United States General Accounting Office 134304

GAO

Report to the Chairman, Subcommittee on National Security Economics, Joint Economic Committee, U.S. Congress

September 1987

FINANCIAL AUDIT

Military Retirement System's Financial Statements for Fiscal Year 1985

134304

040315

GAO

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

Accounting and Financial
Management Division

B-225938

September 30, 1987

The Honorable William Proxmire
Chairman
Subcommittee on National Security Economics
Joint Economic Committee
United States Congress

Dear Mr. Chairman:

In response to your March 3, 1986, request, we audited the financial statements of the U.S. Military Retirement System for fiscal year 1985. Beginning in fiscal year 1985, the Congress has provided funding to the Department of Defense for future payments by the System. Considering this large commitment of funds for fiscal year 1985 and over the next 75 years, you asked us to ensure that the amounts being funded were properly managed and controlled.

Background

Although some aspects of the present military retirement system can be traced to laws enacted before the Civil War, the System is primarily based on legislation enacted in the late 1940's. However, two recent changes to the System have occurred. The first change, under Public Law 98-94, established the Defense Military Retirement Fund on October 1, 1984, for the accumulation of funds on an actuarial basis to finance military retirement and survivor benefit programs. Prior to the enactment of that law, the System operated on an unfunded or "pay-as-you-go" basis with annual appropriations made to the Department of Defense to pay current retiree and survivor benefits. The second change, under Public Law 99-348, revised the benefit payment structure for all service members who joined after July 31, 1986, and was intended to reduce the cost of providing retirement benefits to future retirees.

After the establishment of the Fund, the military services continued to independently process the retirement benefit claims and payments; however, an appropriation was given to the Fund to invest for future payments and to amortize the initial unfunded liability. The responsibility for the System's financial reporting and investment management was assigned to the Washington Headquarters Services of the

Department of Defense. The Department of Defense Office of the Actuary is responsible for the preparation of the System's financial statements and actuarial reports under Public Law 95-595, which requires the preparation of annual pension plan reports.

Objectives, Scope, and Methodology

Our audit was designed to audit the System's financial statements and review related significant internal accounting controls as well as compliance with laws and regulations, as requested. The overall objective of our review was to opine on the fiscal year 1985 financial statements for the System. In addition, we examined the other areas of concern you raised:

- the adequacy of the internal accounting controls,
- opportunities for cost savings and outlay reductions by increasing internal accounting controls and compliance with laws,
- whether funds in excess of current-year payments are invested properly, and
- the reasonableness of assumptions used to project the unfunded liability and to determine the self-sufficiency of the Fund.

Our work was performed at the Defense Manpower Data Center in Arlington, Virginia, and Monterey, California; the Washington Headquarters Services, Washington, D.C.; the Army Finance and Accounting Center, Indianapolis; the Navy Finance Center, Cleveland; the Marine Corps Finance Center, Kansas City, Missouri; and the Air Force Accounting and Finance Center, Denver.

Opinion on Financial Statements

Except for an understatement and a lack of disclosure of approximately $75 million in accounts payable, the Military Retirement System's financial statements present fairly the financial position of the retirement system and the results of its operations for the fiscal year ended September 30, 1985. Our complete opinion on the financial statements is included as part of this report.

Adequacy of Internal Accounting Controls

As part of our audit of the System's financial statements, we tested significant internal accounting controls. A summary of our findings follows.

- At each of the services' finance centers, controls existed to ensure that benefit claims were processed and payments were made without material error.
- The collection and processing of actuarial data was reasonable for projecting the System's estimated future benefit payout.
- Controls existed to ensure proper accounting for all appropriations and the military services' monthly contributions.
- Investment and cash transactions were controlled properly.
- We found internal accounting control weaknesses over the recording and reporting of financial information at the services' finance centers. Specifically, all accounts receivable were not identified, classified, and reported for the Fund. The additional amounts we identified were not material to the financial statements.

A more detailed discussion of our evaluation of the System's internal accounting controls is presented in our report on internal accounting controls.

Report on Compliance With Laws and Regulations

We also tested the implementation of laws and regulations related to the financial operations of the Military Retirement System as part of our audit of the System's financial statements. The following summarizes the results of our tests.

- Benefit claims and payments were calculated properly and the correct laws were used for determining eligibility.
- The investment transactions during fiscal year 1985 were limited to public debt securities, as required by Public Law 98-94.
- Appropriations to cover the liability existing for future benefits when the Fund was established and moneys from the military services to cover the future benefits of current military personnel were correctly processed.
- Accounts receivable and related interest charges for overpayment of benefits and unpaid survivor premiums were not properly handled by all the military services. As a result, not as much was collected and deposited in the Fund or Miscellaneous Receipts of thé U.S. Treasury as should have been.
- Financial and actuarial reporting standards were complied with, as required by Public Law 95-595.

The details of this part of our review are in our report on compliance with laws and regulations.

Opportunities for Cost Savings and Outlay Reductions

Interest was not being charged on accounts receivable for overpayments of benefits. Charging interest on debts owed to the System would provide additional revenue to the government. We estimated that additional collections would be about $548,000 for the Army and about $4,200 the Air Force. We could not develop estimates for the Navy and Marine Corps since their accounts receivable were not aged. We present a detailed explanation of this issue in our report on compliance with laws and regulations.

Additional cost savings were identified during a GAO review of Army and Air Force accounts receivable resulting from overpayments to some military retirees or their survivors.

Propriety of Fund Investment Activities

As a result of Public Law 98-94, the System began to receive funding from two major sources during fiscal year 1985—a permanent appropriation from the Congress and monthly contributions from the four military services. In fiscal year 1985, the funding received by the System from the General Fund of the U.S. Treasury ($9.5 billion) and monthly contributions ($17 billion) totaled $26.5 billion, and the System paid $17.2 billion in retirement benefits. The remaining $9.3 billion was invested in long-term U.S Treasury securities. The Treasury investments provided a third source of income to the Fund—interest. The interest collected—investment income interest of $1.1 billion, less accrued interest receivable of $0.4 billion—during the year amounted to $0.7 billion, which was also invested.

The investment activities of the Fund were closely controlled and monitored. Under Public Law 98-94, the investments can be made only in public debt securities. Fund managers reconciled the investments with Treasury each month. Also, the Fund managers had formal guidelines establishing investment objectives and policies. These guidelines, along with specific legal requirements governing federal government pension plans and Treasury regulations, required the Fund to report monthly to Treasury on its investment activities.

We reviewed all of the fiscal year 1985 investment transactions of the Fund and concluded that the investment activity of the Fund was managed properly and in conformity with legal requirements.

Reasonableness of Assumptions Used To Project the Unfunded Actuarial Liability and the Self-Sufficiency of the Fund

Pension funds have a liability to pay future benefits to plan participants. This liability is a function of the future benefit payments earned by individuals participating in the pension plan and future benefit payments to be earned by such participants less plan assets. An actuary makes a series of assumptions pertaining to expected economic and demographic experience to estimate the liability of a pension plan. For large plans such as the System, these assumptions are usually based on actual experience of the pension plan. The assumptions were developed by the Department of Defense Office of the Actuary and then reviewed by an independent board of actuaries. We reviewed the assumptions developed and used for the System's computation and determined them to be reasonable. The unfunded liability is to be capitalized through annual payments over 75 years, starting with inception of System funding in fiscal year 1985.

Given the reasonableness of the assumptions used by the actuaries to estimate the future costs of the plan and also the Congress' willingness to continue providing funds to pay the unfunded liability of the System, we concluded that the System will be self-sufficient. At the end of the 75-year period, the unfunded actuarial liability will be extinguished, and the funding of the System will require only normal cost contributions if the assumptions in the actuarial valuations are realized.

Additional Information

Additional information on our assessment of significant internal controls over actuarial reporting is presented in our report on internal accounting controls.

Our report on internal accounting controls contains a recommendation to the Secretary of Defense to strengthen internal accounting controls over accounts receivable, and our report on compliance with laws and regulations contains a recommendation to comply with interest provisions of the Debt Collection Act of 1982.

Agency Comments

In commenting on a draft of this report, the Principal Deputy Assistant Secretary of Defense (Comptroller) generally concurred with our findings and said Defense would implement our recommendations. (See appendix II.)

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretary of Defense, and other interested parties. Copies are available to others upon request.

Sincerely yours,

Frederick D. Wolf
Director

Contents

Letter		1
Opinion Letter		10
Report on Internal Accounting Controls		12
	Benefit Claims and Payments	13
	Actuarial Reporting	13
	Revenues	14
	Treasury Operations	14
	Financial Reporting	14
	Conclusion and Recommendation	15
	Agency Comments	15
Report on Compliance With Laws and Regulations		16
	Benefit Claims and Payments	16
	Funding and Investment Restrictions	16
	Accounts Receivable and Related Interest	17
	Financial and Actuarial Reporting	18
	Conclusion and Recommendation	18
	Agency Comments	19
Financial Statements		20
	Statement of Net Assets Available for Benefits	20
	Statement of Changes in Net Assets Available for Benefits	21
	Statement of Financial Position as of September 30, 1985	22
	Statement of Changes in Present Value of Accumulated Plan Benefits	23
	Actuarial Tables	24
	Actuarial Status Information as of September 30, 1985	25
	Footnotes for Table	26
	Comparison of Actuarial Funding With Actual Contributions	27
	Comparison of Actuarial Funding With Actual Contributions—As Percentage of Basic Pay	28
	Annual Economic Assumptions Used in Open Projections	29
	Past and Projected Flow of Plan Assets	30
Opinion of the Enrolled Actuary		38

Statement of General Information 39

Appendixes
Appendix I: Request Letter 42
Appendix II: Comments From the Department of Defense 43

Glossary 52

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To the Secretary of Defense

We have examined the statement of net assets available for benefits of the U.S. Military Retirement System as of September 30, 1985, and the related statements of changes in net assets available for benefits, accumulated plan benefits, and changes in present value of accumulated plan benefits for the year then ended. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The System's statement of net assets available for benefits did not include accounts receivable because System managers knew that the accounts receivable reported by the respective military services were understated. Since System managers could not determine the correct amount, a footnote disclosed the $1.8 million in accounts receivable reported by the finance centers. Based on our limited audit work on accounts receivable, we identified at least an additional $5.8 million that should have been reported.

Accounts payable shown in the statement of net assets available for benefits were understated by $67.8 million for a death payment contingency, and the footnotes to the financial statements do not disclose the liability. Accounts payable are understated by an additional $7 million for Army retirees and survivors not yet receiving benefits, pending approval of their claims.

In our opinion, except for the understatement and the lack of disclosure of accounts payable, as discussed in the third paragraph of this report, the financial statements referred to above present fairly the financial status of the U.S. Military Retirement System as of September 30, 1985, and the changes in its financial status for the year then ended in conformity with generally accepted accounting principles which have been applied on a basis consistent with that of the preceding year. We did not audit the financial statements of the U.S. Military Retirement System for the year ended September 30, 1984, and, accordingly, we do not express an opinion on them.

Our examination was made for the purpose of forming an opinion on the basic financial statements taken as a whole. As additional information for financial statement users, we are including the following supplemental schedules: (1) Actuarial Status Information, (2) Comparison of Actuarial Funding with Actual Contributions, (3) Annual Economic Assumptions Used in Open Projections, (4) Past and Projected Flow of Plan Assets, (5) the Opinion of the Enrolled Actuary, and (6) General Information. Inclusion of the supplemental schedules, except for the annual economic assumptions and the actuary's opinion, is required by the Office of Management and Budget/General Accounting Office Instructions for Preparing the Annual Pension Report under Public Law 95-595 and is not a required part of the basic financial statements. The supplemental schedule of actuarial status information has been subjected to the auditing procedures we applied in the examination of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The other supplemental schedules have not been subjected to the auditing procedures applied in the examination of the basic financial statements and, accordingly, we express no opinion on them.

Frederick D. Wolf
Director

January 9, 1987

Report on Internal Accounting Controls

We have examined the financial statements of the U.S. Military Retirement System for the year ended September 30, 1985, and have issued our opinion thereon. As part of our examination, we evaluated the system of internal accounting controls in accordance with generally accepted government auditing standards. The purpose of our evaluation was to (1) determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the System's financial statements and (2) assess the adequacy of the significant internal controls. For the purpose of this report, we have classified the significant internal accounting controls in the following categories:

- benefit claims and payments,
- actuarial reporting,
- revenues,
- treasury operations, and
- financial reporting.

To assess the adequacy of the significant internal accounting controls over financial reporting, revenues, and treasury operations, we performed substantive audit tests to simultaneously determine the validity and the propriety of accounting transactions and balances and to evaluate the adequacy of significant internal accounting controls. We performed a study and evaluation of the significant internal accounting controls identified in the benefit claims and payments category and in the actuarial reporting category.

The Military Retirement System's management is responsible for establishing and maintaining a system of internal accounting controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that (1) assets are safeguarded against loss from unauthorized use or disposition and (2) transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of the inherent limitations in any system of internal accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with procedures may deteriorate.

While our evaluation disclosed certain conditions which resulted in errors or irregularities, the amounts were not material to the fair presentation of the Military Retirement System's financial statements. We found that the system of internal accounting controls was effective in detecting errors or irregularities promptly, except for the identification and reporting of accounts receivable. The results of our evaluation are described in detail in the following sections.

Benefit Claims and Payments

Based on our tests, we found no material errors in benefit claims processing and payments. We assessed the internal accounting controls over benefit claims processing and benefit payments at each of the four military service finance centers. Specifically, we statistically sampled 160 payments made to retirees and survivors to ensure that benefits were correctly computed. We also statistically sampled benefit cases for 925 retirees and survivors to determine if payments were (1) authorized, (2) paid to the proper individuals, and (3) recorded in the correct accounts. Also, for the 925 cases, we confirmed that data in the services' master files were accurate. Our tests did not reveal any material errors in the computation, payment, or accounting for expenditures, nor did they reveal any unauthorized payees.

Actuarial Reporting

Based on our tests, we found internal accounting controls over the collection of data used by the actuaries and the computation of actuarial projections to be adequate. We assessed the controls over the automated data processing system used to collect the data and develop the assumptions that form the basis of the System's actuarial projections. In addition, we compared data confirmed in the sample of 925 retiree and survivor benefit cases with the input data used by the actuaries to develop the assumptions and actuarial projections. As a result of these tests, we concluded that the internal accounting controls over the collection of actuarial data were adequate. We also assessed the internal accounting controls in place over the automated data processing system used to compute the actuarial projections. Specifically, we determined that the data center had appropriate (1) segregation of duties, (2) quality controls over data input, processing, and output, (3) physical security, (4) documented operating policies and procedures, and (5) authorization of transactions. Based on our testing of this system, we determined the internal accounting controls to be adequate.

Revenues

We found that transactions in the revenue category are adequately controlled. We tested the receipt of the System's appropriation to amortize the unfunded liability and all of the monthly contributions by each of the four military services. We assessed the internal accounting controls and found appropriate assurance that the receipts and contributions were properly authorized, classified, reconciled, and reported.

Treasury Operations

We found internal accounting controls over treasury operations to be effective in preventing or detecting errors in cash or investment transactions. We tested all the System's cash and investment transactions for fiscal year 1985 and found that the transactions were authorized, classified, reconciled, and reported properly.

Financial Reporting

We found internal accounting control weaknesses over the recording and reporting of financial information at the service level. The services reported accounts receivable to the Fund of $1.8 million. When we reviewed the supporting records for the amounts reported as accounts receivable, we identified at least an additional $5.8 million that should have been reported by the services for the Fund. The Department of Defense has not provided the services with policies and procedures for the consistent identification, classification, and reporting of accounts receivable.

During a review of accounts receivable at the Army and Air Force, we identified about $1.5 million in overpayments due to various types of pay offsets that were not being properly applied. In addition, we determined that accounts receivable identified by the services were not being correctly recorded and reported to the Fund, as discussed below.

- The Navy reported accounts receivable of only about $102,000. This represented the amount that the Navy's Retired Pay Department unsuccessfully attempted to collect and referred to the Accounting and Finance Department for further collection efforts. The reported accounts receivable did not include amounts identified by the Retired Pay Department that the Navy was still attempting to collect. As a result of our audit, the Navy was reviewing the accounts receivable not reported and, as of October 29, 1986, had identified approximately $68,000 in additional accounts receivable attributable to fiscal year 1985.

- The Army reported $1.1 million in delinquent Survivor Benefit Plan and Retired Serviceman's Family Protection Plan premiums due from individuals as System accounts receivable. However, these premiums are not valid accounts receivable, since the Army deposits premium receipts for the fund in the General Fund of the Treasury. The Army identified another $4.5 million in accounts receivable to its appropriation for the retirement payments prior to the establishment of the Fund in 1985 but did not classify, and thus did not correctly report, any of this amount as accounts receivable to the Fund.
- The Marine Corps reported $176 as accounts receivable. Because of the lack of adequate records, we were not able to determine the total amount of accounts receivable as of September 30, 1985. However, we reviewed the master file of retirees and survivors as of November 30, 1985, and identified at least $521,850 in accounts receivable that the Marine Corps should have reported for fiscal year 1985.
- The Air Force reported accounts receivable of $600,656. Other than the amounts found by GAO's review of accounts receivable at the Army and Air Force discussed previously, we did not identify any additional accounts receivable that should have been included.

Conclusion and Recommendation

The Department of Defense had not provided policies and procedures for handling the System's accounts receivable and, as a result, the military services were not correctly identifying, classifying, and reporting accounts receivable to the Fund.

We recommend that the Secretary of Defense direct the Fund managers to develop policies and procedures specifically addressing the recording and reporting of all accounts receivable.

Agency Comments

The Principal Deputy Assistant Secretary of Defense (Comptroller) concurred with the recommendation. He noted that Defense's accounting manual includes policies and procedures for recording and reporting accounts receivable. He said that by September 30, 1987, Defense expected to add new chapters to the manual to expand the applicable standards.

Report on Compliance With Laws and Regulations

We have examined the financial statements of the U.S. Military Retirement System for the year ended September 30, 1985, and have issued our opinion thereon. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures, including tests of compliance with laws and regulations, as we considered necessary in the circumstances. Specifically, we tested laws and regulations affecting transactions in the following categories:

- benefit claims and payments,
- funding and investment restrictions,
- accounts receivable and related interest charges, and
- financial and actuarial reporting.

A description of our review for compliance with applicable laws and regulations and the results for each of the above categories follow.

Benefit Claims and Payments

For the transactions we tested, we found that benefit processing and payment complied with the governing laws and regulations. We tested the implementation of the numerous laws and regulations affecting the processing of benefit claims at each of the military service finance centers for a statistical sample of retirees and annuitants. We used this same sample to assess internal controls over benefit claims and payments. Based on our analysis of the sample transactions, we determined that the applicable laws and regulations for processing benefit claims were complied with.

Funding and Investment Restrictions

The Defense Military Retirement Fund held investments with a fair market value of $12.4 billion in public debt securities at September 30, 1985. Two major sources generate the amount available for investment: (1) an appropriation intended to cover the liability existing for future benefits when the Fund was established and (2) amounts from each military service's appropriation to cover the future benefits of current military personnel. We reviewed the latter source and found that amounts the military services transferred to the Fund each month were correctly computed in accordance with Public Law 98-94.

We reviewed all the investment transactions during fiscal year 1985 for compliance with the laws and regulations affecting the System. Public Law 98-94, which set up the funding of the System, specifically limited the fund to make investments in public debt securities. We concluded that this restriction was adhered to in each transaction we reviewed.

Accounts Receivable and Related Interest

The System generates accounts receivable from two sources—overpayment of benefits to retirees and survivors, and unpaid premiums to cover the cost of participating in the Survivor Benefit Plan and the Retired Serviceman's Family Protection Plan due from retirees and survivors. A number of laws provide the authority to offset the receivables against benefits and to charge interest on the accounts receivable. We used a statistical sample of retirees and annuitants to test whether applicable laws and regulations were applied and if the requirements of those laws and regulations were followed for establishing accounts receivable and charging interest on overdue debts. In addition, we spoke with finance center personnel and reviewed operating manuals to test for compliance. We found, as discussed below, that the military services were not complying with the applicable laws and regulations in some instances.

Offsetting receivables against benefits. Accounts receivable due to overpayments of benefits or underpayments of premiums arise from a variety of circumstances. Laws that determine what can be offset vary by type of debt as follows:

- When a retiree has been overpaid and then dies before the debt is liquidated, subsequent survivor benefit payments cannot be involuntarily offset. (10 U.S.C. 1440 and 1450(1))
- When a survivor is overpaid, subsequent benefit payments are to be offset unless overpayment is waived. (10 U.S.C. 1442 and 1453)
- If insufficient survivor benefit premiums were collected from retirees, the survivor benefits are to be offset. (35 Comp. Gen. 12 (1955), 41 Comp. Gen. 28 (1961), 54 Comp. Gen. 493 (1974), and Department of Defense Directive 1332.27, par. 501 (j))
- When erroneous payments of retired pay are accepted by a survivor after the death of the retiree, benefits accrued under the Survivor Benefit Plan during the period of erroneous payments are to be offset. For any remaining indebtedness, later benefit payments can be withheld. (B-222190, February 17, 1987)

Our tests revealed that the military services appeared to follow the laws for the first three circumstances. However, in the fourth case, the Army's policy was to not offset the overpayment caused by erroneous payments received by survivors against Survivor Benefit Plan benefits.

As a result, the Army paid the survivor benefit even though the individual owed it the amount previously received in erroneous payments. Based on a Comptroller General decision (B-222190, February 17, 1987) subsequent to our audit, the Army revised its policy to require offsets of these overpayments.

Charging interest on accounts receivable. Under the Debt Collection Act of 1982 (31 U.S.C. 3717), interest should have been charged on accounts receivable resulting from the overpayment of benefits at an interest rate established by the Secretary of the Treasury. We found that interest resulting was not being charged as required by law. During fiscal year 1985, the Treasury interest rate was 9 percent, but the Army, Air Force, and Marine Corps did not charge interest on benefit overpayments. The Navy charged 9 percent interest on accounts referred to the Accounting and Finance Department. However, no interest was charged on accounts collected through its Retired Pay Department. We estimated that the Air Force should have collected an additional $4,154 and the Army, an additional $548,372. The Navy and Marine Corps did not have an aging of accounts receivable and, therefore, we could not estimate the interest that they should have collected.

Financial and Actuarial Reporting

We reviewed the System's financial and actuarial reporting for compliance with applicable laws and regulations. The primary law affecting the reporting of the System is Public Law 95-595. This law requires the submission of an annual report in accordance with instructions by the President of the United States, delegated to the Office of Management and Budget and issued in conjunction with the General Accounting Office. We compared the financial reports and actuarial tables for the System to these instruction requirements. Based on our review, we did not find material noncompliance with the applicable laws and regulations governing the financial and actuarial reporting of the System.

Conclusion and Recommendation

In our opinion, except for the military services' omission of interest charges on certain accounts receivable, as described in the section on accounts receivable and related interest of this report, the Military Retirement System complied with the terms and provisions of laws and regulations for the transactions tested that could have had a material effect on the financial statements.

We recommend that the Secretary of Defense direct the finance centers to charge interest on accounts receivable in accordance with the Debt Collection Act of 1982.

Agency Comments

The Principal Deputy Assistant Secretary of Defense (Comptroller) agreed with the recommendation and issued a memorandum on May 21, 1987, highlighting the requirements for assessing interest on delinquent accounts receivable.

Statement of Net Assets Available for Benefits (Statement for 1984 Unaudited)

TABLE 1

DEPARTMENT OF DEFENSE
MILITARY RETIREMENT FUND
STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS
($ in thousands)

	For the Plan Year Ended	
	Sept 30, 1985	Sept 30, 1984
Assets:		
Investments, at fair market value U.S. Government securities	$12,385,119 1/	$ -0-
Accounts receivable:	2/	
Accrued interest:	416,873 3/	-0-
Cash	2,364	-0-
Total assets	12,804,356	-0-
Liabilities:		
Accounts payable - Military Retirees or their Survivors	1,456,917	-0-
Net assets available for benefits	$11,347,439	$ -0- 4/

1/ Fair market value of securities have been measured by quoted prices (bid price) in the active U.S. Government securities market. Bid price used represents the mid-afternoon Over-the-Counter quotation supplied by the Federal Reserve Bank of New York and reported in the Wall Street Journal on October 1, 1985. Detailed description contained in Appendix A.

2/ Does not include accounts receivable of $1,845 thousand as of September 30, 1985, as reported by the military services.

3/ Includes accrued interest receivable and interest purchased.

4/ The military retirement system was unfunded until October 1, 1984. A report summarizing the FY84 budget execution is located in Appendix B.

GAO Note: Appendixes A and B are not included in this report.

Statement of Changes in Net Assets Available for Benefits (Statement for 1984 Unaudited)

TABLE 2

DEPARTMENT OF DEFENSE
MILITARY RETIREMENT FUND
STATEMENT OF CHANGES IN NET ASSETS
AVAILABLE FOR BENEFITS
($ in thousands)

	For the Plan Year Ended	
	Sept 30, 1985	Sept 30, 1984
Net assets available for benefits beginning of plan year	$ -0-	$ -0-
Investment income:		
Interest	1,123,054	-0-
Net appreciation in fair market value of investments	1,005,754 1/	-0-
Contributions:		
From Services	16,964,332	-0-
Appropriation to amortize the initial unfunded liability	9,500,000	-0-
Total additions	28,593,140	-0-
Benefits paid to participants	17,245,701 2/	-0-
Net assets available for benefits at end of plan year	$11,347,439	-0- 3/

1/ Investments bought, sold and held during the plan year ended September 30, 1985 appreciated in value by $1,005,754 as follows:

Appreciated Fair Market Value over Book Value	$ 996,691
Amortized Discount	11,475
Amortized Premium	(1,785)
Loss on Sale	(627)
	$ 1,005,754

2/ Benefits paid to participants represent the benefits that have been earned during the year and thus include the September entitlements that are actually paid at the beginning of October.

3/ The military retirement system was unfunded until October 1, 1984. A report summarizing the FY84 budget execution is located in Appendix B.

GAO Note: Appendix B is not included in this report.

Statement of Financial Position as of September 30, 1985 (Statement for FY 1984 Unaudited)

TABLE 3

MILITARY RETIREMENT SYSTEM
DEPARTMENT OF DEFENSE
STATEMENT OF FINANCIAL POSITION
AS OF SEPTEMBER 30, 1985
($ in billions)

		For the Plan Year Ended Sept 30, 1985	For the Plan Year Ended Sept 30, 1984
ACCUMULATED PLAN BENEFITS 1/			
Actuarial present value of vested benefits			
Participants currently receiving payments	=	$322.7	$310.0
Other participants 2/	=	54.7	52.0
Total vested		377.4	362.0
Actuarial present value of nonvested benefits 3/	=	63.2	60.3
Total actuarial present value of accumulated plan benefits		$440.6	$422.3
NET ASSETS AVAILABLE FOR BENEFITS	=	11.3	0.0
EXCESS OF ACCUMULATED BENEFITS OVER NET ASSETS	=	$429.3	$422.3

1/ See definition of accumulated plan benefits on preceding page.

2/ For the purposes of this table, this line includes active duty and Reserve personnel who have attained twenty years of service, even though they have no legal right to future retired pay.

3/ This line includes benefit accumulations for all active duty and Reserve participants with less than twenty years of service.

GAO Note: This statement is usually titled "Statement of Accumulated Plan Benefits."

GAO Note: In reference to footnote 2 to the Statement of Financial Position above, we could find no support for the statement "... even though they have no legal right to future retired pay." However, this does not materially affect the presentation of the financial statements.

Statement of Changes in Present Value of Accumulated Plan Benefits (Statement for 1984 Unaudited)

TABLE 4

MILITARY RETIREMENT SYSTEM
STATEMENT OF CHANGES IN PRESENT
VALUE OF ACCUMULATED PLAN BENEFITS
($ in billions)

	For the Plan Year Ended	
	Sept 30, 1985	Sept 30, 1984
1. Actuarial present value of accumulated plan benefits at beginning of plan year	$422.3	$444.3
2. Increase (decrease) during the year 1/ attributable to:		
a. Benefits accumulated and actuarial gain or loss	18.3	6.7
b. Plan amendment(s)	0.0	9.1
c. Changes in non-economic assumptions	0.0	3.5
d. Changes in economic assumptions	0.0	-41.3
3. Net increase 2/	18.3	-22.0
4. Actuarial present value of accumulated plan benefits at end of year	$440.6	$422.3

1/ It is assumed that the order of occurrence was: 1) plan amendments 2) noneconomic actuarial assumptions, 3) benefits accumulated and actuarial gain or loss, and 4) economic assumptions.

2/ A few changes were made in the military retirement valuation in FY84 which affected the costs shown in Table 4:

1. Four sets of decrement rates and other minor non-economic actuarial assumptions were changed.

2. Annual economic assumptions were changed from: 5% inflation, 5.5% basic pay scale and 6% interest to: 5% inflation, 6.2% basic pay scale and 6.6% interest.

3. A benefit change resulted when PL 98-270 changed the cost-of-living (COLA) indexing of the system. Prior law based the March increase on the annual change in the Consumer Price Index (CPI) ending in the preceding December. Public Law 98-270 moved the increase to December of each year and based that increase on the annual change of the third quarter average CPI. The timing of the new mechanism eliminated the partial COLA for new retirees in their first year.

Actuarial Tables

ACTUARIAL PRESENT VALUE
OF ACCUMULATED PLAN BENEFITS

Accumulated plan benefits are those future periodic payments that are attributable under the Plan's provisions to the service that Armed Service personnel have rendered as of the valuation date. Accumulated plan benefits include benefits expected to be paid to (a) retired military or their survivors, (b) current survivors, (c) present active duty personnel and nonretired Reservists or their survivors. Benefits payable under all circumstances (retirement, disability, and survivor) are included to the extent they are deemed attributable to service rendered prior to the valuation date. No future basic pay scale increases or length of service or promotion pay increases are used but annuities are increased in line with the post-retirement inflation provision.

The actuarial present value of accumulated plan benefits is that amount that results from applying actuarial assumptions to adjust the accumulated plan benefits to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as death, disability, withdrawal, or retirement) between the valuation date and the expected date of payment. The actuarial assumptions are based on the presumption that the Plan will continue. Were the Plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of accumulated plan benefits.

Actuarial Status Information as of September 30, 1985 (Statement for 1984 Unaudited)

TABLE 5

MILITARY RETIREMENT SYSTEM
ACTUARIAL STATUS INFORMATION
AS OF SEPTEMBER 30, 1985
($ in billions)

		For the Plan Year Ended	
		Sept 30, 1985	Sept 30, 1984
1. Present value of future benefits			
a. Annuitants now on roll	=	$322.7	$310.0
b. Nonretired Reservists	=	40.6	37.9
c. Active duty personnel 1/	=	358.2	344.0
TOTAL	=	$721.5	$691.9
2. Present value of future employer/employee normal cost contributions 2/	=	$171.4	$163.2
3. Actuarial accrued liability	=	$550.1	$528.7
4. Actuarial Value of Assets 3/	=	$ 10.4	$ 0.0
5. Unfunded accrued liability	=	$539.7	$528.7
6. Normal cost percentage (NCP) 4/ to be applied to basic pay in the following fiscal year 5/	=	52.0%	52.4%

7. Ratio of assets in fund to present value of future benefits for annuitants now on roll plus accumulated employee contributions. 6/

a. September 30, 1985 = .03223
b. September 30, 1984 = .00000 7/
c. September 30, 1983 = .00000

Footnotes for this table are located on the following page.

Footnotes for Table

FOOTNOTES FOR TABLE 5

1/ The future benefits of active duty personnel who retire as Reservists are counted on line 1-b.

2/ Due to the need of establishing a normal cost percentage for a year in advance of implementation (federal budget deadlines) 50.7% was used to determine the contributions to the fund in FY85 and FY86. Consequently, in the calculation of the present value of future contributions this two year adjustment was made. 50.7% was the normal cost derived using FY83 methods and assumptions.

3/ The actuarial value of assets is determined using the amortized cost method of valuation. A detailed description of the actuarial value of assets and a statement of changes in the actuarial value of assets are contained in Appendix C. This amount is different from the net assets available for benefits, which is based on fair market value, used in Tables 1-3.

4/ The total NCP is developed by calculating a separate NCP for each separate benefit formula pertaining to the nonretired force and weighing the separate NCP's by the relative percentage of basic payroll. During FY86, 44% of the payroll is projected to have a NCP of 48.2% (HI3) and the rest of the force will have a NCP of 55% (final pay). The FY86 total NCP was lower than the FY85 total NCP due to the increased percentage of the payroll entitled to the lower benefit.

5/ Basic pay is only a portion of active duty military compensation. See the summary of the military retirement system for details.

6/ The military retirement system is noncontributory. Ratios are developed by dividing line 4 by line 1a.

7/ The military retirement system was unfunded prior to 10/1/84. Consequently, all asset ratios are zero before this date.

GAO Note. Appendix C and summary are not included in this report

Comparison of Actuarial Funding With Actual Contributions (Table Unaudited)

TABLE 6

MILITARY RETIREMENT SYSTEM
COMPARISON OF ACTUARIAL FUNDING
WITH ACTUAL CONTRIBUTIONS
($ in billions)

(1) Fiscal Year	(2) Normal Cost 1/	(3) Amortization 2/ of Unfunded Liability	(4) Total Actuarial Contribution (Col. 2 plus 3)	(5) Actual Contributions to Plan from All Sources	(6) Difference Between Col. 4 and Col. 5	(7) Col. 5 Divided by Col. 4
1980	$ 9.6	$ 23.7	$ 33.3	$ 11.9	$ 21.4	.357
1981	11.0	27.0	38.0	13.7	24.3	.361
1982	13.1	29.9	43.0	14.9	28.1	.347
1983	15.4	33.0	48.4	15.9	32.5	.329
1984	16.2	35.3	51.5	16.5	35.0	.320
1985	17.5	35.4	52.9	26.5	26.4	.501

1/ The normal cost in this column is based on the normal cost percentage that is determined in the actuarial valuation as of the end of the previous year. However, because of federal budget deadlines, the normal cost percentage that is actually charged in a particular year, which is included in column (5), must be established a year in advance of implementation. The implemented normal cost percentage for FY85 was 50.7%, which amounted to $17.0 billion.

2/ Office of Management and Budget specifications require a presentation of the level dollar financing of the unfunded liability over a 40-year period. However, the DoD Retirement Board of Actuaries chose to amortize the original unfunded accrued liability of the system (as of 9/30/84) with annual payments equalling 33% of the second previous year's basic payroll. This payment amounted to $9.5 billion for FY85. It is projected that this method will completely amortize the liability over 60 years.

Comparison of Actuarial Funding With Actual Contributions—As Percentage of Basic Pay (Table Unaudited)

TABLE 7

MILITARY RETIREMENT SYSTEM
COMPARISON OF ACTUARIAL FUNDING
WITH ACTUAL CONTRIBUTIONS

(As a percent of basic pay) 1/

(1) Fiscal Year	(2) Normal Cost 2/	(3) Amortization 3/ of Unfunded Liability	(4) Total Actuarial Contribution (Col. 2 plus 3)	(5) Actual Contributions to Plan from All Sources	(6) Difference Between Col. 4 and Col. 5
1980	49.3%	121.9%	171.2%	61.2%	110.0%
1981	46.2	113.1	159.3	57.3	102.0
1982	47.0	107.1	154.1	53.5	100.6
1983	50.7	108.8	159.5	52.4	107.1
1984	51.0	111.4	162.4	52.1	110.3
1985	52.4	105.8	158.2	79.2	79.0

1/ Basic pay is only a portion of active duty military compensation. See the summary of the military retirement system for details.

2/ The normal cost in this column is the normal cost percentage that is determined in the actuarial valuation as of the end of the previous year. However, because of federal budget deadlines, the normal cost percentage that is actually charged in a particular year, which is included in column (5), must be established a year in advance of implementation. The implemented normal cost percentage for FY85 was 50.7%, which amounted to $17.0 billion.

3/ Office of Management and Budget specifications require a presentation of the level dollar financing of the unfunded liability over a 40-year period. However, the DoD Retirement Board of Actuaries chose to amortize the original unfunded accrued liability of the system (as of 9/30/84) with annual payments equalling 33% of the second previous year's basic payroll. This payment amounted to $9.5 billion for FY85. It is projected that this method will completely amortize the liability over 60 years.

Annual Economic Assumptions Used in Open Projections (Table Unaudited)

ANNUAL ECONOMIC ASSUMPTIONS
USED IN OPEN PROJECTIONS
TABLE 8 AND TABLE 9 1/

Fiscal Year	Full COLA 2/	Basic Pay		Interest 3/
1986	0.0%	3.0%	Dec	9.375%
			Jun	8.875
1987	3.7	4.0	Dec	8.850
			Jun	8.500
1988	4.3	4.8	Dec	8.125
			Jun	7.250
1989	3.6	5.1	Dec	6.250
			Jun	5.500
1990	3.3	4.9	Dec	5.000
			Jun	4.750
1991	2.7	4.5	Dec	4.500
			Jun	4.500
1992	5.0	6.2	Dec	4.500
			Jun	6.600
1993	5.0	6.2		6.600
1994	5.0	6.2		6.600
1995+	5.0	6.2		6.600

1/ Closed projection long-term annual economic assumptions are 5% COLA, 6.2% Basic Pay and 6.6% Interest.

2/ COLA is equal to cost-of-living increases to retiree and survivor annuities.

3/ Interest assumptions pertain to assumed interest rates for new investments. The rates through December 1991 represent the annualized coupon rate for Treasury bonds with semiannual coupons that are assumed to be issued at par. The 6.6% rate is the effective annual yield for bonds maturing after December 1991.

Past and Projected Flow of Plan Assets (Table Unaudited)

TABLE 8

MILITARY RETIREMENT SYSTEM
PAST FLOW OF PLAN ASSETS 1/
($ in billions)

Fiscal Year	Fund Balance Beginning of Year	Normal 2/ Cost	Payment on Unfunded	Investment 3/ Income	Fund 4/ Disbursements	Fund Balance 5/ End of Year	Total Basic 6/ Payroll
1980	$0.0	$11.9	$0.0	$0.0	$11.9	$0.0	$20.9
1981	0.0	13.7	0.0	0.0	13.7	0.0	23.5
1982	0.0	14.9	0.0	0.0	14.9	0.0	27.9
1983	0.0	15.9	0.0	0.0	15.9	0.0	30.3
1984	0.0	16.5	0.0	0.0	16.5	0.0	31.7
1985	0.0	17.0	9.5	1.1	15.8	11.8	33.5

1/ The military retirement system was unfunded prior to FY85. The disbursements equalled the payments in these years. For display purposes in this table, DoD payments are shown in the normal cost column for the unfunded years.

2/ Public Law 98-94 required that the military retirement system be funded. Under law, the DoD is responsible for the normal cost payment and the Treasury is responsible for the payments on the unfunded liability. There is no employee contribution to the fund.

3/ The economic assumptions used in Tables 8 and 9 are listed on the page preceding Table 8.

4/ Disbursements are on a cash basis. Beginning December 1984, entitlements obligated for a month are paid at the beginning of the following month. Prior to this date, entitlements were paid at the end of the month of obligation. Consequently, FY85 disbursements include only 11 months of payments.

5/ The fund balance on this table reflects actual cash disbursements during the year. On September 30, 1985, assets in the fund totalled $11.8 billion as shown in Appendix C. This number was reduced by unpaid obligated September entitlements which resulted in the $10.4 billion actuarial value of assets shown in Table 5.

6/ These projections assume that future active duty and Reserve force strengths will remain constant. Basic pay is only a portion of military compensation. See the summary of the military retirement system for details.

NOTE: Mortality rates that are applied in the valuation to active (non-Reserve) military, to non-disabled retirees, and to survivor beneficiaries are decreased (or "improved") over time in order to reflect the long-term trends in such declines in mortality, based on data obtained from the Social Security Administration (1982 Trustee's Report, Alternative IIb). The 75 year projections of basic pay and benefit disbursements fully reflect all projected mortality improvement. The normal cost percentages are based on the 1984 Valuation and reflect all mortality improvements for a cohort starting in 1984.

GAO Note Appendix C is not included in this report

(Table Unaudited)

TABLE 8 (continued)

MILITARY RETIREMENT SYSTEM
PROJECTED FLOW OF PLAN ASSETS
($ in billions)

Fiscal Year	Fund Balance Beginning of Year	Normal Cost	Amortization of Unfunded Liability	Investment Income	Fund Disburse-ments	Fund Balance End of Year	Total Basic Payroll
1986	$11.8	$17.7	$10.5	$2.3	$17.7	$24.6	$35.0
1987	24.6	19.0	11.0	3.4	18.5	39.5	36.7
1988	39.5	19.9	11.5	4.7	19.7	55.9	38.8
1989	55.9	21.0	12.1	5.7	20.8	73.9	41.2
1990	73.9	22.1	12.8	6.6	21.9	93.5	43.5
1991	93.5	23.2	13.6	7.4	23.0	114.7	45.8
1992	114.7	24.6	14.4	8.7	24.5	137.9	48.9
1993	137.9	26.2	15.1	10.3	26.2	163.3	52.2
1994	163.3	27.9	16.1	12.0	28.0	191.3	55.7
1995	191.3	29.6	17.2	14.0	30.0	222.1	59.4
1996	222.1	31.4	18.4	15.9	32.1	255.7	63.3
1997	255.7	33.4	19.6	18.2	34.4	292.5	67.4
1998	292.5	35.3	20.9	20.8	37.0	332.5	71.7
1999	332.5	37.4	22.2	23.5	39.7	375.9	76.2
2000	375.9	39.6	23.6	26.5	42.6	423.0	80.9
2001	423.0	42.0	25.1	29.5	45.7	473.9	86.0
2002	473.9	44.5	26.7	33.0	48.9	529.2	91.3
2003	529.2	47.1	28.4	36.0	52.2	588.5	97.0
2004	588.5	50.0	30.1	40.3	55.8	653.1	103.2
2005	653.1	53.1	32.0	44.5	59.4	723.3	109.7
2006	723.3	56.4	34.0	49.0	63.2	799.5	116.7
2007	799.5	59.9	36.2	54.0	67.4	882.2	124.1
2008	882.2	63.7	38.5	59.2	71.8	971.8	131.8
2009	971.8	67.7	40.9	65.1	76.4	1069.1	140.1
2010	1069.1	71.7	43.5	72.0	81.2	1175.1	148.9

*See footnotes on first page of this table.

This table does not reflect any actuarial gains and losses because the method of amortization of these gains and losses has not yet been determined. Consequently, the amortization of the unfunded liability reflects only payments on the original unfunded liability as of 9/30/84.

(Table Unaudited)

TABLE 8 (continued)

MILITARY RETIREMENT SYSTEM
PROJECTED FLOW OF PLAN ASSETS
($ in billions)

Fiscal Year	Fund Balance Beginning of Year	Normal Cost	Amortization of Unfunded Liability	Investment Income	Fund Disburse-ments	Fund Balance End of Year	Total Basic Payroll
2011	$1175.1	$76.3	$46.2	$79.4	$86.2	$1290.8	$158.2
2012	1290.8	81.0	49.1	87.7	91.6	1417.0	168.1
2013	1417.0	86.1	52.2	96.2	97.2	1554.3	178.7
2014	1554.3	91.6	55.5	105.3	103.1	1703.6	190.0
2015	1703.6	97.3	59.0	115.4	109.4	1865.9	201.9
2016	1865.9	103.4	62.7	126.4	116.1	2042.3	214.6
2017	2042.3	109.9	66.6	138.1	123.2	2233.7	228.0
2018	2233.7	116.8	70.8	151.1	130.8	2441.6	242.3
2019	2441.6	124.1	75.2	164.9	138.8	2667.0	257.4
2020	2667.0	131.8	79.9	180.1	147.4	2911.4	273.4
2021	2911.4	140.0	84.9	196.5	156.6	3176.2	290.4
2022	3176.2	148.7	90.2	214.2	166.3	3463.0	308.4
2023	3463.0	157.9	95.8	233.4	176.7	3773.4	327.6
2024	3773.4	167.7	101.8	254.2	187.8	4109.3	347.9
2025	4109.3	178.1	108.1	276.6	199.5	4472.6	369.4
2026	4472.6	189.1	114.8	301.0	212.0	4865.5	392.3
2027	4865.5	200.8	121.9	327.3	225.3	5290.2	416.6
2028	5290.2	213.2	129.5	355.6	239.4	5749.1	442.3
2029	5749.1	226.4	137.5	386.3	254.5	6244.8	469.7
2030	6244.8	240.4	146.0	419.5	270.5	6780.2	498.7
2031	6780.2	255.3	155.0	455.2	287.5	7358.2	529.6
2032	7358.2	271.1	164.6	493.8	305.5	7982.2	562.3
2033	7982.2	287.8	174.8	535.6	324.7	8655.7	597.2
2034	8655.7	305.7	185.6	580.4	345.1	9382.3	634.1
2035	9382.3	324.6	197.1	629.0	366.8	10166.2	673.4

*See footnotes on first page of this table.

This table does not reflect any actuarial gains and losses because the method of amortization of these gains and losses has not yet been determined. Consequently, the amortization of the unfunded liability reflects only payments on the original unfunded liability as of 9/30/84.

(Table Unaudited)

TABLE 8 (continued)

MILITARY RETIREMENT SYSTEM
PROJECTED FLOW OF PLAN ASSETS
($ in billions)

Fiscal Year	Fund Balance Beginning of Year	Normal Cost	Amortization of Unfunded Liability	Investment Income	Fund Disburse-ments	Fund Balance End of Year	Total Basic Payroll
2036	$10166.2	$344.7	$209.3	$681.4	$389.9	$11011.7	$715.2
2037	11011.7	366.1	222.2	737.8	414.4	11923.4	759.5
2038	11923.4	388.8	236.0	798.7	440.5	12906.4	806.6
2039	12906.4	412.9	250.6	864.4	468.2	13966.1	856.6
2040	13966.1	438.5	266.2	935.0	497.7	15108.1	909.8
2041	15108.1	465.7	282.7	1011.1	529.0	16338.6	966.2
2042	16338.6	494.6	300.2	1093.2	562.4	17664.2	1026.2
2043	17664.2	525.3	318.9	1181.6	597.9	19092.1	1089.8
2044	19092.1	557.9	338.6	1276.8	635.7	20629.7	1157.5
2045	20629.7	592.5	359.6	1379.4	675.9	22285.3	1229.3
2046	22285.3	629.3	62.4	1468.4	718.6	23726.8	1305.5
2047	23726.8	668.3	0.0	1559.1	764.1	25190.1	1386.5
2048	25190.1	709.7	0.0	1655.4	812.5	26742.7	1472.5
2049	26742.7	753.7	0.0	1757.2	863.9	28389.7	1563.8
2050	28389.7	800.5	0.0	1865.3	918.6	30136.9	1660.7
2051	30136.9	850.1	0.0	1980.1	976.8	31990.3	1763.7
2052	31990.3	902.8	0.0	2101.9	1038.7	33956.3	1873.1
2053	33956.3	958.8	0.0	2231.0	1104.6	36041.5	1989.2
2054	36041.5	1018.2	0.0	2368.0	1174.6	38253.1	2112.5
2055	38253.1	1081.4	0.0	2513.2	1249.1	40598.6	2243.5
2056	40598.6	1148.4	0.0	2667.2	1328.2	43086.0	2382.6
2057	43086.0	1219.6	0.0	2830.6	1412.3	45723.9	2530.3
2058	45723.9	1295.2	0.0	3003.8	1501.7	48521.2	2687.2
2059	48521.2	1375.5	0.0	3187.5	1596.7	51487.5	2853.8
2060	51487.5	1460.8	0.0	3382.2	1697.6	54632.9	3030.7

*See footnotes on first page of this table.

This table does not reflect any actuarial gains and losses because the method of amortization of these gains and losses has not yet been determined. Consequently, the amortization of the unfunded liability reflects only payments on the original unfunded liability as of 9/30/84.

(Table Unaudited)

TABLE 9

MILITARY RETIREMENT SYSTEM
PAST FLOW OF PLAN ASSETS 1/
(As a percent of basic pay) 6/

Fiscal Year	Fund Balance Beginning of Year	Normal 2/ Cost	Payment on Unfunded	Investment 3/ Income	Fund 4/ Disbursements	Fund Balance 5/ End of Year
1980	0.0%	56.9%	0.0%	0.0%	56.9%	0.0%
1981	0.0	58.3	0.0	0.0	58.3	0.0
1982	0.0	53.4	0.0	0.0	53.4	0.0
1983	0.0	52.5	0.0	0.0	52.5	0.0
1984	0.0	52.1	0.0	0.0	52.1	0.0
1985	0.0	50.7	28.4	3.3	47.2	35.2

1/ The military retirement system was unfunded prior to FY85. The disbursements equalled the payments in these years. For display purposes in this table, DoD payments are shown in the normal cost column for the unfunded years.

2/ Public Law 98-94 required that the military retirement system be funded. Under law, the DoD is responsible for the normal cost payment and the Treasury is responsible for the payments on the unfunded liability. There is no employee contribution to the fund.

3/ The economic assumptions used in Tables 8 and 9 are listed on the page preceding Table 8.

4/ Disbursements are on a cash basis. Beginning December 1984, entitlements obligated for a month are paid at the beginning of the following month. Prior to this date, entitlements were paid at the end of the month of obligation. Consequently, FY85 disbursements include only 11 months of payments.

5/ The fund balance on this table reflects actual cash disbursements during the year. On September 30, 1985, assets in the fund totalled $11.8 billion as shown in Appendix C. This number was reduced by unpaid obligated September entitlements which resulted in the $10.4 billion actuarial value of assets shown in Table 5.

6/ These projections assume that future active duty and Reserve force strengths will remain constant. Basic pay is only a portion of military compensation. See the summary of the military retirement system for details.

NOTE: Mortality rates that are applied in the valuation to active (non-Reserve) military, to non-disabled retirees, and to survivor beneficiaries are decreased (or "improved") over time in order to reflect the long-term trends in such declines in mortality, based on data obtained from the Social Security Administration (1982 Trustee's Report, Alternative IIb). The 75 year projections of basic pay and benefit disbursements fully reflect all projected mortality improvement. The normal cost percentages are based on the 1984 Valuation and reflect all mortality improvements for a cohort starting in 1984.

GAO Note: Although this table was not audited, we did find immaterial differences due apparently to rounding

GAO Note. Appendix C is not included in this report

(Table Unaudited)

TABLE 9 (continued)

MILITARY RETIREMENT SYSTEM
PROJECTED FLOW OF PLAN ASSETS
(as a percentage of payroll)

Fiscal Year	Fund Balance Beginning of Year	Normal Cost	Amortization of Unfunded Liability	Investment Income	Fund Disburse-ments	Fund Balance End of Year
1986	33.8%	50.7%	30.0%	6.5%	50.6%	70.4%
1987	67.1	51.7	30.1	9.4	50.6	107.7
1988	101.8	51.4	29.7	12.0	50.8	144.2
1989	135.9	51.1	29.4	13.8	50.6	179.5
1990	169.8	50.9	29.4	15.1	50.4	214.8
1991	204.2	50.6	29.7	16.3	50.2	250.6
1992	234.6	50.4	29.4	17.7	50.0	282.0
1993	264.2	50.2	28.9	19.7	50.2	312.8
1994	293.2	50.0	29.0	21.6	50.3	343.4
1995	322.0	49.8	29.0	23.4	50.5	373.8
1996	350.8	49.6	29.0	25.3	50.7	403.9
1997	379.5	49.5	29.1	27.1	51.1	434.1
1998	408.2	49.3	29.2	29.0	51.6	464.0
1999	436.6	49.1	29.2	30.8	52.1	493.6
2000	464.6	48.9	29.2	32.6	52.6	522.7
2001	492.0	48.8	29.2	34.4	53.1	551.3
2002	519.1	48.7	29.2	36.1	53.5	579.5
2003	545.4	48.5	29.2	37.3	53.9	606.6
2004	570.6	48.5	29.2	38.9	54.0	633.1
2005	595.1	48.4	29.2	40.5	54.1	659.1
2006	619.6	48.3	29.2	42.0	54.2	684.9
2007	644.5	48.3	29.2	43.4	54.3	711.1
2008	669.2	48.3	29.2	44.9	54.5	737.2
2009	693.7	48.3	29.2	46.5	54.5	763.3
2010	718.2	48.2	29.2	48.3	54.5	789.4

*See footnotes on first page of this table.

This table does not reflect any actuarial gains and losses because the method of amortization of these gains and losses has not yet been determined. Consequently, the amortization of the unfunded liability reflects only payments on the original unfunded liability as of 9/30/84.

GAO Note: Although this table was not audited, we did find immaterial differences due apparently to rounding.

(Table Unaudited)

TABLE 9 (continued)

MILITARY RETIREMENT SYSTEM
PROJECTED FLOW OF PLAN ASSETS
(as a percentage of payroll)

Fiscal Year	Fund Balance Beginning of Year	Normal Cost	Amortization of Unfunded Liability	Investment Income	Fund Disburse-ments	Fund Balance End of Year
2011	742.8%	48.2%	29.2%	50.2%	54.5%	815.9%
2012	767.6	48.2	29.2	52.1	54.5	842.7
2013	792.9	48.2	29.2	53.8	54.4	869.7
2014	818.2	48.2	29.2	55.5	54.3	896.8
2015	843.8	48.2	29.2	57.2	54.2	924.2
2016	869.6	48.2	29.2	58.9	54.1	951.8
2017	895.7	48.2	29.2	60.6	54.0	979.7
2018	922.0	48.2	29.2	62.3	54.0	1007.8
2019	948.6	48.2	29.2	64.1	53.9	1036.2
2020	975.4	48.2	29.2	65.9	53.9	1064.8
2021	1002.5	48.2	29.2	67.6	53.9	1093.6
2022	1029.7	48.2	29.3	69.4	53.9	1122.7
2023	1057.2	48.2	29.3	71.3	53.9	1151.9
2024	1084.7	48.2	29.3	73.1	54.0	1181.3
2025	1112.4	48.2	29.3	74.9	54.0	1210.7
2026	1140.1	48.2	29.3	76.7	54.0	1240.2
2027	1168.0	48.2	29.3	78.6	54.1	1269.9
2028	1196.0	48.2	29.3	80.4	54.1	1299.8
2029	1224.1	48.2	29.3	82.3	54.2	1329.6
2030	1252.2	48.2	29.3	84.1	54.2	1359.5
2031	1280.3	48.2	29.3	86.0	54.3	1389.5
2032	1308.5	48.2	29.3	87.8	54.3	1419.4
2033	1336.7	48.2	29.3	89.7	54.4	1449.5
2034	1364.9	48.2	29.3	91.5	54.4	1479.5
2035	1393.2	48.2	29.3	93.4	54.5	1509.6

*See footnotes on first page of this table.

This table does not reflect any actuarial gains and losses because the method of amortization of these gains and losses has not yet been determined. Consequently, the amortization of the unfunded liability reflects only payments on the original unfunded liability as of 9/30/84.

GAO Note Although this table was not audited, we did find immaterial differences due apparently to rounding

(Table Unaudited)

TABLE 9 (continued)

MILITARY RETIREMENT SYSTEM
PROJECTED FLOW OF PLAN ASSETS
(as a percentage of payroll)

Fiscal Year	Fund Balance Beginning of Year	Normal Cost	Amortization of Unfunded Liability	Investment Income	Fund Disburse- ments	Fund Balance End of Year
2036	1421.5%	48.2%	29.3%	95.3%	54.5%	1539.7%
2037	1449.8	48.2	29.3	97.1	54.6	1569.9
2038	1478.2	48.2	29.3	99.0	54.6	1600.1
2039	1506.6	48.2	29.3	100.9	54.7	1630.3
2040	1535.1	48.2	29.3	102.8	54.7	1660.6
2041	1563.6	48.2	29.3	104.6	54.8	1691.0
2042	1592.2	48.2	29.3	106.5	54.8	1721.4
2043	1620.8	48.2	29.3	108.4	54.9	1751.8
2044	1649.5	48.2	29.3	110.3	54.9	1782.3
2045	1678.2	48.2	29.3	112.2	55.0	1812.9
2046	1707.0	48.2	4.8	112.5	55.0	1817.4
2047	1711.3	48.2	0.0	112.5	55.1	1816.8
2048	1710.8	48.2	0.0	112.4	55.2	1816.2
2049	1710.1	48.2	0.0	112.4	55.2	1815.5
2050	1709.5	48.2	0.0	112.3	55.3	1814.7
2051	1708.7	48.2	0.0	112.3	55.4	1813.8
2052	1707.9	48.2	0.0	112.2	55.5	1812.9
2053	1707.0	48.2	0.0	112.2	55.5	1811.9
2054	1706.1	48.2	0.0	112.1	55.6	1810.8
2055	1705.1	48.2	0.0	112.0	55.7	1809.6
2056	1704.0	48.2	0.0	111.9	55.7	1808.4
2057	1702.8	48.2	0.0	111.9	55.8	1807.1
2058	1701.6	48.2	0.0	111.8	55.9	1805.7
2059	1700.2	48.2	0.0	111.7	56.0	1804.2
2060	1698.9	48.2	0.0	111.6	56.0	1802.7

*See footnotes on first page of this table.

This table does not reflect any actuarial gains and losses because the method of amortization of these gains and losses has not yet been determined. Consequently, the amortization of the unfunded liability reflects only payments on the original unfunded liability as of 9/30/84.

GAO Note: Although this table was not audited, we did find immaterial differences due apparently to rounding.

BUCK CONSULTANTS
1050 Seventeenth Street NW
Washington, D.C 20036 202 I 296 7264

March 27, 1986

STATEMENT OF THE ENROLLED ACTUARY OF THE
MILITARY RETIREMENT SYSTEM AS OF
SEPTEMBER 30, 1985

The report on the Military Retirement System as of September 30, 1985 has been prepared in accordance with generally accepted actuarial principles and practices. In preparing this statement, I have relied upon information maintained by the Office of the Actuary in the Department of Defense regarding plan provisions, plan assets and plan participants.

The decrements used in the valuation are based on actual experience under the Military Retirement System. It was assumed that mortality would improve during the projection period for nondisabled participants and survivors. The mortality improvement factors used are based on social security data, as shown in the 1982 Trustees' Report, Alternative IIb. It was felt that the mortality improvement anticipated for the social security population at large would be applicable to the military population as well.

The economic assumptions have been determined based on the 5% rate of inflation assumption established by the Office of Management and Budget for reports under chapter 95, title 31. The other economic assumptions of 6.6% per annum for assumed investment return and 6.2% per annum for assumed basic pay scale increases were chosen by the Board of Actuaries of the Military Retirement System and agreed to by me.

The report differs from that of prior years because there is now a trust fund for the Military Retirement System. The assets are valued at book value for purposes of calculating the unfunded accrued liability. Both fair value and book value of the fund's assets were relied upon as reported by the Department of Defense Director of Budget and Finance, Washington Headquarters Services.

Under the actuarial cost method in use, the normal cost percentage gradually declines each year in the absence of any changes in assumptions or plan provisions. Under this method a normal cost percentage is developed separately for each benefit formula (final pay formula and high three-year average pay formula). The normal cost percentages are then weighted by the relative percentage of basic pay under the two formulas. Each year the relative percentage under the final pay formula decreases thereby decreasing the weighted normal cost percentage until all active employees are covered by the high three-year average pay formula.

In my opinion, the actuarial assumptions used in preparing the report are in the aggregate reasonably related to the experience of the plan and to reasonable expectations, and represent my best estimate of anticipated experience under the Plan. To the best of my knowledge the report is complete and accurate.

Claire L. Wolkoff

Claire L. Wolkoff
Enrolled Actuary No. 2665

Buck Consultants, Inc.
George B. Buck Consulting Actuaries Inc | Buck Pension Fund Services, Inc | Buck Research Corporation | GBB Associates Ltd

Statement of General Information

(Statement Unaudited)

Report for plan year
ending September 30, 1985

STATEMENT OF GENERAL INFORMATION

1. Name of plan: Military Retirement System

2. Name and address of plan sponsor:

Department of Defense
Washington, DC 20301

3. Name and phone number of plan administrator:

Mr. Chapman B. Cox
Assistant Secretary of Defense (FM&P)
Phone: (202) 695-5254

4. Type of plan entity: Single-employer plan

5. Establishment of plan: Military plan structure as it is today was authorized by PL 80-810, PL 79-305 and Title 10, U.S.C.

6. Information on plan participants at end of plan year:

Full time active duty Reservists and active duty employees = 2,192,268
Total covered annualized basic pay = $32.1 billion

Selected Reservists (not full time active duty) = 1,033,167
Total covered annualized basic pay = $2.8 billion

Nondisability retiree annuitants = 1,235,128
Total annualized annuity = $15.5 billion

Disability retiree annuitants = 139,078
Total annualized annuity = $1.4 billion

Surviving families = 108,459
Total annualized annuity = $.6 billion

7. Type of plan: Defined benefit

8. Administrative costs are not borne by the plan.

9. The plan was neither merged nor consolidated during the plan year, nor were the assets or liabilities transferred to another plan.

10. On October 1, 1984 the military retirement system moved from an unfunded status to an aggregate entry-age normal cost funding method. A trust fund was established.

(Statement Unaudited)

11. The most recent actuarial valuation was prepared as of September 30, 1985 and was used for this report.

12. The actuarial cost method used in completing Tables 3, 4 and 5 is aggregate entry-age-normal.

13. Actuarial assumptions:

A. Economic

A study of economic trends by the Board of Actuaries of the Military Retirement System supports their assumption that, over time, the real annual interest rate on Federal securities will be 1.6 percent and the real annual basic pay scale increase will be 1.2 percent. The Office of Management and Budget has directed that we use an assumed inflation rate of 5% per year which the Board feels is reasonable. Therefore, the assumed investment rate is 6.6% per year and the assumed basic pay scale increase is 6.2% per year.

The Military Retirement System valuation is based on studies of officer and enlistee, rather than male and female, experience. Officers enter the Service at the average age of 22 and enlistees at the average age of 19. The earliest nondisability retirement can occur at 20 years of service or ages 42 and 39 for the above examples. These earliest retirement ages are used in the ratios of basic pay below. The basic pay ratios include an assumed annual basic pay scale increase of 6.2% plus career increases.

Ratio of basic pay at earliest retirement age to basic pay at:

Current Age	Regular Officers	Regular Enlisted
25	5.15	3.72
40	1.19	N/A
55	N/A	N/A

B. Decrements:

1. Mortality and other decrement rates were first created in early FY81 based on military specific experience from FY77-FY80. All rates are reviewed annually in actual-to-expected studies and are recreated if experience warrants change. A complete set of current rates along with a description of the rate-creation process will be published in the FY85 Valuation of the Military Retirement System.

2. A member can retire with immediate benefits after 20 years of service for active duty people and 20 years of service and attainment of age 60 for Reservists.

3. Mortality is assumed to improve in the future based on factors from the 1982 Social Security Trustees' Report, Alternative IIb.

(Statement Unaudited)

Since the military population is a subset of the social security population, it is expected to experience similar mortality improvements in the future.

* * * * * * * * * * * * * * * * * *

I declare that I have examined this report, including accompanying tables and statements, and to the best of my knowledge and belief it is true, correct, and complete.

Signature: Chapman B. Cox
Mr. Chapman B. Cox
Assistant Secretary of Defense (FM&P)

Request Letter

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DEPUTY DIRECTOR

March 3, 1986

The Honorable Charles A. Bowsher
Comptroller General of the
United States
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

Under Public Law 95-595, you have been monitoring Federal pension plans, including the military retirement system, and recently issued a report with general information on the financial statements. For the first time, the Congress provided the Department of Defense with about $11 billion in Fiscal Year 1985 to fund future payments for the Military Pension Fund. Previously, only prior-year payments were funded. Given this large outlay, I want to be assured that the amounts being funded are in accordance with congressional intent.

This letter is to request your office to audit the financial statements of the military retirement system for Fiscal Year 1985 and express an opinion on the fair presentation of the statements. Particular emphasis should include:

* The adequacy of the internal controls in the military retirement system and the Defense Military Pension Fund,

* Opportunities for cost savings or outlay reductions, and

* Whether the funds in excess of the current-year payments are invested properly.

I appreciate your attention to this matter. Please coordinate your efforts with Richard Kaufman of the Joint Economic Committee staff.

Sincerely,

William Proxmire
Vice Chairman
Subcommittee on Economic Resources,
Competitiveness, and Security
Economics

Comments From the Department of Defense

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON D C 20301

COMPTROLLER

JUL 31 1987

Mr. Frank C. Conahan
Assistant Comptroller General
General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to General Accounting Office (GAO) Draft Report, "MILITARY RETIREMENT SYSTEM: Financial Statements for FY 1985," dated May 26, 1987 (GAO Code 916225), OSD Case 7306. The DoD generally concurs with the report.

The specific comments relating to findings and recommendations are enclosed. The Department appreciates the opportunity to comment on this draft report.

Sincerely,

John R. Quetsch
John R. Quetsch
Principal Deputy Assistant Secretary of Defense
(Comptroller)

Enclosure
As Stated

GAO DRAFT REPORT - DATED MAY 24, 1987
(GAO CODE 916225) OSD CASE 7306

"MILITARY RETIREMENT SYSTEM: FINANCIAL STATEMENTS FOR FY 1985"

DOD RESPONSE TO THE GAO DRAFT REPORT

* * * * *

FINDINGS

o FINDING A: Opinion On Financial Statements. The GAO observed that two recent changes to the U.S. Military Retirement System (System) have occurred:

- Public Law 98-94, established the Defense Military Retirement Fund to consolidate the financial activities of the System as of October 1, 1984; and

- Public Law 99-348, revised the benefit payment structure for all Service members who joined after July 31, 1986 and was intended to reduce the cost of providing retirement benefits to future retirees.

The GAO reported that after the establishment of the fund, the Services continued to independently process the retirement benefit claims and payments; however, an appropriation was given to the Fund to invest for future payments and to amortize the initial unfunded liability. The GAO observed that considering the large commitment of funds for FY 1985 and over the next 75 years, there was congressional concern that the amounts being funded were properly managed and controlled. The GAO found, however, that the Retirement System statement of net assets available for benefits did not include accounts receivable because System managers knew that the accounts receivable reported by the respective Services were understated. In addition, the GAO further found that accounts payable shown in the statement of net assets available for benefits were understated by $67.8 million for a death payment contingency and the footnotes to the financial statements do not disclose the liability. (The GAO noted that accounts payable were understated by an additional $7 million for Army retirees and survivors not yet receiving benefits pending approval of their claims.) The GAO concluded that except for the understatement and the lack of disclosure of accounts payable of approximately $75 million, the Military Retirement System

Enclosure

Now on pp 1-3 and 10-11

financial statements present fairly the financial position of the retirement system and the results of its operations for the FY ended September 30, 1985. (pp. 1-3, pp. 10-11/GAO Draft Report)

DoD Position: Concur. The existing DoD Accounting Manual guidance in DoD 7220.9-M requires recording all receivables and payables promptly and conforms with General Accounting Office Title 2, Office of Management and Budget and Treasury Department standards. In the future, the System Managers will assure that the respective Services correctly implement DoD accounting policy for recording and reporting assets and liabilities, including contingent liabilities. A memorandum to this effect will be dispatched to the Service Finance Centers on or before August 1, 1987. This memorandum will also address death payment contingencies.

The amounts of unrecorded liability for retirees and survivors not yet receiving benefits pending approval of their claims were included in the statement of net assets effective September 1986.

Now on pp 3-4, 13, and 16.

- FINDING B: Benefit Claims and Payments. The GAO found no material errors in the computation, payment or accounting for expenditures, nor did they find any unauthorized payees. At each of the four Service finance centers the GAO statistically sampled 160 payments made to retirees and survivors to ensure that benefits were correctly computed. The GAO also statistically sampled 925 retirees and survivors to determine, among other things, that payments were authorized and paid to proper individuals. The GAO also tested the implementation of the numerous laws and regulations affecting the processing of benefit claims at each of the Service finance centers. The GAO concluded that at each of the Service finance centers, controls existed to ensure that benefit claims were processed and payments were made without material error. The GAO further concluded that benefit claims and payments were calculated properly and the correct laws were used for determining eligibility. (pp. 3-5, pp. 14-15, pp. 19-20/GAO Draft Report)

  DoD Position: Concur.

- FINDING C: Financial and Actuarial Reporting. The GAO assessed the controls over the automated data processing system used to collect the data and develop the assumptions that form the basis of the system actuarial projections. The GAO found that the internal accounting controls over the collection of data used by the actuaries and the computation of actuarial projections were adequate. Specifically, the GAO found that the data center had (1) appropriate segregation of duties, (2) quality controls over data input, processing, and output, (3) physical security, (4) documented operating policies and procedures, and (5) authorization of

Now on pp. 3, 13, and 18.

transactions. The GAO noted that the primary law affecting the reporting of the System is Public Law 95-595, which requires the submission of an annual report. The GAO found no material non compliance with the applicable laws and regulations governing the financial and actuarial reporting of the System. The GAO concluded that the collection and processing of actuarial data was reasonable for projecting the System's estimated future benefit payout. The GAO further concluded that financial and actuarial reporting standards were complied with, as required by Public Law 95-595. (pp. 4-5, p. 15, pp. 22-23/GAO Draft Report)

DoD Position: Concur.

Now on pp. 5-6.

- FINDING D: Reasonableness of Assumptions Used to Project The Unfunded Actuarial Liability And the Self-Sufficiency Of The Fund. The GAO explained that pension funds have a liability to pay future benefits to plan participants. The GAO further explained that an actuary makes a series of assumptions pertaining to expected economic and demographic experiences to estimated the liability of a pension plan--usually based on actual experience of the pension plans for large plans such as the System. The GAO found that the assumptions developed and used for the System's computation to be reasonable. The GAO reported that the unfunded liability is to be capitalized through annual payments of 75 years, starting with inception of System funding in FY 1985. The GAO concluded that given the reasonableness of the assumptions used by the actuaries to estimate the future costs of the plans, and also the willingness of the Congress to continue providing funds to pay the unfunded liability of the System, the System will be self-sufficient. (pp. 7-8/GAO Draft Report)

  DoD Position: Concur.

Now on pp. 13-14.

- FINDING E: Revenues and Treasury Operations. The GAO tested the receipt of the System appropriation to amortize the unfunded liability and all of the monthly contributions by each of the four Services and also assessed the internal accounting controls. The GAO found appropriate assurance that the receipt and contributions were properly authorized, classified, reconciled, and reported. The GAO further found internal accounting controls over treasury operations to be effective in preventing or detecting errors in cash or investment transactions. The GAO concluded that (1) controls exist to ensure proper accounting for all appropriations and the Service monthly contributions, and (2) investment and cash transactions were controlled properly. (pp. 15-16/GAO Draft Report)

  DoD Position: Concur.

- Finding F: Financial Reporting. The GAO found internal accounting control weaknesses over the recording and reporting of financial information at the Service level.

Specifically, the GAO found that after reviewing the supporting records for the amounts reported as accounts receivable, it identified at least $5.8 million that should have been reported by the Services for the Fund. The GAO further found that the DoD has not provided the Services with policies and procedures for the consistent identification, classification, and reporting of accounts receivable. (The GAO reported that in another draft report, OSD Case 7279, it <the GAO> had identified about $1.5 million in accounts receivable at the Army and Air Force from overpayments due to various types of pay offsets that were not being properly applied. The GAO further noted that the other report also included recommendations to ensure that required offsets were made that result in correct payment.) Specifically, the GAO determined that accounts receivable identified by the Services were not being correctly recorded and reported to the Fund as follows:

- The Navy reported accounts receivable of only about $102,000, which did not include amounts identified by the Retired Pay Department that the Navy was still attempting to collect. (It was noted that as a result of the GAO audit, the Navy identified approximately $68,000, in additional accounts receivable attributable to FY 1985.)

- The Army reported only delinquent Survivor Benefit Plan and Retired Servicemans' Family Protection Plan premiums due from individuals of $1.1 million as System accounts receivable; however, these premiums are not valid accounts receivable since the law requires premium receipts to be deposited in the General Fund of the Treasury. The Army identified another $4.5 million in accounts receivable to its appropriation for the retirement payments prior to the establishment of the Fund in 1985, but did not classify, and thus did not report any of this amount correctly as accounts receivable to the Fund.

- While the Marine Corps reported $176 as accounts receivable, because of the lack of adequate records, the total amount of accounts receivable as of September 30, 1985, could not be determined. (The GAO identified at least $521,850 in accounts receivable that the Marine Corps did not report as of November 30, 1985).

- The Air Force reported accounts receivable of $600,656. (Other than the amounts reported in the prior draft report, no additional accounts receivable were identified by the GAO that should have been included.)

The GAO concluded that the DoD had not provided policies and procedures on accounts receivable relating to the System and, as a result, the Services were not correctly identifying, classifying, and reporting accounts receivable to the Fund. (p. 4, pp. 16-18/GAO Draft Report)

Now on pp. 14-15.

DoD Position: Partially Concur. The DoD has provided policies and procedures appropriate for this purpose. Chapter 33, DoD 7220.9-M, DoD Accounting Manual issued October 1983 is stated in part:

"B. STANDARDS

Accounts receivable shall be recorded accurately and promptly on completion of the acts that entitle the Department of Defense to collect amounts owed it. Receivables include, but are not limited to, monies due for indebtedness determined as a result of travel and other overdue advances, dishonored checks, sale of goods and services, fines, penalties, interest, overpayments, fees, rent, claims, damages, and any other event resulting in a determination that a debt is owed the Department of Defense..."

Chapter 94, paragraphs D&M, contain the instructions for Financial Statement reporting. The reporting of accounts receivable is a part of the requirement. Paragraph M is quoted in part,

"M. PREPARATION OF THE REPORT ON ACCOUNTS AND LOANS RECEIVABLE DUE FROM THE PUBLIC, (TFS 220.9), FIGURE (94-10).

1. General

a. The Treasury Fiscal Service (TFS) 220.9 (formerly Schedule 9) has been revised and now consists of two parts, "Status of Receivables" and "Administrative Actions." Beginning with Fiscal Year 1986, the TFS 220.9 must be prepared annually except for programs administered by the Defense Security Assistance Agency (DSAA). DSAA will report quarterly.

b. A TFS 220.9 must be prepared for each revolving fund, trust revolving fund, each business-type general and special fund, for each transfer appropriation account (prepared by the spending agency), specified trust funds and certain receipt accounts that generate receivables that are due from the public. One combined report must be prepared for all other accounts under bureau control. In addition, a consolidated report must be prepared by each Military Department and reporting Defense Agency. Washington Headquarters Services will consolidate the reports from Defense Agencies. The concolidated report must show all receivables including those due from foreign, State, and local governments, as well as receivables not supported by the SF 220 report. A memorandum TFS 220.9 must be prepared to show amounts due the U.S. Government as a results of audits.

c. The individual TFS 220.9 reports must be distributed to Treasury, OMB and OASD(C) as prescribed in paragraph 5. The consolidated reports shall be distributed only to OASD(C)...."

o FINDING G: Funding and Investment Restrictions. The GAO reported that the Defense Military Retirement Fund held investments with a fair market value of $12.4 billion in public debt securities at September 30, 1985. The GAO further reported that two major sources generate the amount available for investment:

- an appropriation intended to cover the liability existing for future benefits when the Fund was established; and

- amounts from each Service appropriation to cover the future benefits of current military personnel.

The GAO found that the amounts the Services transferred to the Fund each month were correctly computed in accordance with Public Law 98-94. The GAO noted that Public Law 98-94, which set up the funding of the System, specifically limited the fund to make investments in public debt securities. The GAO concluded that these restrictions were adhered in each instance. The GAO further concluded that appropriations to cover the liability existing for future benefits when the Fund was established and funds from the Services to cover future benefits of current military personnel were correctly processed. (pp. 5-20/GAO Draft Report)

Now on pp. 4-5 and 16-17

DoD Position: Concur.

o FINDING H: Accounts Receivable And Related Interest. The GAO explained that the System generates accounts receivable from two sources--(1) overpayment of benefits to retirees and survivors and (2) unpaid premiums to cover the cost of participating in the Survivor Benefit Plan due from retirees. The GAO found that in some instances the Services were not complying with the applicable laws and regulations. Specifically, while the Services appeared to follow the laws pertaining to offsetting receivables against benefits, the GAO found that the Army policy was to not offset the overpayment caused by erroneous payments received by survivors against Survivor Benefits Plans benefits, as required. The GAO noted that as a result, the Army paid the survivor benefits even though the individual owed them the amount previously received in erroneous payments. (The GAO reported that the Army subsequently reviewed its policy to require offsets of these overpayments.) The GAO also observed that the Debt Collection Act of 1982 required the charging of interest on all accounts receivable at an interest rate established by the Secretary of the Treasury. The GAO found, however, that interest resulting from the overpayment of benefits was not being charged as required by law. As an example, the GAO cited that during FY 1985, the Treasury interest rate was 9 percent, but the Army, the Air Force, and the Marine Corps did not charge interest on benefit overpayments. As another example, the GAO cited, that while the Navy charged 9 percent interest on accounts referred to the Accounting and Finance Department, no interest was charged on accounts collected through its Retired Pay Department. The GAO estimated that the Air Force may collect an additional $4,154, and the Army an additional $548,372. (The GAO Noted that the Navy and Marine Corps did not have an aging of accounts receivable; therefore, no estimate of the interest they may collect was possible.) The GAO concluded that accounts receivable and related interest charges for overpayment of benefits and unpaid survivor premiums were not properly handled by the Services; therefore, fewer collections have been received than should have been collected and deposited in the Fund or Miscellaneous Receipts of the U.S. Treasury. (p. 5, pp. 20-22/GAO Draft Report).

Now on pp. 4 and 17-18.

DoD Position: Concur. The Military Pay and Allowances Committee has addressed this issue, and the results of their action will be included in Change Number 1 to the DoD Military Retirement Pay Manual (DODMRPM). This revision is scheduled for promulgation about September 1987. At that point, the components will be responsible for issuing guidance to their own finance centers, which is to be accomplished within 90 days. Any further delay in implementing the requirements will be dictated by the time required to change the applicable computer programs.

Recommendation 1: The GAO recommended that the Secretary of Defense direct the Fund managers to develop policies and procedures specifically addressing the recording and reporting of all accounts receivable. (p. 18/GAO Draft Report)

Now on p. 15

DoD Position: Concur. DoD 7220.9-M dated October 1983, as amended, contains policies and procedures specifically addressing the recording and reporting of all accounts receivable. Also, chapter 94 to DoD 7220.9-M provides specific guidance and standards regarding the preparation of general purpose financial statements, including specific guidance regarding disclosure of significant contingent liabilities. The DoD expects to issue new chapters by September 30, 1987, which expand the applicable standards. The Fund managers will implement the recommendations promptly.

Recommendation 2: The GAO recommended that the Secretary of Defense direct the finance centers to charge interest on accounts receivable in accordance with the Debt Collection Act of 1982. (p. 23/GAO Draft Report)

Now on p. 18.

DoD Position: Concur. DoD Directive 7045.13, dated October 31, 1986 and DoD Instruction 7045.18, dated March 13, 1985, contain DoD implementing instructions for the charging of interest on accounts receivable in accordance with the Debt Collection Act of 1982. Also, Deputy Assistant Secretary of Defense (Management Systems) May 21, 1987, memorandum, subject, "Debt Management Improvement Plan," highlights the requirement for assessing interest on delinquent accounts receivable.

Glossary

Accumulated Plan Benefits	Benefits that are attributable under the provisions of a pension plan to employees' service rendered up to the benefit information date (the date benefit information was collected).
Actuarial Accrued Liability	The portion of the present value (as of the benefit information date) of a pension plan's projected future benefit costs and administrative expenses that exceeds the present value of future normal cost contributions.
Actuarial Assumptions	Estimates of future conditions affecting pension cost, such as mortality rate, employee turnover, compensation levels, and investment earnings.
Actuarial Cost Method	A recognized technique used in establishing the amount of annual contributions or accounting charges for pension cost under a pension plan.
Actuarial Present Value	The current worth of amounts payable or receivable in the future. If payment or receipt is certain, the present value is determined by discounting the future amount or amounts at a predetermined rate of interest. If payment or receipt is contingent on future events (for example, survival), further discounting for the probability that payment or receipt will occur is necessary.
Actuarial Valuation	The process by which an actuary estimates the present value of benefits to be paid under a pension plan and calculates the amounts of employer contributions or accounting charges for pension cost.
Contributory Plan	A pension plan under which participants bear part of the cost.
Decrements	Assumptions as to rates of plan participants' withdrawal from the plan, retirement, disability, and death, which an actuary uses in making actuarial projections.
Defined Benefit Pension Plan	A pension plan that specifies a determinable pension benefit, usually based on factors such as age, years of service, and salary.

Defined Contribution Pension Plan	A pension plan that specifies the amount of contribution to be made to the plan for each employee. Benefits at retirement are those contributions plus whatever has been earned on them.
Enrolled Actuary	An actuary enrolled under 29 U.S.C. 1242 by the Joint Board for the Enrollment of Actuaries, established by the Secretaries of Labor and the Treasury.
Future Benefits	An estimate of the total benefits payable at retirement, including benefits anticipated to accrue in the future as well as those accruing before the benefit information date. Future benefits may depend on total length of service but with pay averaged over only a limited number of years (often the final 3 years of service).
Net Assets Available for Benefits	The difference between a plan's assets and its liabilities. For purposes of this definition, a plan's liabilities do not include participants' accumulated plan benefits.
Noncontributory Plan	A pension plan under which participants do not make contributions.
Normal Cost	The annual cost assigned, under the actuarial cost method in use, to years subsequent to the inception of a pension plan. "Static" normal cost assumes no increases in pay or retirement benefits.
Participant	Member of a pension plan, including active employees covered by the plan, separated employees entitled to benefits, and retiree and survivor annuitants.
Pay-As-You-Go	A method of paying, from annual appropriations, pension benefits as they come due to retired employees.
Plan Year	Calendar, policy, or fiscal year the plan chooses for record-keeping purposes.

Unfunded Actuarial Accrued Liability

The amount by which the present value of future benefits exceeds the amount in the pension fund and the present value of future normal cost contributions. The actuarial assumptions used for the computations include increases in pay and retirement benefits.

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