Audit Report

INSPECTOR GENERAL, DOD, OVERSIGHT OF THE
AUDIT OF THE MILITARY RETIREMENT FUND
FINANCIAL STATEMENTS FOR FY 1999

Report No. D-2000-085 February 15, 2000

Office of the Inspector General
Department of Defense

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Acronyms

DFAS	Defense Finance and Accounting Service
GAO	General Accounting Office
MRF	Military Retirement Fund
OMB	Office of Management and Budget

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

February 15, 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER
UNDER SECRETARY OF DEFENSE (PERSONNEL AND READINESS)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE INFORMATION SYSTEMS AGENCY

SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Audit of the Military Retirement Fund Financial Statements for FY 1999 (Report No. D-2000-085)

We are providing this audit report for your information and use and for transmittal to the Director, Office of Management and Budget. It includes our endorsement of the unqualified opinion expressed by Deloitte & Touche LLP on the Military Retirement Fund Financial Statements for FY 1999. We have also included the "Department of Defense Military Retirement Fund Annual Financial Report, Fiscal Year 1999." It also includes the reports issued by Deloitte & Touche LLP: the "Independent Auditors' Report" and the "Independent Auditors' Report on Internal Control Over Financial Reporting and Compliance Based Upon the Audit Performed in Accordance With Government Auditing Standards." An audit of the Military Retirement Fund Financial Statements for FY 1999 is required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. David F. Vincent at (703) 604-9109 (DSN 664-9109) (dvincent@dodig.osd.mil) or Mr. Thomas J. Winter at (703) 604-9134 (DSN 664-9134) (twinter@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2000-085 **February 15, 2000**
(Project No. 9FH-6003)

Inspector General, DoD, Oversight of the Audit of the Military Retirement Fund Financial Statements for FY 1999

Executive Summary

Introduction. An audit of the Military Retirement Fund Financial Statements is required by Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994. We delegated, by contract, the audit of the Military Retirement Fund Financial Statements for FY 1999 to Deloitte & Touche LLP, an independent certified public accounting firm. The word Trust is no longer being included in the fund title since the title in Chapter 74, Section 1461 of Title 10 uses Military Retirement Fund.

Audit Objective. Our objective was to determine the accuracy and completeness of the Deloitte & Touche LLP audit of the Military Retirement Fund Financial Statements for FY 1999. See Appendix A for a discussion of the audit process.

Unqualified Opinion. Deloitte & Touche LLP issued an "Independent Auditors' Report," February 4, 2000, expressing an unqualified opinion on the DoD Military Retirement Fund Financial Statements for FY 1999. We concur with the Deloitte & Touche LLP unqualified opinion; our endorsement of that unqualified opinion is Exhibit 1. The Deloitte & Touche LLP "Independent Auditors' Report" is Exhibit 2.

Internal Controls. Deloitte & Touche LLP considered the Military Retirement Fund internal controls when determining the audit procedures for the purpose of expressing an opinion on the financial statements. The Deloitte & Touche LLP report, "Independent Auditors' Report on Internal Control Over Financial Reporting and Compliance Based Upon the Audit Performed in Accordance With Government Auditing Standards," is Exhibit 3. The "Department of Defense Military Retirement Fund Annual Financial Statements, Fiscal Year 1999" is Exhibit 4.

Deloitte & Touche LLP did not detect any material internal control weaknesses during the audit that would be considered a reportable condition. A reportable condition would be a significant deficiency in the design or operation of the internal controls that would cause a material misstatement in the financial data. However, the contractor did identify the non-material conditions described in the following paragraph.

The general electronic data processing controls at the computer processing locations used by the Military Retirement Fund do not provide reasonable assurance that logical security tools and techniques have been implemented, configured, and administered to restrict access to programs, data, and other information resources. Control weaknesses included deficiencies in the design and operation of electronic data processing access

controls, security policies and procedures, and program change controls that could adversely affect the Fund's ability to record, process, and summarize its financial information in accordance with all appropriate requirements. This report does not include details because disclosure of detailed information about security weaknesses may further compromise controls. Details will be presented in a separate management letter with limited distribution in accordance with Government Auditing Standards 5.28.

Compliance With Laws and Regulations. Deloitte & Touche LLP reviewed the Military Retirement Fund for compliance with laws and regulations in order to determine whether the financial statements were free of material misstatements. The Deloitte & Touche LLP review was in accordance with OMB Memorandum 99-08, "Amendments to OMB Bulletin No. 98-08, Audit Requirements for Federal Financial Statements," January 25, 1999, and OMB Circular No. A-127, "Financial Management Systems," as revised July 23, 1993. The Circular requires that Federal financial systems provide complete, reliable, consistent, and useful information on a timely basis. Deloitte & Touche LLP identified instances of non-compliance that must be reported under Government Auditing Standards and OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999, and these instances are described below.

1. The electronic data processing systems utilized by the Military Retirement Fund are not fully compliant with OMB Circular A-127, "Financial Management Systems," July 23, 1993. Deloitte & Touche LLP identified design and operation deficiencies that could compromise the ability to provide reliable data.

2. The Deloitte & Touche LLP review also disclosed that the Military Retirement Fund electronic data processing systems do not comply substantially with the requirements for Federal financial management systems, set forth in the Federal Financial Management Improvement Act of 1996. Although the general ledger is compliant with the U.S. Government Standard General Ledger, it is not transaction-based or derived from an integrated financial system. Additionally, the general ledger has two feeder systems that are not fully compliant with the U.S. Government Standard General Ledger.

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Appendix A. Audit Process

Background

Introduction. This audit was performed as part of our effort to meet the requirements of Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994. The legislation requires financial statement audits by the Inspectors General and prescribes the responsibility of management and the auditors for the financial statements, internal controls, and compliance with laws and regulations. Management is responsible for establishing and maintaining an internal control structure and for complying with laws and regulations applicable to DoD financial accounting and reporting. Our responsibility is to render an opinion on the financial statements, and to determine whether internal controls are adequate and whether the entity complied with laws and regulations.

Accounting Principles. The Military Retirement Fund Financial Statements for FY 1999 were to be prepared in accordance with OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended November 29, 1998. Footnote 1 of the Military Retirement Fund Financial Statements for FY 1999, discusses the significant accounting policies used in preparing the financial statements.

Federal Accounting Standards Advisory Board Standards. The Federal Accounting Standards Advisory Board was established by OMB, the United States Department of the Treasury, and the General Accounting Office. On October 19, 1999, the American Institute of Certified Public Accountants recognized the Federal Accounting Standards Advisory Board as the body to establish generally accepted accounting principles for Federal government entities. Therefore, Statements of Federal Financial Accounting Standards issued by the Federal Accounting Standards Advisory Board are now recognized as generally accepted accounting principles for applicable Federal governmental entities.

Fund Administration. In April 1995, the Defense Finance and Accounting Service (DFAS) consolidated the military retiree and annuity pay systems and operations into the Defense Retiree and Annuitant Pay System at the DFAS Cleveland Center, Cleveland, Ohio, and the DFAS Denver Center, Denver, Colorado. The DFAS Cleveland Center establishes and maintains retiree accounts, and the DFAS Denver Center establishes and maintains survivor annuitant accounts. The Defense Retiree and Annuitant Pay System is the standard DoD system that gathers, stores, and processes data required to generate and account for payroll for all DoD military retirees, former spouses of these retirees, and survivor benefit plan annuitants. The DoD Office of the Actuary determines the funding requirements for the Military Retirement Fund. Based on those requirements, the Investment Trust Fund Directorate, Accounting Deputate, DFAS, monitors the contributions that the Military Departments and the U.S. Treasury make to the Fund and invests those contributions in market-based U.S. securities.

Scope and Methodology

Audit Work Performed. To fulfill our responsibilities under Public Law 101-576, the "Chief Financial Officers Act of 1990," as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," we performed oversight of the independent audit conducted by Deloitte & Touche LLP of the Military Retirement Fund Financial Statements for FY 1999. Our purpose was to determine whether we could rely on the Deloitte & Touche LLP audit. We reviewed the Deloitte & Touche LLP audit approach and planning and monitored audit progress at key points.

Reviewing the Deloitte & Touche LLP Audit Approach. We used the "Federal Financial Statements Audit Manual," January 1993, issued by the President's Council on Integrity and Efficiency, and the "Financial Audit Manual," December 12, 1997, issued by the General Accounting Office, as the criteria for reviewing the Deloitte & Touche LLP audit approach. Specifically, we reviewed the engagement letter, participated in the entrance conference, and commented on audit plans and programs.

DoD-Wide Corporate-Level Government Performance and Results Act (GPRA) Goals: In response to the GPRA, the Secretary of Defense annually establishes 2 DoD-wide corporate level goals, 8 subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal and performance measures.

- **FY 2001 DoD Corporate Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2)**

- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5).**

- **FY 2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and financial systems. **(01-DoD-2.5.1).**

- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2.).**

- **FY 2001 Performance Measure 2.5.3.** Qualitative assessment of reforming information technology management **(01-DoD-2.5.3.).**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

> **Financial Management Area. Objective:** Strengthen internal controls.
> **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act of 1982. **(FM-5.3).**

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management high-risk area.

Audit Period and Standards. Our oversight of the contractor's audit was performed from June 9, 1999 through February 4, 2000. The oversight was performed in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did not use computer-processed data or statistical sampling procedures to conduct this audit.

Contacts During the Audit. We contacted individuals and organizations in the DoD audit and accounting communities. Further details are available on request.

Summary of Prior Coverage

The General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to oversight of financial statement audits and information assurance. Unrestricted General Accounting Office reports can be accessed on the Internet at http://www.gao.gov. Unrestricted Inspector General, DoD, reports can be accessed on the Internet at http://www.dodig.osd.mil.

Appendix B. Report Distribution

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Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
  Director for Accounting Policy
Under Secretary of Defense for Personnel and Readiness
  Deputy Under Secretary of Defense (Program Integration)
    Director, Defense Manpower Data Center
    Chief Actuary, DoD Office of the Actuary
Director, Defense Logistics Studies Information Exchange

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy
Superintendent, Naval Postgraduate School

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
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Inspector General, Defense Intelligence Agency
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Office of Management and Budget
  National Security Division
General Accounting Office
  Accounting and Information Management Division
    Defense Financial Audits
  National Security and International Affairs Division
    Technical Information Center
Inspector General, Department of Education
Deloitte and Touche LLP

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate 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 Committee on Government Reform
House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform

Exhibit 1. Inspector General, DoD, Endorsement Memorandum

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

February 15, 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER
UNDER SECRETARY OF DEFENSE (PERSONNEL AND READINESS)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Audit of the FY 1999 Military Retirement Fund (Project No. 9FH-6003)

In accordance with the Chief Financial Officers Act of 1990, the Inspector General (IG), DoD, is responsible for auditing the Military Retirement Fund (MRF) financial statements. For FY 1999, we contracted with Deloitte & Touche LLP to audit the MRF financial statements. Deloitte & Touche LLP is an independent certified public accounting (CPA) firm that was competitively selected for this audit by the IG, DoD. The Deloitte & Touche LLP report on the FY 1999 MRF Financial Statements, dated February 4, 2000, is at Exhibit 1.

We concur with the Deloitte & Touche LLP report on the FY 1999 MRF Financial Statements, which stated:

- The Principal Statements were reliable in all material respects.
- Management fairly stated that internal controls in place on September 30, 1999, were effective in safeguarding assets from material loss, ensuring material compliance with laws governing the use of budget authority and other laws and regulations, and ensuring that there were no material misstatements in the Principal Statements.
- There was no reportable noncompliance with laws and regulations tested.

Unqualified Audit Opinion. We concur with the Deloitte & Touche LLP unqualified opinion that the FY 1999 MRF Financial Statements and accompanying notes present fairly, in all material respects, the MRF financial position as of September 30, 1999, and the results of its operations for the year then ended. The accompanying balance sheet, and the related statements of net costs, changes in net position, budgetary resources, and financing were prepared in conformity with the hierarchy of accounting principles and standards approved by the Federal Accounting Standards Advisory Board.

Objectives, Scope, and Methodology. Management is responsible for:

- preparing the annual financial statements in conformity with the basis of accounting as described in Note 1;

- establishing, maintaining, and assessing internal controls to provide reasonable assurance that the broad control objectives of the DoD Directive 5010.40, "Management Control Program Procedures," August 28, 1996, are met; and

- complying with applicable laws and regulations.

Audit Responsibilities. We are responsible for obtaining reasonable assurance about whether the Principal Statements are reliable, free of material misstatement, and presented fairly, in all material respects, in conformity with generally accepted accounting principles and other described information in Note 1; and whether management's assertion about the effectiveness of internal controls is fairly stated, in all material respects, based on criteria established under the Management Control Program and Office of Management and Budget (OMB) Circular No. A-123, "Management Accountability and Controls," June 21, 1995. We are also responsible for testing compliance with selected provisions of laws and regulations and for performing limited procedures with respect to other information in the annual financial statements.

To help fulfill these responsibilities, we contracted with the independent CPA firm of Deloitte & Touche LLP to perform a financial statement audit in accordance with generally accepted Government auditing standards; OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999; and the GAO "Financial Audit Manual," December, 1997. The IG, DoD, evaluated the nature, timing, and extent of the work, monitored progress throughout the audit, reviewed the working papers of the CPA firm, met with partners and staff members, evaluated the key judgments, met with officials of the MRF, performed independent tests of the accounting records, and performed other procedures appropriate in the circumstances.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Exhibit 2. Deloitte & Touche LLP Opinion Report, Independent Auditors' Report

Deloitte &
Touche

Deloitte & Touche LLP
1750 Tysons Boulevard
McLean, Virginia 22102-4219

INDEPENDENT AUDITORS' REPORT

To the Inspector General of the
Department of Defense

We have audited the accompanying balance sheets of the Department of Defense (DoD) Military Retirement Fund (the Fund) as of September 30, 1999 and 1998, and the related statements of net cost, changes in net position, budgetary resources, and financing for the years then ended. These financial statements are the responsibility of the management of the Fund. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the DoD Military Retirement Fund as of September 30, 1999 and 1998, and its net cost, changes in net position, budgetary resources and reconciliation of net cost to budgetary obligations for the years then ended, in conformity with generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The other accompanying information on actuarial status at Table I is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This additional information is the responsibility of the Fund's management. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards* and OMB Bulletin No. 98-08, as amended, we have also issued our report dated February 4, 2000 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 98-08, as amended, and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

February 4, 2000

Deloitte &
Touche

Exhibit 3. Deloitte & Touche LLP Report, "Independent Auditors' Report on Internal Control Over Financial Reporting and Compliance Based Upon the Audit Performed in Accordance With Government Auditing Standards"

Deloitte & Touche

Deloitte & Touche LLP
1750 Tysons Boulevard
McLean, Virginia 22102-4219

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Inspector General of the
Department of Defense

We have audited the financial statements of the Department of Defense (DoD) Military Retirement Fund (the Fund) as of and for the year ended September 30, 1999, and have issued our report thereon dated February 4, 2000. We conducted our audit in accordance with generally accepted auditing standards, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operations of the internal control over financial reporting that, in our judgment, could adversely affect the Fund's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial 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 over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described below is not a material weakness.

1. The general electronic data processing (EDP) controls at the computer processing locations used by the Fund do not provide reasonable assurance that logical security tools and techniques have been implemented, configured, and administered to restrict access to programs, data, and other information resources. Our review

disclosed deficiencies in the design and operation of EDP access controls, security policies and procedures, and program change controls that could adversely affect the Fund's ability to record, process, and summarize its financial information in accordance with all appropriate requirements. Because disclosure of detailed information about security weaknesses may further compromise controls, we are providing no further details here. Instead the specifics will be presented in a separate, limited distribution management letter.

Compliance

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Memorandum 99-08, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 98-08, as amended, and that are described below.

1. The EDP systems utilized by the Fund are not fully compliant with OMB Circular A-127, *Financial Management Systems*. The Circular requires that federal financial systems provide complete, reliable, consistent and useful information on a timely basis. Our procedures identified deficiencies in the design and operation of EDP controls that increase the risk of unauthorized access to and modification of sensitive data. This condition compromises the ability of the systems to provide reliable data.

2. The EDP systems utilized by the Fund do not comply substantially with the requirements for Federal financial management systems set forth in the FFMIA. Although the general ledger is compliant with the United States Standard General Ledger (SGL), it is not transaction based or derived from an integrated financial system. Additionally, the general ledger has two "feeder" systems that are not fully compliant with the SGL.

Distribution

This report is intended solely for the information and use of the Inspector General of the Department of Defense, management of the Fund, other Defense Organizations, the Office of Management and Budget, the General Accounting Office, and the United States Congress and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

February 4, 2000

Deloitte &
Touche

Exhibit 4. "Department of Defense Military Retirement Fund Annual Financial Statements, Fiscal Year 1999"

DEPARTMENT OF DEFENSE

MILITARY RETIREMENT FUND

ANNUAL FINANCIAL STATEMENTS

FISCAL YEAR 1999

March 1, 2000

DoD
MILITARY RETIREMENT FUND
ANNUAL FINANCIAL STATEMENTS
FISCAL YEAR 1999

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DoD MILITARY RETIREMENT FUND

OVERVIEW

SUMMARY OF THE MILITARY RETIREMENT SYSTEM

As of September 30, 1999

Description of the Reporting Entity

The reporting entity is the Office of the Under Secretary of Defense for Personnel and Readiness, one of whose missions is to oversee the accounting, investing, and reporting of the Military Retirement Fund (the Fund). In FY 1999, the Fund paid out approximately $32 billion in benefits to military retirees and survivors. In addition to staff members of the reporting entity and the DoD Office of the Actuary, hundreds of individuals at the DFAS Cleveland and Denver Pay Centers are involved in making the benefit payments. The Fund receives income from three sources: monthly normal cost payments from the Services to pay for the current year's service cost, annual payments from Treasury to amortize the unfunded liability, and investment income. During FY 1999, the Fund received $10 billion in normal cost payments, a $15 billion unfunded liability amortization payment, and $14 billion in investment income. No fund accounts have been excluded by this statement. Because the Fund provides a service and not a product, administrative costs are not ascertainable, and are therefore not calculated or reported.

Summary

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). Only those members in plans administered by the Department of Defense are 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. *Final pay*: 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. *High-3:* 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. *Redux:* 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. The FY 2000 Defense Authorization Act provided that Redux members now have a choice of (a) receiving High-3 benefits or (b) staying under the Redux formula and receiving a lump-sum $30,000 payment. Members make their election during the fifteenth year of service. Those who choose the lump-sum payment must remain continuously on active duty until they complete 20 years of active duty service or forfeit a portion of the $30,000.

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 annually 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 who elect the $30,000 payment 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 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, who elect the $30,000 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 FY 1999, 1.35 million nondisability retirees from active duty were paid $26.4 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 FY 1999, 107,000 disability retirees were paid $1.37 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 highest 36 months 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 drill attendance, with 15 automatic 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 with less than 20 creditable years, although points earned in non-creditable years are used in the retirement calculation.

In FY 1999, 233,000 reserve retirees were paid $2.39 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 FY 1987 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 the benefit formula covering the member. 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 FY 1999, 243,000 surviving families were paid $1.77 billion.

Temporary Early Retirement Authority (TERA)

The National Defense Authorization Act for FY 1993 (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 FY 2001.

As of September 30, 1999, there were 53,000 TERA retirees receiving retired pay at an annual rate of $637 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) are increased annually with the full COLA, except for those first entering the armed services on or after August 1, 1986 electing the $30,000. Their benefits are annually increased with a partial COLA equal to 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, retired pay (or the 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 die 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 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. The FY 2000 Defense Authorization Act repealed the reductions in military retired pay for military retirees employed by the federal government effective October 1, 1999.

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 73 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 59 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 usually terminates entitlement to benefits under TRICARE, DoD's three-option managed health care program for the military, although eligibility continues for medical care in military facilities on a space available basis.

Performance Measures

During FY 1999, the Fund made disbursements to approximately two million retirees and annuitants. All checks are sent out on a monthly basis.

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 fourteen years:

a. September 30, 1999 = .35142
b. September 30, 1998 = .34567
c. September 30, 1997 = .32200
d. September 30, 1996 = .31314
e. September 30, 1995 = .30375
f. September 30, 1994 = .30306
g. September 30, 1993 = .28314
h. September 30, 1992 = .27018
i. September 30, 1991 = .25127
j. September 30, 1990 = .21878
k. September 30, 1989 = .19549
l. September 30, 1988 = .16211
m. September 30, 1987 = .11431
n. September 30, 1986 = .07187

This demonstrates a consistent improvement in the strength of the Fund over time. This trend is expected to continue in future years.

The weighted average yield of the Fund on September 30, 1999 was 8.0%.

Core Performance Measures

No operating costs are calculated for the Fund.

Limitations of the Financial Statements

These financial statements have been prepared to report the financial position and results of operations for the Military Retirement 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 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.

Comparative Financial Data

To comply with DoD Financial Management Regulation Volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," all of the Military Retirement Fund principal statements include comparative data for FY 1998. Balances representing a 10 percent increase between fiscal years on any component of a line item are considered material and are discussed in the corresponding footnote.

DoD MILITARY RETIREMENT FUND

PRINCIPAL STATEMENTS

DoD Military Retirement Fund
BALANCE SHEETS
As of September 30
(In Thousands)

	1999	1998
ASSETS:		
Intragovernmental Assets:		
Fund Balances with Treasury (Note 2)	$ 20,441	$ 20,971
Investments, Net (Note 3)	155,985,667	149,855,263
Total Intragovernmental Assets	156,006,108	149,876,234
Accounts Receivable, Net (Note 4)	25,326	25,738
Total Assets	156,031,434	149,901,972
LIABILITIES:		
Liabilities Covered by Budgetary Resources:		
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 5)	149,058,579	147,178,531
Other Liabilities (Note 6)	2,794,213	2,723,441
Total Liabilities Covered by Budgetary Resources	151,852,792	149,901,972
Liabilities Not Covered by Budgetary Resources:		
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 5)	512,681,568	497,145,173
Other Liabilities (Note 6)	136	127
Total Liabilities Not Covered by Budgetary Resources	512,681,704	497,145,300
Total Liabilities	664,534,496	647,047,272
NET POSITION :		
Cumulative Results of Operations	(508,503,062)	(497,145,300)
Total Net Position	(508,503,062)	(497,145,300)
Total Liabilities and Net Position	$ 156,031,434	$ 149,901,972

The accompanying notes are an integral part of these statements.

DoD Military Retirement Fund
STATEMENTS OF NET COST
For the Years Ended
(In Thousands)

	1999	1998
Program Costs:		
With the Public	$ 49,376,848	$ 33,842,108
Total Program Cost	49,376,848	33,842,108
(Less: Earned Revenues)	(38,019,086)	(37,771,030)
Net Program Costs	11,357,762	(3,928,922)
Net Cost of Operations	$ 11,357,762	$ (3,928,922)

Additional information included in Note 7.

The accompanying notes are an integral part of these statements.

DoD Military Retirement Fund
STATEMENTS OF CHANGES IN NET POSITION
For the Years Ended
(In Thousands)

	1999	1998
Net Cost of Operations	$ 11,357,762	$ (3,928,922)
Financing Sources (Other than Exchange Revenue)	0	0
Net Results of Operations (Financing Sources less Net Cost of Operations)	(11,357,762)	3,928.922
Net Change in Cumulative Results of Operations	(11,357,762)	3,928,922
Change in Net Position	(11,357,762)	3,928,922
Net Position-Beginning of the Period	(497,145,300)	(501,074,222)
Net Position-End of the Period	$ (508,503,062)	$ (497,145.300)

The accompanying notes are an integral part of these statements.

DoD Military Retirement Fund
STATEMENTS OF BUDGETARY RESOURCES
For the Years Ended
(In Thousands)

		1999		1998
BUDGETARY RESOURCES:				
Budget Authority	$	38,091,071	$	37,773,868
Unobligated Balance - Beginning of Period		142,953,230		136,412,829
Total Budgetary Resources		181,044,301		174,186,697
STATUS OF BUDGETARY RESOURCES:				
Obligations Incurred		31,985,722		31,233,467
Unobligated Balances - Available		149,058,579		142,953,230
Total Status of Budgetary Resources		181,044,301		174,186,697
OUTLAYS:				
Obligations Incurred		31,985,722		31,233,467
Obligated Balance, Net - Beginning of Period		2,697,703		2,606,084
Less: Obligated Balance, Net - End of Period		(2,794,213)		(2,697,703)
Total Outlays	$	31,889,212	$	31,141,848

The accompanying notes are an integral part of these statements.

DoD Military Retirement Fund
STATEMENTS OF FINANCING
For the Years Ended
(In Thousands)

		1999		1998
OBLIGATIONS AND NONBUDGETARY RESOURCES:				
Obligations Incurred	$	31,985,722	$	31,233,467
Other		(38,019,086)		(37,771,030)
Total Obligations as Adjusted and Nonbudgetary Resources		(6,033,364)		(6,537,563)
RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS:				
Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Received or Provided - (Increases)/Decreases		(25,738)		0
Total Resources That Do Not Fund Net Costs of Operations		(25,738)		0
COSTS THAT DO NOT REQUIRE RESOURCES:				
Other - Increases/(Decreases)		412		0
Total Costs That Do Not Require Resources		412		0
Financing Sources Yet to be Provided		17,416,452		2.608,641
Net Cost of Operations	$	11,357,761	$	(3,928.922)

Additional information included in Note 8.

The accompanying notes are an integral part of these statements.

DoD
MILITARY RETIREMENT
FUND

FOOTNOTES
TO THE
PRINCIPAL STATEMENTS

NOTES TO THE DOD MILITARY RETIREMENT FUND PRINCIPAL STATEMENTS
FOR THE YEARS ENDED 1999 AND 1998

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation. The Department of Defense (DoD) Military Retirement Fund was authorized by Public Law (PL) 98-94 for the accumulation of funds to finance the liabilities of the DoD under military retirement and survivor benefit programs. These financial statements have been prepared to meet the requirements of the Chief Financial Officers (CFO) Act of 1990 and other appropriate legislation. They have been prepared from the books and records of Reporting Division A, Office of the Assistant Deputy Director for Reporting, Accounting Directorate, Defense Finance and Accounting Service, in accordance with the requirements of the Office of Management and Budget (OMB) Bulletin No. 97-01, as amended, "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. Basis of Accounting. Under the authority of the CFO Act of 1990, the Federal Accounting Standards Advisory Board (FASAB) was established to recommend Federal accounting standards to the Secretary of the Treasury, the Director of the Office of Management and Budget and the Comptroller General, co-principals of the Joint Financial Management Improvement Program (JFMIP). The Statements of Federal Financial Accounting Standards (SFFAS) have been issued by the Director of OMB and the Comptroller General, some of which have deferred effective dates. In the event the SFFAS's do not address transactions, the following hierarchy provides sources of accounting principles for the Federal Government: (1) Individual standards agreed to by the Director of OMB, the Comptroller General and the Secretary of the Treasury and published by OMB and the General Accounting Office (GAO); (2) Interpretations related to the SFFAS's issued by OMB in accordance with the procedures contained in OMB Circular A-134, "Financial Accounting Principles and Standards"; (3) Requirements contained in OMB's Form and Content Bulletin in effect for the reporting period covered by the financial statements; and (4) Accounting principles published by other authoritative standard-setting bodies and other authoritative sources.

C. Investments in U.S. Government Securities. Intergovernmental securities represent nonmarketable securities issued by the United States Treasury's Bureau of Public Debt. These securities are redeemable at market value exclusively through the Federal Investment Branch. These nonmarketable market-based Treasury securities are not traded on any securities exchange, but mirror the prices of marketable securities with similar terms. Investments are recorded at amortized cost on the Balance Sheets.

D. Actuarial Information. The DoD Military Retirement Fund financial statements present the unfunded actuarial liability determined as of the end of the fiscal year based on population information as of the beginning of the year and updated using accepted actuarial techniques. The "projected benefit obligation" method is used as required by SFFAS No. 5, "Accounting for Liabilities of the Federal Government."

E. Estimates. The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

NOTE 2. FUND BALANCES WITH TREASURY:
($ In Thousands)

	FY 99	FY 98
1. Fund Balances:	Entity Assets	Entity Assets
Fund Type		
a. Trust Funds	$20,441	$20,971
b. Total	$20,441	$20,971
2. Fund Balance Per Treasury Versus Agency:		
a. Fund Balance Per Treasury	$20,441	$20,971
b. Fund Balance Per Reporting Entity	$20,441	$20,971
c. Reconciling Amount	$ 0	$ 0

NOTE 3. INVESTMENTS, NET:
($ In Thousands)

	FY 99				
	Cost	Amortization Method	Amortized [Premium]/ Discount	Investments, Net	Market Value Disclosure
1. Intragovernmental Securities:					
a. Non-Marketable, Market Based	$160,916,919	Effective Interest	($9,099,433)	$151,817,486	$166,017,710
b. Subtotal	$160,916,919		($9,099,433)	$151,817,486	$166,017,710
c. Accrued Interest	4,168,181			4,168,181	4,168,181
Total	$165,085,100			$155,985,667	$170,185,891
Total Intragovernmental:	$165,085,100		($9,099,433)	$155,985,667	$170,185,891

2. Other Information: The calculated yields match up with yields in published security tables of U.S. Treasury securities.

	FY 98	
1. Intragovernmental Securities:		
a. Non-Marketable, Market Based	$145,629,963	$173,616,650
b. Subtotal	$145,629,963	$173,616,650
c. Accrued Interest	4,225,300	4,225,300
Total	$149,855,263	$177,841,950

Footnotes

NOTE 4. ACCOUNTS RECEIVABLE, NET:
($ In Thousands)

	FY 99			FY 98
	Gross Amount Due	[Allowance for Estimated Uncollectibles]	Net Amount Due	Net Amount Due
1. Entity Receivables:				
With the Public	$26,800	($1,474)	$25,326	$25,738

2. Allowance Method Used: The General Reserve Method, under which a reserve is based on bad debt experience and changes in outstanding accounts receivables, is used as stated in Chapter 3, of Volume 4, Section 030212A. of the DoD Financial Management Regulation.

3. Other Information: Accounts Receivable With the Public represents Refunds Receivable of overpayments of benefits. This is the first year that information pertaining to the Allowance for Estimated Uncollectibles is being presented.

NOTE 5. MILITARY RETIREMENT BENEFITS AND OTHER EMPLOYMENT-RELATED ACTUARIAL LIABILITIES:
($ In Thousands)

	FY 99			
Major Program Activities	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability
Pension and Health Benefits				
Military Retirement Pensions	$661,740,147	6.25%	$149,058,579	$512,681,568
Total:	$661,740,147		$149,058,579	$512,681,568
	FY 98			
Total:	$644,323,704	6.5%	$147,178,531	$497,145,173

1. Other Information:

   a. Actuarial Cost Method Used: Aggregate entry-age normal method.

   b. FY 1999 Assumptions: The Military Retirement System is a single-employer, defined benefit plan. Administrative costs of the Fund are not ascertainable. Projected revenues, authorized by PL 98-94, will 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 6.25 percent assumed annual interest rate, the long-term annual Consumer Price Index is assumed to be 3.0 percent. The long-term annual salary increase is assumed to be 3.5 percent. For fiscal years 1999 and 2000, the actual inflation rates of 1.3 percent and 2.4 percent, and the actual salary increases of 3.6 percent and 4.8 percent were used.

   FY 1998 Assumptions: Along with the 6.5 percent assumed annual interest rate, the long-term annual Consumer Price Index was assumed to be 3.5 percent. The long-term annual salary increase was assumed to be 4.0 percent. Other assumptions, such as mortality and retirement rates were based on actual experience to calculate the actuarial liabilities.

c. Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward using accepted actuarial methods from the prior year's valuation results as reported in the valuation report. For purposes of the Fund's financial reporting, this process is applied annually. The September 30, 1999 liability figure of $661,740,147 was rolled forward from a finalized September 30, 1998 actuarial accrued liability of $649,404,986.

d. Assets Available to Pay Benefits for FY 1999 does not include Accounts Receivable nor earned Accrued Interest Receivable, but they are included in the amount for FY 1998. Prior to FY 1999, Accounts Receivable was reported on all relevant reports as a budget resource. This practice was changed during FY 1999. Accounts Receivable is no longer reported as a Budget Resource. Accrued Interest Receivable is included in Actuarial Status Information as an Asset (Table 1) and it affects the unfunded accrued liability. Accrued Interest Receivable is not a budget resource and therefore cannot be part of the Fund assets used to cover liabilities. The line shown on the Balance Sheets, (Military Retirement Benefits and Other Employment-Related Actuarial Liabilities) is equal to the line shown on the Statements of Budgetary Resources (Unobligated Balances-Available).

NOTE 6. OTHER LIABILITIES:
($ In Thousands)

1. Other Liabilities Covered by Budgetary Resources:

	FY 99		FY 98
	Current	Total	Total
With the Public:	$2,794,213	$2,794,213	$2,723,441
Total	$2,794,213	$2,794,213	$2,723,441

2. Other Liabilities Not Covered by Budgetary Resources:

	FY 99		FY 98
	Current	Total	Total
With the Public: Death Payment Contingencies	$136	$136	$127
Total	$136	$136	$127

Other Information: Other Liabilities represent accrued entitlement benefits for military retirees and survivors. Death Payment Contingencies occur because DoD military retired pay is offset, in some cases, by Department of Veterans Affairs (DVA) payments. DoD entitlements are payable to the exact date of death and DVA entitlements end in the month preceding death. This contingency is payable by DoD because DVA does not pay benefits to those retirees who died in the month.

NOTE 7. FOOTNOTE DISCLOSURES RELATED TO THE STATEMENTS OF NET COST:
($ In Thousands)

Earned Revenues for Program Costs consists of Service Contributions as a percentage of base pay of $10,416,871; the Annual Unfunded Liability Payment of $15,250,000, and Interest on Investments of $12,352,215.

FY 1998 Data: Earned Revenues, consists of Service Contributions as a percentage of base pay of $10,420,687; the Annual Unfunded Liability Payment of $15,119,000 and Interest on Investments of $12,231,343.

NOTE 7A: BENEFIT PROGRAM EXPENSE:
($ In Thousands)

DoD Military Retirement Fund For the years ended September 30	FY 99	FY 98
1. Service Cost	$10,416,871	$10,420,687
2. Period Interest on the Benefit Liability	41,191,898	41,045,712
3. Prior (or Past) Service Cost	4,090,184	0
4. Period Actuarial Gains or Losses	(7,929,607)	(17,624,300)

Note: Changes between FY 1998 and 1999 for Lines 3 and 4 are addressed in Note 9, Other Disclosures.

NOTE 7B: GROSS COST AND EARNED REVENUE BY BUDGET FUNCTIONAL CLASSIFICATION:
($ In Thousands)

	FY 99			
	Budget Function Code	Gross Cost	(Less Earned Revenue)	Net Cost
Federal Employee Retirement and Disability by DoD Military Retirement Fund	602	$49,376,848	$38,019,086	$11,357,762
Total:		$49,376,848	$38,019,086	$11,357,762
	FY 98			
Total:		$33,842,108	$37,771,030	($3,928,922)

NOTE 8. FOOTNOTE DISCLOSURES RELATED TO THE STATEMENTS OF FINANCING:
($ In Thousands)

The amount of $25,738 represents Refunds Receivable from the Public that was recorded as a negative Undelivered Order on the September 30, 1998, Report on Budget Execution (SF 133). This is the reason why a zero balance is shown in FY 1998. In FY 1999 Refunds Receivable were not shown as a negative Undelivered Order on the SF 133 but as a decrease to the Unobligated Balance. Refunds Receivable from the Public amounted to $25,326 for FY 1999 and the net change between fiscal years was $412, which is shown as Other – Increases/(Decreases) representing the net change in Accounts Receivable.

NOTE 9: OTHER DISCLOSURES:
($ In Thousands)

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

	FY 99	FY 98
A. Beginning of Year Accrued Liability	$644,323,704	$641,715,072
B. Normal Cost Liability	10,416,871	10,420,687
C. Plan Amendment Liability	4,090,184	0
D. Assumption Change Liability	1,607,493	0
E. Benefit Outlays	(31,960,396)	(31,233,467)
F. Interest on Pension Liability	41,191,898	41,045,712
G. Actuarial Loss (Gain)	(7,929,607)	(17,624,300)
H. End-of-Year Accrued Liability (A+B+C+D+E+F+G)	$661,740,147	$644,323,704
I. Net Change in Actuarial Liabilities (B+C+D+E+F+G)	$ 17,416,443	$ 2,608,632

Other Information: Assumption Change Liability (Line D.) is new this year. It was not reported separately on previous financial statements, but was included in the Actuarial Loss/(Gain). The Interest on the Pension Liability (Line F.) is calculated as a full year of interest on the Beginning of Year Accrued Liability (Line A.) and one-half year of interest on the Normal Cost Liability (Line B.) and the Benefit Outlays (Line E.). The Plan Amendment Liability (Line C.), which is identical to Line 3. in Note 7A, represents a change in retirement benefits for people who entered the military on or after August 1, 1986. There were no changes in retirement benefits for FY 1998. The Actuarial Loss (Gain) (Line G.) which is identical to Line 4. in Note 7A, represents an aggregate of all other changes from FY 1998 to FY 1999 which are not reflected in Lines C. or D. It can be expected to fluctuate significantly from year to year.

Footnotes

DoD MILITARY RETIREMENT FUND

OTHER ACCOMPANYING INFORMATION

Other Information

Other Information

DoD MILITARY RETIREMENT FUND

AUDIT OPINION

Audit Opinion

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

February 15, 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER
UNDER SECRETARY OF DEFENSE (PERSONNEL AND READINESS)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Audit of the FY 1999 Military Retirement Fund (Project No. 9FH-6003)

In accordance with the Chief Financial Officers Act of 1990, the Inspector General (IG), DoD, is responsible for auditing the Military Retirement Fund (MRF) financial statements. For FY 1999, we contracted with Deloitte & Touche LLP to audit the MRF financial statements. Deloitte & Touche LLP is an independent certified public accounting (CPA) firm that was competitively selected for this audit by the IG, DoD. The Deloitte & Touche LLP report on the FY 1999 MRF Financial Statements, dated February 4, 2000, is at Exhibit 1.

We concur with the Deloitte & Touche LLP report on the FY 1999 MRF Financial Statements, which stated:

- The Principal Statements were reliable in all material respects.
- Management fairly stated that internal controls in place on September 30, 1999, were effective in safeguarding assets from material loss, ensuring material compliance with laws governing the use of budget authority and other laws and regulations, and ensuring that there were no material misstatements in the Principal Statements.
- There was no reportable noncompliance with laws and regulations tested.

Unqualified Audit Opinion. We concur with the Deloitte & Touche LLP unqualified opinion that the FY 1999 MRF Financial Statements and accompanying notes present fairly, in all material respects, the MRF financial position as of September 30, 1999, and the results of its operations for the year then ended. The accompanying balance sheet, and the related statements of net costs, changes in net position, budgetary resources, and financing were prepared in conformity with the hierarchy of accounting principles and standards approved by the Federal Accounting Standards Advisory Board.

Objectives, Scope, and Methodology. Management is responsible for:

- preparing the annual financial statements in conformity with the basis of accounting as described in Note 1;
- establishing, maintaining, and assessing internal controls to provide reasonable assurance that the broad control objectives of the DoD Directive 5010.40, "Management Control Program Procedures," August 28, 1996, are met; and
- complying with applicable laws and regulations.

Audit Responsibilities. We are responsible for obtaining reasonable assurance about whether the Principal Statements are reliable, free of material misstatement, and presented fairly, in all material respects, in conformity with generally accepted accounting principles and other described information in Note 1; and whether management's assertion about the effectiveness of internal controls is fairly stated, in all material respects, based on criteria established under the Management Control Program and Office of Management and Budget (OMB) Circular No. A-123, "Management Accountability and Controls," June 21, 1995. We are also responsible for testing compliance with selected provisions of laws and regulations and for performing limited procedures with respect to other information in the annual financial statements.

To help fulfill these responsibilities, we contracted with the independent CPA firm of Deloitte & Touche LLP to perform a financial statement audit in accordance with generally accepted Government auditing standards; OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999; and the GAO "Financial Audit Manual," December, 1997. The IG, DoD, evaluated the nature, timing, and extent of the work, monitored progress throughout the audit, reviewed the working papers of the CPA firm, met with partners and staff members, evaluated the key judgments, met with officials of the MRF, performed independent tests of the accounting records, and performed other procedures appropriate in the circumstances.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Deloitte & Touche

Deloitte & Touche LLP
1750 Tysons Boulevard
McLean, Virginia 22102-4219

INDEPENDENT AUDITORS' REPORT

To the Inspector General of the
Department of Defense

We have audited the accompanying balance sheets of the Department of Defense (DoD) Military Retirement Fund (the Fund) as of September 30, 1999 and 1998, and the related statements of net cost, changes in net position, budgetary resources, and financing for the years then ended. These financial statements are the responsibility of the management of the Fund. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the DoD Military Retirement Fund as of September 30, 1999 and 1998, and its net cost, changes in net position, budgetary resources and reconciliation of net cost to budgetary obligations for the years then ended, in conformity with generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The other accompanying information on actuarial status at Table I is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This additional information is the responsibility of the Fund's management. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

Deloitte Touche
Tohmatsu

To the Inspector General
of the Department of Defense
February 4, 2000
Page 2

In accordance with *Government Auditing Standards* and OMB Bulletin No. 98-08, as amended, we have also issued our report dated February 4, 2000 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 98-08, as amended, and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

February 4, 2000

Deloitte & Touche

Exhibit 5. Management Representation Letter

OFFICE OF THE UNDER SECRETARY OF DEFENSE
4000 DEFENSE PENTAGON
WASHINGTON, D.C. 20301-4000

FEB 4 2000

PERSONNEL AND
READINESS

Inspector General of the Department of Defense
Attention: Mr. David F. Vincent
Finance and Accounting Directorate
400 Army Navy Drive, Room 831
Arlington, VA 22202

Dear Mr. Vincent:

We are providing this letter in connection with your audits of the balance sheets of the Department of Defense Military Retirement Fund (the MRF) as of September 30, 1999 and 1998, and the related statements of net cost, changes in net position, budgetary resources and financing for the years then ended, for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the financial position of the MRF as of September 30, 1999 and 1998 and its net cost, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with the general accepted accounting principles. We confirm that we are responsible for the fair presentation in the financial statements of financial position, net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations in conformity with generally accepted accounting principles. We also are responsible for the fair presentation of the required supplemental information accompanying the basic financial statements that is presented for the purpose of additional analysis of the basic financial statements.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audits:

1. The financial statements referred to above are fairly presented in conformity with general accepted accounting principles.

2. The MRF has made available to you all:

   a Financial records and related data.

   b. Minutes of the meetings of Department of Defense Board of Actuaries or summaries of actions of recent meetings for which minutes have not yet been prepared.

   c. Actuarial reports and other reports prepared by the Chief Actuary for the MRF.

3. We are responsible for compliance with local, state and federal laws, rules and regulations including Office Management and Budget (OMB) Bulletin 97-01, Form and Content of Agency Financial Statements, as amended. We are responsible for establishing and maintaining the components of internal control relating to our activities in order to achieve the

objectives of: providing reliable financial reports, effective and efficient operations, and compliance with laws and regulations. The MRF is responsible for maintaining accounting and administrative control over revenues, obligations, expenditures, assets, and liabilities.

4. There has been no fraud involving management or employees who have significant roles in internal control.

5. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.

6. There are no unasserted claims or assessments that legal counsel has advised us are probable of assertion and must be disclosed in accordance with Statement of Federal Financial Accounting Standards No. 5 and Federal Accounting Standards Advisory Board (FASAB) Interpretation No. 2.

7 We are not aware of any pending legislation having direct or indirect effects on the operations of the MRF that are required to be accrued or disclosed in the financial statements.

8. The MRF has no plans or intentions that may affect the carrying value or classification of the assets and liabilities.

9. We have completed implementation of our year 2000 remediation plan on a timely basis, and such remediation plan as implemented addresses all mission critical systems. We are not aware of any adverse effects of year 2000 issues on the MRF, including its systems and operations. We have no information that indicates that a significant vendor may be unable to sell to the MRF; a significant customer may be unable to purchase from the MRF; or a significant service provider may be unable to provide services to the MRF, in each case because of year 2000 compliance problems.

10. We agree with the methods and significant assumptions for determining the actuarial present value of projected plan benefits. We have no knowledge or belief that would make such methods or assumptions inappropriate in the circumstances.

Except where otherwise stated below, matters less than $25 million collectively, are not considered to be exceptions that require disclosure for the purpose of the following representations. This amount is not necessarily indicative of amounts that would require adjustment to, or disclosure in, the financial statements.

11. There has been no fraud involving employees (other than management or those who have significant roles in internal control considered in Item 4 above) that could have an effect on the financial statements.

12. The following, to the extent applicable, have been properly recorded or disclosed in the financial statements:

a. Related-party transactions and associated amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements, and guarantees (written or oral).

b. Guarantees, whether written or oral, under which the MRF is contingently liable.

c. Financial instruments with significant individual or group concentration of credit risk.

d. The impact of year 2000 issues on the MRF, including its systems and operations.

13. There have been no:

a. Changes in the method or significant assumptions used to determine the actuarial present value of accumulated plan benefits except as disclosed in footnote 5 of the financial statements.

b. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by Statement of Federal Financial Accounting Standards No. 5 and FASAB Interpretation No. 2 (including asserted claims for benefits that are being contested by the MRF and any liabilities or contingencies pertaining to year 2000 issues).

14 In preparing the financial statements in conformity with generally accepted accounting principles, management uses estimates. There are no estimates where it is reasonably possible that the estimate will change in the near term and the effect of the change could be material to the financial statements.

15. There are no risks associated with concentrations, based on information known to management, that meet all of the following criteria requiring disclosure in the financial statements:

a. The concentration exists at the date of the financial statements.

b. The concentration makes the MRF vulnerable to the risk of a near-term severe impact.

c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term

16. The MRF has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral.

17. The MRF has complied with all aspects of contractual agreements, regulations, and policy directives under the direction of the Department of Defense that would have an effect on the financial statements in the event of noncompliance.

18. There were no omissions from the participants' demographic data used for the purpose of determining the actuarial present value of projected plan benefits reflected in the financial statements.

19. The MRF is responsible for determining and maintaining the adequacy of the allowance for doubtful accounts receivable, as well as estimates used to determine such amounts. Management believes the allowance is adequate to absorb currently estimated bad debts in the account balance.

20. No events (including the effects of year 2000 issues) have occurred subsequent to September 30, 1999 that would require consideration as adjustments to, or disclosures in, the financial statements.

Sincerely,

Jeanne B. Fites

Jeanne B. Fites
Deputy Under Secretary of Defense
Program Integration

cc:
Deloitte & Touche

Exhibit 6. Legal Representation Letter

GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE
1600 DEFENSE PENTAGON
WASHINGTON, D. C. 20301-1600

FEB 15 2000

GENERAL COUNSEL

MEMORANDUM FOR DELOITTE & TOUCHE, LLP

THROUGH: THE DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDITING DEPARTMENT OF DEFENSE

SUBJECT: LEGAL REPRESENTATION LETTER FOR AUDITORS CONCERNING THE DEPARTMENT OF DEFENSE FISCAL YEAR 1999 MILITARY RETIREMENT TRUST FUND FINANCIAL STATEMENTS

REFERENCES:

(a) Assistant Inspector General for Auditing Memorandum dated November 12, 1999, Subject: Legal Representation Letter for the FY 1999 Military Retirement Trust Fund Financial Statement Audit (Project No. 9FH-6003)

(b) Legal Representation Letter For Auditors Concerning The Department of Defense Fiscal Year 1999 Military Retirement Trust Fund Financial Statements, dated December 13, 1999

(c) Assistant Inspector General for Auditing Memorandum dated February 11, 2000, Subject: Legal Representation Letter for the FY 1999 Military Retirement Trust Fund Financial Statement Audit (Project No. 9FH-6003)

This memorandum responds to reference (a) which requests that my office provide a final updated legal representation letter for the Military Retirement Trust Fund. In response to the request contained in reference (a), an interim legal representation letter, reference (b), was submitted to your Office. A copy of that response is attached. In accordance with reference (c), the effective date of the updated legal representation letter is February 4, 2000.

I am aware of no fact or circumstance between the effective date of the interim letter, December 1, 1999, and the effective date specified in reference (c), February 4, 2000, that would call for any change to reference (b). Accordingly, reference (b) remains valid and may be considered to be the final updated legal representation letter for the Military Retirement Trust Fund.

Douglas A. Dworkin
Acting General Counsel

GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE
1600 DEFENSE PENTAGON
WASHINGTON, D. C. 20301-1600

GENERAL COUNSEL

13 DEC 1999

MEMORANDUM FOR DELOITTE & TOUCHE, LLP

THROUGH: THE DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDITING DEPARTMENT OF DEFENSE

SUBJECT: LEGAL REPRESENTATION LETTER FOR AUDITORS CONCERNING THE DEPARTMENT OF DEFENSE FISCAL YEAR 1999 MILITARY RETIREMENT TRUST FUND FINANCIAL STATEMENTS

REFERENCES:

(a) Assistant Inspector General for Auditing Memorandum dated November 12, 1999, Subject: Legal Representation Letter for the FY 1999 Military Retirement Trust Fund Financial Statement Audit (Project No. 9FH-6003)

(b) Statement of Federal Financial Accounting Standard (SFFAS) No. 5, "Accounting for Contingencies," December 1995, as amended by SFFAS Number 12, and Interpretation Number 2 of SFFAS Numbers 4 and 5

(c) American Bar Association Statement of Policy Regarding Lawyer's Responses to Auditors' Requests for Information (December 1975)

This memorandum responds to reference (a) which requests that my office provide an interim legal representation letter for the Military Retirement Trust Fund for the fiscal year ended September 30, 1999 and from the period September 30, 1999 through December 1, 1999, the effective date of this memorandum. In addition, reference (a) requests that a final legal representation letter, effective no earlier than February 15, 2000, be submitted not later than March 1, 2000. Reference (a) further requests information concerning unasserted claims and assessments and requests confirmation that legal counsel are disclosing material loss contingencies as defined in reference (b).

As Acting General Counsel of the Department of Defense, I advise you as follows in connection with your examination of the Military Retirement Trust Fund concerning matters that existed as of September 30, 1999 and from the period September 30, 1999 through December 1, 1999.

As Acting General Counsel of the Department of Defense, I have supervisory authority with respect to claims and litigation made against the Department of Defense and its Agencies, including the Military Retirement Trust Fund. In such capacity, I or one of the lawyers over whom I exercise general supervision, would have reviewed litigation and claims threatened or asserted involving the Military Retirement Trust Fund.

Known Claims, Litigation, and Assessments

Subject to the foregoing, and to the last paragraph of this memorandum, I advise you that, as of September 30, 1999 and from the period September 30, 1999 through December 1, 1999, neither I nor any of the lawyers over whom I exercise general supervision have given substantive attention to, or represented, the Military Retirement Trust Fund in connection with any known litigation, claim, or assessment of $100 million or more made against the Fund.

Unasserted Claims and Assessments

Information is also requested concerning unasserted claims and assessments which this office considers probable of assertion and, if asserted, would have a reasonable possibility of an unfavorable outcome. I have interpreted this request to refer to unasserted claims and assessments which, if asserted, have a reasonable possibility of resulting in a material unfavorable outcome where materiality is defined as $100 million or more.

Subject to the last paragraph of this memorandum, I advise you that neither I nor any of the lawyers over whom I exercise general supervision have given substantive attention to, or represented the Military Retirement Trust Fund in connection with any unasserted claims or assessments which, if asserted, would constitute a material loss contingency within the scope of clause (a) of Paragraph 5 of reference (c).

Representation Concerning Disclosure

Subject to the last paragraph of this memorandum, and consistent with the last sentence of Paragraph 6 of reference (c), this will confirm that whenever, in the course of performing legal services for the Department of Defense, its Agencies or Field Activities with respect to a matter recognized to involve an unasserted possible material claim or assessment against the Military Retirement Trust Fund that may call for financial statement disclosure, I or one of the lawyers over whom I exercise general supervision have formed a professional conclusion that the Department must disclose, or consider disclosure, concerning such possible claim or assessment, the lawyer forming such professional conclusion will so advise the Department and will consult with the Department's financial managers concerning the question of such disclosure and the applicable requirements of reference (b).

Limitation on This Response

This response is limited by, and made in accordance with, the ABA Statement of Policy Regarding Lawyer's Responses to Auditors' Requests for Information (December 1975) (reference (c)). Without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (paragraphs 2 and 7)) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of reference (c) and the accompanying Commentary (which is an integral part of this Statement). In addition, we do not interpret reference (a) to require or authorize the release of information subject to the attorney-client privilege or the work product doctrine, and in responding to reference (a) we have provided no information subject to that privilege or doctrine. Moreover, the information set forth herein is as of December 1, 1999, and covers matters that existed as of September 30, 1999 and for the period September 30, 1999 through December 1, 1999, and I expressly disclaim any undertaking to advise you of changes which may be brought to my attention or to the attention of the lawyers over whom I exercise general supervision after the date of the memorandum to be submitted in February, 2000.

Douglas A. Dworkin
Acting General Counsel

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, produced this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

F. Jay Lane
David F. Vincent
Thomas J. Winter
Lisa Johnson
Joe Powell
Fred McComas
Lee Clinard
Leon Bryant