

Fiscal Year
2020

Military
Retirement
Fund
Audited
Financial
Report

November 9, 2020



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**Management's Discussion and Analysis
Summary of the Military Retirement System
For the Years Ended September 30, 2020 and 2019**

REPORTING ENTITY

The reporting entity is the Department of Defense (DoD) Military Retirement Fund (MRF, or "Fund"). The Military Retirement System (MRS) provides benefits for military members' retirement from active duty and the reserves, disability retirement benefits, and survivor benefits. The MRF accumulates funds to finance, on an actuarial basis, the liabilities of DoD under military retirement and survivor benefit programs.

Within DoD, the operations of the MRS are jointly overseen by the:

- (1) Office of the Under Secretary of Defense (Comptroller) (OUSD(C)),
- (2) Defense Finance and Accounting Service (DFAS), and
- (3) Office of the Under Secretary of Defense for Personnel and Readiness (OUSD(P&R)).

DFAS is responsible for the accounting, investing, payment of benefits, and reporting of the MRF. The DoD Office of the Actuary (OACT) within OUSD(P&R) calculates the actuarial liability and funding requirements of the MRF, relying on data produced from files maintained by the Defense Manpower Data Center (DMDC). The Office of Military Personnel Policy within OUSD(P&R) issues policy related to MRS benefits. While the MRF does not have a designated Chief Financial Officer (CFO) it is overseen by the MRF Financial Management Committee (FMC), relying upon the diverse support team to collectively provide input for the efficient and effective operation of the Fund.

The Fund was established by Public Law (P.L.) 98-94 (currently Chapter 74 of Title 10, United States Code (U.S.C.)) starting October 1, 1984. The Fund is overseen by an independent, three-member Secretary of Defense-appointed DoD Board of Actuaries ("Board"). The Board is required to review valuations of the MRS, determine the method of amortizing unfunded liabilities, report annually to the Secretary of Defense, and report to the President and the Congress at least once every four years on the status of the MRF. OACT provides technical and administrative support to the Board.

The Fund receives income from three sources: (1) normal cost payments from the Services and U.S. Treasury; (2) payment from the U.S. Treasury to amortize the unfunded liability; and (3) investment income.

During Fiscal Year (FY) 2020, the MRF received approximately \$21.8 billion in normal cost payments, and \$100.4 billion payment from the U.S. Treasury consisting of both an amortization and concurrent receipt payment, and earned approximately \$22.6 billion in investment income, net of premium/discount amortization and accrued inflation compensation. In comparison, in FY 2019 the MRF received approximately \$20.5 billion in normal cost payments, a \$95.9 billion payment from the U.S. Treasury consisting of both an amortization and concurrent receipt payment, and earned approximately \$26.7 billion in investment income, net of premium/discount amortization and accrued inflation compensation (see the Financial Performance Overview section for an explanation of the changes).

In FY 2020, the MRF paid approximately \$62.3 billion in benefits to military retirees and survivors compared to approximately \$60.7 billion in FY 2019.

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General Benefit Information

The MRS covers members of the Army, Navy, Marine Corps, and Air Force; however, most of the provisions also apply to retirement systems for uniformed service members of the Coast Guard (administered by the Department of Homeland Security), the Public Health Service (administered by the Department of Health and Human Services), and the National Oceanic and Atmospheric Administration (administered by the Department of Commerce). This report applies only to members in plans administered by the DoD.

Generally, MRS is a funded, noncontributory defined benefit plan that includes non-disability retired pay, disability retired pay, survivor annuity programs, and Combat-Related Special Compensation (CRSC). The Service Secretaries may approve immediate non-disability retired pay at any age with credit of at least 20 years of active duty service. Reserve retirees generally must be at least 60 years old and have at least 20 qualified years of service before retired pay commences; in some cases the age can be less than 60 if the reservist performed certain types of active duty service. There is no vesting of benefits before non-disabled retirement.

There are distinct non-disability benefit formulas related to four populations within the MRS, per current statute (see Tables 1 and 2).

- 1) **Final Pay:** Military personnel who first became members of a uniformed service before September 8, 1980, have retired pay equal to final basic pay times a multiplier. The multiplier is equal to 2.5% times years of service. Retired pay and survivor annuity benefits are automatically adjusted annually to protect the purchasing power of initial retired pay. Final pay retirees have their benefits adjusted annually by the percentage increase in the average Consumer Price Index (CPI). This is commonly referred to as full CPI protection.
- 2) **High-3:** If the retiree first became a member of a uniformed service on or after September 8, 1980, the average of the highest 36 months of basic pay is used instead of final basic pay. The multiplier is also equal to 2.5% times years of service and High-3 retirees also have their benefits adjusted annually by the percentage increase in the average CPI.
- 3) **Career Status Bonus (CSB)/Redux:** Members who first became a member of a uniformed service on or after August 1, 1986, may choose between a High-3 and CSB/Redux retirement. Those who elect CSB/Redux receive the CSB outlined below, also have retired pay computed on a base of the average of their highest 36 months of basic pay, but are subject to a multiplier penalty if they retire with less than 30 years of service; however, at age 62, their retired pay is recomputed without the multiplier penalty. Members make their election during the fifteenth year of service and may receive the CSB of \$30,000 in either a lump sum or multiple installment payments. Those who elect CSB/Redux must remain continuously on active duty until they complete 20 years of active duty service or forfeit a portion of the \$30,000 (exceptions include death and disability retirement). CSB retirees have their benefits adjusted annually by the percentage change in the CPI minus 1% (except when the change in the CPI is less than 1%). When the military member's age is 62, or when the member would have been age 62 for a survivor annuity, the benefits are restored to the amount that would have been payable had full CPI protection been in effect and had there not have been a multiplier penalty. However, after this restoration, partial indexing (CPI minus 1%) continues for future retired pay and survivor annuity payments. The National Defense Authorization Act for FY 2016 (NDAA 2016, P.L. 114-92) sunsets the CSB/Redux benefit tier by not allowing any CSB elections after December 31, 2017.

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- 4) ***Blended Retirement System (BRS)***: Members who first become a member of a uniformed service after December 31, 2017, will be covered under the BRS which was enacted in NDAA FY 2016 and took effect January 1, 2018. Members who first entered the military before January 1, 2018 and who have served for fewer than 12 years (as defined in the statute) as of December 31, 2017 had the option to “opt in” to BRS via an irrevocable election during a one-year (calendar year 2018) open season or remain in the High-3 system. Members who have served 12 or more years as of December 31, 2017 were not permitted to opt in to BRS and will receive benefits based on their current plan. As a result of NDAA 2016, members with 12 or more but fewer than 15 years of service as of December 31, 2017 did not have the opportunity to opt in to BRS or to elect the CSB and will automatically remain in the High-3 system¹. The BRS lowers the nondisabled retired pay multiplier from 2.5% per year to 2.0% and includes automatic and matching government contributions to member Thrift Savings Plan (TSP) accounts and a mandatory mid-career continuation bonus if the member agrees to serve additional time. The BRS also provides members the choice of receiving a portion (either 25% or 50%) of their retired pay entitlement from when the member is eligible to begin receiving retired pay to normal Social Security retirement age (usually 67) as a discounted lump sum instead of an annuity. For additional information, see table at the end of this section or refer to the DoD Office of Military Compensation website (<http://militarypay.defense.gov/>).

Retiree and annuitant pay are automatically adjusted annually by cost-of-living adjustments (COLAs) to protect the purchasing power of the initial benefit. Members first entering a uniformed service before August 1, 1986, and those entering on or after that date who do not elect CSB have their benefits adjusted by the percentage increase in the CPI. This is commonly referred to as “full CPI protection.” Benefits for members who entered on or after August 1, 1986, and who elect CSB are increased by the CPI minus 1% (except when the CPI increase is less than or equal to 1%, when it is increased by the full CPI). At age 62, or when the member would have been age 62 (for a survivor annuity), the benefits are restored to the amount that would have been payable had the full COLA been in effect. This restoration is in combination with the elimination of the penalty for retiring with less than 30 years of service; however, after this restoration, partial indexing (CPI minus 1%) continues for future benefit payments.

The FY 2011 NDAA, P.L. 111-383, required that amounts of retired pay due to a retired member of the uniformed services shall be paid on the first day of each month beginning after the month in which the right to such pay accrues. This means that when the first day of the month falls on a non-business day (weekend / holiday), the retired pay must be disbursed the preceding business day. The law does not apply to survivor annuitant pay and CRSC. It will result in retirees receiving 13 payments in some fiscal years and 11 payments in others, with 12 payments occurring in most fiscal years.

Non-Disability Retirement from Active Service

The current retirement system allows for voluntary retirement at any age upon completion of at least 20 years of service, subject to Service Secretary's approval. The military retiree immediately receives retired pay calculated as base pay multiplied by the specified benefit formula factor and years of service. “Base pay” is equal to terminal basic pay if the retiree first became a member of a uniformed service before September 8, 1980; for all other members, “base pay” is equal to the average of the highest 36 months of basic pay. The number of years of service is rounded down to the nearest month when computing retired pay. Refer to Tables 1 and 2 on the following pages for additional details.

¹ Because of breaks in service and technical differences in the definition of qualifying years of service under BRS compared to CSB/Redux, it is not possible to precisely define this group based solely on dates of entry, but generally it will include members who joined the service after December 31, 2002 and on or before December 31, 2005.

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As of September 30, 2020, there were approximately 1.448 million non-disability retirees from active duty receiving approximately \$48.68 billion of annualized retired pay. For comparison, as of September 30, 2019, there were approximately 1.459 million non-disability retirees from active duty receiving approximately \$48.03 billion of annualized retired pay.

TABLE 1
MILITARY RETIREMENT SYSTEM PROPERTIES
(FOR NONDISABILITY RETIREMENT FROM ACTIVE DUTY)

Benefit System	Final Pay	High-3 (HI-3)	Career Status Bonus (CSB)/Redux	Blended Retirement System (BRS)
Applies to Members Who Joined a Uniformed Service:	• <u>before September 8, 1980</u>	• <u>on or after September 8, 1980 and before August 1, 1986</u> • <u>on or before August 1, 1986 and before January 1, 2003</u> who do not elect to accept the CSB at the 15-year anniversary • <u>on or after January 1, 2003 and before January 1, 2006</u> • <u>on or after January 1, 2006 and before January 1, 2018</u> who do not elect to participate in BRS	• <u>on or after August 1, 1986 and before January 1, 2003</u> who elect to accept the CSB with additional 5-year service obligation	• <u>on or after January 1, 2018</u> • <u>on or after January 1, 2006 and before January 1, 2018</u> who elect to participate in BRS
Retired Pay Computation Basis	Final basic pay rate	Highest 36 months of basic pay rate	Highest 36 months of basic pay rate	Highest 36 months of basic pay rate
Multiplier	2.5% per year of service	2.5% per year of service	2.5% per year of service less 1% for each year of service less than 30 (restored at age 62)	2.0% per year of service
Cost-of-Living Adjustment Mechanism	Full CPI-W	Full CPI-W	Full CPI-W minus 1% (one-time catch-up at age 62)	Full CPI-W
Additional Benefit(s)	---	---	• \$30,000 CSB payable at 15-year anniversary upon assumption of 5-year obligation to remain on continuous active duty	• Choice of receiving a portion (either 25% or 50%) of the retired pay entitlement from retirement age to normal Social Security retirement age (usually 67) as a discounted lump sum instead of an annuity • Automatic and matching Government contributions to TSP account • Mandatory mid-career contribution bonus if member agrees to serve additional time

Notes:

- Due to breaks in service and technical differences in the definition of qualifying years of service under different benefit systems, in some cases above it is not possible to precisely define which benefit systems cover the appropriate members based solely on dates of entry. The above table does not cover every possibility.

- For additional up-to-date information, refer to the DoD Office of Military Compensation website (<http://militarypay.defense.gov/>).

TABLE 2
MILITARY RETIREMENT SYSTEM MULTIPLIERS
 (FOR NONDISABILITY RETIREMENT FROM ACTIVE DUTY)

Years of Service	Final Pay/Hi-3 Multiplier	BRS Multiplier	CSB/Redux Multiplier	
			Before Age 62	After Age 62
20	50.0%	40.0%	40.0%	50.0%
21	52.5	42.0	43.5	52.5
22	55.0	44.0	47.0	55.0
23	57.5	46.0	50.5	57.5
24	60.0	48.0	54.0	60.0
25	62.5	50.0	57.5	62.5
26	65.0	52.0	61.0	65.0
27	67.5	54.0	64.5	67.5
28	70.0	56.0	68.0	70.0
29	72.5	58.0	71.5	72.5
30	75.0	60.0	75.0	75.0
31	77.5	62.0	77.5	77.5
32	80.0	64.0	80.0	80.0
33	82.5	66.0	82.5	82.5
34	85.0	68.0	85.0	85.0
35	87.5	70.0	87.5	87.5
36	90.0	72.0	90.0	90.0
37	92.5	74.0	92.5	92.5
38	95.0	76.0	95.0	95.0
39	97.5	78.0	97.5	97.5
40	100.0	80.0	100.0	100.0
41	102.5	82.0	102.5	102.5
42	105.0	84.0	105.0	105.0
:	:	:	:	:

Disability Retirement

A military member in an active component or on active duty for more than 30 days who is found unfit for duty is entitled to disability retired pay if the disability:

- 1) based upon accepted medical principles, is of a permanent nature and stable;
- 2) was incurred while entitled to basic pay;
- 3) is neither the result of the member's intentional misconduct nor willful neglect;
- 4) was not incurred during a period of unauthorized absence; and
- 5) either:
 - a. the member has at least 20 years of service; or
 - b. the disability is rated at least 30% under the Department of Veterans Affairs (VA) Schedule of Rating Disabilities and one of the following conditions is met:

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- i. the disability was not noted at the time of the member's entrance on active duty (unless clear and unmistakable evidence demonstrates that the disability existed before the member's entrance on active duty and was not aggravated by active military service);
- ii. the disability is the proximate result of performing active duty;
- iii. the disability was incurred in the line of duty in time of war or national emergency; or
- iv. the disability was incurred in the line of duty after September 14, 1978.

Under certain conditions, members on active duty for 30 days or less or on inactive-duty training are also entitled to disability retired pay for disabilities incurred or aggravated in the line of duty.

In disability retirement, the member may elect to receive retired pay equal to either:

- 1) the accrued non-disability retirement benefit regardless of eligibility to retire; or
- 2) base pay multiplied by the rated percent of disability.

Except for members with a multiplier under (1) that is greater than 75% (which will equate to different years of service depending on whether the member is under BRS), the benefit cannot be more than 75% of base pay. Only the excess of (1) over (2) is subject to federal income taxes if the member had service on or before September 24, 1975. If the individual was not a member of a uniformed service on September 24, 1975, disability retired pay is tax-exempt only for those disabilities that are combat or hazardous duty-related. Base pay is equal to final basic pay if the retiree first became a member of a uniformed service before September 8, 1980; otherwise, 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, the member must be physically examined every 18 months for any change in disability, with a final determination made within five years. For retirees placed on this list on or after January 1, 2017, the final determination must be made within three years. The temporary disability pay is calculated like the permanent disability retired pay, except the payment cannot be less than 50% of base pay.

Members who elected the CSB/Redux retirement option, but who retired for disability, are not subject to the reduced CSB/Redux retired pay multiplier and are awarded retired pay based on the disability retirement rules outlined above. However, such members continue to be subject to the reduced CPI (with age 62 restoration) as CSB recipients. Members who are under BRS and who retire for disability do not have the option of receiving a portion of retired pay as a discounted lump sum.

As of September 30, 2020, there were approximately 129,000 disability retirees receiving approximately \$1.91 billion of annualized retired pay. For comparison, as of September 30, 2019, there were approximately 126,000 disability retirees receiving approximately \$1.82 billion of annualized retired pay.

Reserve Retirement

Members of the reserves may retire after 20 qualifying years of creditable service. However, reserve retired pay is not payable until age 60 unless the member performs certain types of active duty or active service specified in NDAA 2008 (P.L. 110-181), in which case the age is reduced below 60 by three months for every 90 days of such

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service within a fiscal year. However, the age cannot be reduced below 50, and eligibility for subsidized retiree health benefits remains at age 60 even if the eligibility age for retired pay is reduced.

For members not under BRS, retired pay is computed as base pay times 2.5% times years of service. For members under BRS (as explained below) the 2.5% multiplier is reduced to 2.0%. If the reservist was first a member of a uniformed service 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 computed as if he/she was on active duty for the entire period preceding the age at which retired pay commences. The years of service are determined by using a point system, where 360 points convert to a year of service. Typically, one point is awarded for one day of active duty service (e.g., active duty training) or one inactive duty training (IDT) drill attendance. Reservists may perform two IDT periods in one day thereby receiving two retirement points per day. In addition, 15 points are awarded for completion of one 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 generally cannot retire with less than 20 creditable years, although points earned in non-creditable years are used in the retirement calculation. Beginning with years of service that include October 30, 2007, non-active duty points are limited in any year to no more than 130. Lesser limitations have applied in the past.

Reservists who first joined the service on or before December 31, 2017 and with fewer than 4,320 points (equating to 360 points per year multiplied by 12 years of service) as of that date are eligible to opt in to BRS. Reservists who first become a member of the uniformed service after December 31, 2017 are automatically under BRS. For reserve retirement under BRS, the discounted lump sum option covers the period from retirement age (i.e., 60 or earlier if certain qualifying service is performed) to normal Social Security retirement age (usually 67).

As of September 30, 2020, there were approximately 427,000 reserve retirees receiving approximately \$7.43 billion of annualized retired pay. For comparison, as of September 30, 2019, there were approximately 418,000 reserve retirees receiving approximately \$7.07 billion of annualized retired pay.

Survivor Benefits

Legislation originating in 1953 provided optional survivor benefits, later referred to as the Retired Servicemen's Family Protection Plan (RSFPP). The plan proved to be expensive to the participants and inadequate, since the survivor annuities were not adjusted for inflation and could not exceed 50% of retired pay. RSFPP was designed to be self-supporting in the sense that, on average, the present value of the premiums equaled the present value of the survivor annuity.

On September 21, 1972, RSFPP was replaced by the Survivor Benefit Plan (SBP) for new retirees. RSFPP still covers those servicemen retired before 1972 who did not convert to the new plan or who retained RSFPP in conjunction with SBP.

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 55% 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 gross monthly retired pay, with one exception. If the member elects CSB/Redux and is subject to a penalty for service under 30 years in the calculation of retired pay, the maximum base amount is equal to the full retired pay without the penalty. However, the annuity for a survivor of a CSB/Redux retiree is subject to the reduced COLA.

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When SBP started in 1972, survivor benefits for those 62 and older were reduced by the estimated amount of Social Security for which the survivor would be eligible based on the member's military pay. In 1985, that reduction formula was changed so all annuitants 62 and over received a reduced flat rate of 35% of the member's base amount. Beginning October 1, 2005, the reduced rate at age 62 was phased out in 5% increments. On April 1, 2008, the survivor benefit reduction at age 62 was fully eliminated and the rate of 55% of the member's elected base amount became the standard for all survivors, regardless of age.

Prior to FY 1987, the survivor annuity benefit for a surviving spouse who remarried before age 60 was suspended. In FY 1987, SBP changed to suspend benefits when the remarriage occurred at the age of 55. If the remarriage ends in divorce or death, the annuity is reinstated.

Members who die on active duty are generally assumed to have retired with full disability on the day they died and to have elected full SBP coverage for spouses, former spouses, and/or children. If it is more beneficial for the survivors to have elected child only because of Dependency and Indemnity Compensation (DIC) offsets, the family has the option to make that election instead. If the death does not occur in the line of duty, the SBP benefit is based on the member's years of service, rather than assuming a full disability retirement. Insurable interest elections may be applicable in some cases. These benefits have been improved and expanded over the history of the program.

The surviving spouse (or dependent children, if there is no surviving spouse or if the spouse subsequently dies) of a reservist who dies in the line of duty while performing IDT service is entitled to an SBP annuity. For payments prior to December 23, 2016, the annuity is based on the reservist's years of service. Effective December 23, 2016, the annuity is based on assuming the reservist retired with full disability and elected full SBP on the day of death.

SBP annuities may be reduced by VA survivor benefits (DIC), and all premiums relating to the reductions are returned to the survivor. The FY 2008 NDAA enacted, and subsequent legislation extended, a temporary Special Survivor Indemnity Allowance (SSIA) that pays a monthly amount to survivors with a DIC offset (or the amount of the DIC offset, if less than the SSIA). The FY 2018 NDAA extended this allowance to a permanent benefit with annual cost-of-living adjustments. For calendar year 2020, the SSIA paid a monthly amount of \$323. The FY 2020 NDAA repealed the DIC offset, phasing it out over three years starting in calendar year 2021. In 2021, SBP benefits for survivors will be subject to an offset equal to the lesser of their SBP pay and two-thirds of their DIC award. In 2022, the offset will be no more than one-third of their DIC award, and effective January 1, 2023, there will not be any offset to SBP pay from a DIC award.

As a result of the "Sharp Case" ruling, the SBP benefit of survivors with entitlement to both DIC and SBP who remarry after age 57 is not reduced by DIC benefits received.

As with retired pay, SBP annuities and premiums are increased annually with COLAs. These COLAs are either full or partial CPI increases, depending on the benefit formula covering the member. If a member who elected the CSB dies before the age of 62, the survivor's benefit is subject to partial COLAs and his/her annuity is increased, on what would have been 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 retired pay reductions applicable under SBP take effect for survivor coverage after a reservist turns 60 (or earlier if they have certain active service) and begins to receive retired pay. The Reserve Component Survivor Benefit Plan (RCSBP) provides annuities to survivors of reservists who die before age 60 (or earlier if they have certain active service) provided they attained 20 years of qualified service and elected to participate in the program (or were within their 90-day election window after receiving a letter confirming 20

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years of credible service). However, if the death occurs either on active or inactive duty as described above, the survivor receives an annuity under SBP. The added cost of RCSBP is borne completely by reservists through deductions from future retired pay.

Beginning October 1, 2008, a “paid-up” provision eliminated the reduction in retired pay for premiums for SBP, RCSBP, and RSFPP coverage for participants age 70 or older whose retired pay has been reduced for at least 360 months.

SBP premiums for members who elect lump sums under BRS will be equivalent to what they would have been without the lump sum, and consequently, the survivors' annuities will be equivalent to what they would have been without the lump sum. The maximum base amount will be equal to unreduced retired pay (i.e., ignoring the lump sum), premiums will be deducted only from monthly retired pay received, and SBP benefits will commence upon the retiree's death.

As of September 30, 2020, there were approximately 312,000 survivors of military members receiving approximately \$3.85 billion in annuity and/or SSIA payments. As of September 30, 2019, there were approximately 315,000 survivors of military members receiving approximately \$3.86 billion in annuity and/or SSIA payments.

Temporary Early Retirement Authority (TERA)

The FY 1993 NDAA (P.L. 102-484) granted 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 was calculated in the usual way, except that there was a reduction of 1% 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 generally treated like regular military retirees for the purposes of other retirement benefits. This authority originally expired on September 1, 2002.

The FY 2012 NDAA (P.L. 112-81) reinstated TERA from January 2012 through December 2018, but without the qualified public service provision. The FY 2017 NDAA further extended TERA through December 2025. These reinstatements of TERA are on a much smaller scale than the FY 1993 authority.

As of September 30, 2020, there were approximately 70,000 TERA retirees receiving approximately \$1.32 billion in annualized retired pay. For comparison, as of September 30, 2019 there were approximately 69,000 TERA retirees receiving \$1.29 billion in annualized retired pay.

Cost-of-Living Increase

All non-disability retirement, disability retirement, and most survivor annuities are adjusted annually for inflation. COLAs are automatically scheduled to occur every 12 months, on December 1, 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 average 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. Many members receive a “partial” COLA on December 1 of their first year of retirement to reflect the fact that they were not retired for the full year. Members under the Final Pay benefit

Management's Discussion and Analysis

system may receive an additional one-time COLA adjustment in the first year of retirement to reflect the fact that an earlier retirement date would have been beneficial for them.

The benefits of retirees (and most survivors) are increased annually with the full COLA, with one exception for those first entering the armed services on or after August 1, 1986, who elect the \$30,000 CSB. Their benefits are increased annually with a partial COLA equal to the full COLA minus 1% (except if the full COLA is less than or equal to 1%). A one-time restoration 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 restoration. Note that the FY 2016 NDAA sunsets the CSB/Redux benefit tier by not allowing any CSB elections after December 31, 2017.

FUND RELATIONSHIPS

Department of Veterans Affairs Benefits

The 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 through December 31, 2003, were not fully additive. Since VA benefits are exempt from federal income taxes, it is often to the advantage of a member to elect them. Through calendar year 2003, retired pay earned from the DoD for military service was offset by any payment received from VA for a VA-rated disability. Beginning with NDAA 2004 (P.L. 108-136), a series of legislation has been enacted that increasingly reduces or eliminates the offset to military retired pay due to receipt of VA disability compensation. Members with a combined VA disability rating of 50% or greater who have at least 20 years of service have their offset eliminated under the Concurrent Retirement and Disability Pay (CRDP) program. Members whose disability meets certain combat-related criteria can elect to receive payments against the offset under the CRSC program. Under CRSC, members are not subject to a phase-in schedule, are not required to have at least 20 years of service, and are not required to have at least a 50% VA disability rating. Although CRSC amounts are calculated based on retired pay lost due to offset and are paid from the MRF, CRSC is not technically considered retired pay. CRSC payments are tax exempt. A member may not participate in both the CRDP and CRSC programs simultaneously, but may change from one to the other during an annual "open season."

For members who elect lump sums under BRS and qualify for VA disability compensation: (1) if the member is not eligible for CRDP or CRSC, the VA will withhold disability payments until the amount withheld equals the lump sum amount, after which VA disability payments, as an offset to retired pay, may be paid; (2) if the member is eligible for CRDP, no withholding of VA disability payments is required, and the retiree may receive VA disability compensation and retired pay without offset; and (3) if eligible for CRSC, the procedures for withholding VA disability payments are more complicated and relate to the portion of the total VA entitlement considered combat-related.

VA benefits also overlap survivor benefits through the DIC program. DIC is payable to survivors of veterans who die from Service-connected causes. Although SBP annuities are generally reduced by the amount of any DIC benefit, all SBP premiums relating to the reduction in benefits are returned to the survivor. The FY 2008 NDAA enacted, and subsequent legislation extended, a temporary SSIA that pays a monthly amount to survivors with a DIC offset (or the amount of the DIC offset, if less than the SSIA). The FY 2018 NDAA extended this allowance to a permanent benefit with annual cost-of-living adjustments. For calendar year 2020, the SSIA paid a monthly amount of \$323. The FY 2020 NDAA repealed the DIC offset, phasing it out over three years starting in calendar year 2021. In 2021, SBP benefits for survivors will be subject to an offset equal to the lesser of their SPB pay and two-thirds of their DIC award. In 2022, the offset will be no more than one-third of the DIC award, and effective January 1, 2023, there will not be any offset to SPB pay from a DIC award.

Management's Discussion and Analysis

As a result of the “Sharp Case” ruling, the SBP benefit of survivors with entitlement to both DIC and SBP who remarry after age 57 is not reduced by DIC benefits received.

As of September 2020, there were 711,000 CRDP members and 96,000 CRSC members. These members were receiving an additional annualized amount of \$15.83 billion and \$1.20 billion, respectively. As of September 2020, there were 66,000 survivors receiving annualized SSIA benefits of \$257 million.

Interrelationships with Other Federal Service

For military retirement purposes, no credit is given for other federal service, except for TERA and 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 and Disability Fund in order to receive credit. Military service is not generally creditable under both systems (but is for reservists and certain disability retirees). Military retirees may qualify separately for Civil Service retirement and receive concurrent pay from both systems.

Retired Pay to Military Compensation

Basic pay is the only element of military compensation upon which non-disability retired pay is based 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) the housing allowance, which varies by grade, location, and dependency status, (3) the subsistence allowance, and (4) the tax advantages accruing to the housing and subsistence allowances because they are not subject to federal income tax. Basic pay represents approximately 70% of RMC for all retirement eligible members. For the 20-year retiree, basic pay is approximately 67% of RMC. Consequently, a member retired with 20 years of service if entitled to 50% of basic pay, would only receive approximately 34% of RMC. Further, such 20-year retirees (except for those who first entered service prior to September 8, 1980) receive a percentage (50%, or 40% for those under CSB/Redux or BRS) of their High 36-month average of basic pay, typically less than final basic pay. For a 30-year retiree, basic pay is approximately 73% of RMC and such members if entitled to 75% of basic pay, would only receive 55% of RMC. Again, note that most members currently retiring with 30 years will actually receive a percentage (75%, or 60% for those under BRS) of their high 36-month average, rather than of their final basic pay. P.L. 109-364 allows certain members, who retire on or after January 1, 2007 with sufficient years of service (greater than 37.5 years under BRS and 30 years under the other benefit formulas), to retire with entitlements exceeding 75% of their High 36-month average of basic pay. 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 generally entitled to the same benefits and are subject to the same eligibility criteria and rules as other employees. Details concerning these benefits are covered extensively 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.

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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. Payments for these wage credits ended in 2002.

Members of the military are also required to pay the Hospital Insurance payroll tax, with the Federal Government contributing the matching employer contribution. Medicare eligibility occurs at age 65, or earlier if the employee is disabled.

SIGNIFICANT CHANGES

From FY 2019 to FY 2020

Changes in the MRF valuation during FY 2020 included:

- 1) Updated noneconomic assumptions approved by the DoD Board of Actuaries at their June 2020 meeting for use in the September 30, 2020 MRF valuation, including: (a) updated retirement rates due to disability, (b) mortality improvement modifications, (c) updated parameters used in the valuation of disability retirement benefits, and (d) various changes in the modeling of reserves;
- 2) New benefits provisions contained in FY 2020 NDAA, primarily the 3-year phase out of the offset of SBP benefits by the DIC award; and
- 3) New economic assumptions due to the Federal Accounting Standards Advisory Board (FASAB) financial reporting Statement of Federal Financial Accounting Standards 33 (SFFAS No. 33), discussed further in Note 13, *Military Retirement and Other Federal Employment Benefits*.

Item (3) is classified as an assumption change in the actuarial valuation. SFFAS No. 33 requires the use of a yield curve based on marketable Treasury securities to determine the interest rates used to calculate actuarial liabilities for federal financial statements. Historical experience is the basis for expectations about future trends in marketable Treasury securities, as well as COLA and salary. The yield curve was provided by the Treasury Office of Economic Policy (the series of Treasury spot rates was provided by the Office of Thrift Supervision in prior years). Item (3) is prescribed and therefore the resulting economic assumptions will be different than those assumed by the DoD Board of Actuaries for funding calculations.

For FY 2021 and Beyond

In the current fiscal climate, it is difficult to predict changes for any particular year. In the coming fiscal years, the potential benefit and assumptions changes with respect to the MRF include:

- 1) Further BRS legislative and policy refinements;
- 2) Continued review of economic assumptions pursuant to SFFAS No. 33;
- 3) Adding the Coast Guard to the MRF; and
- 4) Additional Concurrent Receipt enhancements.

Management's Discussion and Analysis

OACT will propose updates to the actuarial assumptions underlying the valuation of the MRS to more accurately reflect emerging plan experience as changes are implemented, in addition to the ongoing assumptions/parameter review conducted annually each year.

PERFORMANCE MEASURES

MRF made disbursements to approximately 2.316 million retirees and annuitants in September 2020, and to 2.318 million retirees and annuitants in September 2019.

There are many ways to measure the performance of a pension plan. Table 3 depicts a few common measures, specifically 1) Percent Funded, 2) Asset-to-Annuitant Liability Ratio, and 3) Effective Fund Yield. The last twelve years are shown below.

TABLE 3
MILITARY RETIREMENT SYSTEM
PERFORMANCE MEASURES

As of Sept. 30,	Percent Funded	Asset-to-Annuitant Liability Ratio	Effective Fund Yield
2020	54.6%	89.5 %	2.3%
2019	51.1	82.6	3.0
2018	50.3	82.2	3.8
2017	46.5	75.8	2.9
2016	44.3	71.8	2.3
2015	38.5	63.6	1.8
2014	34.9	57.9	3.2
2013	31.8	53.5	3.1
2012	29.0	49.2	2.9
2011	27.3	46.2	4.9
2010	25.6	43.2	3.2
2009	23.7	38.6	1.0

Notes:

- Percent Funded computed as total assets (from Balance Sheet) to actuarial accrued liability.
- Asset-to-Annuitant Liability Ratio computed as total assets (from Balance Sheet) to present value of future benefits for the annuitant population.
- Effective Fund Yield is the approximate fund yield over the course of the associated fiscal year.
- The MRF is invested solely in intragovernmental U.S. Treasury securities, with constraints to hold securities until maturity and invest with the primary objective of meeting the cash flow needs of the Fund. Therefore, the above measures should be used with caution when compared with other retirement funds and cited in the appropriate context.

PROJECTED LONG-TERM HEALTH OF THE FUND

The projected long-term health of the MRF is adequate due to the fact that it has three different sources of funding. The first two sources are:

Management's Discussion and Analysis

- 1) Annual payments from Treasury to amortize the unfunded liability and pay the normal cost of the concurrent receipt benefits; and
- 2) Monthly normal cost payments from the Services to pay for the current years' service cost.

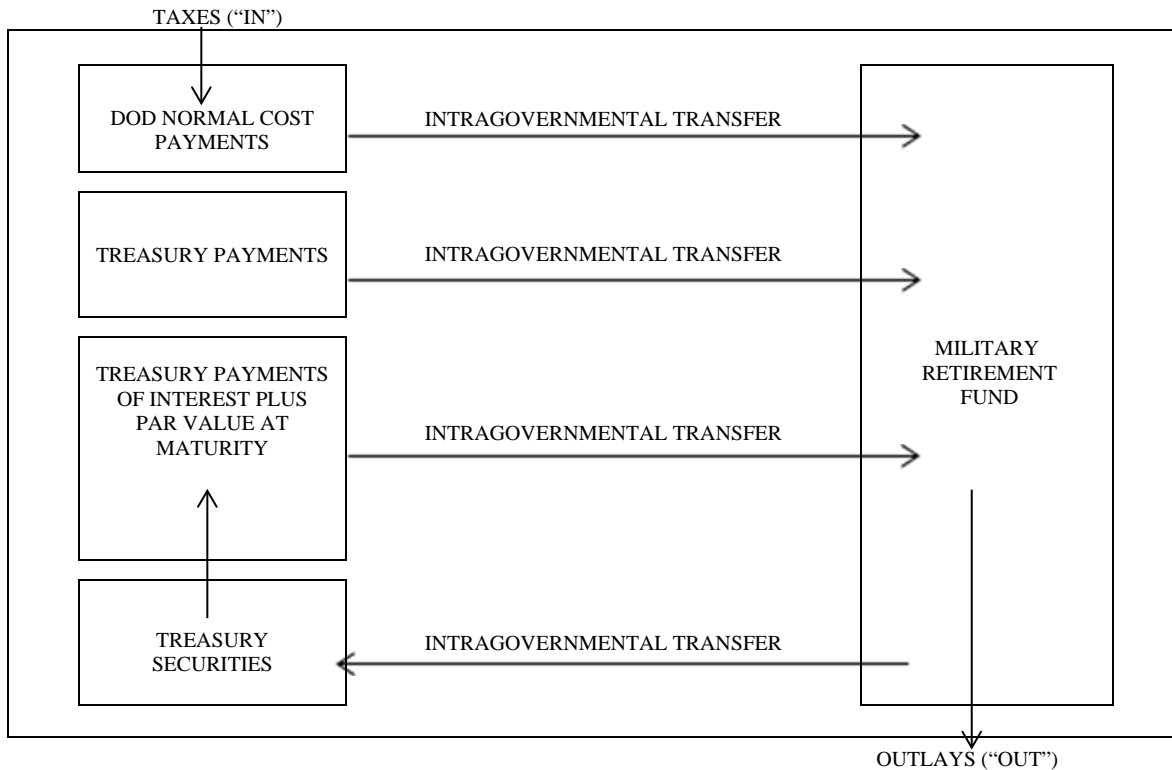
The third source of funding, earnings on investments, is projected to be an increasing contribution to the MRF due to an increasing fund balance. All three of these sources can be considered secure sources of funding, backed by the full faith and credit of the U.S. Government.

MRF investment policy mandates that securities will be held to maturity. Occasionally, however, securities in the portfolio are liquidated prior to their stated maturity date. MRF has the authority to sell all or part of a security early to meet cash flow/benefit payment requirements. Historically, MRF holds cash in overnight securities in an amount equal to approximately 110% of the following month's benefit. During FY 2020, all securities were held to maturity; whereas, during FY 2019, a portion of a security held by MRF was sold prior to its stated maturity date to provide cash needed to pay, or be available to pay, benefit liabilities.

Unified Budget of the Federal Government

The MRF was created inside the Unified Budget of the Federal Government for the monies of the MRS. All three sources of fund income are intragovernmental transactions consisting of transfers from one government account to another. The only transactions in a particular year directly affecting the deficit of the Unified Budget are those passing in or out of the government, such as tax collections ("in") and beneficiary payments ("out"). The intragovernmental transfers are debits and credits within the federal budget, with no direct effect on the deficit. Just as in the pay-as-you-go method, the only transactions directly affecting the deficit in the retirement system accounting process are payments to retirees and survivors (i.e. outlays/payments). The purchase of securities by the Fund does increase the national debt, specifically the portion of the debt held by the government – the portion held by the public does not change (see Figure 1 on the next page).

**FIGURE 1
UNIFIED BUDGET**



However, funding does have an effect on the DoD budget. With the normal cost payments (except for Concurrent Receipt) included in the DoD budget, policymakers now consider the impact on future retirement costs when they make manpower decisions, which could have a significant impact on future federal budgets. For example, if a decision were made today to double the size of the active duty and reserve forces, the DoD budget would automatically have an immediate increase in retirement obligations. Under the pay-as-you-go system, the retirement expenses would not necessarily be considered in the initial decision since they would not show up for 20 years, generally.

The fact that MRF costs are recognized in advance provides greater benefit security over the long term. Also, when there is a retirement fund, the MRS is not as dependent on obtaining the necessary appropriation from Congress each year in order to pay benefits for that year. This can provide additional benefit security. As such, the existence of the Fund promotes a high degree of “psychological security” for plan participants.

20-Year Projection

Table 4 presents a projection of contributions to and disbursements from the MRF. It includes the dollar amounts as a percentage of payroll. The Fund is projected to remain solvent over the 20-year projection period. Further, as long as the funding sources continue making the required payments to the MRF in a timely fashion, the Fund is projected to remain solvent well beyond the 20-year projection horizon.

The following projections were made for FY 2020:

- Basic pay for FY 2020 was projected to be \$72.4 billion.
- Normal cost payments were projected to be \$30.4 billion.

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- The unfunded liability amortization payment was projected to be \$91.9 billion.
- Investment income was projected to be \$49.7 billion.
- Fund disbursements for FY 2020 were projected to be \$62.3 billion.

TABLE 4
MILITARY RETIREMENT SYSTEM
PROJECTED FLOW OF PLAN ASSETS
(In Billions of Dollars and as a Proportion of Payroll)

Fiscal Year	Basic Payroll	Normal Cost Payments	Amortization of Unfunded Liability	Investment Income	Fund Disbursements	Fund Balance End of Year
2021	\$74.7	\$35.1 (0.470)	\$98.1 (1.313)	\$51.9 (0.695)	\$64.0 (0.857)	\$1,124.7 (15.056)
2022	\$75.1	\$36.0 (0.479)	\$101.4 (1.350)	\$57.8 (0.770)	\$66.0 (0.879)	\$1,253.9 (16.696)
2023	\$77.1	\$36.6 (0.475)	\$103.7 (1.345)	\$64.0 (0.830)	\$68.0 (0.882)	\$1,390.2 (18.031)
2024	\$79.1	\$37.2 (0.470)	\$107.1 (1.354)	\$70.6 (0.893)	\$70.2 (0.887)	\$1,534.9 (19.405)
2025	\$81.1	\$37.8 (0.466)	\$110.5 (1.363)	\$77.6 (0.957)	\$72.4 (0.893)	\$1,688.4 (20.819)
2026	\$83.2	\$38.4 (0.462)	\$114.1 (1.371)	\$85.0 (1.022)	\$74.4 (0.894)	\$1,851.5 (22.254)
2027	\$85.4	\$39.0 (0.457)	(\$3.8) 0.044	\$87.2 (1.021)	\$76.4 (0.895)	\$1,897.5 (22.219)
2028	\$87.6	\$39.6 (0.452)	(\$3.9) 0.045	\$89.3 (1.019)	\$78.5 (0.896)	\$1,944.0 (22.192)
2029	\$89.9	\$40.3 (0.448)	(\$4.1) 0.046	\$91.5 (1.018)	\$80.8 (0.899)	\$1,990.9 (22.146)
2030	\$92.8	\$41.3 (0.445)	(\$4.2) 0.045	\$93.7 (1.010)	\$83.3 (0.898)	\$2,038.4 (21.966)
2031	\$95.8	\$42.3 (0.442)	(\$4.3) 0.045	\$95.9 (1.001)	\$85.8 (0.896)	\$2,086.5 (21.780)
2032	\$98.9	\$43.3 (0.438)	(\$4.5) 0.046	\$98.1 (0.992)	\$88.3 (0.893)	\$2,135.1 (21.588)
2033	\$102.0	\$44.3 (0.434)	\$27.4 (0.269)	\$101.9 (0.999)	\$91.1 (0.893)	\$2,217.6 (21.741)
2034	\$105.3	\$45.4 (0.431)	\$28.4 (0.270)	\$105.9 (1.006)	\$93.9 (0.892)	\$2,303.4 (21.875)
2035	\$108.6	\$46.5 (0.428)	\$29.3 (0.270)	\$110.0 (1.013)	\$96.6 (0.890)	\$2,392.6 (22.031)
2036	\$112.0	\$47.6 (0.425)	\$30.3 (0.271)	\$114.2 (1.020)	\$99.4 (0.888)	\$2,485.3 (22.190)
2037	\$115.6	\$48.8 (0.422)	\$27.8 (0.240)	\$118.5 (1.025)	\$102.2 (0.884)	\$2,578.2 (22.303)
2038	\$119.2	\$50.0 (0.419)	\$16.4 (0.138)	\$122.3 (1.026)	\$105.1 (0.882)	\$2,661.8 (22.331)
2039	\$123.1	\$51.3 (0.417)	\$17.0 (0.138)	\$126.3 (1.026)	\$108.0 (0.877)	\$2,748.4 (22.327)
2040	\$127.0	\$52.6 (0.414)	\$17.5 (0.138)	\$130.4 (1.027)	\$111.0 (0.874)	\$2,837.9 (22.346)

Notes

- The preceding projections assume a long-term 4.75% interest rate each year.
- The projections will vary in the short-term depending on the actual economic experience.
- Note that the above projection is based on FY 2019 MRF methods and assumptions for funding purposes.
- The above Fund Disbursements do not include the effect of NDAA 2011 (retired pay date change).

Expected Problems

There are no anticipated problems with respect to MRF that would require disclosure in the Management's Discussion and Analysis.

Investments

**FIGURE 2
INVESTMENTS**

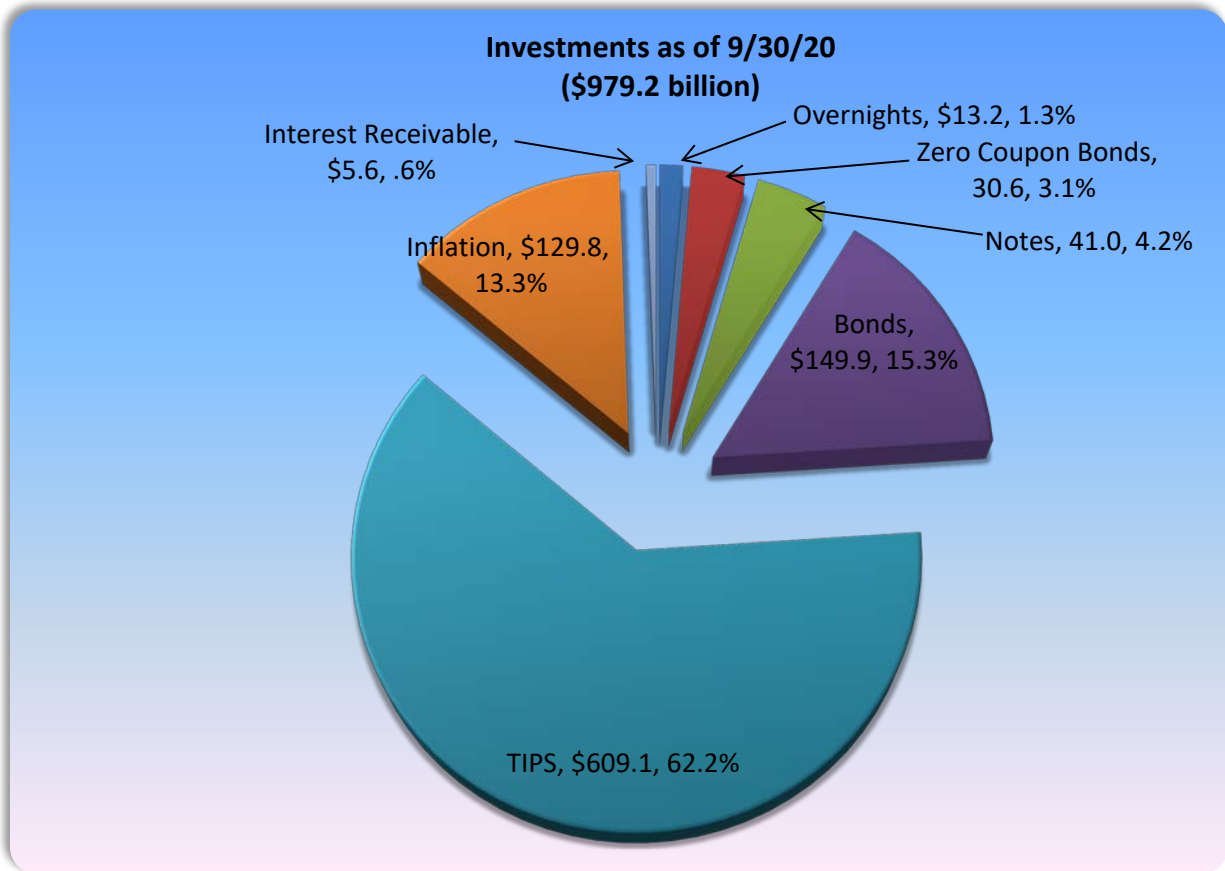


Figure 2 depicts the value (par, net of unamortized discount/premium) of investment holdings as of September 30, 2020.

Management Oversight

The Fund receives management oversight from the DoD Investment Board established in September 2003. The members of the Investment Board are the Director, DFAS; the Deputy CFO, OUSD(C); and a senior military member. The Investment Board meets twice each FY to consider investment objectives, policies, performance, and strategies with the goal of maximizing MRF's investment income. The Investment Board reviews MRF's law and Department of Treasury guidelines to ensure MRF complies with broad policy guidance and public law. At the September 25, 2020 meeting, the Investment Board approved the FY 2021 investments recommended by the Investment Advisory Committee (a group of military reservists whose civilian expertise is investing).

Anticipated Changes between the Expected and Actual Investment Rate of Return

The past decade has seen increased volatility in interest rates and equity markets, increasing deficits, volatility in the markets with regard to energy prices, elevated states of international conflict, increasing sovereign debt levels, unusual central banking monetary policy, and various levels of economic growth. These items have been a catalyst in the on-going discussion of implementing strong U.S. fiscal control and monetary policy among politicians. Active political management of the U.S. debt and annual deficit may create an opportunity to purchase Treasury market securities at higher rates of interest in the future. Conversely, uneasy equity markets tend to

Management's Discussion and Analysis

push participants toward government securities causing downward pressure on interest rates. There has also been a movement among pension plan sponsors to increase pension plan investments in lower risk securities, driven by analysis of risk in relation to liabilities. The current MRF investment strategy is to maintain a portfolio allocation of 75%-90% U.S. Treasury Inflation-Protected Securities (TIPS) to partially hedge against any future inflation.

The Fund receives investment income from a variety of U.S. Treasury-based instruments such as bills, notes, bonds, overnight investment certificates, and zero coupon bonds. U.S. Treasury bills are short-term securities with maturities of less than one year issued at a discount. U.S. Treasury notes are intermediate securities with maturities of one to ten years. U.S. Treasury bonds are long-term debt instruments with maturities of greater than ten years. Overnight certificates are interest-based market securities purchased from the U.S. Treasury maturing the next business day and accrue interest based on the Federal Reserve Bank of New York survey of Reserve repurchase agreement rates. U.S. Treasury zero-coupon bonds are fixed-principal bonds having maturities of at least five years and are purchased at a discount.

The Fund also invests in TIPS. TIPS are fixed-rate instruments designed to protect against inflation, with the principal amount indexed to the CPI by adjusting the CPI at issuance to the current CPI. As inflation increases, so does the principal amount.

FINANCIAL PERFORMANCE OVERVIEW

Financial Data

Table 5 presents significant changes in the comparative financial statement information for the MRF.

TABLE 5
MILITARY RETIREMENT FUND
ANALYSIS OF FINANCIAL STATEMENTS

For the Years Ended September 30, 2020 and 2019

(\$ in Thousands)	<u>2020</u>	<u>2019</u>	<u>Difference</u> Increase / (Decrease)	<u>%</u> Change
<i>BALANCE SHEET</i>				
Intragovernmental:				
Investments	\$979,210,403	\$896,771,421	\$82,438,982	9%
Accounts Receivable	\$0	\$9,371	(\$9,371)	(100%)
Accounts Receivable, Net	\$147,107	\$132,699	\$14,408	11%
Liabilities not covered by Budgetary Resources	\$901,675,521	\$940,755,435	(\$39,079,914)	(4%)
Military Retirement Benefits and other Federal Employment Benefits	\$1,799,172,254	\$1,759,212,362	\$39,959,892	2%
<i>STATEMENT OF NET COST</i>				
Net Cost of Operations	(\$42,484,591)	\$54,886,395	(\$97,370,986)	(177%)

BALANCE SHEET

**Investments and Related Interest
 Intragovernmental Securities**

Total Intragovernmental Securities, Net Investments increased \$82.4 billion (9%) primarily due to the MRF purchase of \$110.0 billion in additional long-term securities, offset by the maturity of \$32.4 billion of securities. The increase is due to normal growth in the MRF from U.S. Treasury and Military Services contributions. The annual investment of these funds has a cumulative effect with an expectation that invested balances will continue growing to cover future benefits.

Accounts Receivable (Intragovernmental)

Intragovernmental Accounts Receivable decreased \$9.4 million (100%). The FY19 receivable represents contributions due from the Navy that were intended for payment in September but that were not received until October. There were no intragovernmental receivables at the end of 4th quarter FY20.

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Accounts Receivable, Net

Nonfederal Accounts Receivable increased \$14.4 million (11%) primarily due to an increase of \$13.4 million in Annuity debt principal. An upward trend is normal, as new debts are established faster than old debts are eliminated through repayment agreements and/or write-offs. Additionally, system changes that expedite the cost refund process (which accounts for many annuity pay debts) and efforts to reduce a backlog in annuity pay cases have led to an increase in receivables.

Liabilities Not Covered by Budgetary Resources

Total Liabilities Not Covered by Budgetary Resources decreased \$39.1 billion (4%). This change is due to an increase of \$40.0 billion in Military Retirement and Other Federal Employment Benefits Liability, offset by an increase of \$79.0 billion in net receipts that are available to pay future benefits. Net receipts are comprised of contributions, interest income, and outlays. See Note 13, *Military Retirement and Other Federal Employment Benefits*, for additional information about these changes.

Military Retirement Benefits and Other Federal Employment Benefits

The Military Retirement and Other Federal Employment Benefits liability, comprised of the actuarial liability plus the liability for benefits due and payable, increased \$40.0 billion (2%). Each year the actuarial liability is expected to increase with the normal cost, decrease with benefit outlays, and increase with the interest cost, resulting in an expected increase of \$35.7 billion in FY 2020. The September 30, 2020, actuarial liability also included changes due to revised actuarial assumptions, plan amendments, and experience. The net effect of these changes was an increase of \$4.1 billion. The MRF actuarial liability is adjusted at the end of each fiscal year. The 4th quarter, FY 2020 balance represents the September 30, 2020 amount that will be effective through 3rd quarter, FY 2021.

STATEMENT OF NET COST

Net Cost of Operations decreased \$97.4 billion (177%), which is primarily caused by the year to date change in actuarial liability. In 2020, the actuarial liability increased \$39.9 billion. In 2019, the actuarial liability increased \$137.8 billion, which impacts Net Cost by \$97.9 billion.

**FIGURE 3
TOTAL ASSETS**

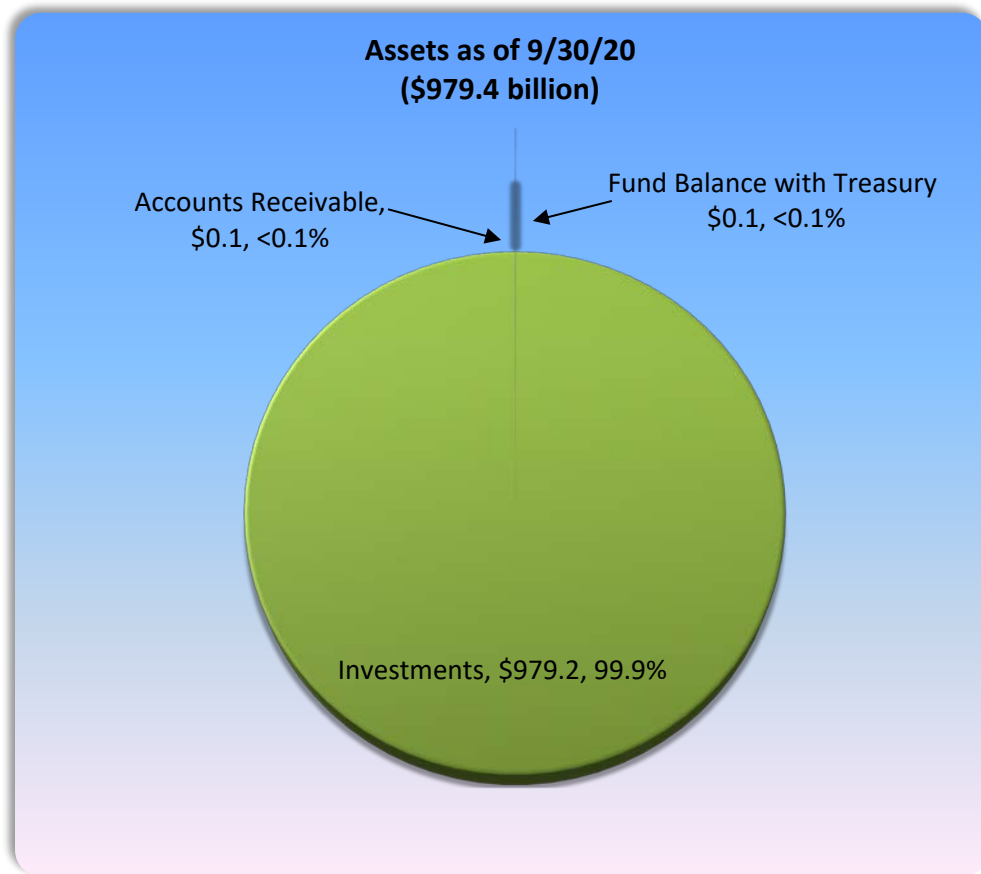


Figure 3 depicts the value of significant assets as of September 30, 2020.

Assets

Assets of \$979.4 billion shown in Figure 3 represent amounts that the MRF owns and manages. Assets increased \$82.4 billion, or 9%, from the end of FY 2019 to the end of FY 2020. This increase is primarily attributable to purchasing new investments of \$110.0 billion with funds received from the U.S. Treasury payments, Service contributions, and interest received; this is offset by the maturity of \$32.4 billion of securities. The net increase in investments is related to expected normal growth to cover unfunded portions of future military retirement benefits. Funds not needed to pay current benefits are invested in U.S. Treasury securities or invested in overnight securities, as necessary, to make future benefit payments.

**FIGURE 4
TOTAL LIABILITIES**

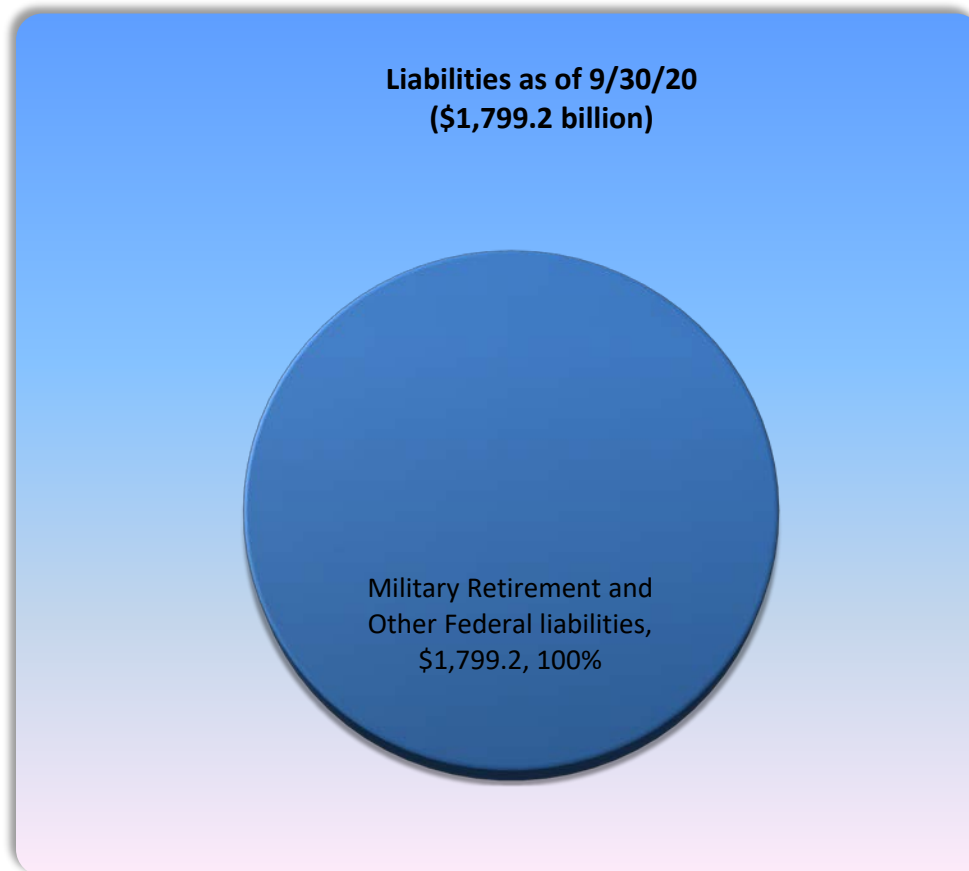


Figure 4 depicts the value of significant liabilities as of September 30, 2020.

Liabilities

Liabilities of \$1.8 trillion shown in Figure 4 represent liabilities related to military retirement pension benefits. The liabilities of the MRF primarily consist of actuarial liability for future benefit payments. Liabilities increased \$40.0 billion, 2% from the end of FY 2019 to the end of FY 2020. This increase is attributable to the increase in the actuarial liability.

The MRF management is confident in the Fund's ability to meet its financial obligations. Of the \$1.8 trillion in liabilities, approximately \$897.5 billion (49.9%) is covered primarily by investments in U.S. Treasury securities (Figure 5). While the liability presents a negative financial position, the majority of the unfunded portion will come from annual appropriations external to DoD ensuring benefits are paid regardless of available assets. The initial unfunded actuarial liability, \$529 billion in 1984, is being amortized over 42 years and is expected to be fully funded through U.S. Treasury contributions by FY 2026. The current investments, the interest received on the investments, and the amortization of the initial liability will provide sufficient funds to cover the financial obligations of the MRF.

**FIGURE 5
FUNDED AND UNFUNDED LIABILITIES**

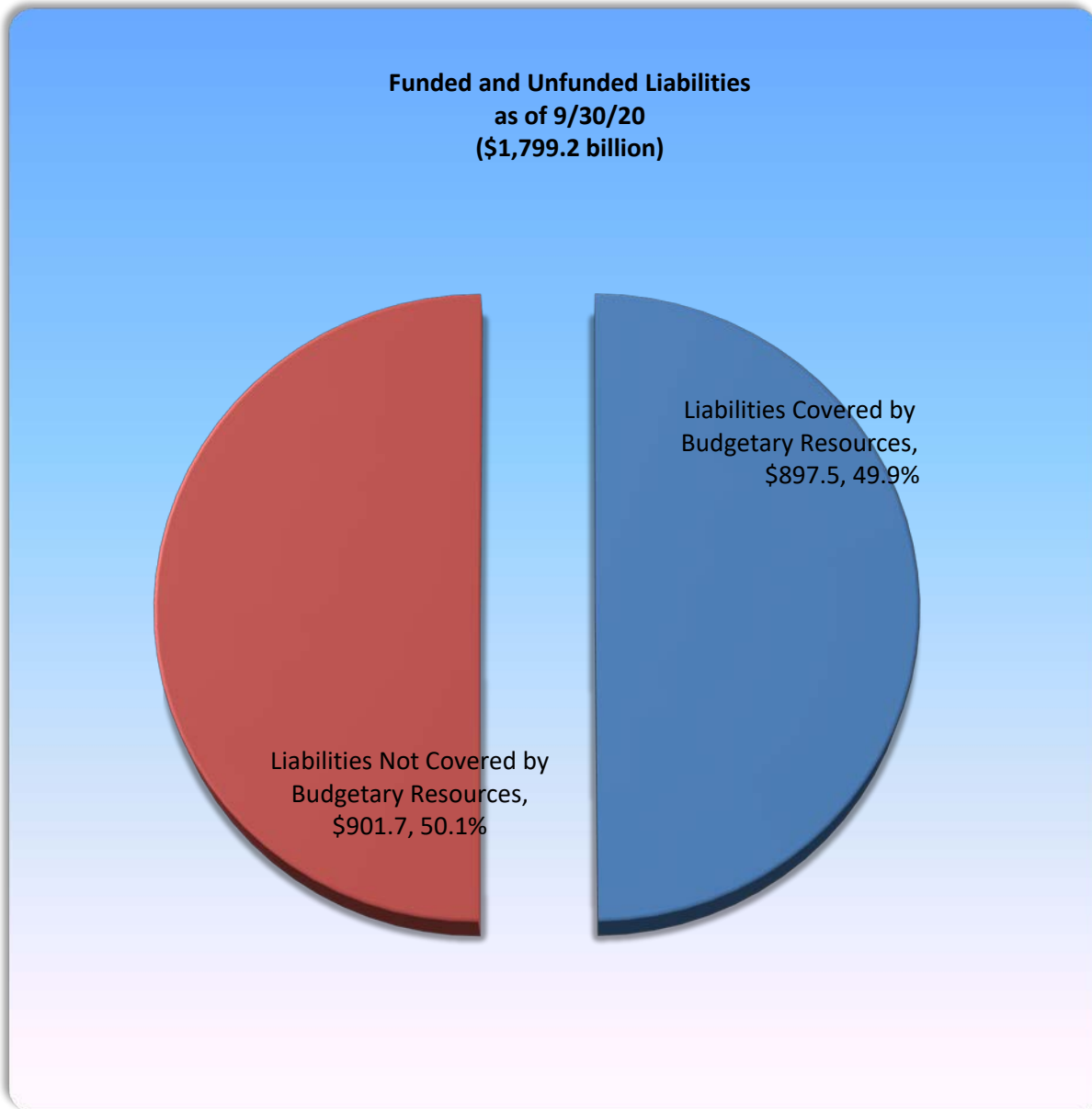


Figure 5 depicts the September 30, 2020, breakout of liabilities between those that are covered by budgetary resources and those that are not.

Analysis of Systems, Controls, and Legal Compliance

Agencies are required to provide certain assurances as to the status and effectiveness of the internal controls and financial management systems that support the preparation of the financial statements. In the context of the MRF Management's Discussion and Analysis, DoD, and not MRF, represents the legislative definition of an Agency. Beginning with FY 2006, as directed in Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, Appendix A, *Internal Control over Financial Reporting*, the 24 CFO Act agencies (including DoD), are required to provide a separate assessment of the effectiveness of the internal controls over financial reporting as a subset of the overall Federal

Management's Discussion and Analysis

Managers Financial Integrity Act (FMFIA) assurance statement. Currently, DFAS and the DoD OACT provide Statements of Assurance for systems and controls relied upon in the day to day operation of MRF. Additionally, an overarching MRF Statement of Assurance was issued for FY 2020 by the Management Control Senior Responsible Official and Chair, MRF FMC. Procedures have been established to ensure adherence to the overarching statutory requirements of OMB Bulletin 19-03, "Audit Requirements for Federal Financial Statements" (defining requirements for conducting and submitting FMFIA assessments and reports) and OMB A-123, "Management's Responsibility for Enterprise Risk Management and Internal Control" (defining management's accountability for internal control in Federal agencies).

During 2020, DFAS and OACT determined that the responsible MRF functions have effective internal controls to support effective and efficient programmatic operations and reliable financial reporting. The service providers are substantially compliant with applicable laws and regulations (FMFIA § 2). The current financial management system conforms to financial systems requirements and is substantially FMFIA compliant (FMFIA § 4).

Under the current management arrangement, DFAS and OACT are responsible for appropriately establishing and maintaining effective internal control and financial management systems meeting the objectives of the FMFIA, subject to MRF operation. They conducted a functional assessment of the effectiveness of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123. Based on the results of this evaluation, the service providers can assure that MRF can provide reasonable assurance that internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations for FY 2020 were operating effectively and no material weaknesses were found in the design or operation of the internal controls.

Additionally under the current management process, DFAS and OACT conducted assessments of the effectiveness of internal control over financial reporting, including safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of these evaluations, DFAS and OACT can assure that MRF can provide reasonable assurance that its internal control over financial reporting as of 3rd Quarter, FY 2020 were operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

LIMITATIONS OF THE FINANCIAL STATEMENTS

These financial statements have been prepared to report the financial position and results of operations for the MRF pursuant to the requirements of the CFO Act of 1990. While the statements have been prepared from the books and records of MRF in accordance with the generally accepted accounting principles for federal entities and formats prescribed by OMB, the statements are in addition to the financial reports 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 component of the U.S. Government, a sovereign entity. Unfunded liabilities reported in the financial statements cannot be liquidated without the enactment of an appropriation.

DoD Transmittal of Auditor's Opinion



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

November 9, 2020

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

SUBJECT: Transmittal of the Independent Auditor's Report on the DoD Military
Retirement Fund Financial Statements and Related Notes for FY 2020 and
FY 2019 (Project No. D2020-D000FP-0081.000, Report No. DODIG-2021-020)

We contracted with the independent public accounting firm of Kearney & Company to audit the Military Retirement Fund Financial Statements and related notes as of and for the fiscal years ended September 30, 2020, and 2019. The contract required Kearney & Company to provide a report on internal control over financial reporting and compliance with laws and other matters, and to report on whether the Military Retirement Fund's financial management systems substantially complied with the requirements of the Federal Financial Management Improvement Act of 1996. The contract required Kearney & Company to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency, "Financial Audit Manual," June 2018, Updated April 2020. Kearney & Company's Independent Auditor's Reports are attached.

Kearney & Company's audit resulted in an unmodified opinion. Kearney & Company concluded that the Military Retirement Fund FY 2020 and FY 2019 Financial Statements and related notes as of September 30, 2020, and 2019, and for the years then ended, are presented fairly, in all material respects, in conformity with Generally Accepted Accounting Principles.

Kearney & Company's separate reports, "Internal Control Over Financial Reporting" and "Compliance With Laws, Regulations, Contracts, and Grant Agreements," did not identify

DoD Transmittal of Auditor's Opinion

any material weaknesses or significant deficiencies related to financial reporting or any instances of noncompliance with laws, regulations, contracts, or grant agreements.

In connection with the contract, we reviewed Kearney & Company's reports and related documentation and discussed them with Kearney & Company's representatives. Our review, as differentiated from an audit of the financial statements in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the Military Retirement Fund FY 2020 and FY 2019 Financial Statements and related notes. Furthermore, we do not express conclusions on the effectiveness of internal control over financial reporting, on whether the Military Retirement Fund's financial systems substantially complied with Federal Financial Management Improvement Act of 1996 requirements, or on compliance with laws and other matters. Our review disclosed no instances where Kearney & Company did not comply, in all material respects, with GAGAS. Kearney & Company is responsible for the attached November 9, 2020, reports, and the conclusions expressed within the reports.

We appreciate the cooperation and assistance received during the audit. Please direct questions to me.



Lorin T. Venable, CPA

Assistant Inspector General for Audit
Financial Management and Reporting

Attachments:

As stated

Independent Auditor's Report



1701 Duke Street, Suite 500, Alexandria, VA 22314
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INDEPENDENT AUDITOR'S REPORT

To the Under Secretary of Defense for Personnel and Readiness and Inspector General of the Department of Defense

Report on the Financial Statements

We have audited the accompanying financial statements of the Military Retirement Fund (MRF), which comprise the balance sheets as of September 30, 2020 and 2019, the related statements of net cost and changes in net position, and the combined statements of budgetary resources (hereinafter referred to as the "financial statements") for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 19-03 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the MRF as of September 30, 2020 and 2019, and its net cost of operations, changes in net position, and budgetary resources for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis (hereinafter referred to as the "required supplementary information") be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by OMB and the Federal Accounting Standards Advisory Board (FASAB), who consider it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management regarding the methods of preparing the information and comparing it for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. Other Information, as named in the Agency Financial Report (AFR), is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements; accordingly, we do not express an opinion or provide any assurance on it.



Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards* and OMB Bulletin No. 19-03, we have also issued reports, dated November 9, 2020, on our consideration of the MRF's internal control over financial reporting and on our tests of the MRF's compliance with provisions of applicable laws, regulations, contracts, and grant agreements, as well as other matters for the year ended September 30, 2020. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance and other matters. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 19-03 and should be considered in assessing the results of our audits.

A handwritten signature in blue ink that reads "Kearney & Company". The signature is written in a cursive, flowing style.

Alexandria, Virginia
November 9, 2020



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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Under Secretary of Defense for Personnel and Readiness and Inspector General of the Department of Defense

We have audited, in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the Military Retirement Fund (MRF) as of and for the year ended September 30, 2020, and the related notes to the financial statements, which collectively comprise the MRF's financial statements, and we have issued our report thereon dated November 9, 2020.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the MRF's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the MRF's internal control. Accordingly, we do not express an opinion on the effectiveness of the MRF's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 19-03. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFLA), such as those controls relevant to ensuring efficient operations.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.



We noted certain additional matters involving internal control over financial reporting that we will report to the MRF's management in a separate letter.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of the MRF's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 19-03 in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in blue ink that reads "Kearney & Company". The signature is written in a cursive, flowing style.

Alexandria, Virginia
November 9, 2020



1701 Duke Street, Suite 500, Alexandria, VA 22314
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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS, REGULATIONS, CONTRACTS, AND GRANT AGREEMENTS

To the Under Secretary of Defense for Personnel and Readiness and Inspector General of the Department of Defense

We have audited, in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the Military Retirement Fund (MRF) as of and for the year ended September 30, 2020, and the related notes to the financial statements, which collectively comprise the MRF's financial statements, and we have issued our report thereon dated November 9, 2020.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the MRF's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and provisions referred to in Section 803(a) of the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions and did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the MRF. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-03.

The results of our tests of compliance with FFMIA disclosed no instances in which the MRF's financial management systems did not comply substantially with the Federal financial management system's requirements, applicable Federal accounting standards, or application of the United States Standard General Ledger (USSGL) at the transaction level.



Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 19-03 in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in blue ink that reads "Kearney & Company".

Alexandria, Virginia
November 9, 2020

**FY 2020 Military Retirement Fund
Principal Financial Statements**

DoD MRF Principal Financial Statements

**Department of Defense
Military Retirement Fund
Balance Sheets
As of September 30, 2020 and 2019**

(\$ in Thousands)	2020	2019
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 75,301	\$ 75,223
Investments (Note 5)	979,210,403	896,771,421
Accounts Receivable (Note 6)	0	9,371
Total Intragovernmental Assets	\$ 979,285,704	\$ 896,856,015
Accounts Receivable, Net (Note 6)	\$ 147,107	\$ 132,699
TOTAL ASSETS	\$ 979,432,811	\$ 896,988,714
LIABILITIES (Note 11)		
Intragovernmental:		
Other Liabilities (Note 15)	\$ 3,688	\$ 4,088
Total Intragovernmental Liabilities	\$ 3,688	\$ 4,088
Military Retirement and Other Federal Employment Benefits (Note 13)	1,799,172,254	1,759,212,362
Other Liabilities (Note 15)	\$ 298	\$ 284
TOTAL LIABILITIES	\$ 1,799,176,240	\$ 1,759,216,734
Commitments and Contingencies (Note 17)		
NET POSITION		
Cumulative Results of Operations - Other Funds	\$ (819,743,429)	\$ (862,228,020)
TOTAL NET POSITION	\$ (819,743,429)	\$ (862,228,020)
TOTAL LIABILITIES AND NET POSITION	\$ 979,432,811	\$ 896,988,714

DoD MRF Principal Financial Statements_____

**Department of Defense
Military Retirement Fund
Statements of Net Cost
For the years ended September 30, 2020 and 2019**

(\$ in Thousands)	<u>2020</u>	<u>2019</u>
Gross Program Costs (Note 19)		
Military Retirement Benefits		
Actuarial Non Assumption Costs	\$ 55,067,245	\$ 28,925,275
Other Program Costs	<u>62,363,999</u>	<u>60,910,619</u>
Total Gross Costs	\$ 117,431,244	\$ 89,835,894
Less: Earned Revenue	<u>(144,715,842)</u>	<u>(143,813,145)</u>
Net Cost before Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	\$ <u>(27,284,598)</u>	\$ <u>(53,977,251)</u>
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits (Note 13)	\$ <u>(15,199,993)</u>	\$ <u>108,863,646</u>
Net Cost of Operations	\$ <u>(42,484,591)</u>	\$ <u>54,886,395</u>

DoD MRF Principal Financial Statements_____

**Department of Defense
Military Retirement Fund
Statements of Changes in Net Position
For the years ended September 30, 2020 and 2019**

(\$ in Thousands)	2020	2019
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	\$ <u>(862,228,020)</u>	\$ <u>(807,341,625)</u>
Net Cost of Operations (+/-)	<u>(42,484,591)</u>	<u>54,886,395</u>
Net Change	<u>42,484,591</u>	<u>(54,886,395)</u>
Cumulative Results of Operations	<u>(819,743,429)</u>	<u>(862,228,020)</u>
Net Position	\$ <u><u>(819,743,429)</u></u>	\$ <u><u>(862,228,020)</u></u>

DoD MRF Principal Financial Statements_____

**Department of Defense
Military Retirement Fund
Statements of Budgetary Resources
For the years ended September 30, 2020 and 2019**

(\$ in Thousands)	<u>2020</u>	<u>2019</u>
BUDGETARY RESOURCES		
Appropriations (discretionary and mandatory)	\$ <u>62,378,792</u>	\$ <u>60,913,768</u>
Total Budgetary Resources	\$ <u>62,378,792</u>	\$ <u>60,913,768</u>
 STATUS OF BUDGETARY RESOURCES		
New obligations and upward adjustments (total)	\$ <u>62,378,792</u>	\$ <u>60,913,768</u>
Total Budgetary Resources	\$ <u>62,378,792</u>	\$ <u>60,913,768</u>
 Outlays, Net:		
Outlays, net (total) (discretionary and mandatory)	\$ 62,286,153	\$ 60,703,255
Distributed offsetting receipts (-)	\$ <u>(91,873,000)</u>	\$ <u>(87,996,000)</u>
Agency Outlays, net (discretionary and mandatory)	\$ <u>(29,586,847)</u>	\$ <u>(27,292,745)</u>

**FY 2020 Military Retirement Fund Footnotes to the
Principal Financial Statements**

Note 1. Significant Accounting Policies

A. Reporting Entity

The Department of Defense (Department or DoD) includes the Office of the Secretary of Defense (OSD), Joint Chiefs of Staff (JCS), DoD Office of the Inspector General (DoD OIG), Military Departments, Defense Agencies, DoD Field Activities, and Combatant Commands, which are considered, and may be referred to as, DoD Components. The Military Departments consist of the Departments of the Army, the Navy (of which the Marine Corps is a component), and the Air Force. The Military Retirement Fund (MRF) is a component of the Department's reporting entity for the purposes of consolidated/combined financial statements.

B. Mission of the Reporting Entity

The mission of MRF is to accumulate funds to finance, on an actuarially sound basis, the liabilities of DoD military retirement and survivor benefit programs. The MRF is a program for the payment of pensions to retired military personnel, annuities to eligible survivors, and special compensation for certain disabled retirees.

C. Basis of Presentation

These financial statements have been prepared to report the financial position and results of MRF operations, as required by the Chief Financial Officers Act of 1990, as amended and expanded by the Government Management Reform Act of 1994, and other applicable legislation. To the extent possible, the financial statements have been prepared from the accounting records of the MRF in accordance with formats prescribed by Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, and in accordance with U.S. Generally Accepted Accounting Principles (GAAP) for federal entities as prescribed by the Federal Accounting Standards Advisory Board. The financial statements account for all resources for which the MRF is responsible, unless otherwise noted.

Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information.

D. Basis of Accounting

The MRF's financial management systems meet all full accrual accounting requirements. The MRF's accounting systems record transactions based on the U.S. Standard General Ledger. Financial and nonfinancial feeder systems and processes are updated from legacy systems to collect and report financial information as required by U.S. GAAP.

The financial statements and supporting trial balances are compiled from the underlying financial data and trial balances. The underlying data for the MRF is largely derived from budgetary transactions (obligations, disbursements, and collections) and proprietary transactions (assets and liabilities) and accruals made for major items such as pension liabilities.

E. Accounting for Intragovernmental and Intragovernmental Activities

The Treasury Financial Manual, Volume 1, Part 2-Chapter 4700 provides guidance for reporting and reconciling intragovernmental balances. The MRF is able to reconcile balances pertaining to investments in federal securities.

DoD MRF Footnotes to the Principal Financial Statements_____

F. Non-Entity Assets

Non-entity assets are not available for use in the MRF's normal operations. The MRF has stewardship accountability and reporting responsibility for non-entity assets. An example of a non-entity asset is the amount of interest, penalties, and administrative charges to be collected by MRF on behalf of the U.S. Treasury.

For additional information, see Note 2, *Non-Entity Assets*.

G. Fund Balance with Treasury

The MRF's monetary resources of collections and disbursements are maintained in U.S. Treasury accounts. The disbursing offices of DFAS process MRF's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS submits reports to the U.S. Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. On a monthly basis, the MRF FBWT is reviewed and adjusted, as required, to agree with the U.S. Treasury accounts.

The U.S. Treasury allows MRF to be fully invested; therefore, FBWT may be zero at various times during the fiscal year. Controls are in place to prevent abnormal balances at the U.S. Treasury.

For additional information, see Note 3, *Fund Balance with Treasury*.

H. Cash and Other Monetary Assets

Not Applicable

I. Investments and Related Interest

The MRF reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts (book value). Premiums or discounts are amortized over the term of the investment using the effective interest rate method. The MRF's intent is to hold investments to maturity unless they are needed to finance claims or otherwise sustain operations. Consequently, there is no provision for unrealized gains or losses on these securities.

The MRF invests in nonmarketable market-based U.S. Treasury securities, issued to federal agencies by the U. S. Treasury's Bureau of Fiscal Service. These securities are not traded on any financial exchange but are priced consistently with publicly traded U.S. Treasury securities. The MRF receives interest semiannually from the U.S. Treasury on the value of these securities.

For additional information, see Note 5, *Investments and Related Interest*.

J. Accounts Receivable

Accounts receivable from other federal entities or from the public include accounts receivable, claims receivable, and refunds receivable. Allowances for uncollectible accounts due from the public are based upon factors such as: aging of accounts receivable, debtor's ability to pay, and payment history during the previous three years. The MRF does not recognize an allowance for benefit contributions receivable from federal entities, as historically they are received in the following month within 30 days.

For additional information, see Note 6, *Accounts Receivable*.

K. Direct Loans and Loan Guarantees

Not Applicable

L. Inventories and Related Property

Not Applicable

M. General Property, Plant and Equipment

Not Applicable

N. Other Assets

Not Applicable

O. Leases

Not Applicable

P. Liabilities

Liabilities represent the probable future outflow or other sacrifice of resources as a result of past transactions or events. However, no liability can be paid by the MRF absent proper budget authority. Liabilities covered by budgetary resources have current resources otherwise available to pay amounts due. Liabilities that are not funded by the current year appropriation are classified as liabilities not covered by budgetary resources in Note 11, *Liabilities Not Covered by Budgetary Resources*. These liabilities represent actuarial liabilities for future pension benefits for which assets are not yet available.

Q. Environmental and Disposal Liabilities

Not Applicable

R. Other Liabilities

Intragovernmental Custodial Liabilities represent a liability for the MRF comprised of interest, penalties, and administrative charges to be collected on behalf of U.S. Treasury.

For additional information, see Note 15, *Other Liabilities*.

S. Commitments and Contingencies

The MRF recognizes contingent liabilities on the Balance Sheet for legal actions where management considers an adverse decision to be probable and the loss amount is reasonably estimable. These legal actions are estimated and disclosed in Note 17, *Commitments and Contingencies*. However, there may be cases where amounts have not been accrued or disclosed because the likelihood of an adverse decision is considered remote or the amount of potential loss cannot be estimated. The MRF reports death payment contingencies that result from DoD's reasonability to cover benefits not paid by the VA during the month of death.

For additional information, see Note 17, *Commitments and Contingencies*.

T. Military and Civilian Retirement Benefits

The Department applies SFFAS No. 33, "Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates," in selecting the discount rate and valuation date used in estimating actuarial liabilities. In addition, gains and losses from changes in long-term assumptions used to estimate the actuarial liability are

DoD MRF Footnotes to the Principal Financial Statements_____

presented separately on the Statement of Net Cost. Refer to Note 13, *Military Retirement and Other Federal Employment Benefits*, and Note 19, *Disclosures Related to the Statement of Net Cost*, for additional information.

U. Revenues and Other Financing Sources

Using methods and assumptions approved by the DoD Board of Actuaries, the DoD OACT determines the amount of the contributions made to MRF. The Military Services make a monthly contribution, which is a percentage of basic pay, to cover accruing costs for currently active military members. The MRF also receives a U. S. Treasury warrant at the beginning of each FY (1) to amortize unfunded liability and (2) to cover accruing costs for concurrent receipts (certain beneficiaries with combat-related injuries who are receiving payments from the VA). In addition, interest is earned on investments. Funds from the contributions that exceed the amounts required to pay current year expenses are invested in long-term securities. These investments and their associated interest revenues will be used to cover future liabilities of MRF.

V. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of benefit expenses in the period incurred. Estimates are used in the computation of actuarial liabilities. The current financial management systems for MRF collect and record on full accrual accounting basis for liabilities and expenses of the fund.

W. Treaties for Use of Foreign Bases

Not Applicable

X. Use of Estimates

The MRF's management makes assumptions and reasonable estimates in the preparations of financial statements based on current conditions which may affect the reported amounts. Actual results could differ materially from the estimated amounts. Significant estimates include actuarial liabilities for military retirement.

Y. Parent-Child Reporting

Not Applicable

Z. Transactions with Foreign Governments and International Organizations

Not Applicable

AA. Fiduciary Activities

Not Applicable

BB. Tax Exempt Status

As an agency of the federal government, the MRF is exempt from all income taxes imposed by any governing body whether it is a federal, state, commonwealth, local, or foreign government.

CC. Standardized Footnotes to the Financial Statements

Beginning in FY 2020, the DoD Agency-wide Footnotes and its stand-alone Components' Footnotes have the same Footnote structure in the notes to the financial statements included in their respective annual financial statements. For Footnotes not applicable to a Component because it does not have such transactions, or has such transactions that are immaterial to the financial statements, the Footnote number and name is included but is marked as "Not Applicable." The shared Footnote structure provides efficiency in the preparation of the DoD Agency-wide financial statements and consistency among the DoD Agency-wide and stand-alone Component annual financial statements.

DoD MRF Footnotes to the Principal Financial Statements _____

Note 2. Nonentity Assets				
As of September 30	2020		2019	
(Amounts in thousands)				
Accounts Receivable	\$	3,688	\$	4,088
Total Nonentity Assets		3,688		4,088
Total Entity Assets		979,429,123		896,984,626
Total Assets	\$	979,432,811	\$	896,988,714

Information Related to Nonentity Assets

Nonentity assets are assets for which the MRF maintains stewardship accountability and responsibility to report but are not available for MRF's operations.

Nonfederal Assets, Accounts Receivable, represent the amount of interest, penalties, and administrative charges to be collected by MRF on behalf of the U.S. Treasury. Once collected, this amount is transferred to the appropriate U.S. Treasury receipt account. This amount is offset by a corresponding custodial liability for MRF reported in Note 15, *Other Liabilities*.

Note 3. Fund Balance with Treasury				
Status of Fund Balance with Treasury				
As of September 30	2020		2019	
(Amounts in thousands)				
Unobligated Balance				
Unavailable	\$	892,952,876	\$	813,431,844
Obligated Balance not yet Disbursed	\$	5,118,007	\$	5,025,368
NonFBWT Budgetary Accounts	\$	(897,995,582)	\$	(818,381,989)
Total	\$	75,301	\$	75,223

Information Related to Status of Fund Balance with Treasury

The Status of FBWT reflects the budgetary resources to support FBWT and is a reconciliation between budgetary and proprietary accounts. It primarily consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursement against current or future obligations.

Unobligated Balance is classified as available or unavailable and represents the cumulative amount of budgetary authority not set aside to cover future obligations. The unavailable balance, consisting primarily of funds temporarily precluded from obligation by law, is invested in U.S. Treasury securities. The unobligated balance for the MRF is restricted for use by the public law establishing the fund and becomes available without further congressional action.

DoD MRF Footnotes to the Principal Financial Statements _____

Obligated Balance not yet Disbursed represents the amount of earned and accrued pension and annuity payments. The MRF balance represents benefits payable on September 30, 2020.

The MRF NonFBWT Budgetary Accounts balance represents investments in U.S. Treasury securities that are reflected in the MRF's budgetary resources, but are not part of the FBWT.

Note 4. Cash and Other Monetary Assets

Not Applicable

Note 5. Investments and Related Interest

	Amounts for 2020 Balance Sheet Reporting						
	Cost	Amortization Method	Amortized (Premium) / Discount	Interest Receivable	Investments, Net	Market Value Disclosure	
(Amounts in thousands)							
Intragovernmental Securities							
Nonmarketable, Market-Based							
Military Retirement Fund	\$ 1,013,708,906	Effective Interest	\$ (40,106,425)	5,607,922	\$ 979,210,403	\$	1,218,732,913
Total Nonmarketable, Market-Based	1,013,708,906		(40,106,425)	5,607,922	979,210,403		1,218,732,913
Total	\$ 1,013,708,906		\$ (40,106,425)	5,607,922	\$ 979,210,403	\$	1,218,732,913
	Amounts for 2019 Balance Sheet Reporting						
	Cost	Amortization Method	Amortized (Premium) / Discount	Interest Receivable	Investments, Net	Market Value Disclosure	
(Amounts in thousands)							
Intragovernmental Securities							
Nonmarketable, Market-Based							
Military Retirement Fund	\$ 928,306,873	Effective Interest	\$ (37,141,662)	5,606,210	\$ 896,771,421	\$	997,841,328
Total Nonmarketable, Market-Based	928,306,873		(37,141,662)	5,606,210	896,771,421		997,841,328
Total	\$ 928,306,873		\$ (37,141,662)	5,606,210	\$ 896,771,421	\$	997,841,328

Information Regarding Investments and Related Interest

The MRF purchases and redeems nonmarketable market-based U.S. Treasury securities that fluctuate in tandem with the current selling price of the equivalent marketable security on the open market. The MRF purchases securities with the intent to hold until maturity; therefore, balances are not adjusted to market value.

DoD MRF Footnotes to the Principal Financial Statements _____

The cash generated from investments is deposited in the U.S. Treasury, which uses the cash for general government purposes. The U.S. Treasury securities are issued to the MRF as evidence of its receipts and are an asset to the MRF and a liability to the U.S. Treasury. Since MRF and the U.S. Treasury are both parts of the Federal Government, these assets and liabilities offset each other from the standpoint of the Federal Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government wide financial statements.

The U.S. Treasury securities provide MRF with authority access funds to make future benefit payments or other expenditures. When MRF requires redemption of these securities to make expenditures, the Federal Government will meet the requirement by using accumulated cash balances, raising taxes or other receipts, borrowing from the public or repaying less debt, or curtailing other expenditures. The Federal Government uses the same method to finance all other expenditures.

At the semiannual meetings, the DoD Investment Board approves the strategy for the type of securities purchased by MRF. These securities can include U.S. Treasury bills, notes, bonds, inflation-protected securities, overnight certificates, and zero-coupon bonds. The U.S. Treasury bills are short-term securities with maturities of one year or less and are purchased at a discount. The U.S. Treasury notes have maturities of at least one year, but not more than ten years, and are purchased at either a discount or premium. The U.S. Treasury bonds are long-term securities with maturities of ten years or more and are purchased at either a discount or premium. TIPS provide protection against inflation and are purchased at either a discount or premium. The TIPS principal increases with inflation and decreases with deflation, as measured by the CPI. When TIPS mature, the U.S. Treasury pays the adjusted principal or original principal, whichever is greater. The TIPS amount includes inflation compensation as well as the par value of the securities. Overnight securities are short-term securities, purchased at face value, that mature the next business day and earn interest at the daily Federal Reserve repurchase agreement rate. U.S. Treasury zero-coupon bonds are fixed-principal bonds having maturities of at least five years and are purchased at a discount.

The cost of the U.S. Treasury Securities is displayed in the following table.

	FY 2020 COST	FY 2019 COST
	(\$ in billions)	(\$ in billions)
Notes	41.9	61.8
Bonds	157.0	157.0
Zero Coupon Bonds	30.0	0.0
TIPS	771.6	701.5
Overnight Securities	<u>13.2</u>	<u>8.0</u>
Total Cost	<u>\$1,013.7</u>	<u>\$928.3</u>

DoD MRF Footnotes to the Principal Financial Statements _____

Note 6. Accounts Receivable, Net				
As of September 30	2020			
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	
(Amounts in thousands)				
Intragovernmental Receivables	\$ 0	N/A	\$ 0	
Nonfederal Receivables (From the Public)	\$ 170,958	\$ (23,851)	\$ 147,107	
Total Accounts Receivable	\$ 170,958	\$ (23,851)	\$ 147,107	
As of September 30	2019			
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	
(Amounts in thousands)				
Intragovernmental Receivables	\$ 9,371	N/A	\$ 9,371	
Nonfederal Receivables (From the Public)	\$ 154,568	\$ (21,869)	\$ 132,699	
Total Accounts Receivable	\$ 163,939	\$ (21,869)	\$ 142,070	

Information Related to Accounts Receivable

Accounts receivable represent the MRF’s claim for payment from military retirees or their survivors for erroneous amounts previously paid. Allowances for uncollectible accounts due from the public are based upon factors such as: aging of accounts receivable, debtor’s ability to pay, and payment history during the previous three years. The MRF only recognizes an allowance for uncollectible amounts from the public. MRF’s intragovernmental receivables are a result of timing differences between the system and end of month cutoff. Historically, the transactions for these receivables are generally processed within 30 days; therefore, an allowance is not recognized. Claims with other federal agencies are resolved in accordance with the business rules published in Appendix 10 of Treasury Financial Manual, Volume I, Part 2, Chapter 4700.

Note 7. Direct Loan and Loan Guarantees, Non-Federal Borrowers

Not Applicable

DoD MRF Footnotes to the Principal Financial Statements _____

Note 8. Inventory and Related Property, Net

Not Applicable

Note 9. General PP&E, Net

Not Applicable

Note 10. Other Assets

Not Applicable

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2020	2019
(Amounts in thousands)		
Military Retirement and Other Federal Employment Benefits	\$ 901,675,223	\$ 940,755,150
Other Liabilities	298	284
Total Liabilities Not Covered by Budgetary Resources	901,675,521	940,755,434
Total Liabilities Covered by Budgetary Resources	\$ 897,500,719	\$ 818,461,300
Total Liabilities	\$ 1,799,176,240	\$ 1,759,216,734

Information Related to Liabilities Not Covered by Budgetary Resources

The MRF Liabilities Not Covered by Budgetary Resources amount represents actuarial liabilities for pension benefits for which assets are not yet available. Refer to Note 13, *Military Retirement and Other Federal Employment Benefits*, for additional details and disclosures.

Nonfederal Other Liabilities represent contingent liabilities payable by DoD for estimated death payments. These liabilities cover the retiree benefits not paid by the VA during the month of death. This amount is also reported on Note 15, *Other Liabilities*.

Note 12. Debt

Not Applicable

DoD MRF Footnotes to the Principal Financial Statements _____

Note 13. Military Retirement and Other Federal Employment Benefits

As of September 30

2020

Liabilities

(Less: Assets Available to Pay Benefits)

Unfunded Liabilities

(Amounts in thousands)

Pension and Health Benefits

Military Retirement Pensions	\$	1,794,054,247	\$	(892,379,024)	\$	901,675,223
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Total Pension and Health Benefits	\$	1,794,054,247		(892,379,024)	\$	901,675,223
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Other Benefits

Other		5,118,007	\$	(5,118,007)	\$	0
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Total Other Benefits	\$	5,118,007	\$	(5,118,007)	\$	0
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Total Military Retirement and Other Federal Employment Benefits:

	\$	1,799,172,254	\$	(897,497,031)	\$	901,675,223
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As of September 30

2019

Liabilities

(Less: Assets Available to Pay Benefits)

Unfunded Liabilities

(Amounts in thousands)

Pension and Health Benefits

Military Retirement Pensions	\$	1,754,186,994	\$	(813,431,844)	\$	940,755,150
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Total Pension and Health Benefits	\$	1,754,186,994		(813,431,844)	\$	940,755,150
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Other Benefits

Other		5,025,368	\$	(5,025,368)	\$	0
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Total Other Benefits	\$	5,025,368	\$	(5,025,368)	\$	0
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Total Military Retirement and Other Federal Employment Benefits:

	\$	1,759,212,362	\$	(818,457,212)	\$	940,755,150
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DoD MRF Footnotes to the Principal Financial Statements

As of September 30	2020		2019	
		Military Retirement Pensions		Military Retirement Pensions
(Amounts in thousands)				
Beginning Actuarial Liability	\$	1,754,186,994		1,616,398,074
Expenses:				
Normal Cost		37,145,696		32,110,337
Interest Cost		59,245,723		56,083,806
Plan Amendments		15,537,771		0
Experience Losses (Gains)		3,811,854		1,091,658
Other factors		1		(1)
Subtotal: Expenses before Losses (Gains) from Actuarial Assumption Changes		115,741,045		89,285,800
Actuarial losses/ (gains)/ due to:				
Changes in trend assumptions		0		0
Changes in assumptions other than trend		(15,199,993)		108,863,646
Subtotal: Losses (Gains) from Actuarial Assumption Changes		(15,199,993)		108,863,646
Total Expenses	\$	100,541,052		198,149,446
Less Benefit Outlays		60,673,799		60,360,526
Total Changes in Actuarial Liability	\$	39,867,253		137,788,920
Ending Actuarial Liability	\$	1,794,054,247		1,754,186,994

The MRF is a nonrevolving trust fund. New members are covered under the fund each passing year. Thus, the MRF actuarial liability is “expected” to increase each year, excluding any changes to underlying plan amendments, actuarial assumptions, or emerging experience.

Each year the actuarial liability is expected to increase with the normal cost (\$37.15 billion), decrease with benefit outlays (\$60.67 billion), and increase with the interest cost (\$59.25 billion), resulting in an expected increase of \$35.73 billion in the actuarial liability in FY 2020.

The September 30, 2020, actuarial liability includes changes due to revised actuarial assumptions, plan amendments, and experience. The revised assumptions include lower long-term economic assumptions under SFFAS No. 33 (3.2% discount rate compared to 3.4% last year, 1.6% COLA compared to 1.8% from last year, and 1.8% across-the-board salary increase, unchanged from last year), as well as changes in benefit plan amendments/provisions and revised non-economic assumptions. The effect of the changes in benefit plan amendments/provisions is an increase in the September 30, 2020, actuarial liability of \$15.5 billion. The net effect of the revised actuarial assumptions is a decrease in the September 30, 2020, actuarial liability of \$15.2 billion, of which there is an increase of \$13.1 billion due to the newly adopted SFFAS No. 33 long-term economic assumptions, offset by a decrease of \$28.3 billion due to revised, non-economic actuarial assumptions. The experience loss, or increase, of \$3.8 billion reflects economic experience being different from that assumed, as well as the new census data on which the September 30, 2020, actuarial liability is based.

DoD MRF Footnotes to the Principal Financial Statements _____

Information Related to Military Retirement Benefit Liabilities

The MRF accumulates funds used to pay pensions to retired military personnel and annuities to their survivors. The MRS is a single-employer, defined benefit plan.

The schedules on page 50 reflect two distinct types of liabilities related to Military Retirement and Other Federal Employment Benefits. The line entitled "Military Retirement Pensions" represents the actuarial liability for future pension benefits not yet paid, i.e., the present value of future benefits less the present value of future normal costs. The line entitled "Other" represents retirement benefits due and payable on the first day of the next reporting period.

This schedule also computes "unfunded liabilities", i.e. liabilities not covered by budgetary resources. The assets presented in this schedule differ from those reported on the balance sheet. The balance sheet assets consist primarily of investments, the value of which is based on the fully amortized cost or "book value" of the securities (see Note 5, *Investments and Related Interest*). The value of assets available to pay benefits presented on the schedules on page 50 is based on available budgetary funding. The difference between investments and assets available to pay benefits is the premium on U.S. Treasury Securities. At the time of purchase, budgetary funding is reduced by the premium on U.S. securities because the premium on securities is no longer a budgetary resource.

MRF complies with the requirements of SFFAS No. 33 (effective FY 2010), which directs that the long-term discount rate, underlying inflation (COLA) rate, and other economic assumptions be consistent with one another. A change in the discount rate may cause other assumptions to change as well. For the September 30, 2020, financial statement valuation, the application of SFFAS No. 33 required the DoD Office of the Actuary (OACT) to set the long-term inflation (COLA) and salary increase assumptions to be consistent with the underlying Treasury spot rates used in the valuation.

The MRF actuarial liability is adjusted at the end of each fiscal year. The 4th Quarter, FY 2020 balance represents the September 30, 2020 amount that will be effective through 3rd quarter, FY 2021.

Actuarial Cost Method

As prescribed by law, the MRF is funded using the Aggregate Entry-Age Normal (AEAN) method. Per SFFAS No. 5, AEAN is also used to compute the actuarial liabilities reported herein. AEAN is a method whereby the costs of future retirement and survivor benefits for a new-entrant cohort are spread over the projected salaries of that group.

Revenues

The MRF receives revenues from three sources: (1) interest earnings on MRF assets, (2) monthly contributions from the Military Services, and (3) an annual contribution from the U.S. Treasury. The contribution from the U.S. Treasury is paid into the MRF at the beginning of each FY and represents the amortizations of (1) the unfunded liability for service performed before October 1, 1984, and (2) subsequent actuarial gains and losses. Starting October 1, 2004, P.L. 108-136 requires a Treasury contribution for the normal cost amount for the concurrent receipt provisions under Sections 1413a and 1414 in addition to the unfunded liability amortization payment. The DoD Board of Actuaries (the Board) approves methods and assumptions used to determine the amounts for contributions by the U.S. Treasury and the Military Services, and the Secretary of Defense directs the Secretary of Treasury to make the required payment.

DoD MRF Footnotes to the Principal Financial Statements _____

Assumptions

The Board sets the long-term economic assumptions for each valuation performed for funding purposes. Prior to FY 2010, the same long-term assumptions were used for the financial statement valuations. The distinction between the two different valuations is discussed below.

	Inflation (COLA)	Salary	Discount
FY 2019 financial statement valuation	1.8%	1.8%	3.4%
FY 2019 funding valuation	2.75%	3.25%	4.75%
FY 2020 financial statement valuation	1.6%	1.8%	3.2%
FY 2020 funding valuation	2.50%	2.75%	4.25%

(Note that the term “discount” refers here and throughout this note to the interest rate used to discount cash flows. The terms “interest” rate and “discount” rate are often used interchangeably in this context.)

The difference in the long-term assumptions between funding and financial statement valuations is attributable to SFFAS No. 33. This applicable financial statement standard is discussed further below. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on a blend of actual experience and future expectations. Because of reporting deadlines and as permitted by SFFAS No. 33, the current year actuarial present value of projected plan benefits for the MRF financial statement is rolled forward from the prior year valuation results as reported in the OACT report “Valuation of the Military Retirement System” using generally accepted actuarial methods. Modifications are made as necessary to adjust liabilities to a financial statement basis.

The effects of changes during the year in major factors such as actual pay raises and COLAs have been incorporated in the roll-forward adjustment. In calculating the FY 2020 “roll-forward” actuarial liability, the following assumptions were used:

	Inflation (COLA)	Salary	Interest / Discount
FY 2020	1.6% (actual)	3.1% (actual)	3.2%
FY 2021	2.0 % (estimated)	3.0% (estimated)	3.2%
Long-Term	1.6%	1.8%	3.2%

For purposes of the Fund’s financial reporting, this roll-forward process is applied annually.

Contributions to the MRF are calculated using appropriate actuarial methods so as to maintain long-term Fund solvency. This means there will be sufficient funds to make all benefit payments to eligible recipients each year, and the Fund balance is projected to eventually equal the actuarial liability; i.e., all unfunded liabilities are liquidated. In order to accomplish this objective, normal costs are calculated to fully fund the current year projected liability for military personnel. In addition, amortization payments are calculated to fund liabilities that were present at plan inception (initial unfunded liability) and any emerging actuarial gains or losses. Because of “sequestration,” OMB required an \$800 million reduction to the actuarially determined contribution made to the MRF at the beginning of FY 2020. However, the Board chose to amortize this shortfall over one year as an experience loss, effectively putting MRF funding at the beginning of FY 2021 back to where it would have been without the sequestration reduction.

The initial unfunded liability of the program was amortized over a 50-year period through the FY 2007 payment. At its August 2007 meeting, the Board decided to decrease the period over which the initial unfunded liability is

DoD MRF Footnotes to the Principal Financial Statements_____

fully amortized by 8 years. The Board's decision was made to ensure, at a minimum, the amortization payment covered the interest on the unfunded actuarial liability. Therefore, starting with the FY 2008 payment, the initial unfunded liability is being amortized over a 42-year period, with the last payment expected to be made October 1, 2025. All subsequent gains and losses experienced by the system are amortized over a period determined by a weighted average using 30 years for the new gain or loss and the remaining period for the existing unamortized balance. Chapter 74 of Title 10, U.S.C., requires the Board approve the methods and assumptions used to (1) compute actuarial costs and liabilities for funding purposes, (2) amortize the initial unfunded liability, and (3) amortize all actuarial gains and losses. The Board is a Federal Advisory Committee appointed by the Secretary of Defense.

SFFAS No. 33, as published on October 14, 2008, by the FASAB requires the use of a yield curve based on marketable U.S. Treasury securities to determine the discount rates used to calculate actuarial liabilities for federal financial statements. Historical experience is the basis for expectations about future trends in marketable U.S. Treasury securities.

The statement is effective for periods beginning after September 30, 2009, and applies to information provided in general purpose federal financial statements. It does not affect statutory or other special-purpose reports, such as pension or Other Retirement Benefit reports. It requires a minimum of five periodic rates for the yield curve input and consistency in the number of historical rates used from period to period. It permits the use of a single average discount rate if the resulting present value is not materially different from what would be obtained using the yield curve.

OACT annually performs two MRF valuations. The primary one is for funding purposes—this valuation is governed by Chapter 74 of Title 10 U.S.C. and must use methods and assumptions approved by the Board. The other is for financial statement purposes and is governed by FASAB standards. For the September 30, 2020, financial statement valuation, OACT determined a single equivalent discount rate of 3.2% by using a 10-year average of quarterly zero coupon Treasury spot rates. These spot rates are from the U.S. Department of the Treasury-Office of Economic Policy's 10-year Average Yield Curve for Treasury Nominal Coupon Issues (TNC yield curve) representing average rates from April 1, 2010, through March 31, 2020. The same spot rate data source was used in production of last year's financial statements. In the summer of 2020, the Board approved a discount rate of 4.25% for the September 30, 2020, funding valuation, which differs from the SFFAS equivalent rate by 105 basis points. Using the SFFAS No. 33 long-term economic assumptions (as compared to Board assumptions) increases the MRF actuarial liability by 3.8%.

Military Services Contributions

The contributions from the Military Services are the product of basic pay and normal cost percentages (NCPs) determined in accordance with the methods and assumptions approved by the Board. Basic pay generally increases each year, and on January 1, 2020, there was a 3.1% across-the-board basic pay increase. The NCPs for FY 2020 were promulgated by the Board in their August 2018 letter: 31.0% (full-time) and 24.4% (part-time). The NCPs for FY 2021 were promulgated by the Board in their July 2019 letter (and later revised in their June 2020 letter): 34.9% (full-time) and 26.9% (part-time). The above NCPs are based on the Board's funding valuation, not the financial statement valuation, and are calculated without regard to the concurrent receipt provisions of Sections 1413a and 1414 of Title 10, U.S.C.

DoD MRF Footnotes to the Principal Financial Statements _____

Market Value of MRF's Securities

The market value of MRF's nonmarketable, market-based securities as of September 30, 2020 totaled \$1.2 trillion. This amount is also reported on Note 5, *Investments and Related Interest*.

Note 14. Environmental and Disposal Liabilities

Not Applicable

Note 15. Other Liabilities

As of September 30	2020		
	Noncurrent Liability	Current Liability	Total
(Amounts in thousands)			
Intragovernmental			
Custodial Liabilities	\$ 0	\$ 3,688	\$ 3,688
Total Intragovernmental	0	3,688	3,688
Contingent Liabilities	0	298	298
Total Other Liabilities	\$ 0	\$ 3,986	\$ 3,986

As of September 30	2019		
	Noncurrent Liability	Current Liability	Total
(Amounts in thousands)			
Intragovernmental			
Custodial Liabilities	\$ 0	\$ 4,088	\$ 4,088
Total Intragovernmental	0	4,088	4,088
Contingent Liabilities	0	284	284
Total Other Liabilities	\$ 0	\$ 4,372	\$ 4,372

Information Related to Other Liabilities

Intragovernmental Custodial Liabilities represent a liability for the MRF comprised of interest, penalties, and administrative charges to be collected on behalf of U.S. Treasury. This amount is also reported as a nonfederal accounts receivable on Note 2, *Nonentity Assets*.

Nonfederal Other Liabilities represent contingent liabilities payable by the MRF for estimated death payments. These liabilities cover the retiree benefits not paid by the VA during the month of death. This amount is also reported on Note 11, *Liabilities not Covered by Budgetary Resources*, and disclosed in Note 17, *Commitments and Contingencies*.

DoD MRF Footnotes to the Principal Financial Statements _____

Note 16. Leases

Not Applicable

Note 17. Commitments and Contingencies

Information Related to Commitments and Contingencies

As of September 30, 2020 there are no known contingent liabilities pending legal action of \$186.9 million or more individually, or exceeding \$467.1 million in aggregate.

The Military Retirement Fund has an estimated contingent liability of \$298 thousand that is measurable and probable and, therefore, has been recorded in the accounting records. These liabilities cover the retiree benefits not paid by the Department of Veterans Affairs during the month of death. This amount is also reported on Note 15, *Other Liabilities*.

Note 18. Funds from Dedicated Collections

Not Applicable

Note 19. Disclosures Related to the Statements of Net Cost

Intragovernmental Costs and Exchange Revenue

As of September 30	2020	2019
(Amounts in thousands)		
Military Retirement Benefits		
Gross Cost	\$ 117,431,244	\$ 89,835,894
Less: Earned Revenue	\$ (144,715,842)	\$ (143,813,145)
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	\$ (15,199,993)	\$ 108,863,646
Total Net Cost	\$ (42,484,591)	\$ 54,886,395

Information Related to the Statement of Net Cost

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the MRF supported by an appropriation or another means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity.

DoD MRF Footnotes to the Principal Financial Statements _____

Intragovernmental costs and revenue represent transactions made between two reporting entities within the federal government. Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

Intragovernmental Earned Revenue is comprised of the following amounts:

Intragovernmental Earned Revenues for Program Costs

(\$ in Billions)		FY 2020		FY 2019
1. Military Service Contributions as a Percentage of Base Pay	\$	21.8	\$	20.5
2. Annual Treasury Unfunded Liability Payment		91.9		88.0
3. Annual Treasury Normal Cost Payment		8.5		7.9
4. Interest on Investments		22.5		26.7
5. Gains on Disposition of Investments		0.0		0.7
Total	\$	<u>144.7</u>	\$	<u>143.8</u>

The MRF complies with SFFAS No. 33, "Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates." This standard requires the separate presentation of gains and losses from changes in long-term assumptions used to estimate liabilities associated with pensions, other retirement benefits and other postemployment benefits on the SNC.

Note 20. Disclosures Related to the Statements of Changes in Net Position

Reconciliation of Appropriations on the Statement of Budgetary Resources to Appropriations Received on the Statement of Changes in Net Position

As of September 30	2020		2019	
(Amounts in thousands)				
Appropriations, Statement of Budgetary Resources	\$	62,378,792	\$	60,913,768
Permanent and Temporary Reductions		0		0
Trust and Special Fund Receipts		(62,378,792)		(60,913,768)
Miscellaneous Items		0		0
Total Reconciling Difference	\$	(62,378,792)	\$	(60,913,768)
Appropriations Received, Statement of Changes in Net Position	\$	0	\$	0

There was a difference of \$62.4 billion between Appropriations Received on the Statement of Changes in Net Position (SCNP) and Appropriations on the Statement of Budgetary Resources (SBR). The MRF records contributions as revenue on the SCNP, while contributions are recorded as Appropriations on the SBR. This is in accordance with OMB reporting requirements.

Note 21. Disclosures Related to the Statement of Budgetary Resources

Permanent Indefinite Appropriations

P.L. 98-94, *The Defense Authorization Act of 1984*, authorized MRF and provided a permanent, indefinite appropriation.

Legal Arrangements Affecting the Use of Unobligated Balances

The MRF's unobligated balances of budget authority represent the portion of trust fund receipts collected in the current FY that exceeds (1) the amount needed to pay benefits or other valid obligations and (2) the receipts temporarily precluded from obligation by law. The receipts, however, are assets of MRF and are available for obligation as needed in the future.

Explanation of Differences between the SBR and the Budget of the U.S. Government

There was a difference of \$62.4 billion between Appropriations Received on the SCNP and Appropriations on the SBR. The MRF records contributions as revenue on the SCNP, while contributions are recorded as Appropriations on the SBR. This is in accordance with OMB reporting requirements. Refer to Note 20, *Disclosures Related to the Statement of Changes in Net Position* for further information.

There are no material differences between amounts reported on the SBR and the SF-133, Report on Budget Execution.

Note 22. Disclosures Related to Incidental Custodial Collections

Not Applicable

Note 23. Fiduciary Activities

Not Applicable

DoD MRF Footnotes to the Principal Financial Statements _____

Note 24. Reconciliation of Net Cost to Net Outlays			
As of September 30	2020		
	Intragovernmental	With the public	Total
(Amounts in thousands)			
Net Cost of Operations (SNC)	\$ (144,715,842)	\$ 102,231,251	\$ (42,484,591)
Components of Net Cost That Are Not Part of Net Outlays:			
Other	0	14,808	14,808
(Increase)/decrease in liabilities:			
Salaries and benefits	0	(92,639)	(92,639)
Other Liabilities	0	(39,867,267)	(39,867,267)
Total Components of Net Cost That Are Not Part of Net Outlays	\$ 0	\$ (39,945,098)	\$ (39,945,098)
Components of Net Outlays That Are Not Part of Net Cost:			
Other	52,842,842	0	52,842,842
Total Components of Net Outlays That Are Not Part of Net Cost	\$ 52,842,842	\$ 0	\$ 52,842,842
Net Outlays	\$ (91,873,000)	\$ 62,286,153	\$ (29,586,847)
Agency Outlays, Net, Statement of Budgetary Resources			\$ (29,586,847)
Reconciling Difference			\$ 0

DoD MRF Footnotes to the Principal Financial Statements_____

As of September 30	2019		
	Intragovernmental	With the public	Total
(Amounts in thousands)			
Net Cost of Operations (SNC)	\$ (143,813,145)	\$ 198,699,540	\$ 54,886,395
Components of Net Cost That Are Not Part of Net Outlays:			
Other	0	3,157	3,157
(Increase)/decrease in liabilities:			
Salaries and benefits	0	(210,513)	(210,513)
Other Liabilities	0	(137,788,929)	(137,788,929)
Total Components of Net Cost That Are Not Part of Net Outlays	\$ 0	\$ (137,996,285)	\$ (137,996,285)
Components of Net Outlays That Are Not Part of Net Cost:			
Other	55,817,145	0	55,817,145
Total Components of Net Outlays That Are Not Part of Net Cost	\$ 55,817,145	\$ 0	\$ 55,817,145
Net Outlays	\$ (87,996,000)	\$ 60,703,255	\$ (27,292,745)
Agency Outlays, Net, Statement of Budgetary Resources			\$ (27,292,745)
Reconciling Difference			\$ 0

The Reconciliation of Net Cost to Net Outlays demonstrates the relationship between the MRF's Net Cost of Operations, reported on an accrual basis, and Net Outlays, reported on a budgetary basis. While budgetary and financial accounting are complementary, the reconciliation explains the inherent differences in timing and in the types of information between the two during the reporting period. The accrual basis of financial accounting is intended to provide a picture of the MRF's operations and financial position, including information about costs arising from the consumption of assets and the incurrence of liabilities. Budgetary accounting reports on the management of resources and the use and receipt of cash by the MRF. Outlays are payments to liquidate an obligation, other than the repayment to the Treasury of debt principal.

Note 25. Public-Private Partnerships

Not Applicable

DoD MRF Footnotes to the Principal Financial Statements_____

Note 26. Disclosure Entities and Related Parties

Not Applicable

Note 27. Security Assistance Accounts

Not Applicable

Note 28. Restatements

Not Applicable

Note 29. COVID-19 Activity

Not Applicable

Note 30. Subsequent Events

Subsequent events have been evaluated from the balance sheet date through November 9, 2020 which is the date the financial statements were available to be issued. Management determined that there were no other items to disclose as of September 30, 2020.

Note 31. Reclassification of Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position for Compilation in the U.S. Government-wide Financial Report

Not Applicable

Other Information

Other Information

SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

Table 1. Summary of Financial Statement Audit

Audit Opinion	Unmodified				
Restatement	No				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
No material weaknesses	0	0	0	0	0
<i>Total Material Weaknesses</i>	0	0	0	0	0

Table 2. Summary of Management Assurances

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	Unmodified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
No Material Weaknesses	0	0	0	0	0	0
<i>Total Material Weaknesses</i>	0	0	0	0	0	0
Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	Unmodified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
No Material Weaknesses	0	0	0	0	0	0
<i>Total Material Weaknesses</i>	0	0	0	0	0	0
Conformance with Federal Financial Management System Requirements (FMFIA § 4)						
Statement of Assurance	Federal Systems conform to financial management system requirements					
Non-Conformances	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
No Non-Conformances	0	0	0	0	0	0
<i>Total non-conformances</i>	0	0	0	0	0	0
Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)						
	Agency			Auditor		
1. Federal Financial Management System Requirements	No lack of compliance noted			No lack of compliance noted		
2. Applicable Federal Accounting Standards	No lack of compliance noted			No lack of compliance noted		
3. USSGL at Transaction Level	No lack of compliance noted			No lack of compliance noted		

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PAYMENT INTEGRITY

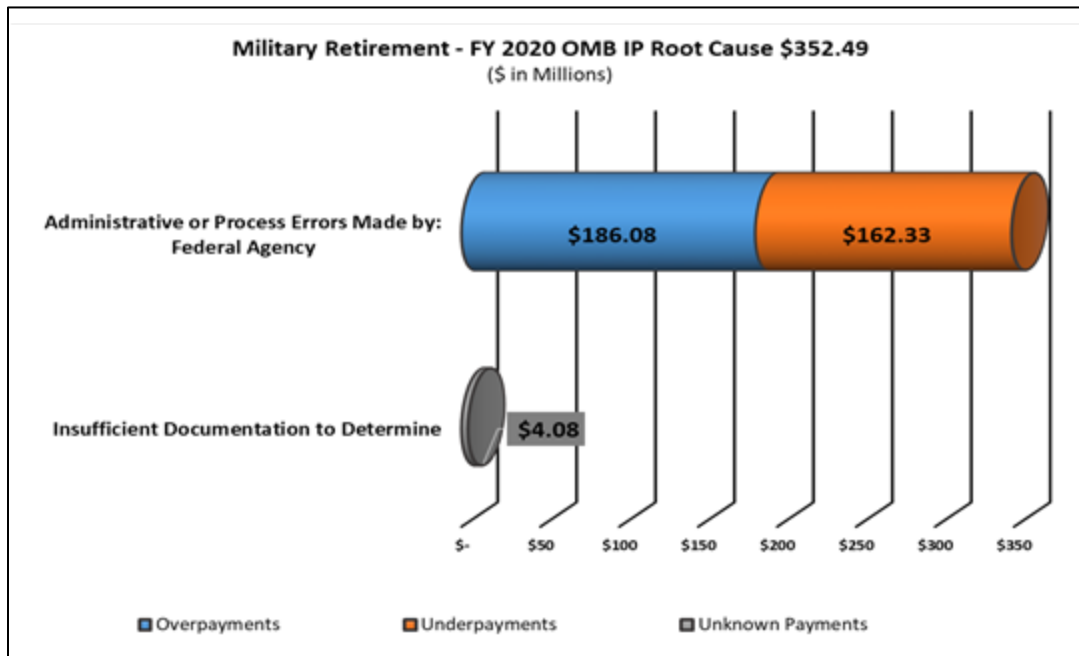
In accordance with the Improper Payment Information Act of 2002, as amended (31 U.S.C. 3321 note), and Appendix B of the Office of Management and Budget Bulletin No. 19-03, "Audit Requirements for Federal Financial Statements," dated August 27, 2019, DoD reports payment integrity information (i.e., improper payments) at the agency-wide level in the consolidated DoD Agency Financial Report. For detailed reporting on DoD payment integrity, refer to the Other Information section of the consolidated DoD AFR at: <https://comptroller.defense.gov/ODCFO/afr2020.aspx>

Headquarters DFAS has conducted analysis/reviews on a wide range of programs that are contributing to improper payments DoD wide. The reviews include the financial transactions from the services and Defense Agencies and Activities, and are focused on determining the root causes and develop corrective actions for each of the areas identified. One such area is in improper payments specific to the Retired and Annuitant Pay section.

In FY 2020, the estimated improper payments for the Military Retirement program were \$352.49 million (see Figure 6). This estimate was based on a sampling methodology with a 95% confidence level, equating to a 0.48% (+/- 0.26) improper payment rate and an estimated proper processing rate of 99.52%.

The primary reason for improper payments in the Military Retirement Program was attributed to Administrative or Process Errors Made by the Federal Agency. These errors accounted for \$348.41 million (98.84%) of the program's improper payments in which \$186.08 million is a monetary loss to the Department. The second major root cause of improper payments was Insufficient Documentation to Determine, which accounted for \$4.08 million (1.16%) of the program's improper payments.

FIGURE 6
FY 2020 MILITARY RETIREMENT ESTIMATED IMPROPER PAYMENTS BY OMB ROOT CAUSE CATEGORY



Other Information

The most common Administrative and Process errors found through the Retired and Annuitant Pay random reviews were in the New Annuitant, New Retired, and Changed Annuitant accounts, and included:

1. Errors in processing/applying procedures and policy changes for cost refunds;
2. Incorrect survivor benefit payments; and
3. Manual computation errors

In addition, the untimely notification of a retiree's or annuitant's death, by family members or other entities, often results in overpayment to a deceased retiree.

**FIGURE 7
MILITARY RETIREMENT SUMMARY CORRECTIVE ACTION PLANS**

Improper Payment Root Cause Category	Corrective Actions	Target Completion Date
<p>Administrative or Process Errors Made by the Department</p> <p>Errors for retired and annuitant pay (new annuitants, new retirees, and changed annuitant account) included:</p> <ul style="list-style-type: none"> • Payments made despite insufficient documentation • Errors in following processing procedures and applying policy changes for Department of Veterans Affairs waiver awards • Untimely application of Dependency and Indemnity Compensation offsets • Systematic computation errors • Manual computation error 	<ul style="list-style-type: none"> • Cost Refund System Change Request (SCR): Automate cost refund processing to eliminate manual entries for new, changed and unchanged accounts. The SCRs will reduce the amount of manual processing, eliminate over 50 excel workbooks currently in use and increase timeliness of processing transactions to establish survivor benefit plan elections accurately at the start of retired pay. 	Completed June 2020
	<ul style="list-style-type: none"> • Update policies based on the automation process to establish current and future annuity accounts. In addition, establish a training plan to identify all stakeholders affected by the new policy and/or procedures. 	December 2020
	<ul style="list-style-type: none"> • Conduct focused based training specifically for the complex cases related to SBP and Annuity and assess results of training on a recurring basis. 	October 2021
	<ul style="list-style-type: none"> • Continuously monitor, on a minimum monthly basis, employees performance for processing transactions in accordance to established performance standards. 	October 2021

Results of Corrective Actions

In FY 2020, there were a wide-range of corrective actions implemented for the Military Retirement Program to include major system updates which eliminated manual entries required to establish and update retiree and annuitant accounts. In addition, the system updates significantly reduced the annuitant backlogs and increased the timeliness of processing transactions – the annuitant backlogs went from 20,000 cases in FY 2019 to less than 1,000 cases in FY 2020.

Since the system updates were implemented during the 3rd Quarter of FY 2020, they had a minimal impact on reducing the estimated improper payment amount. The updates did, however, result in lower improper payment rates during the 4th quarter of FY 2020. Based on the FY 2020 testing results, DFAS concluded that the system updates will require policy to be updated and training to be conducted to achieve its intended goal of reducing

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improper payments. Therefore, the FY 2021 the corrective actions for this program will focus on updating and implementing policy to increase awareness of operational procedures.

The MRF remains committed to identifying root causes in the remediating processes, to updating reviews and supporting system enhancements, and to reducing improper payments for all financial transactions impacting the Fund.