



DEPARTMENT OF DEFENSE

MILITARY RETIREMENT FUND

ANNUAL FINANCIAL STATEMENTS

FISCAL YEAR 1999

March 1, 2000

DoD
MILITARY RETIREMENT FUND
ANNUAL FINANCIAL STATEMENTS
FISCAL YEAR 1999

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Overview

DoD
MILITARY RETIREMENT
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OVERVIEW

SUMMARY OF THE MILITARY RETIREMENT SYSTEM

As of September 30, 1999

Description of the Reporting Entity

The reporting entity is the Office of the Under Secretary of Defense for Personnel and Readiness, one of whose missions is to oversee the accounting, investing, and reporting of the Military Retirement Fund (the Fund). In FY 1999, the Fund paid out approximately \$32 billion in benefits to military retirees and survivors. In addition to staff members of the reporting entity and the DoD Office of the Actuary, hundreds of individuals at the DFAS Cleveland and Denver Pay Centers are involved in making the benefit payments. The Fund receives income from three sources: monthly normal cost payments from the Services to pay for the current year's service cost, annual payments from Treasury to amortize the unfunded liability, and investment income. During FY 1999, the Fund received \$10 billion in normal cost payments, a \$15 billion unfunded liability amortization payment, and \$14 billion in investment income. No fund accounts have been excluded by this statement. Because the Fund provides a service and not a product, administrative costs are not ascertainable, and are therefore not calculated or reported.

Summary

The military retirement system applies to members of the Army, Navy, Marine Corps, and Air Force. However, most of the provisions also apply to retirement systems for members of the Coast Guard (administered by the Department of Transportation), officers of the Public Health Service (administered by the Department of Health and Human Services), and officers of the National Oceanic and Atmospheric Administration (administered by the Department of Commerce). Only those members in plans administered by the Department of Defense are included in this valuation.

The system is a funded, noncontributory defined benefit plan that includes nondisability retired pay, disability retired pay, retired pay for reserve service, and survivor annuity programs. The Service Secretaries approve immediate nondisability retired pay at any age with credit of at least 20 years of active-duty service. Reserve retirees must be 60 years old with 20 creditable years of service before retired pay commences. There is no vesting before retirement.

There are three distinct nondisability benefit formulas related to three populations within the military retirement system. *Final pay*: Military personnel who first became members of the armed services before September 8, 1980 have retired pay equal to (terminal basic pay) times (a multiplier). The multiplier is equal to (2.5 percent) times (years of service) and is limited to 75 percent. *High-3*: If the retiree first became a member of the armed services on or after September 8, 1980, the average of the highest 36 months of basic pay is used instead of terminal basic pay. *Redux*: Members first entering the armed services on or after August 1, 1986 are subject to a penalty if they retire with less than 30 years

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of service; at age 62, their retired pay is recomputed without the penalty. The FY 2000 Defense Authorization Act provided that Redux members now have a choice of (a) receiving High-3 benefits or (b) staying under the Redux formula and receiving a lump-sum \$30,000 payment. Members make their election during the fifteenth year of service. Those who choose the lump-sum payment must remain continuously on active duty until they complete 20 years of active duty service or forfeit a portion of the \$30,000.

Retiree and survivor benefits are automatically adjusted annually to protect the purchasing power of initial retired pay. The benefits associated with members first entering the armed services before August 1, 1986 are adjusted annually by the percentage increase in the average Consumer Price Index (CPI). This is commonly referred to as full CPI protection. Benefits associated with members entering on or after August 1, 1986 who elect the \$30,000 payment are annually increased by the percentage change in the CPI minus 1 percent. At the military member's age 62, the benefits are restored to the amount that would have been payable had full CPI protection been in effect. This restoral is in combination with that described in the previous paragraph. However, after this restoral, partial indexing (CPI minus 1 percent) continues for life.

Nondisability Retirement From Active Service

The current system allows voluntary retirement upon completion of at least 20 years of service at any age, subject to Service Secretary approval. The military retiree receives immediate retired pay calculated as (base pay) times (a multiplier). Base pay is equal to terminal basic pay if the retiree first became a member of the armed services before September 8, 1980. It is equal to the average of the highest 36 months of basic pay for all other members. The multiplier is equal to (2.5 percent) times (years of service, rounded down to the nearest month) and is limited to 75 percent. Members first entering the armed services on or after August 1, 1986, who elect the \$30,000 and who retire with less than 30 years of service receive a temporary penalty until age 62. The penalty reduces the multiplier by one percentage point for each full year of service under 30. For example, the multiplier for a 20-year retiree would be 40 percent (50 percent minus 10 percent). At age 62, the retired pay is recomputed with the penalty removed.

In FY 1999, 1.35 million nondisability retirees from active duty were paid \$26.4 billion.

Disability Retirement

A disabled military member is entitled to disability retired pay if the disability is at least 30 percent (under a standard schedule of rating disabilities by the Veterans Administration) and either (1) the member has eight years of service; (2) the disability results from active duty; or (3) the disability occurred in the line of duty during a time of war or national emergency or certain other time periods.

In disability retirement, the member receives retired pay equal to the larger of (1) the accrued nondisability retirement benefit, or (2) base pay multiplied by the rated percent of disability. The benefit cannot be more than 75 percent of base pay. Only the excess of (1) over (2) is subject to federal income taxes. Base pay is equal to terminal basic pay if the retiree first became a member of the armed services before September 8, 1980. If the retiree first entered the Services on or after September 8, 1980, base pay is equal to the average of the highest 36 months of basic pay.

Members whose disabilities may not be permanent are placed on a temporary-disability retired list and receive disability retirement pay just as if they were permanently disabled. However, they must be physically examined every 18 months for any change in disability. A final determination must be made within five years. The temporary disability pay is calculated like the permanent disability retired pay, except that it can be no less than 50 percent of base pay.

In FY 1999, 107,000 disability retirees were paid \$1.37 billion.

Reserve Retirement

Members of the reserves may retire after 20 years of creditable service, the last eight of which must be in a reserve component. However, reserve retired pay is not payable until age 60. Retired pay is computed as (base pay) times (2.5 percent) times (years of service). If the reservist was first a member of the armed services before September 8, 1980, base pay is defined as the active duty basic pay in effect for the retiree's grade and years of service at the time that retired pay begins. If the reservist first became a member of the armed services on or after September 8, 1980, base pay is the average basic pay for the member's grade in the highest 36 months that he/she was a member of the armed services. The years of service are determined by using a point system, where 360 points convert to a year of service. Typically, a point is awarded for a day of service or drill attendance, with 15 automatic points being awarded for a year's membership in a reserve component. A creditable year of service is one in which the member earned at least 50 points. A member cannot retire with less than 20 creditable years, although points earned in non-creditable years are used in the retirement calculation.

In FY 1999, 233,000 reserve retirees were paid \$2.39 billion.

Survivor Benefits

Legislation originating in 1953 provided optional survivor benefits. It was later referred to as the Retired Servicemen's Family Protection Plan (RSFPP). The plan proved to be expensive and inadequate since the survivor annuities were never adjusted for inflation and could not be more than 50 percent of retired pay. RSFPP was designed to be self-supporting in the sense that the present value of the reductions to retired pay equaled the present value of the survivor annuities.

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On September 21, 1972, RSFPF was replaced by the Survivor Benefit Plan (SBP) for new retirees. RSFPF still covers those servicemen retired before 1972 who did not convert to the new plan and still pays survivor annuities.

Retired pay is reduced, before taxes, for the member's cost of SBP. Total SBP costs are shared by the Government and the retiree, so the reductions in retired pay are only a portion of the total cost of the SBP program.

The SBP survivor annuity is initially 55 percent of the member's base amount. The base amount is elected by the member, but cannot be less than \$300 or more than the member's full retired pay. If a penalty for service under 30 years is included in the calculation of retired pay, the maximum base amount is equal to the full retired pay without the penalty.

The spouse's annuity is considered a two-tier benefit because, at age 62, the annuity is reduced to 35 percent of the base amount. Prior to the enactment of the two-tier benefit, survivor annuities were integrated with Social Security. SBP participants and active and reserve personnel with at least 20 years of service on October 1, 1985 were grandfathered into the two-tier system. Their survivors will be given the higher of the two annuities at age 62.

During FY 1987 the SBP program's treatment of survivor remarriages changed. Prior to the change, a surviving spouse remarrying before age 60 had the survivor annuity suspended. The change lowered the age to 55. (If the remarriage ends in divorce or death, the annuity is reinstated.)

Beginning in April 1992, retirees with base amounts equal to full retired pay could also elect a supplemental annuity for their surviving spouses after age 62, in increments of 5 percent of the base amount, up to a maximum 20 percent benefit. (The cost of this supplemental SBP benefit is borne by retirees in the form of a reduction in retired pay over and above the usual 6.5 percent reduction for SBP.)

Members who die on active duty with over 20 years of service are assumed to have retired on the day they died and to have elected full SBP coverage for spouses and/or children.

SBP annuities are reduced by any VA survivor benefits and all premiums relating to the reductions are returned to the survivor. Additionally, SBP annuities are annually increased with cost-of-living adjustments (COLAs). These COLAs may be based on full or partial CPI increases, depending on the benefit formula covering the member. If the member dies before age 62 and the survivor is subject to partial COLAs, the survivor's annuity is increased (on the member's 62nd birthday) to the amount that would have been payable had full COLAs been in effect. Partial COLAs continue annually thereafter.

For reserve retirees, the same set of retired pay reductions applies for survivor coverage after a reservist turns 60 and begins to receive retired pay. A second set of optional reductions, under the Reserve Component Survivor Benefit Plan, provides annuities to survivors of reservists who die before

age 60, but after attaining 20 years of service. The added cost of this coverage is borne completely by reservists through deductions from retired pay and survivor annuities.

In FY 1999, 243,000 surviving families were paid \$1.77 billion.

Temporary Early Retirement Authority (TERA)

The National Defense Authorization Act for FY 1993 (P.L. 102-484) grants temporary authority for the military services to offer early retirements to members with more than 15 but less than 20 years of service. The retired pay is calculated in the usual way except that there is a reduction of 1 percent for every year below 20 years of service. Part or all of this reduction can be restored at age 62 if the retired member works in a qualified public service job during the period from the date of retirement to the date on which the retiree would have completed 20 years of service. Unlike members who leave military service before 20 years with voluntary separation incentives or special separation benefits, these early retirees are treated like regular military retirees for the purposes of other retirement fringe benefits. This authority is scheduled to expire at the end of FY 2001.

As of September 30, 1999, there were 53,000 TERA retirees receiving retired pay at an annual rate of \$637 million.

Cost-of-Living Increases

All nondisability retirement, disability retirement, and most survivor annuities are adjusted annually for inflation. Cost-of-living adjustments (COLAs) are automatically scheduled to occur every 12 months, on December 1st, to be reflected in checks issued at the beginning of January.

The “full” COLA effective December 1 is computed by calculating the percentage increase in the CPI from the third quarter of the prior calendar year to the third quarter of the current calendar year. The increase is based on the Urban Wage Earner and Clerical Worker Consumer Price Index (CPI-W) and is rounded to the nearest tenth of one percent.

The benefits of retirees (and their survivors) are increased annually with the full COLA, except for those first entering the armed services on or after August 1, 1986 electing the \$30,000. Their benefits are annually increased with a partial COLA equal to the full COLA minus 1 percent. A one-time restoral is given to a partial COLA recipient on the first day of the month after the retiree’s 62nd birthday. At this time, retired pay (or the survivor benefit if the retiree is deceased) is increased to the amount that would have been payable had full COLAs been in effect. Annual partial COLAs continue after this restoral.

Relationship with VA Benefits

Overview

The Department of Veterans Affairs (VA) provides compensation for Service-connected and certain non-Service-connected disabilities. These VA benefits can be in place of (or in combination with) DoD retired pay, but they are not additive. Since VA benefits are exempt from federal income taxes, it is sometimes to the advantage of a member to elect them.

Veterans Administration benefits also overlap survivor benefits through the Dependency and Indemnity Compensation (DIC) program. DIC is payable to survivors of veterans who die from Service-connected causes. Although an SBP annuity must be reduced by the amount of any DIC benefit, all SBP premiums relating to the reduction in benefit are returned to the survivor.

Interrelationship with Other Federal Service

For retirement purposes, no credit is given for other federal service, except where cross-service transferability is allowed. Military service is generally creditable toward the federal civilian retirement systems if military retired pay is waived. However, a deposit (equal to a percentage of post-1956 basic pay) must be made to the Civil Service Retirement Fund in order to receive credit. Military service is not generally creditable under both systems (but is for reservists and certain disability retirees). Retired regular officers employed by the federal government lose a substantial portion of their retired pay while so employed, and all retired members are subject to a combined ceiling equivalent to Level V of the Executive Schedule. The ceiling does not apply to those who retired before October 13, 1978 (or were under age 60 and eligible for Reserve retirement on that date) and were continuously employed by the federal government since that date. The FY 2000 Defense Authorization Act repealed the reductions in military retired pay for military retirees employed by the federal government effective October 1, 1999.

Relationship of Retired Pay to Military Compensation

Basic pay is the only element of military compensation upon which retired pay is computed and entitlement is determined. Basic pay is the principal element of military compensation that all members receive, but it is not representative, for comparative purposes, of salary levels in the public and private sectors. Reasonable comparisons can be made to regular military compensation (RMC). RMC is the sum of (1) basic pay, (2) cash or in kind allowances (the housing allowance, which varies by grade, location, and dependency status, and a subsistence allowance) and (3) the tax advantages accruing to allowances because they are not subject to federal income tax. Basic pay represents approximately 73 percent of RMC for all retirement eligibles. For the 20-year retiree, basic pay is approximately 69 percent of RMC. Consequently, a 20-year retiree may be entitled to 50 percent of basic pay, but only 35 percent of RMC. For a 30-year retiree, the corresponding entitlements are 75 percent of basic pay, but only 59 percent of RMC. These relationships should be considered when military retired pay is compared to compensation under other retirement systems.

Social Security Benefits

Many military members and their families receive monthly benefits indexed to the CPI from Social Security. As full participants in the Social Security system, military personnel are in general entitled to the same benefits and are subject to the same eligibility criteria and rules as other employees. Details concerning the benefits are covered in other publications.

Beginning in 1946, Congress enacted a series of amendments to the Social Security Act that extended some benefits to military personnel and their survivors. These “gratuitous” benefits were reimbursed out of the general fund of the U.S. Treasury. The Servicemen’s and Veterans’ Survivor Benefits Act brought members of the military into the contributory Social Security system effective January 1, 1957.

For the Old Age, Survivors, and Disability Insurance (OASDI) program, military members must contribute the employee portion of the OASDI payroll tax, with the federal government contributing the matching employer contribution. Only the basic pay of a military member constitutes wages for social security purposes. One feature of OASDI unique to military personnel grants a noncontributory wage credit of (i) \$300 for each quarter between 1956 and 1978 in which such personnel received military wages and (ii) up to \$1,200 per year after 1977 (\$100 of credit for each \$300 of wages up to a maximum credit of \$1,200). The purpose of this credit is to take into account elements of compensation such as quarters and subsistence not included in wages for social security benefit calculation purposes. Under the 1983 Social Security amendments, the cost of the additional benefits resulting from the noncontributory wage credits for past service was met by a lump sum payment from general revenues, while the cost for future service will be met by payment of combined employer-employee tax on such credits as the service occurs.

Members of the military are also required to pay the Hospital Insurance (HI) payroll tax, with the federal government contributing the matching employer contribution. Medicare eligibility occurs at age 65, or earlier if the employee is disabled. Entitlement to Medicare usually terminates entitlement to benefits under TRICARE, DoD’s three-option managed health care program for the military, although eligibility continues for medical care in military facilities on a space available basis.

Overview

Performance Measures

During FY 1999, the Fund made disbursements to approximately two million retirees and annuitants. All checks are sent out on a monthly basis.

While there are many ways to measure the funding progress of a pension plan, the ratio of assets in the fund to the present value of future benefits for annuitants on the roll is commonly used. Here is what this ratio has been for the last fourteen years:

- a. September 30, 1999 = .35142
- b. September 30, 1998 = .34567
- c. September 30, 1997 = .32200
- d. September 30, 1996 = .31314
- e. September 30, 1995 = .30375
- f. September 30, 1994 = .30306
- g. September 30, 1993 = .28314
- h. September 30, 1992 = .27018
- i. September 30, 1991 = .25127
- j. September 30, 1990 = .21878
- k. September 30, 1989 = .19549
- l. September 30, 1988 = .16211
- m. September 30, 1987 = .11431
- n. September 30, 1986 = .07187

This demonstrates a consistent improvement in the strength of the Fund over time. This trend is expected to continue in future years.

The weighted average yield of the Fund on September 30, 1999 was 8.0%.

Core Performance Measures

No operating costs are calculated for the Fund.

Limitations of the Financial Statements

These financial statements have been prepared to report the financial position and results of operations for the Military Retirement Fund pursuant to the requirements of the Chief Financial Officers Act of 1990. While the statements have been prepared from the books and records of the Military Retirement Fund in accordance with the formats prescribed by the Office of Management and Budget, the statements are different from the financial statements used to monitor and control budgetary resources that are prepared from the same books and records. These statements should be read with the

realization that they are for a federal entity, that unfunded liabilities reported in the financial statements can not be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by DoD.

Comparative Financial Data

To comply with DoD Financial Management Regulation Volume 6B, “Form and Content of the Department of Defense Audited Financial Statements,” all of the Military Retirement Fund principal statements include comparative data for FY 1998. Balances representing a 10 percent increase between fiscal years on any component of a line item are considered material and are discussed in the corresponding footnote.

DoD
MILITARY RETIREMENT
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PRINCIPAL STATEMENTS

Principal Statements

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**DoD Military Retirement Fund
BALANCE SHEETS
As of September 30
(In Thousands)**

	<u>1999</u>	<u>1998</u>
ASSETS:		
Intragovernmental Assets:		
Fund Balances with Treasury (Note 2)	\$ 20,441	\$ 20,971
Investments, Net (Note 3)	155,985,667	149,855,263
Total Intragovernmental Assets	156,006,108	149,876,234
Accounts Receivable, Net (Note 4)	25,326	25,738
Total Assets	156,031,434	149,901,972
 LIABILITIES:		
Liabilities Covered by Budgetary Resources:		
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 5)	149,058,579	147,178,531
Other Liabilities (Note 6)	2,794,213	2,723,441
Total Liabilities Covered by Budgetary Resources	151,852,792	149,901,972
Liabilities Not Covered by Budgetary Resources:		
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 5)	512,681,568	497,145,173
Other Liabilities (Note 6)	136	127
Total Liabilities Not Covered by Budgetary Resources	512,681,704	497,145,300
Total Liabilities	664,534,496	647,047,272
 NET POSITION :		
Cumulative Results of Operations	(508,503,062)	(497,145,300)
Total Net Position	(508,503,062)	(497,145,300)
Total Liabilities and Net Position	\$ 156,031,434	\$ 149,901,972

The accompanying notes are an integral part of these statements.

Principal Statements

DoD Military Retirement Fund
STATEMENTS OF NET COST
For the Years Ended
(In Thousands)

	<u>1999</u>	<u>1998</u>
Program Costs:		
With the Public	\$ 49,376,848	\$ 33,842,108
Total Program Cost	49,376,848	33,842,108
(Less: Earned Revenues)	<u>(38,019,086)</u>	<u>(37,771,030)</u>
Net Program Costs	11,357,762	(3,928,922)
 Net Cost of Operations	 <u>\$ 11,357,762</u>	 <u>\$ (3,928,922)</u>

Additional information included in Note 7.

The accompanying notes are an integral part of these statements.

Principal Statements

DoD Military Retirement Fund
STATEMENTS OF CHANGES IN NET POSITION
For the Years Ended
(In Thousands)

	<u>1999</u>	<u>1998</u>
Net Cost of Operations	\$ <u>11,357,762</u>	\$ <u>(3,928,922)</u>
Financing Sources (Other than Exchange Revenue)	<u>0</u>	<u>0</u>
Net Results of Operations (Financing Sources less Net Cost of Operations)	<u>(11,357,762)</u>	<u>3,928,922</u>
Net Change in Cumulative Results of Operations	<u>(11,357,762)</u>	<u>3,928,922</u>
Change in Net Position	(11,357,762)	3,928,922
Net Position-Beginning of the Period	<u>(497,145,300)</u>	<u>(501,074,222)</u>
Net Position-End of the Period	\$ <u><u>(508,503,062)</u></u>	\$ <u><u>(497,145,300)</u></u>

The accompanying notes are an integral part of these statements.

Principal Statements

DoD Military Retirement Fund
STATEMENTS OF BUDGETARY RESOURCES
For the Years Ended
(In Thousands)

	<u>1999</u>	<u>1998</u>
BUDGETARY RESOURCES:		
Budget Authority	\$ 38,091,071	\$ 37,773,868
Unobligated Balance - Beginning of Period	142,953,230	136,412,829
Total Budgetary Resources	<u>181,044,301</u>	<u>174,186,697</u>
STATUS OF BUDGETARY RESOURCES:		
Obligations Incurred	31,985,722	31,233,467
Unobligated Balances - Available	149,058,579	142,953,230
Total Status of Budgetary Resources	<u>181,044,301</u>	<u>174,186,697</u>
OUTLAYS:		
Obligations Incurred	31,985,722	31,233,467
Obligated Balance, Net - Beginning of Period	2,697,703	2,606,084
Less: Obligated Balance, Net - End of Period	(2,794,213)	(2,697,703)
Total Outlays	<u>\$ 31,889,212</u>	<u>\$ 31,141,848</u>

The accompanying notes are an integral part of these statements.

Principal Statements

DoD Military Retirement Fund
STATEMENTS OF FINANCING
For the Years Ended
(In Thousands)

	<u>1999</u>	<u>1998</u>
OBLIGATIONS AND NONBUDGETARY RESOURCES:		
Obligations Incurred	\$ 31,985,722	\$ 31,233,467
Other	<u>(38,019,086)</u>	<u>(37,771,030)</u>
Total Obligations as Adjusted and Nonbudgetary Resources	(6,033,364)	(6,537,563)
RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS:		
Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Received or Provided - (Increases)/Decreases	<u>(25,738)</u>	<u>0</u>
Total Resources That Do Not Fund Net Costs of Operations	(25,738)	0
COSTS THAT DO NOT REQUIRE RESOURCES:		
Other - Increases/(Decreases)	<u>412</u>	<u>0</u>
Total Costs That Do Not Require Resources	412	0
Financing Sources Yet to be Provided	<u>17,416,452</u>	<u>2,608,641</u>
Net Cost of Operations	\$ <u><u>11,357,761</u></u>	\$ <u><u>(3,928,922)</u></u>

Additional information included in Note 8.

The accompanying notes are an integral part of these statements.

Principal Statements

DoD
MILITARY RETIREMENT
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FOOTNOTES
TO THE
PRINCIPAL STATEMENTS

NOTES TO THE DOD MILITARY RETIREMENT FUND PRINCIPAL STATEMENTS FOR THE YEARS ENDED 1999 AND 1998

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation. The Department of Defense (DoD) Military Retirement Fund was authorized by Public Law (PL) 98-94 for the accumulation of funds to finance the liabilities of the DoD under military retirement and survivor benefit programs. These financial statements have been prepared to meet the requirements of the Chief Financial Officers (CFO) Act of 1990 and other appropriate legislation. They have been prepared from the books and records of Reporting Division A, Office of the Assistant Deputy Director for Reporting, Accounting Directorate, Defense Finance and Accounting Service, in accordance with the requirements of the Office of Management and Budget (OMB) Bulletin No. 97-01, as amended, "Form and Content of Agency Financial Statements," and subsequent issues.

The program is funded by:

- (1) Annual unfunded liability payment from Treasury.
- (2) Monthly Service contributions as a percentage of base pay.
- (3) Interest on investments.

B. Basis of Accounting. Under the authority of the CFO Act of 1990, the Federal Accounting Standards Advisory Board (FASAB) was established to recommend Federal accounting standards to the Secretary of the Treasury, the Director of the Office of Management and Budget and the Comptroller General, co-principals of the Joint Financial Management Improvement Program (JFMIP). The Statements of Federal Financial Accounting Standards (SFFAS) have been issued by the Director of OMB and the Comptroller General, some of which have deferred effective dates. In the event the SFFAS's do not address transactions, the following hierarchy provides sources of accounting principles for the Federal Government: (1) Individual standards agreed to by the Director of OMB, the Comptroller General and the Secretary of the Treasury and published by OMB and the General Accounting Office (GAO); (2) Interpretations related to the SFFAS's issued by OMB in accordance with the procedures contained in OMB Circular A-134, "Financial Accounting Principles and Standards"; (3) Requirements contained in OMB's Form and Content Bulletin in effect for the reporting period covered by the financial statements; and (4) Accounting principles published by other authoritative standard-setting bodies and other authoritative sources.

C. Investments in U.S. Government Securities. Intergovernmental securities represent nonmarketable securities issued by the United States Treasury's Bureau of Public Debt. These securities are redeemable at market value exclusively through the Federal Investment Branch. These nonmarketable market-based Treasury securities are not traded on any securities exchange, but mirror the prices of marketable securities with similar terms. Investments are recorded at amortized cost on the Balance Sheets.

D. Actuarial Information. The DoD Military Retirement Fund financial statements present the unfunded actuarial liability determined as of the end of the fiscal year based on population information as of the beginning of the year and updated using accepted actuarial techniques. The "projected benefit obligation" method is used as required by SFFAS No. 5, "Accounting for Liabilities of the Federal Government."

E. Estimates. The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

NOTE 2. FUND BALANCES WITH TREASURY:

(\$ In Thousands)

	<u>FY 99</u>	<u>FY 98</u>
	Entity <u>Assets</u>	Entity <u>Assets</u>
1. Fund Balances:		
Fund Type		
a. Trust Funds	<u>\$20,441</u>	<u>\$20,971</u>
b. Total	<u>\$20,441</u>	<u>\$20,971</u>
2. Fund Balance Per Treasury Versus Agency:		
a. Fund Balance Per Treasury	\$20,441	\$20,971
b. Fund Balance Per Reporting Entity	<u>\$20,441</u>	<u>\$20,971</u>
c. Reconciling Amount	<u>\$ 0</u>	<u>\$ 0</u>

NOTE 3. INVESTMENTS, NET:

(\$ In Thousands)

	<u>FY 99</u>				
	<u>Cost</u>	<u>Amortization Method</u>	<u>Amortized [Premium]/ Discount</u>	<u>Investments, Net</u>	<u>Market Value Disclosure</u>
1. Intragovernmental Securities:					
a. Non-Marketable, Market Based	\$160,916,919	Effective Interest	<u>(\$9,099,433)</u>	<u>\$151,817,486</u>	<u>\$166,017,710</u>
b. Subtotal	<u>\$160,916,919</u>		<u>(\$9,099,433)</u>	<u>\$151,817,486</u>	<u>\$166,017,710</u>
c. Accrued Interest	<u>4,168,181</u>			<u>4,168,181</u>	<u>4,168,181</u>
Total	<u>\$165,085,100</u>			<u>\$155,985,667</u>	<u>\$170,185,891</u>
Total Intragovernmental:	<u>\$165,085,100</u>		<u>(\$9,099,433)</u>	<u>\$155,985,667</u>	<u>\$170,185,891</u>
2. Other Information: The calculated yields match up with yields in published security tables of U.S. Treasury securities.					

	<u>FY 98</u>	
1. Intragovernmental Securities:		
a. Non-Marketable, Market Based	\$145,629,963	\$173,616,650
b. Subtotal	<u>\$145,629,963</u>	<u>\$173,616,650</u>
c. Accrued Interest	<u>4,225,300</u>	<u>4,225,300</u>
Total	<u>\$149,855,263</u>	<u>\$177,841,950</u>

- c. Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward using accepted actuarial methods from the prior year's valuation results as reported in the valuation report. For purposes of the Fund's financial reporting, this process is applied annually. The September 30, 1999 liability figure of \$661,740,147 was rolled forward from a finalized September 30, 1998 actuarial accrued liability of \$649,404,986.
- d. Assets Available to Pay Benefits for FY 1999 does not include Accounts Receivable nor earned Accrued Interest Receivable, but they are included in the amount for FY 1998. Prior to FY 1999, Accounts Receivable was reported on all relevant reports as a budget resource. This practice was changed during FY 1999. Accounts Receivable is no longer reported as a Budget Resource. Accrued Interest Receivable is included in Actuarial Status Information as an Asset (Table 1) and it affects the unfunded accrued liability. Accrued Interest Receivable is not a budget resource and therefore cannot be part of the Fund assets used to cover liabilities. The line shown on the Balance Sheets, (Military Retirement Benefits and Other Employment-Related Actuarial Liabilities) is equal to the line shown on the Statements of Budgetary Resources (Unobligated Balances-Available).

NOTE 6. OTHER LIABILITIES:

(\$ In Thousands)

1. Other Liabilities Covered by Budgetary Resources:

	FY 99		FY 98
	Current	Total	Total
With the Public:	<u>\$2,794,213</u>	<u>\$2,794,213</u>	<u>\$2,723,441</u>
Total	<u>\$2,794,213</u>	<u>\$2,794,213</u>	<u>\$2,723,441</u>

2. Other Liabilities Not Covered by Budgetary Resources:

With the Public: Death Payment Contingencies	<u>\$136</u>	<u>\$136</u>	<u>\$127</u>
Total	<u>\$136</u>	<u>\$136</u>	<u>\$127</u>

Other Information: Other Liabilities represent accrued entitlement benefits for military retirees and survivors. Death Payment Contingencies occur because DoD military retired pay is offset, in some cases, by Department of Veterans Affairs (DVA) payments. DoD entitlements are payable to the exact date of death and DVA entitlements end in the month preceding death. This contingency is payable by DoD because DVA does not pay benefits to those retirees who died in the month.

NOTE 7. FOOTNOTE DISCLOSURES RELATED TO THE STATEMENTS OF NET COST:

(\$ In Thousands)

Earned Revenues for Program Costs consists of Service Contributions as a percentage of base pay of \$10,416,871; the Annual Unfunded Liability Payment of \$15,250,000, and Interest on Investments of \$12,352,215.

FY 1998 Data: Earned Revenues, consists of Service Contributions as a percentage of base pay of \$10,420,687; the Annual Unfunded Liability Payment of \$15,119,000 and Interest on Investments of \$12,231,343.

Footnotes

NOTE 7A: BENEFIT PROGRAM EXPENSE:

(\$ In Thousands)

DoD Military Retirement Fund For the years ended September 30	<u>FY 99</u>	<u>FY 98</u>
1. Service Cost	\$10,416,871	\$10,420,687
2. Period Interest on the Benefit Liability	41,191,898	41,045,712
3. Prior (or Past) Service Cost	4,090,184	0
4. Period Actuarial Gains or Losses	(7,929,607)	(17,624,300)

Note: Changes between FY 1998 and 1999 for Lines 3 and 4 are addressed in Note 9, Other Disclosures.

NOTE 7B: GROSS COST AND EARNED REVENUE BY BUDGET FUNCTIONAL CLASSIFICATION:

(\$ In Thousands)

	<u>FY 99</u>			
	<u>Budget Function Code</u>	<u>Gross Cost</u>	<u>(Less Earned Revenue)</u>	<u>Net Cost</u>
Federal Employee Retirement and Disability by DoD Military Retirement Fund	602	\$49,376,848	\$38,019,086	\$11,357,762
Total:		<u>\$49,376,848</u>	<u>\$38,019,086</u>	<u>\$11,357,762</u>
		<u>FY 98</u>		
Total:		<u>\$33,842,108</u>	<u>\$37,771,030</u>	<u>(\$3,928,922)</u>

NOTE 8. FOOTNOTE DISCLOSURES RELATED TO THE STATEMENTS OF FINANCING:

(\$ In Thousands)

The amount of \$25,738 represents Refunds Receivable from the Public that was recorded as a negative Undelivered Order on the September 30, 1998, Report on Budget Execution (SF 133). This is the reason why a zero balance is shown in FY 1998. In FY 1999 Refunds Receivable were not shown as a negative Undelivered Order on the SF 133 but as a decrease to the Unobligated Balance. Refunds Receivable from the Public amounted to \$25,326 for FY 1999 and the net change between fiscal years was \$412, which is shown as Other – Increases/(Decreases) representing the net change in Accounts Receivable.

NOTE 9: OTHER DISCLOSURES:

(\$ In Thousands)

Net Pension Expense: The net pension expense for the actuarial accrued liability is developed in the table below.

	<u>FY 99</u>	<u>FY 98</u>
A. Beginning of Year Accrued Liability	\$644,323,704	\$641,715,072
B. Normal Cost Liability	10,416,871	10,420,687
C. Plan Amendment Liability	4,090,184	0
D. Assumption Change Liability	1,607,493	0
E. Benefit Outlays	(31,960,396)	(31,233,467)
F. Interest on Pension Liability	41,191,898	41,045,712
G. Actuarial Loss (Gain)	<u>(7,929,607)</u>	<u>(17,624,300)</u>
H. End-of-Year Accrued Liability (A+B+C+D+E+F+G)	<u>\$661,740,147</u>	<u>\$644,323,704</u>
I. Net Change in Actuarial Liabilities (B+C+D+E+F+G)	<u>\$ 17,416,443</u>	<u>\$ 2,608,632</u>

Other Information: Assumption Change Liability (Line D.) is new this year. It was not reported separately on previous financial statements, but was included in the Actuarial Loss/(Gain). The Interest on the Pension Liability (Line F.) is calculated as a full year of interest on the Beginning of Year Accrued Liability (Line A.) and one-half year of interest on the Normal Cost Liability (Line B.) and the Benefit Outlays (Line E.). The Plan Amendment Liability (Line C.), which is identical to Line 3. in Note 7A, represents a change in retirement benefits for people who entered the military on or after August 1, 1986. There were no changes in retirement benefits for FY 1998. The Actuarial Loss (Gain) (Line G.) which is identical to Line 4. in Note 7A, represents an aggregate of all other changes from FY 1998 to FY 1999 which are not reflected in Lines C. or D. It can be expected to fluctuate significantly from year to year.

DoD
MILITARY RETIREMENT
FUND

OTHER ACCOMPANYING
INFORMATION

Other Information

TABLE 1

MILITARY RETIREMENT SYSTEM
ACTUARIAL STATUS INFORMATION
SEPTEMBER 30, 1999 AND 1998
(\$ in thousands)

	<u>Sept. 30, 1999</u>	<u>Sept. 30, 1998</u>
1. Present value of future benefits		
a. Annuitants now on roll	\$424,159,636	\$425,783,099
b. Non-retired reservists ¹	\$51,640,247	\$26,138,048
c. Active duty personnel ²	<u>\$270,498,887</u>	<u>\$272,972,526</u>
d. Total	\$746,298,770	\$724,893,673
2. Present value of future normal cost contributions	\$84,558,623	\$80,569,969
3. Actuarial accrued liability	\$661,740,147	\$644,323,704
4. Assets ³	\$149,058,579	\$147,178,531
5. Unfunded accrued liability	\$512,681,568	\$497,145,173

¹ After approval by the Department of Defense Retirement Board of Actuaries, the DoD Office of the Actuary incorporated numerous changes to reserve calculations beginning with the September 30, 1999 valuation. These changes affect both the present value of future benefits for non-retired reservists (line 1-b.) and the present value of future normal cost contributions for non-retired reservists (included in line 2.).

² The future benefits of active duty personnel who are projected to retire as reservists are counted on line 1-b.

³ The assets available to pay benefits are determined using the amortized cost method (book value) of valuation.

Other Information

DoD
MILITARY RETIREMENT
FUND

AUDIT OPINION

Audit Opinion



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

February 15, 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND CHIEF FINANCIAL OFFICER
UNDER SECRETARY OF DEFENSE (PERSONNEL AND
READINESS)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Audit of the
FY 1999 Military Retirement Fund (Project No. 9FH-6003)

In accordance with the Chief Financial Officers Act of 1990, the Inspector General (IG), DoD, is responsible for auditing the Military Retirement Fund (MRF) financial statements. For FY 1999, we contracted with Deloitte & Touche LLP to audit the MRF financial statements. Deloitte & Touche LLP is an independent certified public accounting (CPA) firm that was competitively selected for this audit by the IG, DoD. The Deloitte & Touche LLP report on the FY 1999 MRF Financial Statements, dated February 4, 2000, is at Exhibit 1.

We concur with the Deloitte & Touche LLP report on the FY 1999 MRF Financial Statements, which stated:

- The Principal Statements were reliable in all material respects.
- Management fairly stated that internal controls in place on September 30, 1999, were effective in safeguarding assets from material loss, ensuring material compliance with laws governing the use of budget authority and other laws and regulations, and ensuring that there were no material misstatements in the Principal Statements.
- There was no reportable noncompliance with laws and regulations tested.

Unqualified Audit Opinion. We concur with the Deloitte & Touche LLP unqualified opinion that the FY 1999 MRF Financial Statements and accompanying notes present fairly, in all material respects, the MRF financial position as of September 30, 1999, and the results of its operations for the year then ended. The accompanying balance sheet, and the related statements of net costs, changes in net

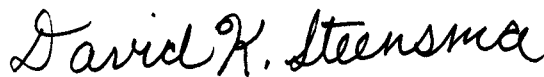
position, budgetary resources, and financing were prepared in conformity with the hierarchy of accounting principles and standards approved by the Federal Accounting Standards Advisory Board.

Objectives, Scope, and Methodology. Management is responsible for:

- preparing the annual financial statements in conformity with the basis of accounting as described in Note 1;
- establishing, maintaining, and assessing internal controls to provide reasonable assurance that the broad control objectives of the DoD Directive 5010.40, "Management Control Program Procedures," August 28, 1996, are met; and
- complying with applicable laws and regulations.

Audit Responsibilities. We are responsible for obtaining reasonable assurance about whether the Principal Statements are reliable, free of material misstatement, and presented fairly, in all material respects, in conformity with generally accepted accounting principles and other described information in Note 1; and whether management's assertion about the effectiveness of internal controls is fairly stated, in all material respects, based on criteria established under the Management Control Program and Office of Management and Budget (OMB) Circular No. A-123, "Management Accountability and Controls," June 21, 1995. We are also responsible for testing compliance with selected provisions of laws and regulations and for performing limited procedures with respect to other information in the annual financial statements.

To help fulfill these responsibilities, we contracted with the independent CPA firm of Deloitte & Touche LLP to perform a financial statement audit in accordance with generally accepted Government auditing standards; OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999; and the GAO "Financial Audit Manual," December, 1997. The IG, DoD, evaluated the nature, timing, and extent of the work, monitored progress throughout the audit, reviewed the working papers of the CPA firm, met with partners and staff members, evaluated the key judgments, met with officials of the MRF, performed independent tests of the accounting records, and performed other procedures appropriate in the circumstances.



David K. Steensma
Deputy Assistant Inspector General
for Auditing

**INDEPENDENT AUDITORS' REPORT**

To the Inspector General of the
Department of Defense

We have audited the accompanying balance sheets of the Department of Defense (DoD) Military Retirement Fund (the Fund) as of September 30, 1999 and 1998, and the related statements of net cost, changes in net position, budgetary resources, and financing for the years then ended. These financial statements are the responsibility of the management of the Fund. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the DoD Military Retirement Fund as of September 30, 1999 and 1998, and its net cost, changes in net position, budgetary resources and reconciliation of net cost to budgetary obligations for the years then ended, in conformity with generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The other accompanying information on actuarial status at Table I is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This additional information is the responsibility of the Fund's management. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

To the Inspector General
of the Department of Defense
February 4, 2000
Page 2

In accordance with *Government Auditing Standards* and OMB Bulletin No. 98-08, as amended, we have also issued our report dated February 4, 2000 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 98-08, as amended, and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

February 4, 2000