Audit Report

OFFICE OF THE INSPECTOR GENERAL

DEFENSE AGENCY TRUST FUND FINANCIAL STATEMENTS FOR FY 1991

Report Number 92-119

June 30, 1992

Department of Defense

The following acronyms are used in this report.

AICPA.....American Institute of Certified Public Accountants
ASD(FM&P).....Assistant Secretary of Defense (Force Management and Personnel)
CFO.....Chief Financial Officer
DFAS.....Defense Finance and Accounting Service
DMDC.....Defense Manpower Data Center
DoD.....Department of Defense
DoL.....Department of Labor
FMFIA.....Federal Managers' Financial Integrity Act
GAO.....General Accounting Office
IMC.....internal management control
OMB.....Office of Management and Budget

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

June 30, 1992

MEMORANDUM FOR SECRETARY OF DEFENSE
DEPUTY SECRETARY OF DEFENSE
ASSISTANT SECRETARY OF DEFENSE (FORCE MANAGEMENT AND PERSONNEL)
COMPTROLLER AND CHIEF FINANCIAL OFFICER, DOD
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on the Defense Agency Trust Fund Financial Statements for FY 1991 (Report No. 92-119)

We are providing this final audit report for your information and use and for use by Congress. The audit was required by the Chief Financial Officers Act of 1990. The Act requires the Inspector General to render an opinion on the fairness of the financial statements of the Defense Agency Trust Fund, in accordance with DoD accounting policies and procedures and generally accepted accounting principles, and to report on internal controls and compliance with laws and regulations. The financial statements of the Defense Agency Trust Fund contain only the statements of the Military Retirement Trust Fund.

The management representation letter for the Fund was not signed by a senior enough official so that the representation could be considered fully adequate. Except for that technicality, the Principal Statements and the Notes to the Principal Statements present fairly, in all material respects, the assets, liabilities, and net financial position of the Defense Agency Trust Fund as of September 30, 1991, and the results of its operations, cash flows, and reconciliation to budget for the year then ended, in accordance with DoD accounting policies and procedures and generally accepted accounting principles.

We noted three material internal control weaknesses requiring management attention and one lapse in controls requiring disclosure. Below the Deputy Secretary of Defense level, no Fund manager was responsible for all operations of the Fund. The Office of the Actuary, DoD, and the Defense Manpower Data Center had not implemented the requirements of the Federal Managers' Financial Integrity Act (FMFIA) or DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. Service contributions to the Military Retirement Trust Fund were not independently verified against base pay. Although internal controls were adequate over the retiree and annuitant payment process, we found that one annuitant was overpaid $25,000 during a 9-year period. Except for the matters noted above, we believe there is reasonable assurance that the control structure meets the internal control objectives.

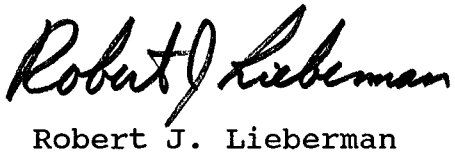
With respect to compliance with laws and regulations, except for the noncompliance with the FMFIA noted in Part II, "Report on Internal Controls," the Defense Agency Trust Fund complied in all material respects with applicable laws and regulations.

In addition, we identified users of the financial statements and requested information on their usefulness. We found that the financial statements were used for reporting data to budget personnel, as reference data for the General Accounting Office, and for incorporation into the consolidated financial statements of the U.S. Government.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, the Assistant Secretary of Defense (Force Management and Personnel); the Chief Financial Officer, DoD; and the Director, Defense Finance and Accounting Service, must provide final comments on the unresolved recommendations. As required by DoD Directive 7650.3, the comments should indicate concurrence or nonconcurrence with each finding and recommendation addressed to you. If you concur, describe the corrective actions taken or planned, the completion dates for actions already taken, and the estimated dates for completion of planned actions. If you nonconcur, please state your specific reasons. If appropriate, you may propose alternative methods for accomplishing desired improvements.

Recommendations are subject to resolution in accordance with DoD Directive 7650.3 in the event of nonconcurrence or failure to comment. To comply with the directive, comments must be received by September 1, 1992.

If you have any questions about this audit, please contact Mr. Raymond D. Kidd, Program Director, at (703) 614-1682 (temporary phone number 693-0099) or Mr. John M. Seeba, Project Manager, at (703) 693-0653 (temporary phone number 693-0101). The courtesies extended to the audit staff are appreciated. The distribution of this report is listed in Part V, Appendix D.



Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General

AUDIT REPORT NO. 92-119 **June 30, 1992**
(Project No. 1FH-0011)

AUDIT REPORT ON THE DEFENSE AGENCY TRUST FUND FINANCIAL STATEMENTS FOR FY 1991

EXECUTIVE SUMMARY

Introduction. The Chief Financial Officers Act of 1990 requires an annual audit of the financial statements of the Defense Agency Trust Fund. The Defense Agency Trust Fund's financial statements contain only the statements of the Military Retirement Trust Fund (the Fund). The Fund was established as a trust fund in 1985 by Public Law 98-94. For the FY 1991, the Fund paid 1.5 million retirees $22.2 billion and 172,000 survivors $1.03 billion. As of September 30, 1991, Fund assets were $93.7 billion, and the unfunded liability was $525.8 billion. The Fund receives revenues from three sources (FY 1991 totals shown): contributions from the Services ($17.2 billion), payments from the United States Treasury for the unfunded liability ($10.7 billion), and interest earned on Treasury securities ($8.5 billion).

Objectives. The objective of the audit was to render an opinion on the fairness of the FY 1991 financial statements of the Defense Agency Trust Fund in accordance with DoD accounting policies and procedures and generally accepted accounting principles. We are also required to report on internal controls and compliance with laws and regulations.

Auditor's Opinion on the Financial Statements. The DoD Components operating the Fund did not provide an adequate management representation letter from senior Component managers. Otherwise, in our opinion, the Principal Statements and the Notes to the Principal Statements present fairly, in all material respects, the assets, liabilities, and net financial position of the Defense Agency Trust Fund as of September 30, 1991, and the results of its operations, cash flows, and reconciliation to budget for the year then ended, in accordance with DoD accounting policies and procedures and generally accepted accounting principles.

Internal Controls. Part II contains our report on internal controls. Although we believe there is reasonable assurance that the control structure meets the internal control objectives, we noted three material internal control weaknesses requiring management attention and one lapse in internal controls requiring disclosure. Below the Deputy Secretary of Defense level, no Fund manager was responsible for all operations of the Fund. The Office of the Actuary, DoD, and the Defense Manpower Data Center had not implemented the requirements of the Federal Managers' Financial Integrity Act (FMFIA) or DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. Service

contributions to the Military Retirement Trust Fund were not independently verified against base pay by the Defense Finance and Accounting Service. Although internal controls were adequate over the retiree and annuitant payment process, we found that one annuitant was overpaid $25,000 during a 9-year period. Except for the matters noted above, we believe there is reasonable assurance that the control structure meets the internal control objectives.

Compliance with Laws and Regulations. Part III contains our report on compliance with laws and regulations. We noted in Part II, "Report on Internal Controls," that the Office of the Actuary, DoD, and the Defense Manpower Data Center had not implemented requirements of the FMFIA. Because noncompliance with laws and regulations may also represent internal control weaknesses, we give details of this issue in Part II. Except for the item noted above, we believe that the Defense Agency Trust Fund complied in all material respects with applicable laws and regulations.

Potential Benefits of Audit. Implementation of Recommendation A.1. and A.2. will ensure consistency among all DoD Components that share in the Fund's administration. Recommendation B. will ensure that the Office of the Actuary, DoD, and DMDC comply with the requirements of the FMFIA. Recommendation C. will provide verification of the Services' and National Guard contributions to the Fund. See Appendix B for a summary of the benefits of the audit.

Recommendations. We recommended that a Fund manager be appointed to take overall responsibility for Fund operations. We also recommended that the Office of the Actuary, DoD, and the Defense Manpower Data Center implement the requirements of the FMFIA and DoD Directive 5010.38. In addition, we recommended that Service contributions to the Fund be independently verified against base pay by the Defense Finance and Accounting Service.

TABLE OF CONTENTS

	Page
TRANSMITTAL MEMORANDUM	1
EXECUTIVE SUMMARY	i
PART I - Independent Auditor's Opinion on the Principal Statements of the Defense Agency Trust Fund	1
PART II - Report on Internal Controls	7
PART III - Report on Compliance with Laws and Regulations	17
PART IV - Financial Statements	21
Summary of the Military Retirement System	26
Principal Statements	30
Report on Financial Position	31
Report on Operations	34
Report on Cash Flow	36
Report on Reconciliation	37
Supporting SF 220s	38
Notes to the Principal Statements	39
Supplemental Financial and Management Information	40
PART V - Additional Information	47
Appendix A - Laws and Regulations	49
Appendix B - Summary of Potential Benefits Resulting from Audit	51
Appendix C - Activities Visited or Contacted	53
Appendix D - Report Distribution	55

This report was prepared by the Financial Management Directorate, Office of the Assistant Inspector General for Auditing, DoD. Copies of this report can be obtained from the Information Officer, Audit Planning and Technical Support Directorate, (703) 614-6303.

PART I -

INDEPENDENT AUDITOR'S OPINION ON THE PRINCIPAL STATEMENTS OF THE DEFENSE AGENCY TRUST FUND FOR FY 1991

PART I -
INDEPENDENT AUDITOR'S OPINION ON THE PRINCIPAL STATEMENTS OF THE DEFENSE AGENCY TRUST FUND

TO THE SECRETARY OF DEFENSE:

We have audited the Principal Statements and the Notes to the Principal Statements of the Defense Agency Trust Fund (the Fund) as of and for the year ended September 30, 1991. These statements consist only of the financial statements of the Military Retirement Trust Fund. These statements are the responsibility of the Assistant Secretary of Defense (Force Management and Personnel) and the Defense Finance and Accounting Service. Our responsibility is to express an opinion on these statements based on our audit.

Scope. Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and Office of Management and Budget (OMB) Bulletin No. 91-14, "Audit Requirements for Federal Financial Statements," September 10, 1991. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements and the Notes to the Principal Statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in these statements, including the notes. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall presentation of the statements. We believe that our audit provides a reasonable basis for our opinion. This financial statement audit was made during the period November 1990 through May 1992.

We requested that the Assistant Secretary of Defense (Force Management and Personnel), in coordination with the Director, Defense Finance and Accounting Service, provide a management representation letter for the period of the audit. A management representation letter confirms in writing to the auditor that the management of the Fund acknowledges responsibility for the fair presentation of the financial statements and the availability of all financial records and data; provides information that may have a material effect on the financial statements; and reduces the possibility for misunderstanding about the subject of the representations. We received a management representation letter signed by the Chief Actuary, Office of the Actuary, DoD, and the Director, DFAS - Washington Center. The management representation letter cannot be considered fully adequate because, as discussed in Part II A., the DoD lacks a senior manager who is responsible for and knowledgeable about all aspects of the Fund. Failure to provide an adequate management

representation letter is technically a scope limitation imposed by the DoD Components on the auditor.

Use of technical expert. We received assistance from the Chief Actuary, Department of Labor (DoL), who performed an independent review of the financial information prepared by the Office of the Actuary, DoD. The DoL Actuary limited his review to assessing the actuarial methods, policies, and procedures used by the Office of the Actuary, DoD, to estimate the present value of accumulated plan benefits as shown on the financial statements.

The DoL Actuary's report determined that the present value of accumulated plan benefits was formulated in accordance with generally accepted actuarial principles and that the actuarial present value of accumulated plan benefits was reasonable. We agree with the assessment of the DoL Actuary, and are not qualifying our report.

Accounting principles. Accounting principles are currently being studied by the Federal Accounting Standards Advisory Board (the Board). Generally accepted accounting principles for Federal entities are to be promulgated by the Comptroller General of the United States and the Director, OMB, based on advice from the Board. In the interim, Federal agencies are to follow the applicable accounting standards contained in agency accounting policy, procedures manuals, and related guidance. The summary of significant accounting policies included in the Notes to Principal Statements describes the accounting methods prescribed by the DoD Accounting Manual and used to prepare the financial statements.

Opinion on the financial statements. In our opinion, except for the management representation letter that was not considered fully adequate, the Principal Statements, including the Notes to the Principal Statements, present fairly, in all material respects, the assets, liabilities, and net financial position of the Defense Agency Trust Fund as of September 30, 1991, and the results of its operations, cash flow, and report on reconciliation for the year ending September 30, 1991, in accordance with DoD accounting policies and procedures and generally accepted accounting principles.

Other financial information. Our audit was conducted for the purpose of forming an opinion on the Principal Statements described above. We have reviewed the financial information in management's overview, contained in the "Summary of the Military Retirement System" and the "Supplemental Financial and Management Information" (Part IV of this report). This information is presented for the purpose of additional analysis. Such information has not been audited by us and, accordingly, we do

not express our opinion on this information. This information is addressed, however, in our "Report on Compliance with Laws and Regulations," Part III, in accordance with Section 6.a.(3), (4), and (5) of OMB Bulletin No. 91-14.

Robert J. Lieberman
Assistant Inspector General
for Auditing

PART II -

REPORT ON INTERNAL CONTROLS

PART II - REPORT ON INTERNAL CONTROLS

Introduction. We have audited the Principal Statements and the Notes to the Principal Statements contained in the Defense Agency Trust Fund as of and for the year ended September 30, 1991, and have issued our report on June 30, 1992. These statements consist only of the financial statements of the Military Retirement Trust Fund.

We noted three internal control weaknesses requiring management attention and one requiring disclosure. Below the Deputy Secretary of Defense level, no Fund manager was responsible for all operations of the Fund. The Office of the Actuary, DoD, and the Defense Manpower Data Center (DMDC) had not implemented the requirements of the Federal Managers' Financial Integrity Act (FMFIA) or DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. Service contributions to the Military Retirement Trust Fund were not independently verified against base pay. Although internal controls were adequate over the retiree and annuitant payment process, we found that one annuitant was overpaid $25,000 during a 9-year period. Except for the matters noted above, we believe there is reasonable assurance that the control structure meets the internal control objectives.

Objectives and scope. We conducted our audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and OMB Bulletin No. 91-14. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements are free of material misstatement.

In planning and performing our audit of the Principal Statements of the Fund for the year ended September 30, 1991, we considered its internal control structure. The purposes of this consideration were to determine our auditing procedures for the purpose of expressing our opinion on the principal statements, and to determine whether the internal control structure met the objectives in the preceding paragraph. This included obtaining an understanding of the internal control policies and procedures and assessing the level of control risk relevant to all significant cycles, classes of transactions, or account balances; and for those significant internal control policies and procedures that have been properly designed and placed in operation, performing sufficient tests to provide reasonable assurance that the controls are effective and working as designed.

The DoD Components that operate the Fund are responsible for establishing and maintaining internal controls. In fulfilling this responsibility, they are required to make estimates and judgments to assess the expected benefits and related costs of internal control policies and procedures. The objectives of

internal controls are to provide management with reasonable but not absolute assurance that obligations and costs are in compliance with applicable laws; that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and that revenues and expenditures applicable to the Fund are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports to maintain accountability over assets.

Prior audit coverage. General Accounting Office (GAO) Report No. AFMD-87-35, "Military Retirement System's Financial Statements for Fiscal Year 1985," August 8, 1987, reported that interest was not charged on accounts receivable for overpayments of benefits. Our audit of the FY 1991 Military Retirement Trust Fund found the same condition at the Defense Finance and Accounting Service (DFAS) - Cleveland Center (DFAS - Cleveland) and DFAS - Kansas City Center (DFAS - Kansas City). We are reporting this issue in a separate letter. GAO also noted that accounts receivable were understated by $5.8 million. Our audit did not find this condition.

Naval Audit Service Audit Report No. 059-N-90, "Navy Retired Pay Program," September 9, 1990, included two findings: the Navy Finance Center did not follow up on recoupment of Survivor Benefit Plan overpayments, and the Navy Finance Center did not adequately control processing of pay adjustments. Our audit did not find these conditions.

Internal control categories. For the purpose of this report, we classified the significant internal control policies and procedures in the following categories:

- Investments: policies, procedures, and internal controls relating to the receipt, investment, and disbursement of funds by DFAS - Washington Center.

- Payments: policies, procedures, and internal controls relating to the disbursement of funds to retirees and annuitants, accounts receivable due the Fund, and Service contributions transferred to the Fund by the DFAS Centers.

- Actuarial: policies, procedures, and internal controls relating to the preparation of the actuarial projections by the Office of the Actuary, DoD, including the present value of accumulated plan benefits and changes in the present value of accumulated plan benefits.

Reportable conditions. We noted conditions in the internal control structure and its operation that we consider to be reportable under standards established by the American Institute of Certified Public Accountants (AICPA) and OMB Bulletin No. 91-14. Reportable conditions are significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's

ability to ensure that obligations and costs are in compliance with applicable law; that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and that revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports to maintain accountability over assets.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure element does not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. The condition described in C., "Verification of Contributions to the Military Retirement Trust Fund," is considered a material weakness. Except for the matters noted below, we believe there is reasonable assurance that the control structure meets the internal control objectives.

We also noted other matters involving the internal control structure and its operation that are not material to our opinion on the Fund's financial statements. We will report these matters to the applicable DoD Components in a separate letter.

The audit disclosed three reportable conditions that warrant management attention and one lapse in controls requiring disclosure. The three conditions are material weaknesses as defined by DoD Directive 5010.38.

A. Military Retirement System Fund Manager

The Fund did not have a designated manager below the Deputy Secretary of Defense level. Several DoD Components, including the Assistant Secretary of Defense (Force Management and Personnel) (ASD[FM&P]), various Centers of the Defense Finance and Accounting Service, and the Military Departments each performed different functions in the administration of military retirement benefits. None of the DoD Components had overall responsibility for administering the Fund. Sound management practices dictate that a single office be responsible for administering the retirement system. The retirement system consists of the various DoD Components that operate the Fund. Because responsibility was shared among several DoD Components, no central management existed to resolve differences and ensure equitable treatment among retirees and annuitants.

Background. The military retirement system is a noncontributory pension plan for members of the Army, Navy, Air Force, and Marine Corps who meet certain eligibility requirements. Several DoD Components participate in managing the retirement system. Responsibilities within the ASD(FM&P) include retirement pay, maintaining personnel data bases (the Defense Manpower Data Center), and providing actuarial data for the Fund's financial statements (Office of the Actuary, DoD). DFAS performs several functions, including management of the Fund's assets, establishing and controlling payments to retirees and annuitants, collecting accounts receivable from retirees and annuitants, and transferring Service contributions to the Fund.

Control environment. An internal control structure consists of the control environment, the accounting system, and the control procedures. AICPA Statement on Auditing Standards No. 55, "Consideration of the Internal Control Structure in a Financial Statement Audit," states, "The control environment reflects the overall attitude, awareness, and actions of the ... management, owners, and others concerning the importance of control and its emphasis in the entity." The control environment is represented by management, and is the focal point for the organization and the internal control structure.

Discussion of detail. The lack of a Fund manager created differing management policies and procedures at the DFAS Centers, and left a void as to who was responsible for the Fund. For example, contributions to the Fund from the Services and National Guard Bureaus were not verified against base pay. Each Service and National Guard Bureau calculated a monthly contribution amount based on a preset formula. We found over- and undercontribution errors of several million dollars. Although the dollar amounts were not material to the financial statements of the Fund, we believe that improved controls are necessary, since the contributions were substantial. Without a designated Fund manager, responsibility for verifying contributions was not assigned to any of the activities that operate the Fund. Section C. of this report gives details of the problem with verification.

Because an overall Fund manager did not exist, we attempted to determine who was responsible for preparing and submitting a management representation letter. AICPA Statement on Auditing Standards No. 19, "Client Representations," recommends that the representation letter be signed by "... members of management whom the auditor believes are responsible and knowledgeable, directly or through others in the organization, about matters covered by the representations. Normally, the chief executive officer and the chief financial officer should sign the representations." Since the ASD(FM&P) and the Director, DFAS, most closely parallel the chief executive officer and the chief financial officer for the Fund, we requested that they provide us with a management representation letter. The request led to confusion as to who was responsible for providing the letter. We

took this issue to the Chief Financial Officer, DoD, for resolution. Although we received a management representation letter signed by the Chief Actuary, Office of the Actuary, DoD, and the Director DFAS - Washington Center, we do not believe they are responsible for representing all aspects of the Fund. Without an adequate management representation letter, our opinion had to be qualified.

Several DoD Components worked together to accomplish the goals of the Fund. However, when overall direction was needed, no Fund manager was available to resolve the issues.

Recommendations

1. We recommend that the Comptroller, DoD, and the Assistant Secretary of Defense (Force Management and Personnel) identify a Fund manager to be responsible for the overall management of the Fund to ensure consistency among all DoD Components that share in the Fund's administration; and forward this recommendation to the Deputy Secretary of Defense for his action.

2. We recommend that the Deputy Secretary of Defense appoint a manager of the Military Retirement Trust Fund.

B. Federal Managers' Financial Integrity Act Reviews

The Office of the Actuary, DoD, and the Defense Manpower Data Center (DMDC) had not implemented an internal control program as required by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. This occurred because the ASD(FM&P) had not sufficiently emphasized the requirements of the internal control program. As a result, the program was not conducted in accordance with OMB and DoD guidelines for evaluating, improving, and reporting on internal control systems in the Federal Government. This condition represented an internal control weakness and noncompliance with laws and regulations.

Background. DoD Directive 5010.38 requires each DoD Component to establish an internal management control (IMC) program. The IMC program is the organization, methods, and procedures adopted by management to provide reasonable assurance that the objectives of United States Code, title 31, sec. 3512 (FMFIA) are met. These policies and procedures require Federal managers to implement internal management controls to provide reasonable assurance that assets are used properly and programs are effectively and efficiently managed.

Discussion of detail. Our review of the internal control structure at the Office of the Actuary, DoD, and the Defense Manpower Data Center determined that an IMC program had not been implemented by either office. The FMFIA coordinator for the ASD(FM&P) could not provide documentation that IMC reviews were

performed in these offices. DoD Directive 5010.38 requires management at all levels to be involved in the IMC program. This directive also requires that DoD managers receive training in their IMC responsibilities and obligations.

Our review did not disclose any other internal control weakness at the Office of the Actuary, DoD, or DMDC. We believe that internal controls are adequate at these offices. However, by implementing the requirements of the FMFIA and DoD Instruction 5010.38, the Office of the Actuary, DoD, and DMDC can ensure that internal controls remain adequate and comply with laws and regulations.

Recommendation. We recommend that the Assistant Secretary of Defense (Force Management and Personnel) implement the requirements of the Federal Managers' Financial Integrity Act and DoD Directive 5010.38 for the Office of the Actuary, DoD, and the Defense Manpower Data Center.

C. Verification of Contributions to the Military Retirement Trust Fund

The Services and the National Guard made over- and undercontributions to the Fund. This occurred because internal controls had not been established to verify Service and National Guard contributions due the Fund. In FY 1991, the Services and the National Guard made a net overcontribution to the Fund of $26.8 million out of total contributions of $17.2 billion. Although $26.8 million was not material to the financial statements, we believe that the establishment of adequate internal controls is necessary to prevent material errors.

Background. The Fund receives revenues from three sources: monthly contributions from the Services to fund current pension costs; annual payments from the United States Treasury to fund the prior unfunded liability over a period of 60 years; and interest earned on investments in Treasury securities. The monthly contributions are based on the normal cost percentages determined by the Office of the Actuary, DoD, multiplied by the amounts of base pay accrued by the Services. ("Normal cost" is an actuarial term referring to the Services' monthly contributions necessary to fund future pension benefits.) Contributions are transferred monthly by the Services or DFAS Centers to the Fund. The normal cost percentage for active duty personnel in 1991 was 43.3 percent, and the reserve and part-time National Guard percentage was 13.3 percent.

Discussion of detail. Each month, military base pay is accrued by the Services or DFAS Centers. These accruals are then multiplied by the applicable normal cost percentage, and a contribution is transferred to the Fund. Our analysis of each of the Services' contributions indicated the need for internal

controls to verify contributions against base pay. The 1991 contributions by Service were as follows:

RETIRED PAY ACCRUALS BY SERVICE

Service	Amount Contributed ($ millions)	Audit Amount ($ millions)	Difference ($ millions)
Army			
Active Duty & Reserve	$6,214.0	$6,224.4	($10.4)
Army National Guard	422.7	398.5	24.2
Navy	4,486.8	4,483.5	3.3
Air Force			
Active Duty	4,493.2	4,487.2	6.0
Air National Guard & Reserve [1/]	116.2	114.0	2.2
Marine Corps	1,442.5	1,441.0	1.5
Totals	$17,175.4 [2/]	$17,148.6	$26.8

[1/] Analysis for the Air National Guard & Reserve is for 7 months due to lack of supporting documentation.
[2/] The $17.4 million difference from the financial statement is due to prior period adjustments and contributions that we did not review because they were not material.

The variances shown indicate that over- and undercontributions to the Fund are common. Without internal controls to verify the amounts due the Fund, DoD managers could manipulate funds within Military Personnel accounts (the source of monthly Service contributions), which could affect budget estimates. In addition, the United States Treasury incurs additional interest costs to finance overcontributions to the Fund.

Gains and losses experienced by the Fund are factored into the annual Treasury contribution. The net overcontribution to the Fund in FY 1991 would be considered a gain to the Fund and would cause a reduction to the Treasury contribution in FY 1992. DoD has paid part of the cost normally paid by the United States Treasury for the Fund's unfunded liability. The overcontribution needlessly reduces DoD's Military Personnel pay accounts, and these funds could be better used for other programs.

Recommendation. We recommend that the Director, Defense Finance and Accounting Service, establish procedures to verify the Services' and National Guard contributions to the Fund.

D. Retiree and Annuitant Payments

Our substantive testing of the payment process found one annuitant, out of 160 retirees and 80 annuitants tested, who was overpaid a total of $25,000 over a 9-year period. Although internal controls did not detect this error, we believe that internal controls over the payment process are adequate.

In 1983, a reserve retiree died before collecting retirement pay at age 60. The surviving spouse, who should have received approximately 55 percent of the retiree's retirement pay, received 100 percent. The internal controls in this area consisted of a reviewer, who checked the computations of a preparer, and periodic review by supervisors. In this case, the preparer and reviewer failed to detect the error.

Although internal controls were in place, they were subject to error. We are presenting this condition for information purposes only. Based on our sample results, this was the only error found. We believe the internal controls are reasonable if properly implemented; therefore, we do not recommend changes to the system.

PART III -

REPORT ON COMPLIANCE WITH

LAWS AND REGULATIONS

PART III - REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Introduction. We have audited the Principal Statements and the Notes to the Principal Statements contained in the Defense Agency Trust Fund as of and for the year ended September 30, 1991, and have issued our report on June 30, 1992. These statements consist only of the financial statements of the Military Retirement Trust Fund.

Objectives and scope. We conducted our audit in accordance with generally accepted Government auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and OMB Bulletin No. 91-14. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements are free of material misstatement.

Compliance with laws and regulations applicable to the Fund are the responsibility of the ASD(FM&P) and the Director, DFAS. As part of obtaining reasonable assurance about whether the Principal Statements are free of material misstatement, we tested compliance with laws and regulations that may directly affect the financial statements, and with certain other laws and regulations designated by OMB and DoD (Appendix A). As part of our audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems as required by the FMFIA and compared the entity's most recent FMFIA reports with our evaluation of the internal control system. We also reviewed and tested the entity's policies, procedures, and systems for documenting and supporting financial, statistical, and other information presented in the overview of the Fund, which consists of the "Summary of the Military Retirement System" and the "Supplemental Financial and Management Information," (Part IV of this report). However, our objective was not to provide an opinion on overall compliance with such provisions.

Results of Review. The results of our tests indicate that with respect to the items tested, except for noncompliance with the FMFIA, as described in Part II of this report, "Report on Internal Controls," the Fund complied in all material respects with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the DoD Components operating the Fund had not complied in all material respects with the provisions identified above.

PART IV -

FINANCIAL STATEMENTS OF THE

DEFENSE AGENCY TRUST FUND

Note: Blank pages in the Defense Agency Trust Fund financial statements were omitted from this report.

Department of Defense

Defense Agency Trust Fund

Fiscal Year 1991

Financial Statements

OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

JUN 26 1992

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DODIG

SUBJECT: Transmittal of the final Defense Industrial Fund (Communications Services Activity) and DoD Retirement Trust Fund Financial Statements on FY 1991 Financial Activity

The attached Defense Industrial Fund (Communications Services Activity) and DoD Military Retirement Trust Fund financial statements on FY 1991 financial activity are submitted for inclusion in your June 30, 1992, audit reports as required by the Chief Financial Officers Act of 1990.

The Defense Industrial Fund (Communications Services Activity) financial statements incorporate our agreed upon corrections and adjustments to the financial statements submitted for audit on March 10, 1992.

The DoD Military Retirement Trust Fund financial statements includes the actuarial liability for the pension plan as of September 30, 1991. The financial statements were initially submitted for audit on February 25, 1992, and contained actuarial liabilities as of September 30, 1990.

I appreciate the cooperative effort exhibited by you and your staff in the audit of these financial statements and will work to sustain the same level of cooperative effort in the future.

Alvin Tucker
Deputy Chief Financial Officer

Attachments

cc: Assistant Secretary of Defense (Force Management & Personnel)(Requirements & Resources)
Defense Information Systems Agency
Defense Finance and Accounting Service

TABLE OF CONTENTS

Defense Agency Trust Fund ——— 5

Fiscal Year 1991 Financial Statements

- **Principal Statements** ——— 11
- **Supporting SF 220's** ——— 19
- **Notes to the Principal Statements** ——— 29

Supplemental Financial and Management Information ——— 33

SUMMARY OF THE MILITARY RETIREMENT SYSTEM as of September 30, 1991

OVERVIEW:

The military retirement system applies to 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 retirements.

There are three distinct nondisability benefit formulas (relevant to three distinct 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%) times (years of service) and is limited to 75%. 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%. 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%) 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%) times (years of service, rounded down to the nearest month) and is limited to 75%. 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 under 30. For example, the multiplier for a 20-year retiree would be 40% (50% minus 10%). At age 62, the penalty is removed and the retired pay is restored.

In FY91, 1.18 million nondisability retirees from active duty were paid $19 billion.

DISABILITY RETIREMENT:

A disabled military member is entitled to disability retired pay if the disability is at least 30% (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% 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 disability 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% of base pay.

In FY91, 132,000 disability retirees were paid $1.51 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%) 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. In effect, the retired pay of any member who entered the Armed Forces on or after September 8, 1980, and who later separates from a reserve component before turning 60 is based on active duty pay at the time of separation.

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 FY91, 187,000 reserve were paid $1.69 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% 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. However, no fund was involved.

Since September 21, 1972, RSFPP has been 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% 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% of the base amount. Prior to the enactment of the two-tier benefit, the survivor annuity was integrated with Social Security. SBP participants and active and reserve personnel with at lease 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.

During FY 87 a change was made to the SBP that increased benefits for survivors. Prior to FY 87, a widow remarrying before age 60 lost her survivor annuity. The age after which there is no loss of benefits to a surviving spouse who remarries has been reduced from age 60 to 55.

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 veteran's survivor benefits and all premiums relating to the reductions are returned to the widow. Additionally, SBP annuities are annually increased with cost-of-living adjustments (COLAs). These COLAs may be based on full or partial Consumer-Price Index increases, depending on when the member fist 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 apply to survivor coverage after the reservist reaches age 60 (when the reservist begins to receive retired pay). A second set of optional reductions (funded by the member only) extends this coverage to reservists who have enough service to retire, but have not attained age 60. The added cost of the pre-age 60 coverage is deducted from the member's retired pay and the survivor's annuity.

In FY 91, 172,000 surviving families were paid $1.03 billion.

COST OF LIVING I NCREASES:

All nondisability retirement, disability retirement, and most survivor annuities are adjusted annually for inflation. Cost-of-living adjustments (COLA) 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 increase effective December 1st is computed by calculating the percentage increase in the Consumer Price Index 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 1/10 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%. A onetime 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 VETERANS ADMINISTRATION BENEFITS:

The Veterans Administration (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 Dependence and Indemnity Compensation (DIC) program. DIC is payable to survivors of veterans who died from Service-connected causes. A reduction of this amount is made to the SBP annuity; however, all premiums relating to the reductions are returned to the widow.

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 Scheduled.

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 or private sectors. Reasonable comparisons can be made, however, to basic military compensation (BMC) or regular military compensation (RMC). BMC is the sum of basic pay, the quarters allowance (either cash or in kind), a subsistence allowance (either cash or in kind), and the Federal tax advantages accruing to allowances, since they are not subject to Federal income tax. RMC is BMC plus the average variable housing allowance (which varies by location) and the additional tax advantage it brings. Basic pay represents approximately 77% of BMC or 73% of RMC for all retirement eligibles. For the 20-year retiree, basic pay is approximately 76% of BMC or 71% of RMC. Consequently, a 20-year retiree may be entitled to 50% of basic pay, but only 38% of BMC or 35% of RMC. For a 30-year retiree the corresponding entitlements are 75% of basic pay but only 60% of BMC or 56% of RMC. These relationships should be considered when military retired pay is compared to compensation under other retirement systems.

Department of Defense
Defense Agency Trust Fund

FINANCIAL STATEMENTS
FOR FISCAL YEAR 1991

11

SF 220

REPORT ON FINANCIAL POSITION
as of September 30, 1991

Identification:
Department/Agency: **Department of Defense**
Bureau/OrganizationalUnit: **Defense Agency Trust Fund**
OMB Identification Code: **Principal Statements**
Basis Used:

ASSETS		Total
1. Fund Balance with Treasury and Cash		
a. Fund Balance	28,256	
b. Cash		
c. Foreign Currency, Net		
d. Subtotal		28,256
2. Accounts Receivable		
a. Federal Agencies		
1. Current	3,285,565,830	
2. Noncurrent		
b. Public		
1. Current	27,881,910	
2. Noncurrent		
c. Less: Allowances		
d. Subtotal		3,313,447,740
3. Advances and Prepayments		
a. Federal Agencies		
b. Public		
c. Subtotal		
4. Inventories		
a. Operating consumables		
b. Product or Service Components		
c. Stockpiled materials		
d. Other		
e. Subtotal		
5. Investments, Net		
a. Federal Securities	90,422,006,797	
b. Non-Federal Securities		
c. Other-Public Securities		
d. Subtotal		90,422,006,797
6. Loans Receivables		
a. Federal Agencies		
1. Current		
2. Noncurrent		
b. Public		
1. Current		
2. Noncurrent		
c. Less: Allowances		
d. Subtotal		

12

SF 220

REPORT ON FINANCIAL POSITION
as of September 30, 1991

Bureau/Organizational Unit:

ASSETS Continued		**Total**
7. Property, Plant, and Equipment, Net		
a. Structures, Facilities, and Leasehold Improvements		
b. Military Equipment		
c. ADP Software		
d. Equipment		
e. Assets Under Capital Lease		
f. Other		
g. Construction-in-Progress		
h. Land		
i. Allowances		
j. Subtotal		
8. Other Assets		
a. Acquired Collateral		
b. Deferred Exp from Cap Lease		
c.		
d. Other		
e. Subtotal		
9. TOTAL ASSETS		93,735,482,793
LIABILITIES		
10. Accounts Payable		
a. Federal Agencies		
b. Public	2,028,042,903	
c. Subtotal		2,028,042,903
11. Interest Payable		
a. Federal Agencies		
b. Public		
c. Subtotal		
12. Accrued Payroll and Benefits		
13. Accrued Unfunded Annual Leave		
14. Unearned Revenue (Advances)		
a. Federal Agencies		
b. Public		
c. Subtotal		
15. Deposit Funds		
16. Debt Issued Under Borrowing		
a. Gross Federal Debt		
b. Intragovernmental Debt		
c. Other Debt		
d. Subtotal		
17. Actuarial Liabilities		
a. Pension Plans	525,800,000,000	
b. Insurance and Annuity Programs		
c. Subtotal		525,800,000,000

13

SF 220

REPORT ON FINANCIAL POSITION
as of September 30, 1991

Liabilities Continued		Total
18. Other Liabilities		
a. Death Payment Contingency	119,234	
b.		
c.		
d.		
e.		
f. Subtotal		119,234
19. TOTAL LIABILITIES		527,828,162,137
EQUITY		
Appropriated Fund Equity		
20. Unexpended Financed Budget Authority		
a. Unexpended Appropriations		
b. Less: Unfilled Customer Orders		
c. Subtotal		
21. Invested Capital		
Revolving Fund Equity		
22. Revolving Fund Balance(s)		
a. Appropriated Capital		
b. Cumulative Results		
c. Donations		
d. Subtotal		
Trust Fund Equity		
23. Trust Fund Balances		-434,092,679,344
24. TOTAL EQUITY		-434,092,679,344
25. TOTAL LIABILITIES AND EQUITY		93,735,482,793

AGENCY CONTACTS	
1. Preparer's Name **Robert A. Bateman**	2. Telephone No. **(703) 607-1090**
3. Address **DFAS-Washington Center** **Operations Directorate** **Washington DC 20376-5001**	
4. Supervisor's Name **Christine D. Johnson**	5. Telephone No. **(703) 607-1090**

14

SF 221

REPORT ON OPERATIONS
for the year ended September 30, 1991

Bureau/Organizational Unit: **Defense Agency Trust Fund**
OMB Identification Code: **Principal Statements**

REVENUES AND FINANCING SOURCES		
1. Appropriated Capital Used		
2. Revenue		
a. Federal Sources	27,974,768,279	
b. Public Sources		
c. Subtotal		27,974,768,279
3. Government receipts		
4. Other		
a. Interest Revenue Approp/Fund & Govt	8,491,832,716	
b. Interest Revenue Approp/Fund & NonGovt		
c. Gains		
d. Other		
e. Subtotal		8,491,832,716
5. Less: Receipts Returned to Treasury		
6. Total Financing Sources		36,466,600,995
OPERATING EXPENSES		
7. Cost of Goods Sold		
8. Operating/Program Expenses, Funded		23,241,017,939
9. Interest Expense, Funded		
a. Federal Financing Bank/ Treasury Borrowings		
b. Federal Securities		
c. Other		
d. Subtotal		
10. Other Funded Expenses		
a. Loss on Disposition of Assets		
b. Inventory Losses		
c. Investment Losses		
d. Other Losses (Loss on Securities Sold)	24,681	
e. Subtotal		24,681

15

SF 221

REPORT ON OPERATIONS
for the year ended September 30, 1991

Bureau/Organizational Unit:

NET RESULTS		Total
11. Unfunded Expenses		
12. Total Operating Expenses		23,241,042,620
13. Net Results Before Adjustments		13,225,558,375
14. Less: Capital Expenditures		
15. Less Extraordinary Items		3,079
16. Net Results		13,225,555,296

AGENCY CONTACTS	
1. Preparer's Name **Robert A. Bateman**	2. Telephone No. **(703) 607-1090**
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4. Supervisor's Name **Christine D. Johnson**	5. Telephone No. **(703) 607-1090**

16
SF 222

REPORT ON CASH FLOW
for the year ended September 30, 1991

Bureau/Organizational Unit: **Defense Agency Trust Fund**
OMB Identification Code: **Principal Statements**
Basis Used:

Description		Total
1. Fund balance with Treasury and cash, beginning of period (PY SF 220)		10,541,334
2. Sources of funds:		
a. Increase in debt		
b. Appropriations		
c. Revenue	27,974,768,279	
d. Sale of assets		
e. Increase in payables	151,701,933	
f. Decrease in receivables and advances	-450,738,730	
g. Interest Income	8,491,832,716	
h. Total		36,167,564,198
3. Application of funds:		
a. Operating expenses (SF 221)	23,241,042,620	
b. Less: Expenses not requiring outlays (SF 221)		
c. Increase in investments	12,937,034,656	
d. Increase in inventory		
e. Purchase of property, plant and equipment		
f. Other		
g. Total		36,178,077,276
4. Fund balance with Treasury and cash, end of period (SF 220)		28,256

AGENCY CONTACTS	
1. Preparer's Name **Robert A. Bateman**	2. Telephone No. **(703) 607-1090**
3. Address **DFAS-Washington Center** **Washington DC 20376-5001**	
4. Supervisor's Name **Christine D. Johnson**	5. Telephone No. **(703) 607-1453**

17

SF 223

REPORT ON RECONCILIATION
for the year ended September 30, 1991

Bureau/Organizational Unit: **Defense Agency Trust Fund**
OMB Identification Code: **Principal Statements**
Basis Used:

Description	Total
1. Total operating expenses (SF 221)	23,241,042,620
2. Adjustments:	
Add:	
a. Capital expenditures	
b. Increase (decrease) in inventories	
Deduct:	
a. Increase (decrease) in accounts payable	150,127,843
b. Accrued expenses not requiring outlays	24,680
3. Total gross disbursements	23,090,890,097
4. Less: Offsetting collections credited	
5. Net disbursements	23,090,890,097

AGENCY CONTACTS	
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4. Supervisor's Name **Christine D. Johnson**	5. Telephone No. **(703) 607-1453**

Supporting SF 220's

19

Note: The Supporting SF 220's are omitted from this report because they duplicate the Principal Statements.

NOTES TO THE PRINCIPAL STATEMENTS
DOD MILITARY RETIREMENT TRUST FUND
FISCAL YEAR ENDING SEPTEMBER 30, 1991

1. Summary of Significant Accounting Policies

A. DoD Military Retirement Trust Fund. The accounting for the Trust Fund is accomplished by the Defense Finance and Accounting Service - Washington Center (DFAS-WC). Reports are prepared from Trial Balance data generated by an automated system which is on the accrual basis. Trust Fund balances are reconciled monthly with balances in U.S. Treasury records.

B. Revenue on line 2.a. of the Standard Form 221 consists of $10,782,000,000.00 paid from the General Fund of Treasury which is the amount required for FY 1991 to amortize the unfunded liability and Military Service contributions of $17,192,667,114.37. Service contributions are computed at 43.3% of base pay for full time members and 13.3% of base pay for part time members.

2. Accounts Receivable

Accounts receivable on line 2.a.1, of the Standard Form 220 includes accrued interest receivable on Federal Securities of $3,232,179,935.86 and accrued interest purchased of $53,385,893.97.

3. Investments Net

Investments on line 5.a. of the Standard Form 220 is amortized book value of Federal Securities held. Yields and amortization of securities are computed on the Effective Interest Method. Market value of investments as of September 30, 1991 is $102,906,262,961.37. Total face amount of investments held (United States Treasury Notes and Bonds) for same date is $76,055,694,000.00. Interest rates range from 10% to 15.75%. Effective yield on these securities range from 7.809% to 12.495%.

The securities purchased by the DoD Military Retirement Fund are U.S. Treasury non-marketable, market-based special issues. These securities are issued exclusively to the fund, registered in the name of the Fund, on the books of Treasury and not bought or sold on the open market. They mirror U.S. Treasury issues (carry the same interest rate and maturity date) and are bought and sold at current market prices. The yield is subject to market fluctuations.

4. Actuarial and Retirement Liabilities

Actuarial liabilities are based upon aggregate entry-age normal cost funding method. The three key assumptions used in this method consist of a COLA increase of 5%, a salary increase of 5.75% and an interest rate of 7%.

SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

TABLE 1

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

	For the Plan Year Ended:	
ASSETS:	Sept 30, 1991	Sept 30, 1990
Investments, at fair market value U.S. Government securities [1]	$102,906,263	$80,903,790
Accounts receivable Accrued interest [2]	$3,285,566	$2,836,401
Due from Military Retirees or their Survivors	$27,882	$26,308
Cash	$10,528	$10,541
Total Assets	$106,219,739	$83,777,040
Accounts Payable [3]	$2,028,043	$1,876,341
Total Assets Available for Benefits	$104,191,696	$81,900,699

[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, 1991.

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

[3] The statement has been revised to show the liabilities for benefit payments due retirees and survivors.

TABLE 2

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

	For the Plan Year Ended: Sept 30, 1991	Sept 30, 1990
Net Assets avail. for benefits at beginning of plan year	$81,900,699	$73,170,081
Investment income		
Interest	$8,951,216	$7,823,180
Net apprec. (deprec.) in fair market value of investment [1]	$8,606,030	($ 4,347,719)
Contributions		
From services	$17,192,667	$16,323,726
Appropriation to amortize unfunded liability	$10,782,000	$10,596,000
Transfer from Office of Personnel Management	$10	0
Total additions	$45,532,015	$30,395,188
Benefits paid to participants [2]	$23,241,018	$21,664,570
Net assets available for benefits at end of plan year	$104,191,696	$81,900,699

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

	PY 1991	PY 1990
(Depreciated) Appreciated Fair Value	$9,065,439	($3,870,733)
over Book Value	568	12,617
Amortized Discount	(459,952)	(489,972)
Amortized Premium	(25)	369
Gain (Loss) on Sale	8,606,030	($4,347,719)

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

	PY 1991	PY 1990
Benefits paid on cash basis	$23,089,316	$21,537,436
Increase in liability for benefits due at end of year	151,702	127,134
Benefits paid on accrual basis [1]	$23,241,018	$21,664,570

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 the survivors, (b) current survivors, (c) present active duty personnel and nonretired Reservists or their survivors. Benefits payable under all circumstances (retirements, disability, and survivor) are included to the extent that 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.

TABLE 3

DEPARTMENT OF DEFENSE
MILITARY RETIREMENT FUND
STATEMENT OF ACCUMULATED PLAN BENEFITS
($ in billions)

	For The Plan Year Ended: Sept 30, 1991	Sept 30, 1990
ACCUMULATED PLAN BENEFITS [1]		
Actuarial present value of vested benefits		
Participants currently receiving payments [2]	$389.6	$367.5
Other vested participants	$64.0	$60.7
Total vested	$453.6	$428.2
Actuarial present value of nonvested benefits	$72.2	$69.0
Total actuarial present value of accumulated plan benefits	$525.8	$497.2
TOTAL ASSETS [2]	$106.2	$83.8
EXCESS OF ACCUMULATED BENEFITS OVER NET ASSETS:	$419.6	$413.4

[1] See definition of accumulated plan benefits on preceding page.

[2] Total assets are reported in this table because the liability for benefit payments due is included in the actuarial present value of benefits for participants currently receiving payments.

TABLE 4

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

	For The Plan Year Ended: Sept 30, 1991	Sept 30, 1990
1. Actuarial present value of accumulated plan benefits at beginning of plan year	$497.2	$468.3
2. Increase (decrease) during the year [1] attributable to:		
a. Benefits accumulated and actuarial gain (loss)	$28.6	$28.9
b. Plan amendment(s)	$0.0	$0.0
c. Changes in actuarial assumptions	$0.0	$0.0
3. Net increase	$28.6	28.9
4. **Actuarial present value of plan benefits at end of year**	$525.8	$497.2

[1] The assumed order of occurrence was: (1) plan amendments, (2) changes in actuarial assumptions, and (3) benefits accumulated and actuarial gain (loss).

PART V - ADDITIONAL INFORMATION

APPENDIX A - Laws and Regulations

APPENDIX B - Summary of Potential Benefits Resulting from Audit

APPENDIX C - Activities Visited or Contacted

APPENDIX D - Report Distribution

APPENDIX A. LAWS AND REGULATIONS

Uniformed Services Contingency Option Act of 1953, P.L. 83-239
Armed Forces-Retired Pay Act of 1961, P.L. 87-381
Uniform Services Pay Act of 1963, P.L. 88-132
Dual Compensation Act of 1964, P.L. 88-448
Survivor Benefit Plan Act of 1972, P.L. 92-425
Civil Service Reform Act of 1978, P.L. 95-454
Personnel Management Act of 1981, P.L. 96-513[1/]
Federal Managers' Financial Integrity Act of 1982, P.L. 97-255
Debt Collection Act of 1982, P.L. 97-365
Department of Defense Authorization Act of 1983, P.L. 98-94[2/]
Omnibus Budget Reconciliation Act of 1983, P.L. 98-270[3/]
Deficit Reduction Act of 1984, P.L. 98-369[4/]
Public Debt Limit-Balanced Budget & Emergency Deficit Control Act of 1985, P.L. 99-177
Chief Financial Officers Act of 1990, P.L. 101-576
Title 2 of the General Accounting Office's "Policies and Procedures Manual for Guidance of Federal Agencies"
OMB Bulletin No. 91-15, "Guidance on Form and Content of Financial Statements on FY 1991 Financial Activity," September 10, 1991
DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987
DoD Instruction 7220.9, "DoD Accounting Policy," October 1981
DoD Manual 7220.9-M, "DoD Accounting Manual"

1/ Changed computation method to high 36 months' pay.
2/ Established the Military Retirement Trust Fund.
3/ Current provision for yearend cost of living allowance.
4/ Made entitlements payable at beginning of the month.

APPENDIX B. SUMMARY OF POTENTIAL BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Type of Benefit
A.1.,A.2.	Internal control. Ensures consistency among all DoD Components that share in the Fund's administration.	Nonmonetary.
B.	Compliance with laws and regulations. Provides reasonable assurance that the objectives of the FMFIA are met.	Nonmonetary.
C.	Internal control. Provides verification of the Services' and National Guard contributions to the Fund.	Nonmonetary.

APPENDIX C. ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Office of the Assistant Secretary of Defense (Force Management and Personnel), Washington, DC
- Deputy Assistant Secretary of Defense (Military Manpower and Personnel Policy), Washington, DC
- Defense Manpower Data Center, Arlington, VA
- Defense Manpower Data Center, Monterey, CA
- Office of the Actuary, DoD, Arlington, VA

Deputy Comptroller of the Department of Defense, (Program/Budget), Washington, DC

Headquarters, Defense Finance and Accounting Service, Washington, DC
- Defense Finance and Accounting Service - Washington Center, Arlington, VA
- Defense Finance and Accounting Service - Cleveland Center, Cleveland, OH
- Defense Finance and Accounting Service - Denver Center, Denver, CO
- Defense Finance and Accounting Service - Indianapolis Center, Indianapolis, IN
- Defense Finance and Accounting Service - Kansas City Center, Kansas City, MO

Department of the Army

Army Comptroller Division, National Guard Bureau, Washington, DC

Comptroller Division, Office of the Chief of Army Reserve, Washington, DC

Army Reserve Personnel Center, St. Louis, Missouri

Army Enlisted Records Center, Fort Benjamin Harrison, Indiana

Army Guard Personnel Center, Alexandria, VA

Offices of the Adjutant General
- State of Texas, Texas Army Guard, Austin, TX
- State of Colorado, Colorado Army Guard, Englewood, CO
- State of Maryland, 1-115th Infantry Battalion, Greenbelt, MD
- State of Indiana, Indiana Army Guard, Indianapolis, IN
- State of Virginia, Virginia Army Guard, Richmond, VA
- State of Missouri, 880th Engineering Battalion, Jefferson Barracks, MO

APPENDIX C. ACTIVITIES VISITED OR CONTACTED (cont'd)

Department of the Navy

Bureau of Naval Personnel, Arlington, VA
Naval Reserve Personnel Center, New Orleans, LA
Deputy Chief of Staff for Finance, Naval Reserve Force, Budget Division, New Orleans, LA
Manpower and Reserve Affairs, Personnel Management Division, Quantico, VA

Air Force

Air Force Military Personnel Center, San Antonio, TX
Air Force Reserve Personnel Center, Denver, CO

Marine Corps

Headquarters, Marine Corps, Arlington, VA

Non-DoD Activities

National Personnel Records Center, St. Louis, MO

APPENDIX D. REPORT DISTRIBUTION

Office of the Secretary of Defense

Secretary of Defense
Deputy Secretary of Defense
Comptroller and Chief Financial Officer of the Department of Defense
Assistant Secretary of Defense (Force Management and Personnel)
Assistant Secretary of Defense (Public Affairs)
Assistant Secretary of Defense (Reserve Affairs)
Deputy Chief Financial Officer of the Department of Defense
Director for Administration and Management, Department of Defense

Department of the Army

Auditor General, U.S. Army Audit Agency
Department of the Army, Inspector General
Chief, Army Comptroller Division, National Guard Bureau
Chief, Comptroller Division, Army Reserve

Department of the Navy

Assistant Secretary of the Navy (Financial Management)
Comptroller of the Navy
Director, Naval Audit Service
Deputy Chief of Staff for Finance, Naval Reserve Force

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, U.S. Air Force Audit Agency

Defense Agencies

Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service - Cleveland Center
Director, Defense Finance and Accounting Service - Denver Center
Director, Defense Finance and Accounting Service - Indianapolis Center
Director, Defense Finance and Accounting Service - Kansas City Center

Non-DoD Federal Organizations

Office of Management and Budget
U.S. General Accounting Office
NSIAD Technical Information Center

APPENDIX D. REPORT DISTRIBUTION (cont'd)

Chairmen and Ranking Minority Members of the following Congressional Committees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Subcommittee on Manpower and Personnel, Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Subcommittee on Military Personnel and Compensation, Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations

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