Department Of Defense Military
Retirement Trust Fund

# Chief Financial Officer Annual Financial Statement FY 1997

February 27,1998

# *DoD MILITARY RETIREMENT TRUST FUND*

# *OVERVIEW*

## SUMMARY OF THE MILITARY RETIREMENT SYSTEM

### As of September 30, 1997

### Overview

The military retirement system applies to members of the Army, Navy, Marine Corps, and Air Force. However, most of the provisions also apply to retirement systems for members of the Coast Guard (administered by the Department of Transportation), officers of the Public Health Service (administered by the Department of Health and Human Services), and officers of the National Oceanic and Atmospheric Administration (administered by the Department of Commerce). Those not in plans administered by the Department of Defense are not included in this valuation.

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

There are three distinct nondisability benefit formulas related to three populations within the military retirement system. Military personnel who first became members of the Armed Services before September 8, 1980 have retired pay equal to (terminal basic pay) times (a multiplier). The multiplier is equal to (2.5 percent) times (years of service) and is limited to 75 percent. If the retiree first became a member of the Armed Services on or after September 8, 1980, the average of the highest 36 months of basic pay is used instead of terminal basic pay. Members first entering the Armed Services on or after August 1, 1986 are subject to a penalty if they retire with less than 30 years of service; at age 62, their retired pay is recomputed without the penalty.

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

## Nondisability Retirement From Active Service

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

In FY97, 1.31 million nondisability retirees from active duty were paid $24.94 billion.

## Disability Retirement

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

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

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

In FY97, 116,000 disability retirees were paid $1.46 billion.

## Reserve Retirement

Members of the reserves may retire after 20 years of creditable service, the last eight of which must be in a reserve component. However, reserve retired pay is not payable until age 60. Retired pay is computed as (base pay) times (2.5 percent) times (years of service). If the reservist was first a member of the Armed Services before September 8, 1980, base pay is defined as the active duty basic pay in effect for the retiree's grade and years of service at the time that retired pay begins. If the reservist first became a member of the Armed Services on or after September 8, 1980, base pay is the average basic pay for the member's grade in the last three years that he/she was a member of the Armed Services. The years of service are determined by using a point system, where 360 points convert to a year of service. Typically, a point is awarded for a day of service or a drill attendance, with 15 points being awarded for a year's membership in a reserve component. A creditable year of service is one in which the member earned at least 50 points. A member cannot retire without 20 creditable years, although points earned in non-creditable years are used in the retirement calculation.

In FY97, 221,000 reserve retirees were paid $2.22 billion.

## Survivor Benefits

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

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

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

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

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

During FY87 the SBP program's treatment of survivor remarriages changed. Prior to the change, a surviving spouse remarrying before age 60 had the survivor annuity suspended. The change lowered the age to 55. (If the remarriage ends in divorce or death, the annuity is reinstated.)

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

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

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

For reserve retirees, the same set of retired pay reductions applies for survivor coverage after a reservist turns 60 and begins to receive retired pay. A second set of optional reductions, under the Reserve Component Survivor Benefit Plan, provides annuities to survivors of reservists who die before age 60, but after attaining 20 years of service. The added cost of this coverage is borne completely by reservists through deductions from retired pay and survivor annuities.

In FY97, 223,000 surviving families were paid $1.62 billion.

## Temporary Early Retirement Authority (TERA)

The National Defense Authorization Act for FY93 (P.L. 102-484) grants temporary authority for the military services to offer early retirements to members with more than 15 but less than 20 years of service. The retired pay is calculated in the usual way except that there is a reduction of 1 percent for every year below 20 years of service. Part or all of this reduction can be restored at age 62 if the retired member works in a qualified public service job during the period from the date of retirement to the date on which the retiree would have completed 20 years of service. Unlike members who leave military service before 20 years with voluntary separation incentives or special separation benefits, these early retirees are treated like regular military retirees for the purposes of other retirement fringe benefits. This authority is scheduled to expire at the end of FY99.

As of September 30, 1997, there were 48,000 TERA retirees receiving retired pay at an annual rate of $561 million.

## Cost-of-Living Increases

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

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

The benefits of retirees (and their survivors) first entering the Armed Services before August 1, 1986 are annually increased with the full COLA; all other benefits are annually increased with a "partial" COLA. The partial COLA is the full COLA minus 1 percent. A one-time restoral is given to a partial COLA recipient on the first day of the month after the retiree's 62nd birthday. At this time, the retiree benefit (or survivor benefit if the retiree is deceased) is increased to the amount that would have been payable had full COLAs been in effect. Annual partial COLAs continue after this restoral.

## Relationship with VA Benefits

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

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

## Interrelationship with Other Federal Service

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

## Relationship of Retired Pay to Military Compensation

Basic pay is the only element of military compensation upon which retired pay is computed and entitlement is determined. Basic pay is the principal element of military compensation that all members receive, but it is not representative, for comparative purposes, of salary levels in the public and private sectors. Reasonable comparisons can be made to regular military compensation (RMC). RMC is the sum of (1) basic pay, (2) cash or in kind allowances (the housing allowance, which varies by grade, location, and dependency status, and a subsistence allowance) and (3) the tax advantages accruing to allowances because they are not subject to Federal income tax. Basic pay represents approximately 72 percent of RMC for all retirement eligibles. For the 20-year retiree, basic pay is approximately 69 percent of RMC. Consequently, a 20-year retiree may be entitled to 50 percent of basic pay, but only 35 percent of RMC. For a 30-year retiree, the corresponding entitlements are 75 percent of basic pay, but only 56 percent of RMC. These relationships should be considered when military retired pay is compared to compensation under other retirement systems.

## Social Security Benefits

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

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

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

Members of the military are also required to pay the Hospital Insurance (HI) payroll tax, with the Federal Government contributing the matching employer contribution. Medicare eligibility occurs at age 65, or earlier if the employee is disabled. Entitlement to Medicare terminates entitlement to benefits under the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS), although eligibility continues for medical care in military facilities on a space available basis.

## Performance Measures

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

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

## Limitations of the Financial Statements

These financial statements have been prepared to report the financial position and results of operations for the Military Retirement Trust Fund pursuant to the requirements of the Chief Financial Officers Act of 1990. While the statements have been prepared from the books and records of the Military Retirement Trust Fund in accordance with the formats prescribed by the Office of Management and Budget, the statements are different from the financial statements used to monitor and control budgetary resources that are prepared from the same books and records. These statements should be read with the realization that they are for a Federal entity, that unfunded liabilities reported in the financial statements can not be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by DoD.

# *DoD*
# *MILITARY RETIREMENT TRUST FUND*

# *PRINCIPAL STATEMENTS*

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**Department of Defense**
**DoD Military Retirement Fund**
**Statement of Financial Position**
**as of September 30, 1997**
**(Thousands)**

| ASSETS | 1997 | 1996 |
|---|---|---|
| **1. Entity Assets:** | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Fund Balances with Treasury (Note 2) | $4,645 | $57,869 |
| (2) Investments, Net (Note 4) | 139,014,269 | 131,065,203 |
| (3) Accounts Receivable, Net (Note 5) | 0 | 0 |
| (4) Interest Receivable | 4,228,139 | 4,200,579 |
| (5) Advances and Prepayments | 0 | 0 |
| (6) Other Federal (Intragovernmental) (Note 6) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Investments,Net (Note 4) | 0 | 0 |
| (2) Accounts Receivable, Net (Note 5) | 24,969 | 12,253 |
| (3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7) | 0 | 0 |
| (4) Interest Receivable, Net | 0 | 0 |
| (5) Advances and Prepayments | 0 | 0 |
| (6) Other Non-Federal (Governmental) (Note 6) | 0 | 0 |
| c. Cash and Other Monetary Assets (Note 3) | 0 | 0 |
| d. Inventory, Net (Note 8) | 0 | 0 |
| e. Work in Process (Note 9) | 0 | 0 |
| f. Operating Materials/Supplies, Net (Note 10) | 0 | 0 |
| g. Stockpile Materials, Net (Note 11) | 0 | 0 |
| h. Seized Property (Note 12) | 0 | 0 |
| i. Forfeited Property, Net (Note 13) | 0 | 0 |
| j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14) | 0 | 0 |
| k. Property, Plant and Equipment, Net (Note 15) | 0 | 0 |
| l. War Reserves | 0 | 0 |
| m. Other Entity Assets | 0 | 0 |
| **n. Total Entity Assets** | $143,272,022 | $135,335,904 |
| **2. Non-Entity Assets:** | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Fund Balance with Treasury (Note 2) | $0 | $0 |
| (2) Accounts Receivable, Net (Note 5) | 0 | 0 |
| (3) Interest Receivable, Net | 0 | 0 |
| (4) Other (Note 6) | 0 | 0 |

**The accompanying notes are an integral part of these statements.**

**Department of Defense**
**DoD Military Retirement Fund**
**Statement of Financial Position**
**as of September 30, 1997**
**(Thousands)**

| ASSETS, Continued | 1997 | 1996 |
|---|---|---|
| **2. Non-Entity Assets** | | |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Receivable, Net (Note 5) | $0 | $0 |
| (2) Interest Receivable, Net | 0 | 0 |
| (3) Other (Note 6) | 0 | 0 |
| c. Cash and Other Monetary Assets (Note 3) | 0 | 0 |
| d. Other Non-Entity Assets | 0 | 0 |
| **e. Total Non-Entity Assets** | 0 | 0 |
| **3. Total Assets** | $143,272,022 | $135,335,904 |
| **LIABILITIES** | | |
| **4. Liabilities Covered by Budgetary Resources:** | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Accounts Payable | $0 | $0 |
| (2) Interest Payable | 0 | 0 |
| (3) Debt (Note 16) | 0 | 0 |
| (4) Other Federal (Intragovernmental) Liabilities (Note 17) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Payable | 2,631,053 | 2,548,044 |
| (2) Accrued Payroll and Benefits | | |
| (a) Salaries and Wages | 0 | 0 |
| (b) Annual Accrued Leave | 0 | 0 |
| (c) Severance Pay and Separation Allowance | 0 | 0 |
| (3) Interest Payable | 0 | 0 |
| (4) Liabilities for Loan Guarantees (Note 7) | 0 | 0 |
| (5) Lease Liabilities (Note 18) | 0 | 0 |
| (6) Pensions and Other Actuarial Liabilities (Note 19) | 140,640,969 | 132,787,860 |
| (7) Other Non-Federal (Governmental) Liabilities (Note 17) | 0 | 0 |
| **c. Total Liabilities Covered by Budgetary Resources** | $143,272,022 | $135,335,904 |

**The accompanying notes are an integral part of these statements.**

**Department of Defense**
**DoD Military Retirement Fund**
**Statement of Financial Position**
**as of September 30, 1997**
**(Thousands)**

| LIABILITIES, Continued | 1997 | 1996 |
|---|---|---|
| **5. Liabilities Not Covered by Budgetary Resources:** | | |
| a. Transactions with Federal (Intragovernmental) Entities: | | |
| (1) Accounts Payable | $0 | $0 |
| (2) Debt (Note 16) | 0 | 0 |
| (3) Other Federal (Intragovernmental) Liabilities (Note 17) | 0 | 0 |
| b. Transactions with Non-Federal (Governmental) Entities: | | |
| (1) Accounts Payable | 0 | 0 |
| (2) Debt (Note 16) | 0 | 0 |
| (3) Lease Liabilities (Note 18) | 0 | 0 |
| (4) Pensions and Other Actuarial Liabilities (Note 19) | 501,074,103 | 414,912,140 |
| (5) Other Non-Federal (Governmental) Liabilities (Note 17) | 118 | 110 |
| **c. Total Liabilities Not Covered by Budgetary Resources** | $501,074,221 | $414,912,250 |
| **6. Total Liabilities** | $644,346,243 | $550,248,154 |
| **NET POSITION (Note 20)** | | |
| **7. Balances:** | | |
| a. Unexpended Appropriations | $0 | $0 |
| b. Invested Capital | 0 | 0 |
| c. Cumulative Results of Operations | 0 | 0 |
| d. Other | 0 | 0 |
| e. Future Funding Requirements | (501,074,221) | (414,912,250) |
| **f. Total Net Position** | ($501,074,221) | ($414,912,250) |
| **8. Total Liabilities and Net Position** | $143,272,022 | $135,335,904 |

**The accompanying notes are an integral part of these statements.**

**Department of Defense**
**DoD Military Retirement Fund**
**Statement of Operations and Changes in Net Position**
**For Period Ended September 30, 1997**
**(Thousands)**

| | 1997 | 1996 |
|---|---|---|
| **REVENUES AND FINANCING SOURCES** | | |
| 1. Appropriated Capital Used | $0 | $0 |
| 2. Revenues from Sales of Goods and Services | | |
| a. To the Public | 0 | 0 |
| b. Intragovernmental | 0 | 0 |
| 3. Interest and Penalties, Non-Federal | 0 | 0 |
| 4. Interest, Federal | 11,859,066 | 11,280,558 |
| 5. Taxes (Note 21) | 0 | 0 |
| 6. Other Revenues and Financing Sources (Note 22) | 26,252,570 | 21,873,163 |
| 7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies | 0 | 0 |
| **8. Total Revenues and Financing Sources** | $38,111,636 | $33,153,721 |
| **EXPENSES** | | |
| 9. Program or Operating Expenses (Note 23) | $30,258,527 | $28,991,489 |
| 10. Cost of Goods Sold (Note 24) | | |
| a. To the Public | 0 | 0 |
| b. Intragovernmental | 0 | 0 |
| 11. Depreciation and Amortization | 0 | 0 |
| 12. Bad Debts and Write-offs | 0 | 0 |
| 13. Interest | | |
| a. Federal Financing Bank/Treasury Borrowing | 0 | 0 |
| b. Federal Securities | 0 | 0 |
| c. Other | 0 | 0 |
| 14. Other Expenses (Note 25) | 15,943,199 | 18,600,000 |
| **15. Total Expenses** | $46,201,726 | $47,591,489 |
| 16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items | ($8,090,090) | ($14,437,768) |
| 17. Plus (Minus) Extraordinary Items (Note 26) | (8) | (7) |
| 18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | ($8,090,098) | ($14,437,775) |

**The accompanying notes are an integral part of these statements.**

**Department of Defense**
**DoD Military Retirement Fund**
**Statement of Operations and Changes in Net Position**
**For Period Ended September 30, 1997**
**(Thousands)**

| | 1997 | 1996 |
|---|---|---|
| **EXPENSES, Continued** | | |
| **19. Net Position, Beginning Balance, as Previously Stated** | ($414,912,250) | ($407,169,291) |
| 20. Adjustments (Note 27) | (78,071,873) | 6,694,816 |
| 21. Net Position, Beginning Balance, as Restated | ($492,984,123) | ($400,474,475) |
| 22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses | (8,090,098) | (14,437,775) |
| 23. Plus (Minus) Non Operating Changes (Note 28) | 0 | 0 |
| **24. Net Position, Ending Balance** | ($501,074,221) | ($414,912,250) |

**The accompanying notes are an integral part of these statements.**

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# *DoD MILITARY RETIREMENT TRUST FUND*

# *FOOTNOTES TO THE PRINCIPAL STATEMENTS*

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# NOTES TO THE DoD MILITARY RETIREMENT FUND PRINCIPAL STATEMENTS AS OF SEPTEMBER 30, 1997

**Note 1. Significant Accounting Policies:**

A. The DoD Military Retirement Fund was authorized by PL98-94 for the accumulation of funds in order to finance on an actuarially sound basis liabilities of the Department of Defense under military retirement and survivor benefit programs. These financial statements have been prepared to report the financial position and results of operations of the Department of Defense Military Retirement Fund, as required by the Chief Financial Officers (CFO) Act of 1990, and other appropriate legislation. They have beenprepared from the books and records of the Defense Finance and Accounting Service Accounting Deputate Investment Trust Directorate (DFAS-HQ/AE). These financial statements are presented on the accrual basis of accounting in accordance with the requirements of the Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements", and subsequent issues.

The program is funded by:
(1) Annual unfunded liability payment from Treasury
(2) Monthly Service contributions as a percentage of base pay
(3) Interest on investments.

B. Accounting Method Used to Present Actuarial Liability. Starting in FY 1997, the Military Retirement Trust Fund financial statements present the unfunded actuarial liability determined as of the end of the fiscal year. <u>This is a change from prior year reporting, which presented the beginning-of-year liability</u>. This figure is approximate because of the lengthy time required to develop an accurate end-of-year actuarial estimate and the accelerated deadlines for these financial statements.

Actuarial Cost Method: Starting in FY 1997, the Military Retirement Trust Fund financial statements present the actuarial liability as of the end of the fiscal year using the "projected benefit obligation" (PBO) cost method required by the Office of Management and Budget (OMB) Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government." <u>This is a change from prior year reporting, which presented the accumulated benefit obligation, which assumes no future salary increases</u>.

**Note 2. Fund Balances with Treasury (in thousands):**

A. Fund and Account Balances:

| | Entity Assets | | | | |
|---|---|---|---|---|---|
| | Trust Funds | Revolving Funds | Appro-priated Funds | Other Fund Types | Total |
| Unobligated Balance Available: | | | | | |
| Available | $4,645 | $0 | $0 | $0 | $4,645 |
| Restricted | 0 | 0 | 0 | 0 | 0 |
| Reserve For Anticipated Resources | 0 | 0 | 0 | 0 | 0 |
| Obligated (but not expensed) | 0 | 0 | 0 | 0 | 0 |
| Unfunded Contract Authority | 0 | 0 | 0 | 0 | 0 |
| Unused Borrowing Authority | 0 | 0 | 0 | 0 | 0 |
| Treasury Balance | $4,645 | $0 | $0 | $0 | $4,645 |

B. Other Information: Securities are redeemed to cover expenses.

**Note 3. Cash, Foreign Currency and Other Monetary Assets (in thousands):** Not applicable

**Note 4. Investments, Net (in thousands):**

| | (1) Cost | (2) Market Value | (3) Amorti-zation Method | (4) Amortized Premium/ (Discount) | (5) Investments Net |
|---|---|---|---|---|---|
| A. Intragovernmental Securities: | | | | | |
| (1) Marketable | $0 | $0 | | $0 | $0 |
| (2) Non-Marketable Par Value | 0 | 0 | | 0 | 0 |
| (3) Non-Marketable Market Based | 145,479,816 | 157,029,135 | Effective | (6,465,547) | 139,014,269 |
| Subtotal | $145,479,816 | $157,029,135 | Interest | ($6,465,547) | $139,014,269 |
| B. Governmental Securities: | | | | | |
| (1) Not applicable | $0 | $0 | | $0 | $0 |
| Subtotal | $0 | $0 | | $0 | $0 |
| Total | $145,479,816 | $157,029,135 | | ($6,465,547) | $139,014,269 |

C. Other Information: The method used to determine amount amortized, book value of investments, as of September 30, 1997, currently held and related yield on investments conforms to the prevailing practice in the financial community. The calculated yields match up with yields in published security tables of U.S. Treasury securities.

**Note 5. Accounts Receivable, Net (in thousands):**

| | (1) Gross Amount Due | (2) Allowance For Estimated Uncollectibles | (3) Allowance Method Used (see below) | (4) Net Amount Due |
|---|---|---|---|---|
| A. Entity Receivables: | | | | |
| Intragovernmental | $0 | $0 | | $0 |
| Governmental | 24,969 | 0 | | 24,969 |
| B. Non-Entity Receivables: | | | | |
| Intragovernmental | $0 | $0 | | $0 |
| Governmental | 0 | 0 | | 0 |

C. Other Information: Accounts Receivable represent Refunds Receivable of overpayments of benefits.

**Note 6. Other Federal (Intragovernmental) and Non-Federal (Governmental) Assets (in thousands):** Not applicable

**Note 7. Loans and Loan Guarantees, Non-Federal Borrowers (in thousands):** Not applicable

**Note 8. Inventory, Net (in thousands):** Not applicable

**Note 9. Work in Process (in thousands):** Not applicable

**Note 10. Operating Materials and Supplies (OM&S), Net (in thousands):** Not applicable

**Note 11. Stockpile Materials, Net (in thousands):** Not applicable

**Note 12. Seized Property (in thousands):** Not applicable

**Note 13. Forfeited Property, Net (in thousands):** Not applicable

**Note 14. Goods Held Under Price Support and Stabilization Programs, Net (in thousands):** Not applicable

**Note 15. Property, Plant, and Equipment, Net (in thousands):** Not applicable

**Note 16. Debt (in thousands):** Not applicable

**Note 17. Other Liabilities (in thousands):**

A. Other Liabilities Covered by Budgetary Resources Not applicable

B. Other Information: Not applicable

C. Other Liabilities Not Covered by Budgetary Resources:

| | Non-Current Liability | Current Liability | Total |
|---|---|---|---|
| 1. Intragovernmental: | | | |
| (a) Canceled Budget Authority | $0 | $0 | $0 |
| Total | $0 | $0 | $0 |

| | Non-Current Liability | Current Liability | Total |
|---|---|---|---|
| 2. Governmental: | | | |
| (a) Canceled Budget Authority | $0 | $0 | $0 |
| (b) Death Payment Contingency | 118 | 0 | 118 |
| Total | $118 | $0 | $118 |

D. Other Information: Not applicable

**Note 18. Leases (in thousands):** Not applicable

**Note 19. Pensions and Other Actuarial Liabilities (in thousands):**

| | (1) Actuarial Accrued Liability | (2) Assumed Interest Rate(%) | (3) Assets Available to Pay Benefits | (4) Unfunded Actuarial Liability |
|---|---|---|---|---|
| A. Pension and Health Plans: | $641,715,072 | 6.5 | $140,640,969 | $501,074,103 |
| B. Insurance/Annuity Programs: | | | | |
| C. Other: Not applicable | | | | |
| D. Total Lines A+B+C: | $641,715,072 | | $140,640,969 | $501,074,103 |

E. Other Information: The Military Retirement System is a single-employer plan. It is a defined benefit plan. Administrative costs are not borne by the plan. The actuarial cost method used is the aggregate entry-age-normal. Projected revenues, as authorized by PL98-94, are to be paid into the Fund at the beginning of each fiscal year by the Secretary of the Treasury as certified by the Secretary of Defense. This permanent, indefinite appropriation, determined by the Board of

Actuaries, represents the amortization of the unfunded liability for service performed prior to October 1, 1984. Along with the 6.5% assumed annual interest rate, the long-term annual Consumer Price Index is assumed to be 3.5% and the annual basic pay increase is assumed to be 4.0%. Other assumptions, such as mortality and retirement rates, are based on actual experience.

Accounting Method Used to Present Actuarial Liability: Starting in FY 1997, the Military Retirement Trust Fund financial statements present the unfunded actuarial liability determined as of the end of the fiscal year. This is a change from prior year reporting, which presented the beginning-of-year liability. This figure is approximate because of the lengthy time required to develop an accurate end-of-year actuarial estimate and the accelerated deadlines for these financial statements.

Actuarial Cost Method: Starting in FY 1997, the Military Retirement Trust Fund financial statements present the actuarial liability as of the end of the fiscal year using the "projected benefit obligation" (PBO) cost method required by the Office of Management and Budget (OMB) Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government." This is a change from prior year reporting, which presented the accumulated benefit obligation, which assumes no future salary increases.

**Note 20. Net Position (in thousands):**

| | Revolving Funds | Trust Funds | Appropriated Funds | Total |
|---|---|---|---|---|
| A. Unexpended Appropriations: | | | | |
| (1) Unobligated, | | | | |
| a. Available | $0 | $0 | $0 | $0 |
| b. Unavailable | 0 | 0 | 0 | 0 |
| (2) Undelivered Orders | 0 | 0 | 0 | 0 |
| B. Invested Capital | 0 | 0 | 0 | 0 |
| C. Cumulative Results of Operations | 0 | 0 | 0 | 0 |
| D . Other | 0 | 0 | 0 | 0 |
| E. Future Funding Requirements | 0 | (501,074,221) | 0 | (501,074,221) |
| F. Total | $0 | ($501,074,221) | $0 | ($501,074,221) |

G. Other Information: The future funding requirement is the amount of the unfunded portion of the DoD Military Retirement Trust fund actuarial liability.

**Note 21. Taxes (in thousands):** Not applicable

**Note 22. Other Revenues and Financing Sources (in thousands):**

A. Other Revenues and Financing Sources:

| | 1997 | 1996 |
|---|---|---|
| (1) Normal Cost Contribution from Services | $ 11,101,570 | $11,174,163 |
| (2) Unfunded Liability Payment from Treasury | 15,151,000 | 10,699,000 |
| Total | $26,252,570 | $21,873,163 |

B. Other Information: Not applicable

**Note 23. Program or Operating Expenses (in thousands):**

| | 1997 | 1996 |
|---|---|---|
| A. Operating Expenses by Object Classification: | $0 | $0 |
| (1) Personal Services and Benefits | 0 | 0 |
| (2) Travel and Transportation | 0 | 0 |
| (3) Rental, Communication and Utilities | 0 | 0 |
| (4) Printing and Reproduction | 0 | 0 |
| (5) Contractual Services | 0 | 0 |
| (6) Supplies and Materials | 0 | 0 |
| (7) Equipment not Capitalized | 0 | 0 |
| (8) Grants, Subsidies and Contributions | 0 | 0 |
| (9) Insurance Claims and Indemnities | 30,258,527 | 28,991,489 |
| (10) Other (describe): | 0 | 0 |
| (11) Total Expenses by Object Class | $30,258,527 | $28,991,489 |

B. Operating Expenses by Program: Not applicable

**Note 24. Cost of Goods Sold (in thousands):** Not applicable

**Note 25. Other Expenses (in thousands):**

| | 1997 | 1996 |
|---|---|---|
| A. Other Expenses: | | |
| (1) Change in Actuarial Liability for period | $15,943,199 | $18,600,000 |
| Total | $15,943,199 | $18,600,000 |

Other Information: Starting in FY 1997, the Military Retirement Trust Fund financial statements present the actuarial liability as of the end of the fiscal year using the "projected benefit obligation" (PBO) cost method required by the OMB Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government." This is a change from prior year reporting, which presented the beginning-of-the-year accumulated benefit obligation, which assumes no future salary increases. The above figure for 1997 represents the change in the end-of year PBO from FY 1996 to FY 1997.

## Note 26. Extraordinary Items (in thousands):

| | 1997 |
|---|---|
| A. Extraordinary Items: | |
| (1) Death Payment Contingency - (Increase) - Decrease | ($8) |
| Total | ($8) |

## Note 27. Prior Period Adjustments (in thousands):

| | 1997 |
|---|---|
| A: Prior Period Adjustments: | |
| (1) Change in Actuarial Liability | ( $78,071,873) |
| Total | ( $78,071,873) |

B. Other Information: The FY 1996 actuarial liability using the ABO method was $547.7 billion. The above figure represents the change in going from ABO to PBO for 1996.

## Note 28. Non-Operating Changes (in thousands): Not applicable

## Note 29. Intrafund Eliminations (in thousands):

Schedule A: Sales within the General Fund by transactions Sales or services rendered) relative to the DoD Component. Not Applicable

Schedule B: The selling Working Capital Fund (WCF) Component will report intrafund transactions (sales or services) within the WCF Component. Not Applicable

Schedule C: Sales and services between the DoD Military Retirement Trust Fund and other DoD reporting entities by transactions and according to general ledger amounts for accounts receivable, revenues, unearned revenues, and collections. It is presumed that an equal amount of accounts payable, expenses, advances, and disbursements have been entered on the accounting records of the purchasing activity.

| Seller Activity | Column A | Column B | Column C | Column D |
|---|---|---|---|---|
| | Accounts Receivable | Revenue | Unearned Revenue | Collections |
| DoD Military Retirement Trust Fund | N/A | $26,252,570 | N/A | $26,252,570 |
| Total | | $26,252,570 | | $26,252,570 |

| Customer Activity: | Column A | Column B | Column C | Column D |
|---|---|---|---|---|
| | Accounts Payable | Expenses | Advances | Disbursements |
| Department of the Army (T.I. 21) | N/A | $3,974,471 | N/A | $3,974,471 |
| Department of the Navy (T.I. 17) | N/A | 4,034,921 | N/A | 4,034,921 |
| Department of the Air Force (T.I. 57) | N/A | 3,092,178 | N/A | 3,092,178 |
| Other Defense Organizations (97*0040) | N/A | 15,151,000 | N/A | 15,151,000 |
| Total | N/A | $26,252,570 | N/A | $26,252,570 |

Other Information: $11,101,570 are collections from the Military Personnel accounts of the Military Services and $15,151,000 are funds appropriated to account, Payments to Military Retirement Fund, Defense and subsequently transferred to the Military Retirement Fund.

Schedule D: Sales or services between the DoD Military Retirement Trust Fund and other U.S. Government reporting entities by transactions and according to general ledger amounts for accounts receivable, revenues, unearned revenues, and collections. It is presumed that an equal amount of accounts payable, expenses, advances, and disbursements have been entered on the accounting records of the purchasing activity.

| Seller Activity | Column A | Column B | Column C | Column D |
|---|---|---|---|---|
| | Accounts Receivable | Revenue | Unearned Revenue | Collections |
| DoD Military Retirement Trust Fund | $4,228,139 | $11,807,681 | N/A | $11,807,681 |
| Total | $4,228,139 | $11,807,681 | N/A | $11,807,681 |

| Customer Activity: | Column A | Column B | Column C | Column D |
|---|---|---|---|---|
| | Accounts Payable | Expenses | Advances | Disbursements |
| Department of the Treasury (T.I. 20) | $4,228,139 | $11,807,681 | N/A | $11,807,681 |
| Total | $4,228,139 | $11,807,681 | N/A | $11,807,681 |

Other Information: $4,228,139 is Accrued Interest Receivable on U.S. Treasury Notes and Bonds held by the DoD Military Retirement Fund.
For securities purchased on October 1, 1986 and subsequent, discount and premium are amortized through account 97X8097.2 Earnings on Investments. The amortization of discount and premium for securities purchased prior to October 1, 1986 is reported to Treasury by changing the Preclosing Unexpended Balance for account 97X8097.941 on report FMS 2108. Gains and loses on securities sold are also reported through account 97X8097.2. $11,920,116 was reported to account 97X8097.2 and (112,435) was reported via FMS 2108, which equals $11,807,681 as reported above.

On the Statement of Operations and Changes in Net Position, Line 4 Interest, Federal shows an amount of $11,859,066. This amount was determined as follows:

| | |
|---|---|
| Interest collected (cash) | $13,076,320 |
| Amortized Premium | (1,300,403) |
| Amortized Discount | 31,760 |
| Gain on sale | 4 |
| Subtotal | $11,807,681 |
| Increase in Accrued Interest Receivable | 51,385 |
| | $11,859,066 |

**Note 30. Contingencies (in thousands):** Not applicable

**Note 31. Other Disclosures (in thousands):**

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

| | |
|---|---|
| A. Beginning-of-Year Accrued Liability | $625,771,873 |
| B. Normal Cost Liability | 11,101,570 |
| C. Plan Amendment Liability | 0 |
| D. Benefit Outlays | (30,258,527) |
| E. Interest on Pension Liability (A, B, C, and D) | 40,052,570 |
| F. Actuarial Loss (Gain) | (4,952,414) |
| G. End-of-Year Accrued Liability (A+B+C+D+E+F) | $641,715,072 |
| H. Net Pension Expense (B+C+D+E+F) | $15,943,199 |

Other Information: The interest on the pension liability (Line E) is calculated as a full year of interest on the beginning-of-year accrued liability (Line A) and a half year of interest on the normal cost liability and the benefit outlays (Line B and Line D).

# *DoD MILITARY RETIREMENT TRUST FUND*

# *SUPPLEMENTAL INFORMATION*

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## TABLE 1

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

| | For the Plan Year Ended: Sept 30, 1996 | Sept 30, 1997 |
|---|---|---|
| Assets | | |
| Investments, at fair market value, U.S. Government securities [1] | $146,294,217 | $157,029,135 |
| Accounts receivable | | |
| Accrued interest [2] | $4,200,580 | $4,228,139 |
| Due from Military Retirees or their Survivors | $12,253 | $24,969 |
| Cash | $57,869 | $4,645 |
| Total Assets | $150,564,919 | $161,286,888 |
| Accounts Payable | ($2,548,044) | ($2,631,053) |
| Total Assets Available for Benefits | $148,016,875 | $158,655,835 |

[1] Fair market value of securities has been measured by quoted prices (bid price) in the active U.S. Government securities market. Bid price used represents the over-the-counter quotations as of 4 p.m. Eastern time, as reported in the Wall Street Journal on October 1.

[2] Includes accrued interest receivable (including interest purchased).

## TABLE 2

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

| | For the Plan Year Ended: Sept 30,1996 | Sept 30,1997 |
|---|---|---|
| Net assets available for benefits at beginning of plan year | $148,658,870 | $148,016,875 |
| Investment income | | |
| Interest | $12,502,872 | $13,127,704 |
| Net appreciation (depreciation) in fair market value of investment [1] | ($6,026,543) | $1,517,213 |
| Contributions | | |
| From services | $11,174,164 | $11,101,570 |
| Appropriation to amortize unfunded liability | $10,699,000 | $15,151,000 |
| Total additions | $28,349,493 | $40,897,487 |
| Benefits paid to participants [2] | $28,991,489 | $30,258,527 |
| Net assets available for benefits at end of plan year | $148,016,875 | $158,655,835 |

---

[1] Investments bought, sold and held during the plan year ended September 30 appreciated (depreciated) in value as follows:

| | PY 1996 | PY 1997 |
|---|---|---|
| Appreciated (depreciated) fair value over book value | ($4,804,228) | $2,785,852 |
| Amortized discount | 151,912 | 31,760 |
| Amortized premium | (1,374,227) | (1,300,403) |
| Gain (loss) on sale | 0 | 4 |
| | ($6,026,543) | $1,517,213 |

[2] The statement has been adjusted to show benefits paid to participants on an accrual basis.

| | PY 1996 | PY 1997 |
|---|---|---|
| Benefits paid on cash basis | $28,831,111 | $30,188,234 |
| Increase in liability for benefits due at end of year | 160,378 | 70,293 |
| Benefits paid on accrual basis | $28,991,489 | $30,258,527 |

## TABLE 3

MILITARY RETIREMENT SYSTEM
ACTUARIAL STATUS INFORMATION
AS OF SEPTEMBER 30, 1997 [1,2]
($ in billions)

| | For the Plan Year Ended: Sept 30, 1996 | Sept 30, 1997 |
|---|---|---|
| 1. Present value of Accumulated Plan Benefits | | |
| a. Actuarial present value of vested benefits | | |
| I. Participants currently receiving payments | $431.3 | n/a |
| II. Other vested participants | $55.1 | n/a |
| b. Total vested | $486.4 | n/a |
| c. Actuarial present value of non-vested benefits | $61.3 | n/a |
| d. Total actuarial present value of accumulated plan benefits | $547.7 | n/a |
| 2. Present value of future benefits | | |
| a. Annuitants now on roll | n/a | $426.5 |
| b. Non-retired reservists | n/a | $24.0 |
| c. Active duty personnel [3] | n/a | $271.1 |
| d. Total | n/a | $721.6 |
| 3. Present value of future normal cost contributions | n/a | $79.9 |
| 4. Actuarial accrued liability | n/a | $641.7 |
| 5. Assets [4, 5] | $151.0 | $140.6 |
| 6. Excess of accumulated benefits over assets | $396.7 | n/a |
| 7. Unfunded accrued liability | n/a | $501.1 |

FOOTNOTES FOR TABLE 3

1. Starting in FY 1997, the Military Retirement Trust Fund financial statements present the unfunded actuarial liability determined as of the end of the fiscal year.

2. Starting in FY 1997, the Military Retirement Trust Fund financial statements present the actuarial liability as of the end of the fiscal year using the "projected benefit obligation" cost method required by the Office of Management and Budget (OMB) Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government."

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

4. Total assets are reported for 9/30/96 because the liability for benefit payments due is included in the actuarial present value of benefits for participants currently receiving payments.

5. The assets available to pay benefits is reported for 9/30/97 and is determined using the amortized cost method (book value) of valuation.

# *DoD*
# *MILITARY RETIREMENT TRUST FUND*

# *AUDIT OPINION*

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The Office of the Inspector General (OIG), Department of Defense, has performed audit work on the FY 1997 Military Retirement Trust Fund financial statements. However, the OIG stated that insufficient work has been completed, at the time of publication, to determine whether the statements are fairly presented.