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GAO

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

Human Resources Division

146226

March 23, 1992

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

This responds to your request for information about the accuracy of premiums paid by pension plans to the Pension Benefit Guaranty Corporation (PBGC). On December 13, 1991, we briefed your office on the General Accounting Office's premium-related work. Our premium-accuracy work is part of a series of studies we are performing on PBGC's premium collection program.

The Employee Retirement Income Security Act of 1974 (ERISA), as amended, requires defined benefit pension plans to pay annual premiums to PBGC which insures the benefits of plan participants. Plans pay a fixed premium for each participant. Plans may also pay a variable premium if they are underfunded--their current liabilities for immediate and deferred nonforfeitable benefits exceed the actuarial value of their assets.

We assessed the accuracy of the 1990 plan year premiums paid by 24 single-employer pension plans located in the Dallas/Fort Worth area. We calculated each plan's premium, using PBGC's rules and information provided by the plans. Our plan selection included 13 that paid both fixed and variable premiums and 11 that paid a fixed premium only; it excluded plans (1) with less than 25 participants, (2) with plan year starting dates other than January 1, 1990, or (3) in litigation. The results of our work are not projectable. (See enclosure I for details about our scope and methodology.)

RESULTS OF SMALL SAMPLE ANALYSES

Though the error rate was high--13 of the 24 plans made premium calculation errors--most errors were small. About

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three-fourths of the errors were less than $100. Moreover, revenue losses to PBGC were negligible; plans underpaid $1,049, or less than one percent of the total 1990 premiums paid by the 24 plans. There were several reasons for errors, most of which involved calculations of variable premiums by underfunded pension plans--12 of the 15 errors involved the variable premium.

BACKGROUND

The federal pension benefit guaranty program, established by ERISA in 1974, guarantees private pensions of more than 40 million Americans in about 85,000 private defined benefit pension plans--plans that pay specific retirement benefits based on years of service, earnings, or both. Premiums are the PBGC's primary source of revenue used to pay operating expenses, such as benefits for participants in PBGC administered plans that terminated with insufficient funds. For 1990, PBGC received $680 million in premiums--$659 million from single-employer plans and $21 million from multiemployer plans[1].

For 1990, the fixed premium for a single-employer, defined benefit pension plan was $16 per participant. The variable premium was $6 for every $1,000 of unfunded vested benefits, up to $34 per participant; this premium was established in 1988 so underfunded plans, which increase PBGC's potential liability, pay their fair share. Some plans, however, were exempt from the variable premium.

In January 1991, PBGC's Inspector General issued an audit report which identified weaknesses in PBGC's premium program, including the inability to identify and collect premiums. The report noted that PBGC could be losing premium income due to program weaknesses. Subsequently, your office asked us to look at PBGC's program.

PROPORTIONALLY SMALL LOSSES TO PBGC

Lost premium revenue to PBGC was negligible because premium calculation errors were small, as shown in Table 1. In addition, some errors benefitted PBGC.

[1]Multiemployer plans are those involving more than one employer and maintained pursuant to collective bargaining agreements. For 1990, such plans paid fixed premiums of $2.60 for each participant and no variable premium.

Table 1: Magnitude of Premium Errors

Size of Error	Number of Errors Resulting in PBGC Losses	Gains	Total	Net Gain (Loss)
Under $10	5	1	6	$ (6)
$11-$99	3	2	5	82
$100 or more	3	1	4	(1,125)
Total	11	4	15	$ (1,049)

Thirteen plans made a total of 15 errors; two plans made multiple errors. As table 1 shows, 11 errors resulted in losses to PBGC and 4 resulted in gains. Underpayment errors ranged from less than $1 to $1,110, and overpayment errors ranged from less than $6 to $580. The net result was an underpayment of $1,049, or .26 percent of the $411,359 in premiums paid by the 24 plans.

MOST PREMIUM ERRORS INVOLVED VARIABLE PREMIUM

As shown in table 2, errors occurred for a number of reasons and usually involved variable premium calculations. Most of the plans in our sample that paid a variable premium made at least one error resulting in an erroneous premium payment.

Table 2: Types and Frequency of Errors

TYPES OF ERRORS	FREQUENCY
Variable Premium Calculations	
Did not update unfunded vested benefits	1
Used wrong retirement age to calculate vested benefits	1
Did not use available exemption	1
Failed to include contribution in assets	1
Used wrong interest rate to discount contributions	3
Rounded improperly	5
Fixed Premium Calculations	
Undercounted participants	3
Total	15

The largest error--$1,110--involved a plan that did not update unfunded vested benefits from the beginning to the end of 1989. The plan also made an offsetting $90 error because it did not use PBGC's required 6.32 percent interest rate to discount contributions included as assets. The net effect was a $1,020 underpayment to PBGC.

Another plan underpaid its variable premium by $179 because it used the wrong retirement age in calculating vested benefits. The plan failed to use the retirement age reported on the Internal Revenue Service (IRS) Form 5500 for the 1989 plan year.

Three plans underpaid a total of $480 due to undercounting participants when calculating their fixed premiums. One plan failed to count 26 participants and the others failed to count 2 participants each.

Two plans overpaid PBGC. One paid $580 because it did not take advantage of an exemption to the variable premium allowed by PBGC for plans whose sponsors have made the maximum plan contribution allowed by the IRS. Another plan overpaid $74 because it failed to include contributions received in valuing its assets.

The remaining errors involved using the wrong interest rate to discount contributions (2 errors) and improper rounding (5 errors). In total, these errors resulted in an underpayment of $24.

PBGC EFFORTS TO ENSURE ACCURATE PREMIUMS

PBGC officials told us they are studying the feasibility of field audits to ensure accurate premium payments, and that detailed information we shared with them about our methodology will be useful. The officials also said they will study the information we provided about erroneous payments by the plans we reviewed to determine whether to collect from plans that underpaid or reimburse plans that overpaid 1990 premiums. We will monitor PBGC's progress on both these initiatives.

STUDY RESULTS LIMITED

Readers should use caution interpreting the results of this work. Our results cannot be projected nationally with any degree of accuracy because we chose a small sample, selected only plans located in the Dallas/Fort Worth area, and eliminated certain plans. In addition, we drew our sample from a PBGC list without assuring that it included all plans in the area; information to do so was not readily available. Moreover, we did not verify the information obtained from the plans, including calculations by actuaries for certain plans. See Enclosure I.

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A copy of this letter is being sent to PBGC's Executive Director. Unless you publicly announce its contents earlier, we plan no further distribution of this letter until 5 days after its issuance. At that time, it will be made available on request. If you have any questions, please call me on (202) 512-7215. Other major contributors to this work are listed in enclosure II.

Sincerely yours,

Joseph F. Delfico

Joseph F. Delfico
Director, Income Security Issues

SCOPE AND METHODOLOGY

We checked the accuracy of 1990 premiums paid to the Pension Benefit Guaranty Corporation (PBGC) by 24 single-employer defined benefit pension plans. We calculated the premiums owed by each plan using information provided by the plans and PBGC rules. We compared our calculation with the actual premiums paid to determine whether each plan paid correctly.

PLAN SELECTION

We randomly selected our sample from a PBGC list of plans, located in the Dallas/Fort Worth area, that paid premiums for 1990. Our original selection included 26 plans, but two were dropped because they had terminated. The location was chosen because our Dallas staff did the field work.

We considered a number of factors in selecting plans. We chose only plans with 25 or more participants. We excluded plans in litigation to avoid access to records problems. We selected only plans with plan years beginning on January 1, 1990, to help ensure the availability of information; some information is not available for up to 9 1/2 months after the plan year ends. We selected 13 plans--half of the original sample--that paid a variable premium to ensure adequate coverage; PBGC information indicated less than 20 percent of all plans pay variable premiums. Finally, we limited our selection to single-employer plans because they account for most of PBGC premium income.

PLAN INFORMATION

We used information from documents provided by the plans to calculate each plan's premium. We obtained the 1990 PBGC Form 1 and Schedule A, which documented the plan's fixed and variable premium payment. We also obtained the 1989 and 1990 IRS Form 5500--Form 5500-C or Form 5500-R for plans with under 100 participants[2]--and Schedule B, which contained actuarial and other information about the plan. In addition, we verified each plan's 1990 premium payment by comparing it with PBGC's computerized payment records.

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[2]For reporting purposes, we refer to information on the Form 5500, Form 5500-C, or Form 5500-R as Form 5500 information.

CALCULATING PREMIUMS

We used PBGC rules to calculate each plan's premium. An explanation of our methodology for calculating fixed and variable premiums follows.

Fixed Premiums

We calculated the fixed premium for all 24 plans by multiplying the applicable rate--$16 for 1990--times the number of participants shown on each plan's PBGC Form 1. We corroborated the participant count by comparing the count on the plan's PBGC Form 1 with the count on the plan's Form 5500. When the numbers were different, we contacted a representative of the plan to determine the correct number; if the representative could not explain the difference, we used the higher number to calculate the plan's premium.

Variable Premiums

We calculated the variable premium for each of the 13 plans that paid a variable premium by multiplying the applicable rate--$6 for 1990--times each $1,000 of the plan's unfunded vested benefits as of the last day of the preceding plan year--December 31, 1989. We also did the calculations necessary to confirm that no variable premium was owed by 3 other plans. The remaining 8 plans were exempt from the variable premium; PBGC exempts plans, among other reasons, if their sponsors have made the maximum plan contribution allowed by IRS.[3]

We determined each plan's unfunded vested benefits by subtracting the plan's adjusted assets from its adjusted vested benefits. The calculation of unfunded vested benefits varies depending on the method used by the plan. Under the General Rule--one of two methods allowed by PBGC--unfunded vested benefits are calculated by an enrolled actuary and represent specific information about the plan's assets and vested benefits of each plan participant as of the end of the preceding plan year. Under the optional Alternative Method, unfunded vested benefits are calculated by the plan using asset and vested benefit information reported on the preceding year's IRS Form 5500 or Schedule B. This information, which reflects the plan status as of the

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[3]IRS limits contributions to (1) the lesser of 150 percent of current liability or the accrued liability over (2) the lesser of the fair market or actuarial value of plan assets.

beginning of the preceding year, is projected to the end of that year. The less precise Alternative Method does not require a current actuarial evaluation.

Alternative Method

The first step in calculating the variable premium for the ten plans that used the Alternative Method was to determine the adjusted value of plan assets as of January 1, 1989. Using the plan's 1989 IRS Schedule B, we obtained the actuarial value of the assets as of that date. We adjusted this figure by (1) subtracting all contributions receivable that were included as assets and (2) adding the discounted value of contributions for 1989 and previous years which were made after January 1, 1989, but before the 1990 premium was due or paid. The contributions were discounted using PBGC's required interest rate--6.32 percent for our plans.

Then, we calculated the adjusted value of vested benefits as of January 1, 1989. From the plans 1989 Schedule B, we obtained the reported present value of vested benefits for retirees and beneficiaries receiving payments and for participants not receiving payments. We adjusted the reported present values of these benefits to reflect PBGC's required 6.32 percent interest rate; the reported present values were based on the plans' interest rates. In addition, to recognize the accrual of benefits during the 1989 plan year by participants not yet retired, we increased the value of vested benefits for these participants using PBGC's required 7 percent accrual factor.

Next, we projected these values to December 31, 1989. We (1) subtracted the adjusted value of plan assets from the adjusted value of vested benefits and (2) multiplied the result by PBGC's required 6.32 percent interest rate. The product was the plan's unfunded vested benefits.

Finally, we calculated each plan's variable premium by (1) multiplying the unfunded vested benefits as of December 31, 1989, rounded up to the next $1,000, by 0.006, (2) dividing the product by the number of participants reported on the plan's 1990 PBGC Form 1, and (3) comparing the quotient, rounded to the nearest cent, to the required per-participant cap--$34 for our plans. If the cap was not exceeded, the quotient was multiplied by the number of participants to determine the plan's variable premium.

General Rule

We performed most of the same steps in calculating the variable premium for the three plans that used the General Rule. Because the information used under this method already reflects the plan's situation as of the end of plan year 1989, we did not (1) apply the accrual factor in determining vested benefits for participants not receiving payments or (2) project the unfunded vested benefits forward. We did use PBGC's required interest rate to adjust assets and the present value of vested benefits. All other calculations were the same as for the Alternative Method.

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We did our work during the period of April 1991 to March 1992. Our work was done in accordance with generally accepted auditing standards.

MAJOR CONTRIBUTORS TO THIS REPORT

HUMAN RESOURCES DIVISION, WASHINGTON, D.C.

Robert F. Hughes, Assistant Director, (202) 512-7218
Byron S. Galloway, Assignment Manager
Harry A. Johnson, Senior Evaluator
John W. Wood, Actuary

DALLAS REGIONAL OFFICE, DALLAS, TEXAS

Sherrill Johnson, Issue Area Manager
Raimondo Occhipinti, Senior Evaluator
Steven Boyles, Evaluator

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