the UAL Plan Asset Evaluation submitted by the independent CPA Firm. This three-tier process includes a primary review by members of BAPD who were not associated with the original UAL Plan Asset Audits, a secondary management level review, and a third level review conducted by a committee consisting of professionals from both within and outside of BAPD. The review committee reports directly to me, and I will make the final decision as to the completeness and accuracy of the submitted contractor work. In addition, as you will see from our responses to the recommendations in Appendix I, we have now responded to the open issues identified in your report, such as the use of thresholds, which will ensure that our review process is robust.

Strategic Review of BAPD operations and procedures

Several months ago, the Director of PBGC-assigned me to conduct a top to bottom Strategic Review of BAPD's organization with the goal of deciding what changes are necessary. The Strategic Review is currently underway and recommendations are being developed by me and vetted with PBGC's executive leadership. Decisions regarding what changes to make in process, personnel, and organization will be made by the Director. The implementation of these decisions will be carried out over the next several years.

Did these Mistakes Change Anyone's PBGC Benefits?

There is no question that the plan asset and participant data audit work done in 2007-2008 did not meet acceptable quality and documentation standards. Nonetheless, for most people in the UAL Plans, the amount of plan assets received by PBGC has no effect on the benefits they receive from PBGC. Any increase in assets will not affect anyone who is already receiving their full plan benefit.

Who Might Get a Higher Benefit? Generally, participants who have a chance of receiving additional benefits if we find that there are additional assets are those who retired or could have retired three years before their plan's termination date and whose benefits are above the amount that PBGC can guarantee. This is because these participants are given priority treatment in the allocation of plan assets under ERISA. When this category of benefits is satisfied, the next priority goes to guaranteed benefits; which, due to the high level of underfunding in the UAL plans, is unlikely to be fully satisfied. In the UAL Plans, the largest changes to any benefit amounts are limited to the Pilots; due to the way the asset allocation operates, we do not expect more than minimal changes to the benefits of other participants.

Appendix I: Specific Responses to Individual OIG Recommendations

PBGC has implemented or will implement each of your specific recommendations as described below.

OIG Recommendation 1

Ensure that PBGC policies, procedures, and protocols consistently require plan assets to be valued based on the method that most accurately reflects fair market value.

PBGC Response:

BAPD plan asset procedures clearly indicate that the plan assets are to be valued at Fair Market Value.

OIG Recommendation 2

For plan asset audits or valuations of very large plans, plans with significant valuation challenges, and plans where error rates exceed allowable thresholds, ensure that a member of senior leadership with an understanding of asset valuation issues is briefed on audit or valuation results and documents concurrence in deviations, if any, from established protocols.

PBGC Response

BAPD under the direction of the DDO will establish a process in which large plan asset evaluations or plans with significant plan asset valuation challenges are vetted through senior leadership for concurrence. BAPD will update its manual to reflect this new process.

OIG Recommendation 3

Clarify BAPD procedures to require documentation of the resolution of variances identified as part of plan asset valuations and post-termination participant audits.

PBGC Response

BAPD will update its procedures manual to properly reflect the requirement for documentation to support the resolution of variances found in the plan asset evaluations and the participant data reviews.

OIG Recommendation 4

Develop specific procedures for the audit or validation of allocation percentages, when plan assets are held in a master trust or otherwise commingled. Ensure that the procedures produce sufficient, competent, and reliable evidence of the accuracy of allocation percentages.

PBGC Response

BAPD currently has procedures in its manual that address how to audit the allocation of assets in a plan that is in a Master Trust. The procedures outlined are reflective of those prescribed by the AICPA (American Institute of Certified Public Accountants) for Auditing Employee Benefit Plans. In consultation with others outside of PBGC, BAPD will evaluate the existing procedures and make adjustments to ensure that the procedures meet PBGC's need to provide a high level of confidence that the allocation of assets is appropriate and accurate.

OIG Recommendation 5

Develop procedures to be followed in the event that a plan sponsor denies access to records. These procedures should include requirements that the denial of access be documented and that the General Counsel be consulted concerning the need for a subpoena or other action.

PBGC Response

BAPD will update appropriate sections of its procedures manual to identify the specific steps that are needed when plan sponsors or other parties deny access to records pertaining to PBGC's trusteeship of their plan(s), and will have these updates reviewed by the Office of the General Counsel. BAPD will obtain legal assistance to subpoena records where needed.

OIG Recommendation 6

Clarify BAPD procedures and establish controls to ensure that conclusions are not based on non-representative samples.

PBGC Response

BAPD will update its procedure manual and sampling methodology to ensure that sample data tested in the participant data reviews are representative of the population of participants tested to ensure that the proper conclusions are reached. This will also be added to the Audit Technical Reviewers' Checklist as an element to check during their review of the work.

OIG Recommendation 7

Ensure that PBGC employees and contract personnel who conduct and review post-termination audits and evaluations have the necessary knowledge, skills, and abilities by requiring continuing professional education and that at least some team leaders and managers have enhanced qualifications, such as a CPA designation or credible audit experience gained outside of BAPD.

PBGC Response

As one of BAPD's FY 2012 goals for its Audit Program, more emphasis will be placed on developing the core competencies for its audit staff. To address this issue, BAPD has worked with an outside consultant to develop core competencies for auditors at various grades that are in line with the OPM requirements. As part of BAPD's Strategic Review, BAPD Management has identified a number of competency gaps in the audit staff. BAPD, in coordination with HRD will develop training to address these deficiencies. BAPD will also implement and track continuing education requirements for its audit staff. BAPD is committed to encouraging its audit staff to acquire professional designations such as CPA, CIA, etc. As BAPD seeks to fill some management positions, it will look to candidates with audit experience outside of BAPD and professional designations. Currently, BAPD has openings for staff auditors and is actively seeking to fill some of these positions at the mid-career level with candidates with outside experience and professional designations.

OIG Recommendation 8

Develop a quality event tracking tool to address the risk that training needs are being overlooked, system issues are undocumented or unaddressed, and that performance issues are unaddressed. The tool should include a statement of the issue, population affected, root cause analysis of why the error or issue occurred, event resolution, and appropriate remedial action to limit or reduce recurrence of the event.

PBGC Response:

PBGC agrees and will create a process and related tool to evaluate quality issues and if determined to be of a systematic nature (i.e., that it is not linked to a specific individual's performance, but rather to a process, system, or general training weakness), we will capture the quality issue, determine the root cause, identify an owner, develop a corrective action plan, monitor the plan until completion, and validate the plan's instantiation. We have created and hired for each TPD a new position of Audit Technical Reviewer; this was put in place in December 2010. The duties of the position include identifying training needs and auditor adherence to procedures. PBGC has implemented a Process and Product Quality Assurance (PPQA) program during the past fiscal year over the audit activities.

OIG Recommendation 9

Elevate the compliance function for post-termination audits and evaluations to promote objectivity and provide a greater emphasis on compliance with standards and audit/evaluation quality. The unit's organizational placement should encourage independence of thought and action for the compliance unit; until quality issues in BAPD have been resolved, the compliance function should report directly to the highest levels of PBGC management.

PBGC Response

PBGC Management is committed to the quality of the post-termination audit/review work conducted by BAPD. As such, organizational placement of the compliance /quality assurance reviews will be addressed as part of BAPD's Strategic Review. In the interim we have developed the PPQA Program which evaluates BAPD's compliance with procedures in both the Plan Asset Evaluation and the Participant Data Reviews. PPQA is housed in the Business Process Management Unit which reports directly to the DDO outside of BAPD. Additionally, we will capture interim remediation measures as appropriate.

OIG Recommendation 10

For UAL plan asset valuations, value plan assets at fair market value based on the method that most accurately reflects the fair market value. For assets where the only evidence of fair market value is the trustee's valuation, document the efforts to obtain an alternative or independent source for the value.

PBGC Response

To ensure that assets are valued in a manner that most accurately reflects fair market value, BAPD will supplement the independent CPAs work, by contacting investment managers and others to obtain additional pricing data for securities in which the CPA relied solely on the Trustee values. Efforts to obtain additional information will be documented.

OIG Recommendation 11

For UAL plan asset valuations, adjust the value of plan assets for increases and decreases in value, even in instances where those increases and decreases do not meet the arbitrary 10 percent threshold.

PBGC Response

PBGC acknowledges that the method, in which the contractor applied the thresholds, as a means of recommending adjustments to the plan asset values, produced a result that was inconsistent with PBGC's regulation. PBGC will make the necessary adjustments to reflect the fair market value as of the date of plan termination.

In order to comply with the fair market value requirement in PBGC's regulation, PBGC will look to develop a policy approved by PBGC's Director to address the use of thresholds. The use of thresholds will serve as a basis for determining when additional investigation will be needed to validate pricing differences between values reported by the prior plan Trustees and the independent pricing obtained through Bloomberg or some other source. For securities that are publicly traded, thresholds will not apply, since these should be exact with the exception of rounding differences. However, because non-public securities are not exact, established thresholds shall be applied. Variances in prices outside the established thresholds will be investigated and documented. PBGC believes that the application of thresholds will not be inconsistent with the requirement to apply "the fair market value, based on a method of valuation that most accurately reflects such fair market value".

OIG Recommendation 12

For UAL plan asset valuations, ensure that the Ground Employees are treated consistently with the other UAL plans and receive the benefit of increases in asset value by developing and implementing a method to estimate or interpolate more accurate values for partnership assets as of 3/11/05.

PBGC Response

PBGC is in the process of developing a methodology that will to apply to alternative investments in plans where the DOPT falls between pricing periods for the security. This methodology will be applied to the Ground Plan to more accurately reflect the value of the partnerships as of the plan's DOPT of March 11, 2005.

OIG Recommendation 13

For UAL plan asset valuations, carefully review the CPA firm's workpapers and require necessary adjustments.

PBGC Response

PBGC has implemented a three-tier review process for UAL that will ensure that work submitted by the CPA Firm is adequately reviewed and the proper adjustments to asset valuation amounts are made. PBGC will assess the process and make adjustments as needed.

OIG Recommendation 14

For UAL plan asset valuations, consult with industry experts to determine how to obtain sufficient, competent and reliable evidence about the accuracy of allocation percentages when they have been determined using a time-weighted methodology.

PBGC Response

PBGC is in initial conversations with two large independent CPA firms (which were not involved with the UAL plan asset evaluation), and we are also reaching out to DOL/EBSA to determine appropriate audit steps that should be applied to plans in which a time-weighted allocation methodology is used. PBGC management will then determine the appropriate action based on this input. At this point we are very early in the discussion phase; no recommendations or decisions have been made. Once decisions are made by PBGC Management, we will determine if the work conducted by the independent CPA firm is adequate or if additional work is necessary. BAPD will update its procedures once decisions are made.

OIG Recommendation 15

As part of the on-going Strategic Review, develop and implement processes to ensure that post-termination participant audits are done in accordance with applicable standards and in a manner that provides the appropriate level of assurance.

PBGC Response

PBGC Management is committed to the quality of its post termination review work. Management will ensure that the Strategic Review addresses process issues surrounding the participant data reviews.

Appendix C – Summary of Monetary Results

	Schedule of Monetary Results	
Funds expended on audit services not performed consistent with contract terms requiring that audits be consistent with Government Auditing Standards	$26,008,959.11	Funds to Be Put to Better Use

Appendix D – Abbreviations

AICPA..American Institute of Certified Public Accountants

BAPD...Benefits Administration and Payment Department

CPA..Certified Public Accountant

ERISA...Employee Retirement Income Security Act of 1974

Flight Attendants.....................................Flight Attendant Defined Benefit Pension Plan

Ground Employees..Ground Employees Retirement Plan

IMRG……………………...………………...…..Integrated Management Resources Group

MAPC…Management, Administrative, and Public Contact Defined Benefit Pension Plan

OIG...Office of Inspector General

PBGC..Pension Benefit Guaranty Corporation

Pilots...United Airlines Pilot Benefit Pension Plan

QDRO...Qualified Domestic Relation Order

TABS..Total Benefits Administration System

UAL...United Airlines

If you want to report or discuss confidentially any instance of misconduct, fraud, waste, abuse, or mismanagement, please contact the Office of Inspector General.

Telephone:
The Inspector General's HOTLINE
1-800-303-9737

The deaf or hard of hearing, dial FRS (800) 877-8339 and give the Hotline number to the relay operator.

Web:
http://oig.pbgc.gov/investigation/details.html

Or Write:
Pension Benefit Guaranty Corporation
Office of Inspector General
PO Box 34177
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