



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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ACCOUNTING AND FINANCIAL
MANAGEMENT DIVISION

MAY 21 1982

The Honorable Lawrence J. Korb
Assistant Secretary of Defense (MRA&L)

Dear Dr. Korb:

Subject: The Results of Our Initial Review of the
Financial and Actuarial Statements Submitted
Pursuant to Public Law 95-595 (GAO/AFMD-82-67)

We have completed our review of the Department of Defense's (DOD's) fiscal 1980 financial statements and actuarial statements relating to the military retirement system, a noncontributory, pay-as-you-go (unfunded) system that pays benefits to retired military personnel and certain retirees' survivors. Public Law 95-595 (31 U.S.C. 68), enacted November 3, 1978, requires all Federal Government pension plans to file an annual report with the Congress for plan years beginning after September 30, 1978.

Our review of the statements was made pursuant to the requirement of the Budget and Accounting Procedures Act of 1950, as amended (31 U.S.C. 68a), and was limited principally to conducting discussions with personnel responsible for preparing the statements, performing analytical procedures on financial and actuarial data, and determining compliance with Office of Management and Budget instructions for preparing the annual report. This letter provides our comments regarding the following matters:

- The financial statements did not disclose the existence of valid accounts receivable and unpaid obligations, which were reported to the Department of Treasury as part of the yearend closing process but were omitted from the pension statements required by Public Law 95-595.
- Our analysis of the techniques, formulas, assumptions, and computer program logic showed that the methodology employed in the actuarial valuation process is satisfactory to produce reasonable actuarial projections on the future of the military retirement system.

The following sections of this letter discuss more fully the above matters.



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VALID ACCOUNTS RECEIVABLE AND UNPAID OBLIGATIONS
NOT DISCLOSED IN THE FINANCIAL STATEMENTS

Because the military retirement system is unfunded, DOD contended that a required financial statement and other information need not be prepared. This contention led to the omission of valid receivables and payables from the pension report.

At the close of each fiscal year, all departments and agencies of the executive branch are required to submit an analysis of appropriation and fund account balances including an analysis of receivables and unpaid obligations. This analysis is used by the Department of the Treasury in reporting such Federal Government activity to the Congress and the public. In its fiscal 1980 report to the Treasury, DOD acknowledged the existence of valid accounts receivable and unpaid obligations. However, in its pension report, DOD omitted this information. Over \$1 million in receivables and \$23 million in obligations were not reported.

The two separate reporting requirements (Treasury and Public Law 95-595) are accomplished by different DOD offices. DOD's Office of the Actuary and the Assistant Secretary of Defense (Comptroller) need to improve coordination in the preparation of the pension report, which was viewed primarily as an actuarial report. More recognition should be given to adhering to generally accepted accounting principles, which require, among other things, disclosure of accrued receivables and payables. Future reports should disclose these items either in the financial statements or in the footnotes thereto. Such disclosure would enhance the usefulness and fair presentation of the report.

METHODOLOGY IS SOUND FOR VALUING
THE ACTUARIAL STATUS OF THE SYSTEM

The valuation of the military retirement system, conducted by the DOD's Office of the Actuary in consultation with an enrolled actuary, was done using procedures different from those of past years. For the first time, the valuation included over 800,000 nonretired reservists thereby accounting more precisely for a major actuarial liability that previously was only crudely estimated.

In valuing a pension plan, various economic and noneconomic actuarial assumptions must be made. The former includes factors for inflation, general salary increases, and investment return. In the case of the military retirement system, investment return is a theoretical assumption since the system is unfunded (no assets exist on which to earn investment income). The noneconomic assumptions include actuarial rates for withdrawal, transfers, disability, retirement, and death. In 1980, DOD developed actuarial rates based on an empirical study of over 90 percent of known participants for the period July 1976 through September 1980.

Although we did not perform any checks of data accuracy or completeness, we did review the techniques and formulas used to produce the various decrement rates and found them to be in accordance with accepted actuarial practices. From our limited review of documents and calculations supporting the valuation itself, as well as analyzing the actuarial assumptions and computer valuation program logic, we believe that sound actuarial techniques and procedures are being followed that should produce reliable actuarial projections about the system.

If you have any questions or wish to discuss these matters further, we will be happy to meet with you or your staff. We would appreciate being kept informed of any changes you may implement as a result of this letter.

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Copies of this report are being sent to the Director, Office of Management and Budget, the Secretary of Defense, and the Secretary of the Treasury.

Sincerely yours,



Ronald J. Points
Associate Director