

DOCUMENT RESUME

06745 - [B1926957]

Disability Provisions of Federal and District of Columbia Employee Retirement Systems Need Reform. FCCD-78-48; B-118638. July 10, 1978. 15 pp. + 9 appendices (44 pp.).

Report to the Congress; by Elmer B. Staats, Comptroller General.

Issue Area: Personnel Management and Compensation (300);
Personnel Management and Compensation: Compensation (305).
Contact: Federal Personnel and Compensation Div.
Budget Function: Income Security: Federal Employee Retirement and Disability (602).
Organization Concerned: Civil Service Commission; Department of the Army; Department of the Navy; Department of Defense; Department of the Air Force; District of Columbia.
Congressional Relevance: House Committee on Post Office and Civil Service; Congress.
Authority: P.L. 89-205. H.R. 2465 (95th Cong.). H.S. 12441 (94th Cong.).

Previous reports have discussed shortcomings in the disability provisions of Federal and District of Columbia retirement programs. Action on recommendations made in prior reports is still needed. Findings/Conclusions: The number of retirees receiving civil service disability annuities more than doubled from 1970 to 1977. The Civil Service Commission's (CSC's) interpretation of entitlement to disability retirement is based on an employee's ability to perform specific functions, and employees are not obligated to accept reassignment. Within the civil service retirement system, earlier and more generous retirement benefits are authorized for Federal law enforcement and firefighter personnel. The costs of providing early retirement benefits under the special retirement policy are over 50% greater than they would be for regular optional retirement. Seven retirement systems cover most Federal personnel and there is wide variation in the disability provisions of these systems. The District of Columbia policy and firemen's retirement system permits members to retire on disability for service-connected disability or after 5 years for other disabilities. Optional retirement benefits under this system are among the best in the country, but most of the personnel have retired under the system's aggravation clause. Recommendations: The Congress should: enact legislation that will encourage retention of potentially productive employees under the civil service system; revise this system's definition of economic recovery to preclude disability retirees from retaining annuities if they are earning more than the current pay for their former jobs; study and legislate a resolution to the issue of using Federal tax returns to verify reported income; reevaluate the need to continue the special retirement policy, and if it is needed, reevaluate eligibility criteria; establish an overall Federal retirement policy; and enact legislation making new Federal personnel in

positions now covered by D.C. systems subject to civil service systems, revising eligibility criteria and benefits for disability retirements under the D.C. police and firemen's retirement system, and precluding retirees from benefiting from cost-of-living increases that occurred while they were employed. The CSC should encourage job reassignment, discontinue its policy of advising employees to use extended sick leave before filing for disability retirement, require more information on annuitants' current job duties, develop means to verify reported income, and analyze the adequacy of annuities for those severely disabled. (HTW)

6957

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Disability Provisions Of Federal And District Of Columbia Employee Retirement Systems Need Reform

Many employee disability retirements under Federal and District of Columbia retirement systems have added substantially to the cost of these systems. The Congress must take corrective measures to reverse the trend and to improve the financial stability of the retirement programs.

Several recent reports have discussed shortcomings in the disability provisions of various employee retirement programs. This one highlights the seriousness of the situation, summarizes the findings and conclusions of those reports, and reiterates GAO's recommendations for needed reform.



FPCD-78-48

JULY 10, 1978



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-118638


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

Many Federal and District of Columbia employees retire on disability, which contributes greatly to the growing costs of Federal and District retirement systems.

We issued several reports on the disability provisions of Federal and District of Columbia retirement programs. Enclosure I highlights the seriousness of the situation by summarizing the findings and conclusions from these earlier reports and reiterating the recommendations made for needed reform.

We made our report pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Chairman, Civil Service Commission; the Director, Office of Management and Budget; and the Mayor and City Council, District of Columbia.


Comptroller General
of the United States

C o n t e n t s

	<u>Page</u>
THE CASE FOR DISABILITY RETIREMENT REFORM	3
Improvements needed in the civil service disability retirement program	3
Special retirement policy for Federal law enforcement and firefighter personnel needs reevaluation	7
Inconsistent disability provisions and practices among Federal retirement systems	10
Disability retirements under the D.C. police and firemen's retirement system	11
Conclusions and recommendations	14
 APPENDIX	
I Digest from GAO report "Civil Service Disability Retirement: Needed Improvements" (FPCD-76-61), November 19, 1976	17
II Digest from GAO report "Adequate Medical Evidence Needed When Approving Extended Sick Leave for Retiring Employees" (B-152073), February 19, 1974	20
III Summary from Defense Audit Service, February 28, 1978, "Report on the Audit of Department of Defense Civilian Disability Retirements"	22
IV Statement of H. L. Krieger, Director, Federal Personnel and Compensation Division, U.S. General Accounting Office, before the Subcommittee on Compensation and Employee Benefits of the Committee on Post Office and Civil Service, U.S. House of Representatives on a General Accounting	

APPENDIX

Page

	Office report entitled "Special Retirement Policy for Federal Law Enforcement and Firefighter Personnel Needs Reevaluation" (FPCD-76-97), February 24, 1977	24
V	Digest from GAO report "Federal Retirement Systems: Unrecognized Costs, Inadequate Funding, Inconsistent Benefits" (FPCD-77-48), August 3, 1977	36
VI	Disability retirement provisions of selected Federal employee retirement systems	39
VII	Digest from GAO report "Federal and District of Columbia Employees Need to Be in Separate Pay and Benefit Systems" (FPCD-77-71), January 12, 1978	46
VIII	Letter from the Comptroller General to the Honorable Charles C. Diggs, Jr., Chairman, Committee on the District of Columbia, House of Representatives, dated March 23, 1977, regarding GAO's views and comments on H.R. 2465, 95th Congress, 1st Session	49
IX	Report to the Congress by the Comptroller General entitled "Cost-of-Living Adjustments for New Federal Retirees: More Rational and Less Costly Processes Are Needed" (FPCD-78-2), November 17, 1977	55

ABBREVIATIONS

CPI	Consumer Price Index
CSC	Civil Service Commission
D.C.	District of Columbia
DOD	Department of Defense
FBI	Federal Bureau of Investigation
FY	fiscal year
IRS	Internal Revenue Service
OASD	Office of the Assistant Secretary of Defense
TVA	Tennessee Valley Authority

THE CASE FOR DISABILITY RETIREMENT REFORM

We have issued several reports which have discussed major shortcomings in the disability provisions of various Federal and District of Columbia (D.C.) retirement programs. The purpose of this report is to highlight the seriousness of the situation by (1) summarizing the findings and conclusions from those reports and (2) reiterating the recommendations made for needed reform.

This report discusses the following matters.

- Disability retirements under the civil service retirement system.
- Special early retirement policy for Federal law enforcement and firefighter personnel.
- Inconsistent disability provisions and practices among Federal retirement systems.
- Disability retirements under the D.C. police and firemen's retirement system.

IMPROVEMENTS NEEDED IN THE CIVIL SERVICE
DISABILITY RETIREMENT PROGRAM

The number of retirees receiving civil service disability annuities more than doubled from 1970 to 1977. At the end of fiscal year 1977, there were about 306,000 disabled retirees that will collect annuities totaling about \$1.9 billion annually. In our report entitled "Civil Service Disability Retirement: Needed Improvements" (FPCD-76-61, Nov. 19, 1976), we discussed the need for revising the civil service disability retirement program. The major findings, conclusions, and recommendations are summarized below. The report's digest is included as appendix I.

The civil service retirement law provides that a covered employee may retire on disability after 5 years' civilian service if, because of disease or injury, the employee is unable to perform useful and efficient service in the grade or class of position last occupied. Conditions caused by "vicious habits, intemperance, or willful misconduct" within the last 5 years do not qualify as disabling. All disabled employees retire on full disability because no provision exists for partial disability.

Under the civil service disability retirement program, employees can be considered disabled for their jobs and yet do other work. If the disabled employee can perform in other positions and the agency can find a position for which the employee is qualified, we believe the agency should have re-assignment authority and actively seek an alternative position. Retirement and reassignment can be effectively used as long as decisions to retire or reassign are based on substantive information and prudent professional judgment. We estimated that about 15,000 annuitants receiving disability benefits in fiscal year 1975 were probably capable of performing other types of work at the time of retirement. Employees, however, are not obligated to accept reassignment and have several major disincentives for not doing so. Agencies may also see disability retirement as more advantageous than reassigning an employee with less motivation.

According to Civil Service Commission (CSC) regulations, agencies are responsible for retaining the skills and services of employees who, though unfit for service in their present position, are medically and otherwise qualified to perform in another available position without detriment to themselves or the Government. CSC, however, does not adequately enforce agencies' adherence to this instruction. A disability retirement application requires information regarding agency efforts to reassign the employee to a suitable position. This information was not included in 62 percent of the cases sampled in our November 19, 1976, report. In such instances, CSC does not attempt to gather the required data.

CSC encourages employees to exhaust their accumulated sick leave before applying for disability retirement. We believe this policy is inappropriate. Use of extended sick leave can adversely affect agency operations, increase costs, and increase the likelihood of hardships if disability approval decisions are delayed.

We issued a report on February 19, 1974, which also addressed sick leave usage immediately prior to retirement. Of 263 employees optionally retiring at five military bases during the 6-month period ending May 31, 1973, 139 used an average of 172 days of sick leave, valued at over \$1 million after their last day of work. Moreover, 246 employees were on extended sick leave pending optional retirement as of May 31, 1973, and received approval for an average of 222 days of sick leave, valued at about \$2.7 million. The report's digest is included as appendix II.

In monitoring employment of disabled annuitants, CSC needs more specific information on current job duties to

properly evaluate annuitants' disability status. CSC has no way of knowing whether permanently or temporarily disabled annuitants are performing functions similar or identical to those performed in their last Government job. A review of 51 disability cases in our November 19, 1976, report showed 18 annuitants who could be performing jobs similar to their prior Government jobs. The files, however, contained no evidence of attempts to obtain more details on the nature of the work.

Disability payments continue until annuitants become medically or economically recovered. Economic recovery is assumed if, in each of 2 consecutive years, annuitants' earnings equal or exceed 80 percent of the current rate of compensation for their last Government job. This income limitation provision can be manipulated. Annuitants have earned more than the pay for their prior Government jobs over a 2-year span, received sizable annuity payments, and yet were not considered economically recovered. We reported the following examples.

Annuitant	Outside earned income			Salary of prior Government job in			Earned income exceeding Government pay
	1972	1973	Total	1972	1973	Total	
A	\$50,007	\$ 5,393	\$55,400	\$ 6,406	\$ 6,781	\$13,187	\$42,213
B	16,777	47,480	64,257	21,014	22,055	43,069	21,188
C	43,850	8,291	52,141	16,608	18,090	34,698	17,443

In addition, the income limitation cannot be effectively enforced without verifying the accuracy of reported income data--a procedure CSC discontinued in 1970.

The following recommendations, which have not been acted upon, were made to the Chairman, CSC:

- Encourage job reassignment by (1) directing agencies to try all possible alternatives to retain productive employees through job modification or job details as opposed to disability retirement and (2) requiring agencies to include, on any disability application, sufficient information concerning these efforts.
- Discontinue its policy of advising employees to use extended sick leave before filing applications for disability retirement.

- Require more specific information on disabled annuitants' current job duties to use in evaluating their disability status.
- Develop means to independently verify annuitants' reported income.
- Analyze, as part of its ongoing disability retirement policy study, the adequacy of annuities for those severely or totally disabled.

In addition, we recommended that the Congress:

- Reevaluate the civil service disability retirement provisions and enact legislation that will encourage, instead of discourage, retention of potentially productive employees. Any new legislation enacted should require Federal agencies, except for compelling reasons, to reassign employees to vacant positions within the same occupational class when the applicants are able to do that job. Reassignment to a lower graded position should also be authorized with appropriate incentives, such as saved pay.
- Revise the definition of economic recovery to preclude annuitants from earning more than the current pay for their former Government jobs and yet retaining their annuities. Because payment of annuities is predicated on a level of earned income, the sensitive issue of using Federal income tax returns to independently verify reported income should be studied and a resolution legislated.

In its July 1976 comments on our report, CSC said it believed it should encourage job reassignment but did not believe it had the authority to require reassignment. CSC had initiated a study of disability retirement policies intended to address many of the areas discussed in our report. CSC, therefore, reserved comment on needed policy changes, pending completion of its study. CSC also reserved comment on sick leave usage pending completion of another CSC study started in December 1974.

A recent report by the Defense Audit Service further supports the need to reexamine the disability program. In its February 28, 1978, "Report on the Audit of Department of Defense Civilian Disability Retirements," the Service reported similar findings, conclusions, and recommendations, as discussed above. It also found that:

"DOD civilian disability retirements in FY 1976 included about 300 individuals who had previously been granted military disability retirement. In 25 percent of these cases, military disability data were available. In one-half of these cases, both the civilian and military retirements were justified by a similar medical condition. Although there appears to be no legal restriction against drawing more than one disability pension from the Federal Government, we believe this condition represents an unwarranted extension of the real intent of the civilian disability retirement program."

The Service also reported that about 45 percent of all Department of Defense retirements in fiscal year 1976 were for disability, while the Government-wide disability rate in recent years has run at about 30 percent. The report's summary is included as appendix III.

We met with CSC officials in late March 1978 to discuss the results of their disability retirement policy study and actions taken on our recommendations. They informed us that action has not been taken on the above recommendations and that their study had not been finished because of higher priority work related to (1) civil service reform and (2) Federal agency reorganizations.

Although civil service reform and agency reorganizations are important, the need to reevaluate the civil service disability retirement program cannot be overlooked. Our report on this program was issued in the fall of 1976; it is now mid-1978; recommendations have not been implemented; and the number of disability retirees is increasing. CSC was studying the disability program before we issued our report but, to date, has presented no firm conclusions, alternatives, or recommendations to change the program.

SPECIAL RETIREMENT POLICY FOR FEDERAL
LAW ENFORCEMENT AND FIREFIGHTER PERSONNEL
NEEDS REEVALUATION

Within the civil service retirement system, the law authorizes earlier and more generous retirement benefits for about 52,000 Federal employees whose primary duties are (1) investigating, apprehending, or detaining persons suspected or convicted of Federal crimes or (2) controlling and extinguishing fires, or maintaining and using firefighting equipment. The provision provides retirement benefits to these employees who, because of age, are presumed to be unable to

perform their jobs. In a sense, it is a broadly based disability program which enables employees to receive higher benefits than other civil servants, without demonstrating a disabling condition.

Covered employees are eligible to retire at the age of 50 after 20 years of service, with an annuity of 50 percent of average pay. Additionally, they receive 2 percent of average pay for each year of service thereafter. By comparison, the earliest most other civil servants can retire is at age 55, after 30 years of service, and their benefits are computed using a much less liberal formula.

The purpose of the special retirement provision is to improve the quality of law enforcement and firefighting services by helping to maintain a young, vigorous work force. It is not intended as a reward for performing hazardous duty, as evidenced by the Congress' changing the law in 1974 by deleting all references to employee hazard as a basis for coverage.

We reviewed the special retirement provision for law enforcement and firefighter personnel at the request of the Subcommittee on Compensation and Employee Benefits, House Committee on Post Office and Civil Service, and issued the report on February 24, 1977. Our statement, which was presented to the Subcommittee during subsequent hearings on the report, is included as appendix IV.

The special retirement policy is an expensive method of marginally reducing the age of retirement. CSC actuarial estimates show that the costs of providing the early retirement benefits are over 50 percent greater than the costs would be if these employees were provided regular optional retirement benefits. Despite the increased costs, covered employees have only retired 1 to 3 years younger than other civil servants. Consequently, we question whether the special retirement policy should be continued.

In 1947 the policy offered a potential reduction of 10 years in the minimum retirement age of covered employees compared to most other civil servants. However, liberalized pay and retirement benefits for all civil servants have reduced the overall average retirement age. This, combined with the fact that most law enforcement and firefighter personnel choose not to retire when first eligible, has reduced the potential decrease of 10 years in average retirement age to an actual decrease of 1 to 3 years. Mandatory retirement at age 55, which began in January 1978, will further reduce the average retirement age of covered employees. However, other Federal employees are also retiring earlier.

Although maintaining a trained, alert, and vigorous work force is difficult, these problems exist, to varying degrees, in most Federal occupations. Such problems are normally resolved by using available personnel management techniques, other civil service retirement programs, and special rates of pay. Moreover, many law enforcement and firefighter duties do not require youth and vigor. For example, a questionnaire sent to a random sample of program retirees who retired between July 1, 1974, and February 20, 1976, disclosed that over half served in administrative and supervisory positions at the time of retirement. Although some administrative and supervisory positions involve occasional operating-level duties, many primarily involve management activities which we believe do not require an exceptionally young and vigorous work force.

If it is considered necessary for recruitment, retention, or other purposes to compensate certain law enforcement and firefighter personnel for the hazard and stress commonly associated with these occupations, we believe that compensation should be reflected in pay, not in retirement benefits. Employees who cannot perform satisfactorily before reaching normal retirement eligibility should be reassigned to less demanding duties, or, as a last resort, retired under existing civil service or Federal workers' compensation disability programs.

If the Congress decides to continue the special retirement policy, it should reevaluate the (1) eligibility criteria, (2) age 55 mandatory retirement provision, and (3) benefit structure.

In commenting on our draft report in December 1976, the Director of CSC's Bureau of Retirement, Insurance and Occupational Health, agreed that the policy needed to be reevaluated but withheld comment on the continued need for special benefits, pending completion of a CSC review. As part of his statement provided to the Subcommittee on November 30, 1977, the Director said:

"* * * we have carefully studied this special retirement program and have found evaluations of its effectiveness to be much more complex than we originally thought. * * * In summary, the Commission feels that on the basis of its review of the special retirement program, a further study is needed. [sic] One which is far broader based and which includes a number of aspects other than retirement."

INCONSISTENT DISABILITY PROVISIONS AND
PRACTICES AMONG FEDERAL RETIREMENT SYSTEMS

Different committees of the Congress have legislative jurisdiction over the various Government retirement systems, and no overall Federal policy exists to guide retirement systems' development. In the absence of a coherent, coordinated policy, Federal retirement programs have evolved on a piecemeal basis. Federal personnel may be treated quite differently depending upon which Government retirement system applies to them. While legitimate reasons may exist for treating certain types of employees differently, many of the differences are without apparent explanation. Appendix V contains the digest from an August 3, 1977, report we issued on this subject.

Seven retirement systems cover most Federal personnel and each system provides benefits to employees who become disabled before retirement. However, as shown in appendix VI, the disability provisions of the systems vary considerably. The major differences are summarized below.

- Basic eligibility: Ranges from immediate eligibility to 20 years creditable service or at least 30-percent disability.
- Definitions of disability: Range from totally disabled or incapacitated for useful and efficient service to the inability to perform efficiently in the specific position occupied.
- Establishment of disability: Some programs require documentary evidence and medical examinations by designated physicians, while others allow employees to provide their personal physician's report. Some programs require only that employees certify their own disability.
- Periodic reexaminations: Range from no reexaminations to annual reexaminations for those individuals whose disability is classified as temporary.
- Periods of coverage: All systems provide life-long benefits to individuals who remain disabled, although some impose earning restrictions.
- Benefit levels: Benefits are computed on various bases, such as salary at time of retirement, pay for the 3 highest paid years, or percentage of disability.

We believe that these and many of the other differences in Federal retirement programs are caused by the lack of an overall Federal retirement policy. The fact that different committees of the Congress have legislative jurisdiction over Federal retirement systems has probably contributed to the situation.

Our report recommended that the Congress establish an overall Federal retirement policy to guide retirement system development and improvement. Centralization of committee jurisdiction over all Federal employee retirement systems would facilitate establishment and implementation of such a policy.

DISABILITY RETIREMENTS UNDER THE D.C.
POLICE AND FIREMEN'S RETIREMENT SYSTEM

Members of the D.C. police and fireman's retirement system include any officer or member of the Metropolitan Police force, the Fire Department of the District of Columbia, the U.S. Park Police force, and certain officers or members of the United States Secret Service. In a January 12, 1978, report entitled "Federal and District of Columbia Employees Need to Be in Separate Pay and Benefit Systems," we reported that the 1,500 Federal law enforcement personnel covered by the District's system receive higher pay for the same levels of work and have much better retirement benefits than their counterparts covered by the civil service retirement system. The report's digest is included as appendix VII.

The D.C. police and firemen's retirement system permits members to retire on disability (1) if they are injured or contract a disease in the performance of duty or if an injury or disease is aggravated by duty and permanently disables them for the performance of duty or (2) if, after completing 5 years of service, they are disabled for further service due to injury or disease contracted other than in the performance of duty.

Employees with service-connected or service-aggravated disabilities receive nontaxable annuities equal to 2.5 percent of high 12 months' salary (generally the final year of employment) for each year of creditable service, not to exceed 70 percent but not less than two-thirds of that salary. Employees whose disability is nonservice-connected receive a taxable annuity equal to 2 percent of high-12 months' salary for each year of creditable service, not to exceed 70 percent but not less than 40 percent of that salary.

Although the optional retirement benefits provided under the D.C. police and firemen's system are among the best

in the United States, most have been retired on disability under the system's aggravation clause. Of all former District police and firemen and Federal personnel on the retirement rolls as of December 31, 1976, 81 percent were on disability retirement.

The percentage of new D.C. police and firemen retiring on disability has decreased in recent years, however. It began to decrease in calendar year 1970, following a change in the law that year which permitted optional retirement after 20 years of service at any age. Before then, individuals had to be at least 50 years of age, with 20 years or more of service. The District's records show the following numbers and percentages of new optional and disability retirements for each calendar year from 1966 to 1977.

<u>Calendar year</u>	<u>Number of retirements</u>	<u>Number of optional retirements</u>	<u>Percent of optional retirements</u>	<u>Number of disability retirements</u>	<u>Percent of disability retirements</u>
1966	201	24	12	177	88
1967	201	15	8	185	92
1968	254	10	4	244	96
1969	245	3	1	242	99
1970	176	5	3	171	97
1971	234	40	17	194	83
1972	191	45	24	146	76
1973	187	75	40	112	60
1974	145	70	48	75	52
1975	175	67	38	108	62
1976	171	69	40	102	60
1977	175	79	45	96	55

Several bills have been introduced since January 1977 to modify the D.C. police and firemen's retirement system. Among other provisions, the bills would change the eligibility criteria and benefits for disability retirements.

Some of the major proposed revisions to the system are

--changing from a high 12-month salary average to a high 3-year salary average for annuity calculations;

--restricting application of the special provisions for injuries or diseases "aggravated by the job";

--providing for partial disability depending on the nature and extent of the injury or illness (whether job

related or not) in lieu of the current definition of disability, which assumes that the employee is completely disabled and therefore entitled to the maximum benefit; and

--adopting a cost-of-living annuity adjustment process for retirees under the system rather than the current recomputation of annuity amounts each time active employees' pay is increased.

On February 15, 1977, the Chairman, House Committee on the District of Columbia, requested our views and comments on one of the bills--House bill 2465. We generally supported the changes to the disability provisions and cost-of-living adjustment process as each affected D.C. employees. Regarding the effect on Federal employees, however, we stated:

"H.R. 2465 would not change any of the current benefit provisions for the 1,500 Federal employees covered by the policemen and firemen's system. Although we have reservations about the inclusion of Federal employees in pay and retirement systems under District control, we believe that since their pay and benefits are currently tied to those of District police and firemen, the benefit changes in H.R. 2465 should be made to apply to these Federal employees, as well.

"We recommend that Section 208(a)(1)(b) providing annuity cost-of-living adjustments equal to the percentage rise in the Consumer Price Index (CPI), plus 1-percent, to survivors of former Federal employees covered by the policemen and firemen's system be modified to eliminate the 1-percent add-on feature."

Our complete comments on House bill 2465 are included as appendix VIII.

The major Federal retirement systems and the current bills to modify the D.C. retirement system for police and firemen permit disability and other retirees to benefit from cost-of-living increases that occurred while they were still employed. A more rational and less costly method would involve prorating initial cost-of-living adjustments of new retirees to include only that portion of the increase that occurred after their retirement. Using the proration method, for example, would have saved the civil service retirement system over \$800 million in lifetime annuity payments to employees retiring in 1978 alone. A detailed

explanation of the current method of computing semi-annual increases and our recommended method, with examples, is included in our November 17, 1977, report entitled "Cost-of-Living Adjustments for New Federal Retirees: More Rational and Less Costly Processes Are Needed." (See app. IX.)

CONCLUSIONS AND RECOMMENDATIONS

There are many basic shortcomings in Federal and D.C. retirement programs as evidenced by the disability retirement problems detailed in this and our prior reports. Action must be taken by the Congress as well as the administering agencies to reform the disability programs. Disability reform would assist considerably in reducing retirement program costs and assuring greater equity for all covered personnel.

We continue to believe that actions on the following recommendations made in our prior reports are needed to correct these serious problems.

The Congress should:

- Enact legislation that will encourage, instead of discourage, retention of potentially productive employees under the civil service system.
- Revise the civil service system's definition of economic recovery to preclude disability retirees from earning more than the current pay for their former Government jobs and yet retaining their annuities.
- Study and legislate a resolution to the sensitive issue of using Federal tax returns to independently verify reported income of disability retirees.
- Reevaluate the need to continue the special retirement policy for Federal law enforcement and firefighter personnel. If the Congress decides to continue the special retirement policy, it should reevaluate the eligibility criteria, the age 55 mandatory retirement provision, and the benefit structure.
- Establish an overall Federal retirement policy to guide retirement system development and improvement.
- Enact legislation making all new Federal personnel in positions now covered by D.C. compensation systems subject to civil service pay and retirement systems.

- Enact legislation revising the eligibility criteria and benefits for disability retirements under the D.C. police and firemen's retirement system.
- Enact legislation to preclude disability and other retirees under Federal and D.C. retirement systems from benefiting from cost-of-living increases that occurred while they were still employed.

The Civil Service Commission should:

- Encourage job reassignment as opposed to disability retirement by (1) directing agencies to try all possible alternatives to retain productive employees through job modification or job details and (2) requiring agencies to include on any disability application sufficient information concerning these efforts.
- Discontinue its policy of advising employees to use extended sick leave before filing applications for disability retirement.
- Require more specific information on disabled annuitants' current job duties to use in evaluating their disability status.
- Develop means to independently verify annuitant's reported income.
- Analyze the adequacy of annuities for those severely or totally disabled.

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESSCIVIL SERVICE DISABILITY
RETIREMENT: NEEDED
IMPROVEMENTS
Civil Service CommissionD I G E S T

Civil service disability retirements almost doubled from 1970 to 1975. At the end of fiscal year 1975, about 258,000 disabled retirees collected annuities that totaled over \$1 billion annually. (See p. 2.)

The Congress should change the disability policy for civil service retirement to encourage reassigning or retaining potentially productive employees under certain conditions. Civil service employees are legally disabled if they are unable, because of disease or injury, to perform usefully and efficiently in the grade or class of position last occupied. The Civil Service Commission's interpretation--that an employee unable to do one essential function of his job is entitled to disability retirement--was based on administrative precedent. Employees are not obligated to accept reassignment, and they have several significant disincentives for not doing so. (See p. 8.)

The Commission needs to improve its administration of the current reassignment policy by requiring that disability retirement applications submitted by agencies contain sufficient information on reassignment efforts. Although this lack of enforcement may have resulted in employees retiring needlessly, it is perhaps indicative of the difficulty of attempting reassignment within existing authorities. Efforts should be made to encourage greater use of job details, job restructuring, and job reassignment. (See pp. 9 and 10.)

About 20 percent of disability retirement applications GAO reviewed had been approved without sufficient evidence. GAO estimates the Government pays about 15,000 retirees annual annuities totaling \$65 million although

records do not contain sufficient justification for these payments. The Commission needs to develop documentation criteria and to establish quality controls to insure that sufficient medical information has been obtained before approving disability claims. (See pp. 12 to 15.)

During the same period that the disability workload has almost doubled, the Civil Service Commission had encountered difficulties attracting enough qualified medical personnel. Despite these problems, the ever-increasing cost of the retirement program makes it essential that unentitled employees not be approved for payments. (See p. 16.)

The Commission needs to strengthen procedures to determine continuing medical and economic eligibility of disabled annuitants. In recent years, the Commission has removed less than 1 percent of those on the disability roll because of medical recovery or excess earned income. The Commission needs to develop detailed criteria to use in annually reviewing the temporarily disabled, require more specific information on job duties, and develop means to independently verify annuitants' reported income. (See pp. 19, 21, 22, and 24.)

The Congress should revise the definition of economic recovery. Although many annuitants are considered disabled for their specific jobs, they obtain employment in the non-Federal sector. The income limitation permits them to earn more than the pay for their prior Government jobs over a 2-year span, receive annuities tax-free up to \$5,200 a year, and yet not exceed income limitation. A better definition and stronger enforcement procedures would provide assurance that only those annuitants entitled to benefits continue to receive them. (See pp. 23 and 28.)

The Commission believes it should encourage job reassignment but does not believe it has the authority to impose reassignment as a requirement. Near the end of GAO's review, the Commission initiated a study of disability retirement policies and intends to

cover many of the same areas discussed in this report, including the recommendations to the Congress. Pending the 1977 outcome of its own study, the Commission did not comment on needed policy changes.

It agreed there was a need to study costs and benefits of developing minimum documentation standards but hesitated to implement additional review procedures because of potential hardships to applicants during anticipated processing delays. Although agreeing to move toward requiring more specific information on annuitants' current job duties, the Commission said it would be too expensive to verify the income annuitants report without using Federal tax returns. Because annuity payments are predicated on a level of earned income, GAO believes that the Congress should study and legislate a solution to the sensitive issue of using Federal tax returns to independently verify reported income.

GENERAL ACCOUNTING OFFICE
REPORT TO THE SECRETARY OF
DEFENSE

ADEQUATE MEDICAL EVIDENCE NEEDED
WHEN APPROVING EXTENDED SICK LEAVE
FOR RETIRING EMPLOYEES B-152073

D I G E S TWHY THE REVIEW WAS MADE

Federal civilian employees earn 13 days of sick leave a year and any not used may be accumulated. Before 1969, unused sick leave was forfeited when employees retired. To prevent the forfeiture of unused sick leave, the retirement law was amended in 1969 to permit unused sick leave to be used to increase employees' service time in computing their retirement annuities.

During other reviews, the General Accounting Office (GAO) noted at some military bases that a large number of employees had taken extended periods of sick leave immediately prior to their retirement. Accordingly, GAO made an examination during 1973 at five military bases to evaluate the procedures for approving extended sick leave in conjunction with optional retirements and to determine the extent and impact of this practice.

FINDINGS AND CONCLUSIONS

While the amendment to the retirement law created some incentive for conserving sick leave, it still is financially more advantageous for employees to use sick leave immediately before retirement. By doing that, the employees generally obtain a larger increase in their retirement annuities as well as receiving full pay while using accumulated sick leave.

Of 263 employees optionally retiring during the six-month period ended May 31, 1973, at the five bases reviewed, 139 used an average of 172 days of sick leave valued at over \$1 million after their last day of work. Moreover, 246 employees were on extended sick leave pending optional retirement as of May 31, 1973, and received approval for an average of 222 days of sick leave valued at about \$2.7 million. (See pp. 5 and 6.)

At three installations extended sick leave was routinely approved for employees who requested it. Determinations of incapacity generally were based on opinions of private physicians which were usually not supported by adequate medical evidence to corroborate the employees' incapacity for work. Physical examinations or independent medical evidence were generally not required nor was there a requirement for periodic reevaluation of employees on extended sick leave. One base required adequate support for all sick leave requests and the other prohibited extended sick leave in connection with optional retirement. These varying practices may have occurred because the Department of Defense has not issued guidelines to administer this aspect of sick leave. (See pp. 5 to 12.)

Employees on sick leave before retirement are included in agency personnel ceilings and continue on the payroll until their leave

February 19, 1974

expires and they retire. Limitations on manpower spaces and funds have prevented the hiring of additional permanent employees to replace those on sick leave. Consequently, some work was deferred, the workload of employees on duty was increased, overtime and hiring of temporary employees were required, and funds were diverted from other programs to pay for the increased costs. (See pp. 13 and 14.)

About 300,000 DOD employees--one third of the work force--are either now eligible for optional retirement or will be in the near future. Under these conditions, the improper granting of extended sick leave prior to optional retirement could become a major problem throughout the Department unless sound and uniform administrative controls and practices are instituted. (See p. 15.)

RECOMMENDATIONS

The Secretary of Defense should:

1. Establish uniform policies for approving extended sick leave which would include:
 - requiring medical examinations,
 - defining the type of medical evidence that should be obtained to support an incapacity for further duty,
 - monitoring extended absences, and
 - if practicable, reassigning disabled employees to other positions which they could perform.
2. Require DOD installations to review current cases of employees who are on extended sick leave pending optional retirement and obtain sufficient medical evidence for those who were determined to be incapacitated based on inadequate medical evidence. (See p. 15.)

SUMMARY FROM DEFENSE AUDIT SERVICE
FEBRUARY 28, 1978, "REPORT ON THE AUDIT OF
DEPARTMENT OF DEFENSE
CIVILIAN DISABILITY RETIREMENTS"

SUMMARY

The high rate of civilian disability retirements within the Department of Defense has been a topic of growing interest at higher management levels. About 45 percent of all DoD retirements in FY 1976 were for disability, while the Government-wide disability rate in recent years has run at about 30 percent. Our review was made to test DoD compliance with basic Civil Service retirement policies and procedures, as well as to assess the equity and rationale of these fundamental guidelines.

In general, we found that DoD activities needed to improve procedures and practices for processing medical examinations and granting leave to retirees. Further, we believe there are more serious difficulties with the basic Civil Service regulations on disability retirement, which we feel are not realistic in some respects. The reforms which we are proposing could, we believe, be accomplished without imposing undue hardships on employees, and should produce substantial savings to the Government.

We estimated that due to a liberal Civil Service interpretation of total disability, about 25 percent of the approximately 15,000 DoD employees separated under disability retirement provisions during FY 1976 were not totally disabled in the general sense of the term, and could have been productively employed had they been reassigned to less physically demanding jobs, at a savings of \$22.5 million to the Government.

DoD civilian disability retirements in FY 1976 included about 300 individuals who had previously been granted military disability retirement, often for a similar medical condition.

Unnecessary accrued leave costs, estimated at about \$5.4 million for FY 1976, were being incurred by DoD because Civil Service regulations do not provide for prompt separation of approved disability retirees with unused sick leave.

DoD components should strengthen the administration of their disability retirement programs in the areas of applicants' medical examinations and retirees' use of leave.

A draft of this report was furnished to and discussed with representatives of the Office of the Assistant Secretary of Defense (Manpower, Reserve Affairs and Logistics) and the Office of the Assistant Secretary of Defense (Health Affairs). It was also furnished to the Services and to the Civil Service Commission. The OASD (Manpower, Reserve Affairs and Logistics), OASD (Health Affairs), and the Navy were generally supportive of the report. The Civil Service Commission stated that the issues discussed in the report were under study. The Army and the Air Force raised some philosophical and procedural arguments for maintaining the system as is. We considered all responses in preparing the final report.

Defense Audit Service

STATEMENT OF
H. L. KRIEGER, DIRECTOR
FEDERAL PERSONNEL AND COMPENSATION DIVISION
U.S. GENERAL ACCOUNTING OFFICE
BEFORE THE
SUBCOMMITTEE ON COMPENSATION AND EMPLOYEE BENEFITS
OF THE COMMITTEE ON POST OFFICE AND CIVIL SERVICE
U.S. HOUSE OF REPRESENTATIVES

ON A

GENERAL ACCOUNTING OFFICE REPORT ENTITLED
"SPECIAL RETIREMENT POLICY FOR FEDERAL LAW
ENFORCEMENT AND FIREFIGHTER PERSONNEL NEEDS
REEVALUATION" (FPCD-76-97), FEBRUARY 24, 1977

Madam Chair and Members of the Subcommittee:

I am pleased to be here to discuss the General Accounting Office's report to the House Committee On Post Office and Civil Service on the special, early retirement policy for Federal law enforcement officers and firefighters.

The Subcommittee's members are undoubtedly aware of GAO's deep concern about the civil service and other Federal retirement systems. Beginning in 1974, we have issued a series of reports covering a number of issues related to basic policies, financing, administration, and benefits of the various retirement programs. In the latest report, for example, issued on August 3, 1977, we reported that the actual cost of the civil service system is about two and one-half times the cost generally recognized and also pointed out that many of the differing and inconsistent provisions of the various systems are without apparent explanation. Our reports have consistently called for the establishment of an overall policy to provide objectives and principles to guide retirement system development and improvement. Our previous work has convinced us of the importance of giving serious consideration to need, design, equity, and the cost of any proposed changes or improvements to the retirement programs, particularly when the changes apply only to selected groups.

At the request of the former Chairman of the House Committee on Post Office and Civil Service and this Subcommittee, GAO evaluated the adequacy, effectiveness, reasonableness, and costs of the Government's policy of providing earlier and more generous retirement benefits to Federal law enforcement and firefighter personnel.

EXISTING LAW AND ITS HISTORY

Federal employees whose primary duties are (1) investigating, apprehending, or detaining persons suspected or convicted of Federal crimes or (2) controlling and extinguishing fires or maintaining and using firefighting apparatus and equipment are permitted, by law, to voluntarily retire at age 50 after 20 years of such service. These employees' annuities are computed at the rate of 2.5 percent of average annual pay (average high 3 years' pay including administratively uncontrollable overtime for law enforcement officers) for the first 20 years of service plus 2 percent of average pay for each year of covered service thereafter. Employees and employing agencies each contribute 7.5 percent of basic pay toward retirement. Effective January 1, 1978, the law requires mandatory retirement of such employees at age 55 or upon completion of 20 years of service, whichever comes later. The head of the agency can, however, retain an employee to age 60.

In comparison, Federal employees under the regular civil service retirement provisions are generally eligible for voluntary retirement at age 55 after 30 years of service, at age 60 after 20 years of service, or at age 62 after 5 years of service. Their annuities are computed at the rate of 1.5 percent of average annual pay (highest average annual salary for 3 consecutive years, generally excluding all premium pay) for the first 5 years of service, 1.75 percent for the next 5 years, and 2 percent for each year of service beyond 10 years. Retirement is mandatory at age 70 after 15 or more years of service. Employees and employing agencies each contribute 7 percent of pay toward retirement.

The Congress' objective in providing early retirement to law enforcement and firefighting personnel was to improve the quality of these services by helping to maintain a young, vigorous work force. The more generous annuity formula was designed to make early retirement economically feasible--not to reward those employees for performing demanding or sometimes hazardous duties.

In 1947 the Congress enacted legislation permitting Federal Bureau of Investigation (FBI) agents to retire with an increased annuity at age 50 after 20 years of service. Many agents had been leaving the FBI to receive higher salaries in the non-Federal sector. The special retirement provisions were believed necessary to offset the lure of the higher non-Federal salaries and help the FBI become a career service. Also, a young, vigorous force was desired because FBI agents worked long hours; maintained irregular eating and rest schedules; were subject to many pressures, risks, and hazards; traveled for long periods; and were exposed to adverse environmental conditions. Congressional testimony indicated that the cost of this liberalized retirement program would not be great because only 30 agents would be eligible to retire when the law was passed and only 64 agents would become eligible for retirement during the next 5 years.

Almost immediately, other employee groups began requesting equivalent benefits. In 1948 the Congress extended special retirement benefits to all employees in positions with duties that were primarily investigating, apprehending, or detaining persons suspected or convicted of committing Federal crimes. In 1956 the Congress further extended coverage to employees of correctional institutions who had frequent and direct contact in the detention, direction, supervision, inspection, training, employment, care, transportation, or rehabilitation of persons suspected or convicted of violating the criminal laws of the United States, the District of Columbia, or the Uniform Code of Military Justice. In 1972, the liberalized retirement provisions were accorded to employees in positions whose duties primarily involved controlling and extinguishing fires or maintaining and using firefighting equipment. In addition, these laws provide coverage for employees who are transferred to supervisory or administrative positions.

Finally, a 1974 law (1) further liberalized the benefits, (2) deleted all references to employee hazard as a basis for coverage, (3) emphasized in its legislative history that the special retirement provisions are provided to improve the quality of law enforcement and firefighting services by helping to maintain a young and vigorous work force and that the generous benefits are provided to make earlier retirement economically feasible, and (4) established, effective January 1978, mandatory retirement at age 55 or upon completing 20 years of covered service, whichever comes later.

The Civil Service Commission (CSC) is responsible for administering the special retirement provisions and certifying employees' eligibility.

JOBS COVERED

Many occupational groups of employees are eligible for benefits. Examples of the types of positions included follow.

Investigation and apprehension of criminals--includes such employees as special agents in the FBI, Internal Revenue Service (IRS), Secret Service, and Drug Enforcement Administration. Customs and immigration border patrol officers and airplane pilots, game wardens, postal inspectors, and Bureau of Indian Affairs and Panama Canal Zone police also receive benefits.

Detention of criminals--includes all employees working inside the walls of a Federal or District of Columbia detention facility. Covered positions include not only correctional officers but also cooks, plumbers, carpenters, paint foremen, mailclerks, telephone operators, accountants, and secretaries. Also covered are research chemists, pharmacologists, physicists, and photographers at a drug addiction center and parole hearing examiners in the Department of Justice.

Fighting fires--includes employees fighting both structural and forest fires. In addition, the eligibility criteria have been interpreted to cover such positions as tanktruck operators, certain airplane pilots, and certain foresters.

Supervisory and administrative personnel--includes employees who transferred from covered operating positions to positions responsible for supervising operating-level employees or to positions where operating experience is required to perform the various administrative duties. Included are program administrators in headquarters organizations, accountants, personnel officers, administrative officers, and training course developers and instructors.

CSC regulations specifically exclude employees in positions whose primary duties involve (1) maintaining law and order, (2) protecting life and property, or (3) guarding against or inspecting for violations of law or investigating persons other than those suspected of violating criminal laws. Also excluded are employees whose duties only occasionally or incidentally require the investigation, apprehension, or detention of persons suspected or convicted of violating criminal laws.

About 52,000 employees in various Federal agencies and the District of Columbia government are covered under the special retirement program. As of June 30, 1976, 11,603 retired employees were receiving annuities totaling about \$150 million a year.

CONTINUED NEED FOR SPECIAL
RETIREMENT IS QUESTIONABLE

A need for the special retirement program may have existed in 1947, when the program was established to make certain Federal jobs more attractive and to make it economically feasible for employees in such jobs to retire at a younger age. But the continued need for special retirement is questionable because

- regular civil service retirement benefits have been increased substantially, thus reducing the average retirement age for all civil servants;
- covered employees are not retiring much earlier than employees who do not receive the additional benefits but the costs of covered employees' benefits are much greater;
- many covered employees could continue to perform their jobs satisfactorily after age 50 and others could be assigned to less demanding jobs; and
- civil service disability retirement and Federal workers' compensation benefits are available to employees who can no longer perform their duties.

The special retirement policy for law enforcement and firefighter personnel is an expensive method of marginally reducing the age of retirement. In 1947 the policy offered a potential reduction of 10 years in the minimum retirement age of covered employees compared to most other civil servants. However, liberalized pay and retirement benefits for all civil servants have reduced the overall average retirement age. This, combined with the fact that most covered employees choose not to retire when first eligible, has reduced the potential decrease of 10 years in average retirement age to an actual decrease of about 1 to 3 years. Covered employees are retiring at earlier ages but then so are all other Federal employees. Mandatory retirement will, of course, further reduce the average retirement age of covered employees beginning in 1978. However, we question whether further reductions in retirement ages will be great enough to justify the high costs of the special benefits. And mandatory

retirement at age 55 will still permit most covered employees to work a full 25- to 30-year career and to receive greater benefits than regular civil service employees with similar earnings and years of service. Also, many of the covered employees who will be mandatorily retired at age 55 will be supervisors or administrators who generally do not need to be any more vigorous than any other Federal supervisor or administrator.

To achieve the current 1- to 3-year reduction in the average retirement age of covered employees, the Government pays heavily. Based on CSC actuarial estimates, the Government's annual normal cost was \$311 million in 1976--\$118 million (61 percent) more than the cost of providing regular optional benefits to these employees (assuming a 3-percent annual salary adjustment and a 4-percent annual annuity adjustment). CSC estimated that the unfunded liability of the special retirement program was \$5.3 billion under those assumptions. The normal cost of the special retirement benefits--the present value of all benefit rights earned annually, expressed as a percentage of total payroll--without considering general pay increases and annuity cost-of-living adjustments (static basis) was estimated by CSC to be 19.7 percent of pay, considerably more than the combined agency-employee contribution rate of 15 percent. On a dynamic basis--assuming 3 percent pay and 4 percent annuity increases--the estimated cost was 43.6 percent of pay. By comparison, the composite normal cost of the civil service retirement system, including the special retirement provisions, was estimated by CSC to be about 13.6 percent of pay on a static basis and 28.7 percent of pay if the conservative assumptions of 3 percent pay and 4 percent annuity increases are used in the cost calculations.

Maintaining a trained, alert, and vigorous work force is difficult, but such problems exist, to varying degrees, in most Federal occupations. Such problems are normally resolved by using available personnel management techniques, other civil service retirement programs, and, if needed for recruitment and retention purposes, special rates of pay. Employees who cannot perform satisfactorily before the optional retirement age should be reassigned to less demanding duties or, as a last resort, retired under existing civil service or Federal workers' compensation programs.

The Congress should reevaluate the need for providing special retirement benefits to law enforcement and firefighting personnel.

Agency and union comments
on need for special benefits

The Civil Service Commission agreed that the special retirement policy needs to be reevaluated but withheld comment on the continued need for special benefits, pending the completion of its own review.

Operating agencies and employees unions generally disagree with GAO's conclusions. They said it was premature to question the effectiveness of special benefits in helping to maintain a younger, more vigorous work force because (1) the current annuity formula had been in effect only since July 1974 and (2) the mandatory retirement provision beginning in 1978 will eventually result in earlier and more equitable retirements for covered employees. They also said the special retirement benefits are necessary for recruiting and retaining employees, maintaining a high level of employee morale, and rewarding employees for doing demanding and dangerous jobs.

GAO evaluation of agency
and union comments

We do not believe those are compelling reasons for not reevaluating the continued need for the special retirement benefits. The ineffectiveness of the special retirement benefits in helping to maintain a younger, more vigorous work force is only one of several factors which raise serious questions about the continued need for the special retirement policy. Over the early retirement policy's 30-year history, including periods when there were substantial differences between the special and regular retirement benefit structures, covered employees have never retired much earlier than employees under the regular civil service optional retirement provisions. We believe that a 30-year period is long enough to judge the special policy's overall effectiveness.

Because the special benefits for certain law enforcement personnel have existed for 30 years, we could not determine exactly what effects they have had on recruitment and retention. We could also not ascertain exactly what impact eliminating or reducing the special benefits would have on the recruitment and retention of prospective employees. The special benefits obviously enhance recruitment and retention. But are they justified and necessary to attract and retain competent people?

In that regard, CSC recently said that, nationwide, there were about 24 applicants for every Federal job opening--about 30 applicants for every Federal job in the Washington, DC, area. There were reportedly about 1,000 qualified applicants for FBI special agent jobs, but no openings. In comparison with local governments' retirement systems, Bureau of Labor Statistics compensation surveys in major U.S. cities showed that the benefits of 38 of 47 local police and firefighter retirement systems are generally less liberal than the special Federal benefits. In relation to the 38 local retirement systems, the Federal system generally had more liberal minimum age and service requirements and provided a higher percentage of salary. Also, a recent CSC study showed that Federal criminal investigators and firefighters are generally paid more than their non-Federal counterparts.

Like all other Federal white-collar positions, law enforcement and firefighter jobs are placed in appropriate grades in accordance with their duties, responsibilities, and qualification requirements. The knowledge, skills, and abilities required by these jobs' characteristics have been considered in setting position classifications which in turn establish basic rates of pay. Job characteristics (for example, hazard; working conditions; and the physical, mental, and emotional stress commonly associated with law enforcement and firefighting occupations) are generally not considered directly in valuing or classifying Federal positions. If it is considered necessary for recruitment, retention, or other purposes to provide additional compensation for certain Federal jobs because of such factors, that additional compensation should be reflected in pay, not in retirement benefits.

SEVERAL MATTERS NEED REEVALUATION IF SPECIAL RETIREMENT POLICY CONTINUES

If the special, early retirement policy continues, we believe the Congress should (1) reevaluate the eligibility criteria, mandatory retirement provision, and benefit structure and (2) amend the law to require additional retirement contributions by employing agencies.

ELIGIBILITY CRITERIA-- PRACTICAL CONSIDERATIONS

Despite the concern over maintaining a vigorous work force, the present retirement eligibility criteria do not address the need for vigorous incumbents in determining coverage. Instead, benefits are provided to all employees who occupy certain positions. As a result of these occupationally based criteria, many individuals receive coverage

even though the primary duties of their positions do not require extraordinary vigor.

These occupational criteria are probably the result of law enforcement and firefighter personnel persuasively stating their case to legislators and the public over the years. On the other hand, many other groups have sought and been denied coverage throughout the 30-year history of the program because of the occupationally based eligibility criteria. Included among these groups have been customs and immigrations inspectors, aircraft pilots, coal mine inspectors, and employees with abnormal exposure to disease or accident. The law automatically excludes coverage of these positions because the duties do not primarily involve the "investigation, apprehension, or detention" of criminals or the "control and extinguishment of fires," and not because the positions do not require exceptional vigor.

To more fully meet the law's objective, the eligibility criteria would have to be based on the need for extraordinarily vigorous employees. Especially vigorous employees could be necessary where lapses in performance significantly and immediately inhibit accomplishment of the agency mission and where the duties of the position require

--extraordinary physical stamina and continual mental alertness over long periods or

--frequent short-term extraordinary physical exertion under environmentally adverse conditions.

These criteria could encompass, for example, the duties of an individual frequently required to maintain continual alertness during all night investigative surveillances or to make arrests of dangerous criminals or fight forest or structural fires. In such situations, lapses could result in immediate negative consequences. However, we know of no practical eligibility criteria or administrative procedures which would make certain that special retirement is granted only to employees whose duties require exceptional youth and vigor.

Considering the administrative and financial burden that would be incurred in trying to identify specifically which Federal employees perform duties that require youth and vigor and considering the employee rotational policies employed by some agencies, we believe that continuing to grant special retirement coverage on the basis of the primary duties of overall job classification may be the most practical criteria for coverage under the special retirement program.

Agency and union comments
on eligibility criteria

CSC withheld comment pending completion of its independent review. Operating agencies generally believed that the eligibility criteria should be left alone. Some agencies said, however, that coverage has been unduly expanded over the years to positions that do not require exceptional youth and vigor through changes in law, innovative interpretations of law and modifications to or interpretations of job descriptions. Employee unions said the eligibility criteria should be expanded to specifically include other Federal jobs which involve hazard or physical stress.

MANDATORY RETIREMENT PROVISION
MAY ENCOMPASS TOO MANY

Effective January 1, 1978, all covered employees must retire when they reach age 55 or complete 20 years of service, whichever comes later. Agency heads may grant individual waivers up to age 60 on a selected basis.

The mandatory retirement provision beginning in 1978 will apply to all covered employees, including supervisors and administrators who frequently possess valuable experience. Especially young and vigorous individuals are normally not needed to perform supervisory or administrative duties or many covered operating duties. The premature retirement of such employees through the generalized application of the mandatory retirement provision may unnecessarily cost the Government the vital resource of experience.

Agency and union comments
on mandatory retirement

CSC withheld comment pending completion of its independent review. Operating agencies indicated that they do not plan to seek exceptions to the age 55 mandatory retirement provision. Employee unions generally were opposed to mandatory retirement at age 55.

AN ALTERNATIVE BENEFIT
STRUCTURE IS AVAILABLE

The existing benefit formula--2.5 percent of average pay for each of the first 20 years and 2 percent of average pay for each year thereafter--provides an economic incentive for law enforcement and firefighter personnel to retire at an earlier age and with fewer years of service than regular civil service employees. But, the program goes beyond

compensating for an assumed occupationally shortened career by continuing to extend liberal benefits when full careers are served. That is, covered personnel who work full 30-year careers receive greater benefits than regular employees with similar preretirement earnings and years of service. To correct this, the benefits could be restructured like those for air traffic controllers.

The law also provides special retirement benefits to air traffic controllers. Controllers are eligible to retire on an immediate annuity after 25 years of service or upon reaching age 50 after 20 years of service. Like law enforcement and firefighter personnel, the purpose of special retirement for controllers is to improve public safety by maintaining a young, vigorous work force. Controllers' annuities are not, however, computed under a more generous benefit formula. Instead, their annuity is equal to the higher of (1) that produced by the regular civil service formula or (2) 50 percent of average pay. Thus, controllers meeting the age/service criteria are guaranteed an annuity of at least 50 percent of average pay. The special retirement provisions for controllers provide an economic incentive to retire early, but they do not permit controllers choosing to serve full 30-year careers to receive greater retirement benefits than other civil service employees.

Agency and union comments
on benefit structure

CSC withheld comment pending completion of its independent review. Operating agencies generally took the position that covered employees should receive greater benefits than other employees with similar earnings and years of service. In that regard, most agencies believed the benefit structure used for air traffic controllers would not be appropriate for law enforcement or firefighter personnel. Employee unions said the more liberal benefit structure is justified.

FULL COSTS OF RETIREMENT BENEFITS
SHOULD BE RECOGNIZED AND FUNDED

In previous reports to the Congress and the Post Office and Civil Service Committees and testimony before this Subcommittee we have taken the position that the full costs of civil service retirement benefits; including expected pay and annuity increases should be fully recognized and fully funded. This applies equally to the additional costs of the special retirement benefits. The proper recognition of retirement costs would enable the Congress not only to make well-informed decisions on retirement matters but also to

better evaluate the cost effectiveness of agency programs. In our opinion, the preferable approach to retirement funding would require cost recognition and funding on a "dynamic" basis, with full consideration of the effect of pay raises and cost-of-living adjustments on ultimate annuity payments, and allocation of all Government retirement costs to agency operations.

Until the true costs of civil service retirement benefits are fully recognized and fully funded, the Congress should amend the law to require contributions from employing agencies equal to the difference between employee contributions (currently 7.5 percent of pay) and the static normal cost of special benefits (currently about 20 percent of pay). Such additional contributions would serve to better recognize the costs of special retirement benefits and law enforcement/firefighting functions.

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This concludes my statement, Madam Chair, and I will be pleased to answer questions.

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESSFEDERAL RETIREMENT SYSTEMS:
UNRECOGNIZED COSTS,
INADEQUATE FUNDING,
INCONSISTENT BENEFITSD I G E S T

This report states once again GAO's concern over Federal employee retirement systems. In 1976, seven of the Government's retirement systems paid over \$15.6 billion to retirees and the survivors of deceased employees and retirees--an increase of \$10 billion since 1970. The systems also reported liabilities exceeding \$320 billion for which less than \$44 billion had been set aside in Federal trust funds.

The Congress should enact legislation requiring that the full cost of Federal retirement systems be recognized and funded and that the difference between currently accruing cost and employee contributions be charged to agency operations.

Federal retirement systems' funding requirements vary, and in most cases are less stringent than those imposed by law on private pension plans. The cost and liabilities of Federal retirement programs are much greater than recognized by current costing and funding procedures. Usually, little or no consideration is given to the effect of future general pay increases and annuity adjustments on ultimate benefit payments, resulting in a considerable understatement of benefit costs accruing each year. For the civil service retirement system alone, unrecognized retirement costs in 1976 amounted to an estimated \$7 billion. In some programs, none of the currently accruing cost is recognized. (See pp. 3 to 5.)

Because most Federal retirement trust funds are required by law to be invested in Federal debt securities, full funding of Government retirement liabilities would not eliminate the need for future taxing and borrowing to meet benefit payments as they become due.

August 3, 1977

FPCD-77-48

However, full funding would enhance cost recognition and budgetary discipline as well as promote sounder fiscal and legislative decisionmaking. Under existing funding provisions, the unfunded liabilities of Federal retirement systems will continue to grow. (See pp. 5 to 13.)

Costs not covered by employee contributions must ultimately be paid by the Government. When retirement costs are understated, the costs of Government operations and agency programs are also understated. One side effect of the underallocation of retirement costs to agency operations is the unrecognized subsidy that accrues to Government organizations whose programs are required by law to be financed by the users of their services. Understatement of retirement costs may also result in a tendency to adopt benefits which could jeopardize the affordability of the retirement systems. (See pp. 16 to 21.)

Some of the agencies responsible for administering Federal retirement programs agreed with GAO that the full cost of retirement benefits should be recognized. The Department of Defense did not comment on the report, and others had no comments on GAO's recommendations. Self-supporting agencies, whose retirement contributions would be higher if costing and funding techniques recognized general pay increases and annuity adjustments, generally agreed that the costs of their operations were being understated. Some believed the Congress should appropriate funds to pay the higher costs rather than increase charges to the users of the agencies' services. (See pp. 21 and 22.)

GAO further recommends that the Congress establish an overall Federal retirement policy to guide retirement system development. Centralization of committee jurisdiction over all Federal employee retirement systems would facilitate the establishment and implementation of such a policy.

There is no standard or method of assessing the adequacy of Federal employee retirement programs. Different committees of the Congress

have legislative jurisdiction over the various systems. There is no overall policy for guidance in establishing, financing, or amending these programs.

Federal retirement systems have developed on an independent, piecemeal basis. Many inequities, inconsistencies, and common problems exist among the systems. Some of the differences may be legitimate, but many of the benefit provisions differ without apparent explanation.

- Employee contribution rates vary. Some systems require no cost sharing by the covered employees. (See app. I.)
- Each system has its own age and service requirements that employees must meet to become eligible for a retirement annuity. (See pp. 23 and 24.)
- Transfers of service credits between retirement systems are treated inconsistently. (See pp. 23 and 25-26.)
- Benefits payable at retirement vary from system to system. (See pp. 26 to 28.)
- There are wide variations in the survivor benefit programs of the systems. (See pp. 28 and 29.)
- Each system has differing provisions regarding the amounts reemployed annuitants may receive. (See pp. 29 to 31.)
- Disability provisions and practices are not consistent. (See pp. 31 and 32.)
- Social security coverage is provided to employees under two of the retirement systems. Employees in the other systems are prohibited by law from participating in social security through their Federal employment. (See p. 32.)

Most Federal agencies responsible for administering the various retirement systems made no specific comments to GAO on whether the many different provisions and practices followed are justified. (See pp. 32 and 33.)

DISABILITY RETIREMENTCIVIL SERVICE RETIREMENT SYSTEM

Basic eligibility--5 years' creditable service.

Definition of disability--inability to perform useful and efficient service in the specific position occupied at the time application for retirement is made.

Establishment of disability--application by the employee or employing agency accompanied by a statement from the employee's superior officer showing how the employee's condition affects job performance and a report from the employee's doctor fully describing the disability. The Civil Service Commission may also require the employee to undergo an additional medical examination by an approved physician. The employee's disability is rated either temporary or permanent.

Periodic reexamination--for temporary disabilities, the Commission reviews the case annually until the retiree reaches age 60 or is reclassified permanently disabled.

Payments for partial disability--none.

Length of coverage--until death, medical recovery, or restored earning capacity before reaching age 60. If the retiree recovers, payment of the annuity continues for 1 year. Earning capacity is deemed restored if in each of 2 succeeding calendar years the annuitant's income equals at least 80 percent of the current rate of pay of the position occupied immediately before retirement. However, the annuity is restored if the earnings fall below 80 percent in a later calendar year.

Computation of annuity--the larger of amounts derived from the general formula or the guaranteed minimum.

(1) General formula--larger of the following two amounts:

(a) 1.5 percent of the high-3 average pay for each of the first 5 years of creditable service, plus 1.75 percent for each of the second 5 years of service, plus 2 percent for each year over 10 years; or

- (b) substitute 1 percent of the high-3 average pay plus \$25 for any or all of the percentages in (a) where it will yield a larger amount, multiplied by the years of service as shown in (a).
- (2) Guaranteed minimum--the lesser of the following two amounts:
- (a) 40 percent of the high-3 average pay or
 - (b) the amount obtained under the general formula after increasing the employee's actual creditable service by the time remaining between the date of separation and the date he attains age 60.

FOREIGN SERVICE RETIREMENT AND DISABILITY SYSTEM

Basic eligibility--5 years' creditable service.

Definition of disability--totally disabled or incapacitated for useful and efficient service by reason of disease, illness, or injury not due to vicious habits, intemperance, or willful misconduct on employee's part.

Establishment of disability--application by employee accompanied by a description of the disability and a full explanation of the manner in which it affects the performance of duties; must inform immediate supervisor of application for disability retirement and undergo medical examination. Disability is determined by the Secretary of State, or his designated representative, on the basis of advice provided by one or more duly qualified physicians or surgeons designated to conduct examinations. The employee's disability is rated either temporary or permanent.

Periodic reexamination--unless the disability is rated permanent at the time of retirement or at a later date, examinations by duly qualified physicians or surgeons designated by the Secretary are made annually until annuitants reach the mandatory retirement age for their class in the service.

Payments for partial disability--none.

Length of coverage--remainder of lifetime unless annuitant recovers to the extent that he can return to

duty. If the retiree recovers, payment of the annuity continues 6 months after the date of examination.

Computation of annuity--2 percent of average basic salary for the high-3 consecutive years, times years of service not exceeding 35. The average high-3 years do not have to be consecutive for a Chief of Mission whose service in that capacity was interrupted. For retirees with less than 20 years' service, the annuity is computed as though the employee has 20 years' service; but the additional service credit may not exceed the difference between the employee's age at time of retirement and the mandatory retirement age.

UNIFORMED SERVICES RETIREMENT SYSTEM

Basic eligibility--20 years' service, or at least 30-percent disability and (1) 8 years' service, (2) disability being the proximate result of performing active duty, or (3) disability being incurred in line of duty during war or national emergency.

Definition of disability--unfit to perform the duties of office, grade, rank, or rating because of a physical disability which did not result from the member's intentional misconduct or willful neglect and was not incurred during a period of unauthorized absence.

Establishment of disability--report to sick bay and request physical evaluation board's ruling on physical fitness to maintain duties in the military. Physical evaluation board makes decision on disability on the basis of medical advice from military doctors. The disability is rated either temporary or permanent.

Periodic reexamination--if the disability is temporary, the retiree must undergo a physical examination at least every 18 months. If the disability still exists after 5 years, it is considered permanent.

Payments for partial disability--yes. If member has less than 20 years' service, disability must be at least 30 percent.

Length of coverage--remainder of lifetime unless retiree recovers from disability or fails to report to an examination without just cause.

Computation of retired pay--monthly basic pay on day before retirement multiplied by either (1) 2.5 percent times years of service or (2) the percentage of disability. The retired pay cannot exceed 75 percent of the monthly basic pay. Those temporarily disabled receive at least 50 percent of the monthly basic pay.

FEDERAL JUDICIARY RETIREMENT SYSTEM

Basic eligibility--judges and justices of the United States: appointment to position of judge or justice of the United States. Judges of the District Court of Guam, Canal Zone, and the Virgin Islands: 10 years' creditable service.

Definition of disability--unable to discharge all duties efficiently because of permanent mental or physical disability.

Establishment of disability--written certification to the President signed by the chief official of the court. The President may retire any judge or justice whom he finds to be mentally or physically incapable of discharging all the duties of his office.

Periodic reexamination--none.

Payments for partial disability--no provisions.

Length of coverage--remainder of lifetime.

Computation of annuity--justices and judges of the United States: if 10 years' service, the salary of the office; if less than 10 years' service, one-half the salary of the office. Judges of the District Court of the Canal Zone, Guam, and the Virgin Islands: if 16 years' service, salary of the office at the time of relinquishment; if 10-15 years' service, salary times years of service, divided by 16.

U.S. TAX COURT JUDGES RETIREMENT SYSTEM

Basic eligibility--appointment to a U.S. Tax Court judge position.

Definition of disability--unable to discharge efficiently all the duties of the office by reason of permanent mental or physical disability.

Establishment of disability--written certification to the President. The President must concur with the Chief Judge's disability retirement. The Chief Judge must sign any other judge's disability certification. The President shall declare any judge retired if he finds the judge to be permanently disabled from performing duties.

Periodic reexamination--none.

Payments for partial disability--none.

Length of coverage--same as Federal judiciary.

Computation of annuity--if 10 or more years' judicial service, 100 percent of the salary payable to a judge; if less than 10 years' judicial service, 50 percent of the salary payable to a judge.

TVA RETIREMENT SYSTEM

Basic eligibility--5 years' creditable service.

Definition of disability--inability to continue in present position because of a physical or mental disability that is likely to be permanent and a lack of another available TVA position for which the employee is qualified. The determination must be made by the TVA Retirement System Board of Directors on the basis of a report either by the medical board (three physicians independent of TVA) or by the director of the TVA division of medical services and information from the TVA employment branch.

Establishment of disability--application by TVA or by employee, who authorizes the retirement system to obtain reports from his personal physician(s), the TVA physician, his supervisor, and the TVA division of personnel. The completed file is then reviewed by the Director of the TVA division of medical services and, if appropriate, by the medical board, and approved by the TVA retirement system board of directors.

Periodic reexaminations--as may be determined by the board of directors.

Payments for partial disability--none.

Length of coverage--until death, reemployment in a position covered by TVA retirement system, or until earnings plus regular disability benefit exceed his prior position's salary, which initiates a reduction. Obligated upon request by the directors to file, within 30 days, a proper application for social security disability insurance benefits or, at age 65, a social security old-age benefit; if he does not, the TVA disability pension may be discontinued.

Computation of disability retired pay--disability benefit consists of two parts:

- (1) An annuity--the actuarial equivalent of the employee's accumulated contributions.
- (2) A pension from TVA's contributions to the system. The pension is equal to 1.1 percent of the member's average compensation for each year of creditable service. However, an alternative formula is used if this results in less than a 30-percent pension. Under the alternative formula a 30-percent minimum is provided, except for older employees with short service.

If the member becomes entitled to social security disability insurance or old-age benefits, the TVA pension is subject to reduction.

FEDERAL RESERVE BOARD RETIREMENT SYSTEM

Basic eligibility--5 years' creditable civilian service.

Definition of disability--inability to perform useful and efficient service in specific position occupied at the time application for retirement is made.

Establishment of disability--application accompanied by a report from member's personal physician fully describing the disability. A medical examination is also made by a physician designated by the employer. Decision of disability is made by the

medical board, based on the examination reports of the physicians. The disability is rated temporary or permanent.

Periodic reexamination--if the disability is rated temporary or subject to improvement, a reexamination is required annually until retiree reaches age 60.

Payments for partial disability--none.

Length of coverage--same as civil service.

Computation of annuity--same as civil service.

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESSFEDERAL AND DISTRICT OF COLUMBIA
EMPLOYEES NEED TO BE IN SEPARATE
PAY AND BENEFIT SYSTEMSD I G E S T

The Congress should end the longstanding pay and fringe benefit interrelationships of Federal and District of Columbia employees so that each government controls the nature, level, and costs of its employees' compensation.

About 1,500 Federal law enforcement personnel of the Executive Protective Service, Park Police, and Secret Service participate in pay and/or retirement systems designed for municipal police and firemen and administered by the District. They receive higher pay for the same levels of work and have much better retirement benefits than their Federal civil service counterparts. The District's retirement system is considerably more costly than the Federal civil service system, but participating employees' contributions are less. The Federal Government should administer and control these Federal protective services employees' compensation so that it is equitable, affordable, and consistent with that provided to other Federal law enforcement personnel.

Most District employees are covered by Federal general salary and wage schedules and civil service retirement and other benefit programs. Before home rule began in 1975, District employees were considered Federal employees, and, properly, their pay and fringe benefits were the same as those of other similarly employed Federal personnel. But the Home Rule Act established for the District a form of municipal government somewhat like that of other U.S. cities--responsible and accountable to local residents. The act requires the District to establish an employee merit system by 1980 and gives it the option of creating its own employee compensation systems or continuing to participate in all or part of the Federal civil service systems.

GAO believes the District should control and administer the pay and fringe benefits of all District employees so that their compensation is consistent with its local personnel management objectives and affordable for District residents.

To achieve the proper separation of Federal and District of Columbia compensation systems, GAO is recommending that the Congress enact legislation:

- Making all new Federal protective services employees of the Executive Protective Service, Park Police, and Secret Service subject to Federal civil service pay and retirement systems. (See p. 20.)
- Excluding existing Executive Protective Service employees from the District's police and firemen's annual pay adjustment process and providing them annual pay adjustments equal to the average percentage increase in Federal General Schedule salaries. (See p. 20.)
- Requiring the Civil Service Commission, with the assistance of the Office of Management and Budget, Department of the Treasury, and Department of the Interior, because of the potential impact on affected employees, to study and report to the Congress on the desirability and feasibility of transferring existing Federal employees now covered by the District's police and firemen's retirement system to the Federal civil service retirement system. (See p. 20.)
- Providing that the District government (1) establish its own pay and benefit policies and systems for District employees now subject to Federal pay and retirement systems and (2) make, if it chooses to administratively adopt Federal pay systems, independent decisions about granting any future

Federal pay raises to existing District employees. (See p. 30.)

--Requiring the Civil Service Commission, Office of Management and Budget, and District government to study and report on the desirability of (1) transferring existing District employees covered by the Federal civil service retirement system to a District administered and controlled system or (2) retaining them in the Federal system. (See p. 31.)

GAO is also recommending that (1) the Civil Service Commission expeditiously complete its ongoing study of Federal protective services employees' pay systems and propose any appropriate legislative changes to the Congress (see p. 20), (2) the District government establish its own pay and benefit systems for District employees now subject to Federal compensation systems (see p. 30), and (3) the Congress require all Federal retirement systems to be fully funded and the costs charged to participating agencies and instrumentalities (see p. 31.)

The Civil Service Commission, Office of Management and Budget, and Departments of Treasury and Interior agreed that Federal employees should no longer be covered by District pay and retirement systems. The District government is considering new independent pay and benefit systems for District employees but believes that its existing employees should be permitted to retain their vested Federal benefits. (See apps. I through VI.)



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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FPC-77-18

MAR 23 1977

The Honorable Charles C. Diggs, Jr.
Chairman, Committee on the District
of Columbia
House of Representatives

Dear Mr. Chairman:

Your letter of February 15, 1977 requested our views and comments on H. R. 2465, 95th Congress, 1st Session, a bill "To establish an actuarially sound basis for financing retirement benefits for policemen, firemen, teachers, and judges of the District of Columbia and to make certain changes in such benefits." Because of the limited time available to us to study the bill we were not able to analyze the many provisions in detail. We were glad to see that our comments on a previous bill, H.R. 12441, 94th Congress, 2nd Session, were considered in preparing H.R. 2465. The following comments represent our general observations on the major provisions of H.R. 2465.

The primary objectives of H. R. 2465 appear to be to (1) establish a sound means of funding District of Columbia retirement systems, (2) provide Federal funds to assist the District in meeting the costs of its retirement programs, and (3) change certain benefit features to less costly ones.

The District operates separate retirement programs for its policemen/firemen, teachers, and judges. About 1,500 Federal employees (Park Police, Executive Protective Service officers, and certain Secret Service agents) also participate in the District's Policemen and Firemen's Retirement and Disability System. Furthermore, approximately 31,000 District employees are under the Federal Civil Service Retirement and Disability system.

As of September 1975, the unfunded liability of the three District retirement systems was about \$1.6 billion (\$1.1 billion, policemen and firemen; \$513 million, teachers; and \$9 million, judges). Under existing law, the systems are financed essentially on a "pay-as-you-go" basis. Policemen,

B-118638

fireman, and teachers contribute 7 percent of pay each. Judges contribute 3.5 percent of pay for retirement benefits and an additional 3 percent if they elect to participate in the survivor annuity plan. The District pays the remaining annuity costs. Except for about \$59 million in the teachers and \$1 million in the judges retirement funds, the District's retirement obligations are unfunded. Federal employees in the District's system also contribute 7 percent of pay, and the Federal Government reimburses the District for the additional amount needed to make retirement and survivor benefit payments to Federal annuitants.

The bill would establish three retirement funds, controlled and managed by a 10-member Board. The Board is to be composed of eight active and retired District employee participants in the three retirement systems, one member to be appointed by the District Council, and one member to be appointed by the Mayor. The Board would elect one member to be Chairman. The ratio of beneficiaries of the fund to public representatives seems to be out of proportion considering their financial contributions to the fund. Except for prohibiting investment of the funds in District-issued or guaranteed securities and District real property, the bill provides no specific guidance on fund investment policies that are to be followed by the Board. In carrying out its responsibilities, the Board is to engage the services of investment counsel or counsels and necessary staff. Board expenses are to be borne by the District.

The bill calls for Federal payments totaling \$42.2 million to the policemen and firemen, teachers, and judges retirement funds in fiscal year 1978 and payments of up to \$787.3 million from 1979 to 2003 based on a formula included in the bill. These payments would be in addition to those now paid for Federal employees covered under the District system--about \$5.2 million in fiscal year 1975. The benefits for Federal employees in the policemen and firemen's system would not be paid from these retirement funds. Instead their benefits would continue to be on a pay-as-you-go basis.

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The issues of whether the Federal Government should contribute funds toward District retirement liabilities and the amount of such contributions are matters of policy for the Congress to decide.

We fully endorse the purpose of H.R. 2465 which is to place the financing of retirement systems for policemen, firemen, teachers, and judges of the District of Columbia on an actuarially sound basis. We have continually taken the position that the full costs of Federal retirement benefits should be recognized and funded. It should be noted, however, that H.R. 2465 would require Federal assistance in fully funding the District's retirement systems at a time when full funding of Federal retirement systems is not required.

We are concerned that, in its present form, the bill would result in a cash outflow from the Federal Treasury. Under Federal retirement programs, fund balances are invested in Federal securities, and cash is needed only at the time of annuity payments. We believe serious consideration should be given to requiring the Federal payments under H.R. 2465 to be in the form of Federal securities. It is entirely possible that the return from investments in Federal securities could be even greater than the net return that could be received from other investments after payment of the Board, staff, investment counsel, and other expenses incurred in making the investments. Also, requiring the fund assets to be in Federal securities does not seem unreasonable since the fund assets would consist entirely of Federal dollars and associated investment earnings.

Beginning with fiscal year 1979, the Federal payment to each fund under H.R. 2465 would be the lesser of (1) the estimated amount specified in the bill or (2) that amount determined by subtracting the District's share of pay-as-you-go cost (the amount of benefits to be paid by the District including refunds and lump-sum payments less employee contributions) from the net level percentage of payroll cost (the amount required to be deposited in each fund annually in perpetuity in order to meet the outlays of the funds in perpetuity less employee contributions). The Federal payments would cease whenever the District's share of pay-as-you-go cost equals the net level percentage cost and the District would be paying the level percentage cost in perpetuity.

B-118638

The ultimate purpose of the Federal payments is to build the funds' assets to a level which will generate interest income that, when added to the District's level percentage contributions and the employees' contributions, will be sufficient to pay all benefits in perpetuity. Therefore, since the pay-as-you-go cost will not exceed the level percentage cost for at least 20 to 25 years, H.R. 2465 would provide no financial relief to the District until that time. In fact, the cost of operating the proposed Board will be an additional financial burden on the District.

A stated purpose of H.R. 2465 is to help the District finance its retirement system liabilities incurred prior to the establishment of home-rule. If the District is to be completely responsible for any additional retirement liabilities incurred for its employees after home-rule, it should contribute more to the Federal civil service retirement fund under which most District employees are covered. The required combined contribution rate of 14 percent of pay from the District and its 31,000 employees participating in the Federal civil service retirement system are far short of covering the cost of benefits being earned by those employees. Using economic assumptions that are conservative when compared to the assumptions used to compute the Federal payments to the District under H.R. 2465, we estimate that the Federal Government subsidized the District by more than \$67 million in fiscal year 1975 through the civil service retirement system. This subsidy will continue and probably grow each year as long as the District is permitted to participate in the civil service system and the current financing arrangements remain unchanged.

H.R. 2465 would reduce retirement benefit provisions for new District employees under the policemen and firemen's system. The major revisions concern (1) changing from a final 12-month salary average to a 3-year salary average base for annuity calculations, (2) establishing eligibility for an immediate annuity at age 50 after 25 years of service instead of the current requirement of 20 years at any age, (3) restricting the application of the special disability retirement provisions for injuries "aggravated by the job", (4) providing for partial disability

B-118638

depending upon the nature and extent of the injury or illness whether job related or not in lieu of the current definition of disability which assumes that the employee is completely disabled and therefore entitled to the maximum disability benefit, and (5) adopting a cost-of-living annuity adjustment process for retirees under the system rather than the current recomputation of annuity amounts each time active employees' pay is increased. The restricted aggravation clause and the annuity cost-of-living adjustment provision would also apply to current District employees.

H.R. 2465 would not change any of the current benefit provisions for the 1500 Federal employees covered by the policemen and firemen's system. Although we have reservations about the inclusion of Federal employees in pay and retirement systems under District control, we believe that since their pay and benefits are currently tied to those of District police and firemen, the benefit changes in H.R. 2465 should be made to apply to these Federal employees, as well.

We recommend that Section 208(a)(1)(b) providing annuity cost-of-living adjustments equal to the percentage rise in the Consumer Price Index (CPI), plus 1-percent, to survivors of former Federal employees covered by the policemen and firemen's system be modified to eliminate the 1-percent add-on feature.

Studies have shown that District policemen and firemen's benefits are quite liberal in comparison to those received by policemen and firemen in other major cities and will remain comparatively more liberal even if the changes are made. If the benefit changes are not made, the District's retirement costs will increase substantially.

Both the current police and fire system and the system proposed by the bill provide for a retiring employee's benefits to be calculated at 2.5 percent of his salary base for each of the first 20 years of service and 3 percent for each year of service thereafter. The legislative history of the current retirement system shows that the purpose of the increased multiplier after 20 years was to encourage continued employment with the District of Columbia employees

B-118638

eligible to retire. This purpose would seem to be no longer valid with the changes made by H.R. 2465 since it requires employees to work until age 50 and complete 25 years of service to qualify for immediate retirement.

We trust that these comments will be of assistance to you in considering H.R. 2465.

Sincerely yours,



Deputy Comptroller General
of the United States

REPORT TO THE CONGRESS BY THE
 COMPTROLLER GENERAL OF THE UNITED STATES ENTITLED
 "COST-OF-LIVING ADJUSTMENTS FOR NEW FEDERAL RETIREES:
 MORE RATIONAL AND LESS COSTLY PROCESSES ARE NEEDED"
 (FPCD-78-2), DATED NOVEMBER 17, 1977

A pension system operates on the premise that those who have worked are entitled someday to stop working and to receive a retirement income as a right earned through their past service. Inflation shrinks the purchasing power of all Americans, especially pensioners, annuitants, and others on fixed incomes.

To protect the purchasing power of retirement income, the annuities of those under the civil service, uniformed services, foreign service, Central Intelligence Agency, and Federal Reserve Board retirement systems are automatically adjusted each March 1 and September 1 for the increase in the Consumer Price Index (CPI) during the preceding 6-month period ending December 31 and June 30, respectively.

Since, by law, cost-of-living adjustments are applicable to all annuities payable on the effective date of the increase, retiring Federal employees benefit from cost-of-living increases which occurred while they were still employed. They can receive a higher starting annuity which reflects the preceding annuity cost-of-living adjustment and, depending on the timing of their retirement, may be eligible for an additional adjustment immediately. Such increases escalate the already high costs of Federal retirement by inflating the basic annuity upon which succeeding adjustments are applied and can encourage valuable, experienced employees to retire.

This report updates our comments to the Congress, various congressional committees, and individual Congressmen on the Government's annuity adjustment policy for new retirees. In this report, we are reiterating our concerns about the inflated starting benefits and the cost implications which will continue to result if the existing policy is not changed. The following comments are generally limited to the civil service system, since it is the largest system and often leads the other systems to change. Most of our observations, however, also pertain to other Federal retirement systems.

ADJUSTMENT PROCESS INFLATES
 PURCHASING POWER OF NEW RETIREES' ANNUITIES

The legislative purpose of the cost-of-living adjustment process is clearly to protect the purchasing power of the annuity at retirement. Thus, retiring employees should not

benefit from a process designed for those already in a retired status. But the law permits new Federal retirees to receive annuity increases based on CPI changes that occurred while they were still employed. We believe it is inappropriate and inequitable for individuals drawing full salary when the CPI increases occur to reap the additional benefits of those increases in their annuities. Federal pay rates are adjusted periodically to maintain pay comparability with the private sector. To the extent that cost-of-living changes influence private sector pay levels, they are reflected in the Federal pay rates upon which retirement annuities are based.

The amount of a civil service retirement annuity is determined by an employee's average annual salary during his/her 3 consecutive highest paid years and his/her years and months of service, including unused sick leave. The earned annuity is a direct function of the average salary and length of service and usually increases proportionately to these two factors.

But an anomaly was introduced into the retirement system along with the periodic CPI-related adjustment provision in 1965. That law--Public Law 89-205--removed the requirement of prior law that, to be eligible for a cost-of-living adjustment, retirees had to be on the retirement rolls for more than a year prior to the effective date of the adjustment. When the automatic adjustment process became law in 1962, it called for an annual annuity adjustment if the CPI rose by at least 3 percent during the preceding year. The process was changed in 1965 to gear adjustments to monthly changes in the CPI because the annual process had not produced an adjustment. The legislative history of the 1965 law is not clear regarding the rationale for removing the 1-year waiting period for annuity adjustment eligibility, but it appears that the change was made so that all annuitants would receive the December 1965 legislated annuity adjustment--the first adjustment in almost 3 years.

The 1965 law provides that cost-of-living adjustments are applicable to all annuities payable on the effective date of the increase. Until 1973 that provision permitted an employee who retired on that date to receive a higher starting annuity than an employee who retired the following day. For the most part a decision to remain on the job resulted in lower future annuity payments and, consequently, large numbers of employees, particularly those whose pay rates were frozen, retired immediately before scheduled annuity increases.

To correct this anomaly, the law was changed in 1973-- Public Law 93-136--to guarantee that retiring employees would receive a basic annuity at least equal to the annuity they could have earned if they had retired as of the effective date of the last cost-of-living adjustment. Retiring employees receive the higher of (1) an annuity based on their average salary and length of service at retirement or (2) an annuity based on their salary and service at the time of the preceding annuity cost-of-living adjustment, plus that adjustment which they would have received if they had retired at that time. Although the 1973 amendment has reduced the number of retirements occurring before a scheduled annuity increase, it allows employees who retire immediately before a cost-of-living increase to receive that increase and to have the preceding cost-of-living increase considered in their basic annuity calculation.

The existing process overcompensates retiring employees by providing annuity increases based on changes in the CPI which occurred before their retirement. For example, employees who retired August 31, 1977, had considered in their basic annuity calculation the March 1, 1977, 4.8-percent increase which represented the percentage rise in the CPI from December 1975 through December 1976. The resulting starting annuity frequently would have been greater than an annuity based solely on salary and service. Additionally, the new retiree would have received the full 4.3-percent annuity increase of September 1, 1977, which was based on the percentage change in the CPI for the 6-month period ended June 30, 1977.

Eliminating the added enrichment of compensating retiring Federal employees and new Federal retirees for living cost increases which occur while they are still in an active status would still fully protect the purchasing power of retirement annuities. Federal annuity cost-of-living adjustment processes, which fully protect the purchasing power of retirement income as living costs rise, would still be more liberal than those of essentially all non-Federal pension systems. Few non-Federal plans have automatic adjustment provisions and those which do generally limit the amount of increase that can be granted in any 1 year. A 1974 survey by the Conference Board--an independent, nonprofit business research corporation--revealed that only 4 percent of the benefit programs of 1,800 major private employers had pension plans which were automatically adjusted for increases in the cost of living. Further, a recent congressional task force survey disclosed that less than 5 percent of the 371 largest State and local government pension plans had unlimited automatic adjustments for cost-of-living increases.

ELIMINATING THE OVERCOMPENSATION ASSOCIATED
WITH THE EXISTING POLICY WOULD RESULT IN
CONSIDERABLE COST SAVINGS

Despite the fact that cost-of-living adjustments are designed to protect the purchasing power of those already in a retired status, existing law also permits new Federal retirees who were not retired when the living cost increases occurred to benefit equally from those adjustments. A more rational method of computing adjustments of new retirees would be to prorate their adjustments to reflect only the cost-of-living increases that occur after they retire.

Proration of the annuity adjustments of new retirees would be much less costly than the existing process. For the 92,000 civil service employees expected to retire in 1978, we estimate that the retirement fund would save over \$800 million in annuity payments over their expected remaining lifespans. (See app. I.) This savings estimate is conservative since annuity payments to survivors of former civil service employees and retirees were not considered in the calculation.

To illustrate how prorating the adjustments would be less costly than the existing process, assume that a civil service employee retires February 28, 1978, is entitled to a \$1,000 basic monthly benefit based on length of service and average salary, and the CPI rises by 3 percent each 6-month period ending June 30 and December 31. Under existing law, the retiring employee's basic monthly benefit would be increased to \$1,030 the next day, March 1, 1978, to reflect the CPI increase occurring the 6-month period ending December 1, 1977 when the employee is still working. Effective September 1, 1978, the retiree's monthly benefit would be increased to \$1,061 to reflect the CPI increase during the 6-month period ending June 30, 1978, including the months of January and February when the employee is still working and drawing full salary. Under a policy of prorating adjustments to reflect only CPI increases after retirement, the same retiree would not be eligible for the March 1, 1978, adjustment since it would represent the percentage rise in the CPI during the last 6 months of 1977, when the individual is still working. Instead, the new retiree would continue to receive the basic \$1,000 monthly benefit from March 1978 through August 1978. Effective September 1, 1978, the monthly benefit would be increased by 2 percent to \$1,020 to reflect the 4 months--March 1978 through June 1978--the individual would actually be retired.

while we did not develop estimates of cost savings which could also be realized under the other Federal retirement systems if the annuity cost-of-living adjustments of new retirees were prorated, the savings would be considerable. For example, over 50,000 military personnel retired in fiscal years 1975 and 1976, and those trends are expected to continue.

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Federal employees should always earn a higher basic annuity by continuing to work rather than by retiring early. We believe that the annuity adjustment policy should be changed to require prorating new retirees' annuity adjustments to reflect only CPI increases after the effective date of retirement. A similar policy exists for the Federal Employees Compensation Act program--to be eligible for a cost-of-living adjustment a recipient's disability must have occurred more than 1 year before the effective date of the adjustment. Such a policy would insure higher basic annuities for continued Federal service and should encourage valuable employees who are considering retirement to remain.

Additionally, prorating new retirees' annuity adjustments would eliminate the need for the annuity guarantee provision of the 1973 amendment. In that regard, the alternate annuity calculations required by law are difficult and time consuming for the administering agency. The Civil Service Commission said that those required calculations have increased the administrative costs of the civil service retirement system which, like the benefits, are financed by employee and Government contributions.

RECOMMENDATIONS TO THE CONGRESS

The Congress should enact legislation making the cost-of-living adjustment processes of the civil service, uniformed services, foreign service, Central Intelligence Agency, and Federal Reserve Board retirement systems more rational and less costly by (1) repealing the provisions of existing law which permit retiring employees and new retirees to receive higher starting annuities because of changes in the CPI before their retirement and (2) providing that new retirees' cost-of-living adjustments be prorated to reflect only CPI increases after their retirement.

COMPARISON OF RETIREMENT PAYMENTS UNDER THE
PRESENT METHOD AND THE PRORATION METHOD OVER
THE REMAINING LIFESPANS OF CIVIL SERVICE EMPLOYEES
EXPECTED TO RETIRE IN 1978 (note a)

Year	Population	Average age	Total annuity payments		Potential savings (note b)
			Present method	Proration method	
(000 omitted)					
1978					
(note c)	92,000	57	\$ 429,364	\$ 419,286	\$ 11,079
1979	90,068	58	822,501	795,112	27,389
1980	87,996	59	851,801	822,669	29,132
1981	85,726	60	880,267	850,162	30,105
1982	83,480	61	907,595	876,555	31,040
1983	81,059	62	933,800	901,864	31,936
1984	78,546	63	959,518	926,702	32,816
1985	75,875	64	982,430	948,831	33,599
1986	73,068	65	1,003,078	968,773	34,305
1987	70,145	66	1,021,031	986,112	34,919
1988	67,059	67	1,034,653	999,268	35,385
1989	63,840	68	1,044,103	1,008,195	35,708
1990	60,520	69	1,049,175	1,013,293	35,882
1991	57,070	70	1,048,718	1,012,852	35,866
1992	53,532	71	1,042,750	1,007,088	35,662
1993	49,892	72	1,030,170	994,938	35,232
1994	46,200	73	1,011,179	976,597	34,582
1995	42,504	74	986,093	952,369	33,724
1996	38,806	75	954,317	921,679	32,638
1997	35,158	76	916,464	885,121	31,343
1998	31,607	77	873,333	843,465	29,868
1999	28,099	78	822,992	794,846	28,146
2000	24,727	79	767,674	741,420	26,254
2001	21,463	80	706,326	682,170	24,156
2002	18,372	81	640,870	619,952	21,918
2003	15,451	82	571,316	551,777	19,539
2004	12,763	83	500,233	483,125	17,108
2005	10,313	84	428,464	413,811	14,653
2006	8,137	85	358,345	346,090	12,255
2007	6,217	86	290,216	280,291	9,925
2008	4,563	87	225,786	218,064	7,722
2009	3,180	88	166,794	161,090	5,704
2010	2,077	89	115,477	111,528	3,949
2011	1,254	90	73,903	71,376	2,527
2012	683	91	42,667	41,208	1,459
2013	320	92	21,190	20,465	725
2014	117	93	8,212	7,931	281
2015	31	94	2,306	2,227	79
2016	4	95	315	304	11
Total			<u>\$25,525,426</u>	<u>\$24,656,806</u>	<u>\$868,620</u>

a/Using a \$700 anticipated average starting monthly annuity based on average salary and length of service, 6-percent annual rate of inflation and mortality factors for those age groups.

b/Based on adjusting the \$700 average monthly starting annuity of 1978 retirees only for cost-of-living increases that occur after they retire.

c/1978 amounts based on an average of only about 6-1/2 months in retired status.