Military Retirement Fund

Fiscal Year 2000

Audited Financial Statements

February 1, 2001

DoD
MILITARY RETIREMENT FUND
FISCAL YEAR 2000
AUDITED FINANCIAL STATEMENTS

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DoD MILITARY RETIREMENT FUND

OVERVIEW

Overview

SUMMARY OF THE MILITARY RETIREMENT SYSTEM

As of September 30, 2000

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 2000, the Fund paid out approximately $33 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 2000, the Fund received $11 billion in normal cost payments, a $15 billion unfunded liability amortization payment, and $13 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, or those entering after that date but who elect to switch to the High-3 benefit formula, 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 2000, 1.36 million nondisability retirees from active duty were paid $27.1 billion.

Disability Retirement

A disabled military member is entitled to disability retired pay if the member has at least 20 years of service, or 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 2000, 102,000 disability retirees were paid $1.32 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 2000, 238,000 reserve retirees were paid $2.48 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.

A paid-up provision eliminating the reduction in retired pay for premiums for SBP and RSFPP coverage is effective October 1, 2008 for participants age 70 or older whose retired pay has been reduced for 30 years or more.

In FY 2000, 251,000 surviving families were paid $1.85 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, 2000, there were 54,000 TERA retirees receiving retired pay at an annual rate of $654 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).

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.

Overview

Performance Measures

During FY 2000, 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 fifteen years:

a. September 30, 2000 = .35085
b. September 30, 1999 = .35142
c. September 30, 1998 = .34567
d. September 30, 1997 = .32200
e. September 30, 1996 = .31314
f. September 30, 1995 = .30375
g. September 30, 1994 = .30306
h. September 30, 1993 = .28314
i. September 30, 1992 = .27018
j. September 30, 1991 = .25127
k. September 30, 1990 = .21878
l. September 30, 1989 = .19549
m. September 30, 1988 = .16211
n. September 30, 1987 = .11431
o. 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, 2000 was 7.9%.

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 1999. 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

Principal Statements ____

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

		2000		1999
ASSETS:				
Intragovernmental Assets:				
Fund Balances with Treasury (Note 3)	$	20,640	$	20,441
Investments, Net (Note 4)		162,628,640		155,985,667
Total Intragovernmental Assets		162,649,280		156,006,108
Accounts Receivable, Net (Note 5)		21,626		25,326
Total Assets	$	162,670,906	$	156,031,434
LIABILITIES:				
Intragovernmental:				
Other Liabilities (Notes 6 & 7)	$	544	$	0
Total Intragovernmental Liabilities		544		0
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 9)		687,583,547		661,740,147
Other Liabilities (Notes 7 & 8)		2,898,474		2,794,349
Total Liabilities		690,482,565		664,534,496
NET POSITION :				
Cumulative Results of Operations		(527,811,659)		(508,503,062)
Total Net Position		(527,811,659)		(508,503,062)
Total Liabilities and Net Position	$	162,670,906	$	156,031,434

The accompanying notes are an integral part of these statements.

Department of Defense
DoD Military Retirement Fund
STATEMENTS OF NET COST
For the Years Ended September 30
(In Thousands)

	2000	1999
Program Costs:		
With the Public	$ 58,759,603	$ 49,376,848
Total Program Cost	58,759,603	49,376,848
(Less: Earned Revenues)	(39,451,006)	(38,019,086)
Net Program Costs	19,308,597	11,357,762
Net Cost of Operations	$ 19,308,597	$ 11,357,762

Additional information included in Note 10.

The accompanying notes are an integral part of these statements.

Department of Defense
DoD Military Retirement Fund
STATEMENTS OF CHANGES IN NET POSITION
For the Years Ended September 30
(In Thousands)

	2000	1999
Net Cost of Operations	$ 19,308,597	$ 11,357,762
Financing Sources (Other than Exchange Revenue)	0	0
Net Results of Operations (Financing Sources less Net Cost of Operations)	(19,308,597)	(11,357,762)
Net Change in Cumulative Results of Operations	(19,308,597)	(11,357,762)
Change in Net Position	(19,308,597)	(11,357,762)
Net Position-Beginning of the Period	(508,503,062)	(497,145,300)
Net Position-End of the Period	$ (527,811,659)	$ (508,503,062)

The accompanying notes are an integral part of these statements.

Department of Defense
DoD Military Retirement Fund
STATEMENTS OF BUDGETARY RESOURCES
For the Years Ended September 30
(In Thousands)

	2000	1999
BUDGETARY RESOURCES:		
Budget Authority	$ 38,805,637	$ 38,091,071
Unobligated Balance - Beginning of Period	149,058,579	142,953,230
Total Budgetary Resources	$ 187,864,216	$ 181,044,301
STATUS OF BUDGETARY RESOURCES:		
Obligations Incurred	$ 32,911,949	$ 31,985,722
Unobligated Balances - Available	154,952,267	149,058,579
Total, Status of Budgetary Resources	$ 187,864,216	$ 181,044,301
OUTLAYS:		
Obligations Incurred	$ 32,911,949	$ 31,985,722
Obligated Balance, Net - Beginning of Period	2,794,213	2,697,703
Less: Obligated Balance, Net - End of Period	(2,898,327)	(2,794,213)
Total Outlays	$ 32,807,835	$ 31,889,212

The accompanying notes are an integral part of these statements.

Department of Defense
DoD Military Retirement Fund
STATEMENTS OF FINANCING
For the Years Ended September 30
(In Thousands)

	2000	1999
OBLIGATIONS AND NONBUDGETARY RESOURCES:		
Obligations Incurred	$ 32,911,949	$ 31,985,722
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget	(39,451,006)	(38,019,086)
Total Obligations as Adjusted and Nonbudgetary Resources	(6,539,057)	(6,033,364)
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	0	(25,738)
Total Resources That Do Not Fund Net Costs of Operations	0	(25,738)
COSTS THAT DO NOT REQUIRE RESOURCES:		
Bad Debts Related to Uncollectible Non-Credit Reform Receivables	4,139	1,474
Other - Increases/(Decreases)	104	(1,061)
Total Costs That Do Not Require Resources	4,243	413
Financing Sources Yet to be Provided	25,843,411	17,416,451
Net Cost of Operations	$ 19,308,597	$ 11,357,762

Additional information included in Note 11.

The accompanying notes are an integral part of these statements.

Principal Statements

DoD MILITARY RETIREMENT FUND

FOOTNOTES TO THE PRINCIPAL STATEMENTS

Footnotes

NOTES TO THE DOD MILITARY RETIREMENT FUND PRINCIPAL STATEMENTS FOR THE YEARS ENDED SEPTEMBER 30, 2000 AND 1999

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 report the financial position and results of operations of the Military Retirement Fund, as required by the Chief Financial Officers (CFO) Act of 1990, expanded by the Government Management Reform Act (GMRA) of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the Trust Fund Accounting Division, 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 generally accepted accounting principles. The Military Retirement Fund financial statements, in addition to the financial reports, are prepared by the Military Retirement Fund pursuant to OMB directives, which are used to monitor and control the Military Retirement Fund's use of budgetary resources.

A more detailed explanation of these financial statement elements is discussed in the applicable footnote.

B. Mission of the Reporting Entity. The mission of the DoD Military Retirement Fund is to accumulate funds in order to finance on an actuarially sound basis the liabilities of the DoD under military retirement and survivor benefit programs.

The asset accounts used to prepare the statements are categorized as either entity or nonentity in the trial balances if applicable. Entity accounts consist of resources that the agency has the authority to use, or where management is legally obligated to use funds to meet entity obligations. Nonentity accounts are assets that are held by an entity but are not available for use in the operations of the entity.

C. Budgets and Budgetary Accounting. The Military Retirement Fund is a pension program established for the payment of annuities and pensions to retired personnel and the survivor benefit program. The FY 1984 Defense Authorization Act, PL 98-94, changed the method of financing this fund effective October 1, 1984. Under the former method, the department estimated retired pay requirements for the forthcoming year, obtained an appropriation from the Congress, and made periodic payments of retired pay, retainer pay, and survivor benefits. Under the new law, such payments are made to the Military Retirement Fund.

The Military Retirement Fund's appropriations are designated trust funds. These appropriations and funds are used to fund and report how resources have been used in the course of executing the Military Retirement Fund's mission.

The DoD Military Retirement Fund is classified as a trust fund and makes use of both receipt and expenditure accounts since it is not designated as a trust revolving fund. Trust funds represent the receipts and expenditure of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

The Military Retirement Fund's symbol is 97X8097. The account uses a budget activity level structure at the budget activity level. Lower level accounts are established as necessary to meet reporting requirements.

D. 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 (OMB) 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 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.

E. Revenues and Other Financing Sources. Financing sources for the Military Retirement Fund are provided primarily through an annual unfunded liability payment from Treasury, monthly Service contributions as a percentage of base pay, and interest earned on investments.

For financial reporting purposes, the DoD policy requires the recognition of benefit expenses in the period incurred.

F. Accounting for Intragovernmental Activities. The Military Retirement Fund purchases and redeems nonmarketable market-based securities issued by the United States Treasury Bureau of Public Debt. Nonmarketable market-based securities include Treasury bills, notes, bonds, and overnight certificates. Treasury bills are short-term securities with maturity of one year or less and are purchased at a discount. Treasury notes have a maturity of at least one year but not more than ten and are purchased at a discount or premium. Treasury bonds are long term securities with maturity terms of ten years or more and are purchased at either a discount or premium.

The Military Retirement Fund records investments at market value on the trial balance in SGL 1600. Discounts and premiums are recorded on the Fund's trial balances in SGL 1611 and 1612, respectively. The Fund calculates amortization of discounts and premiums using the effective interest method and records this amortization on the trial balance in SGL 1613.

The Military Retirement Fund receives interest on the value of its non-marketable securities from Treasury on a semi-annual basis.

G. Funds with the U.S. Treasury and Cash. The Military Retirement Fund's financial resources are maintained in U.S. Treasury Accounts. The Defense Finance and Accounting Service (DFAS) Arlington processes all fund receipts and adjustments. DFAS-Arlington prepares monthly reports, which provide information to the U.S. Treasury on transfers and deposits.

In addition, DFAS-Arlington submits reports to Treasury, by appropriation, on collections received. Treasury then records this information to the appropriation Fund Balance with Treasury (FBWT) account maintained in the Treasury's system. Differences between the Military Retirement Fund's recorded balance in the FBWT account and Treasury's FBWT are reconciled.

H. Accounts Receivable. As presented in the Balance Sheets, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by the Fund.

I. Investments in U.S. Government Securities. Intragovernmental 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. Material disclosures are provided at Note 4.

J. Net Position. Net Position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent amounts of authority, which are unobligated and have not been rescinded or withdrawn, and amounts obligated but for which legal liabilities for payments have not been incurred.

K. Comparative Data. The Military Retirement Fund presents the current and previous year's financial data for comparative purposes. This data is presented in the financial statements, as well as in the footnotes to the principal statements.

L. 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 updating using accepted actuarial techniques. The "projected benefit obligation" method is used as required by SFFAS No. 5, "Accounting for Liabilities of the Federal Government."

M. 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. NONENTITY ASSETS:

($ In Thousands)	FY 00	FY 99
1. Total Nonentity Assets	$0	$0
2. Total Entity Assets	$162,670,906	$156,031,434
3. Total Assets	$162,670,906	$156,031,434

NOTE 3. FUND BALANCES WITH TREASURY:

($ In Thousands)	FY 00	FY 99
1. Fund Balances:	Entity Assets	Entity Assets
Fund Type		
a. Trust Funds	$20,640	$20,441
b. Total	$20,640	$20,441
2. Fund Balance Per Treasury Versus Agency:		
a. Fund Balance Per Treasury	$20,640	$20,441
b. Fund Balance Per Military Retirement Fund	$20,640	$20,441
c. Reconciling Amount	$ 0	$ 0

NOTE 4. INVESTMENTS:

($ In Thousands)

	FY 00				
	Cost	Amortization Method	Amortized [Premium]/ Discount	Investments Net	Market Value Disclosure
1. Intragovernmental Securities:					
a. Non-Marketable, Market Based	$168,511,628	Effective Interest	($10,681,673)	$157,829,955	$170,125,011
b. Subtotal	168,511,628		($10,681,673)	157,829,955	170,125,011
c. Accrued Interest	4,798,685			4,798,685	4,798,685
Total	$173,310,313			$162,628,640	$174,923,696
Total Intragovernmental:	$173,310,313		($10,681,673)	$162,628,640	$174,923,696

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

	FY 99	
1. Intragovernmental Securities:		
a. Non-Marketable, Market Based	$151,817,486	$166,017,710
b. Subtotal	$151,817,486	$166,017,710
c. Accrued Interest	4,168,181	4,168,181
Total	$155,985,667	$170,185,891

NOTE 5. ACCOUNTS RECEIVABLE:

($ In Thousands)

	FY 00			FY 99
	Gross Amount Due	[Allowance for Estimated Uncollectibles]	Net Amount Due	Net Amount Due
1. Entity Receivables:				
With the Public	$25,798	($4,172)	$21,626	$25,326

2. 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 to calculate an allowance percentage.

3. Other Information. Accounts Receivable with the Public represents Refunds Receivable of overpayments of benefits. For FY 99, the allowance for uncollectibles totaled $1,474. The increase in the change in the allowance for uncollectibles between FY 00 and FY 99 is discussed in Note 11.

NOTE 6. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES:

($ In Thousands)	FY 00	FY 99
1. Intragovernmental Liabilities:		
a. Other	$544	$0
Total Intragovernmental Liabilities	$544	$0
2. Nonfederal Liabilities:		
a. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	$532,631,280	$512,681,568
b. Other	$147	$136
Total Nonfederal Liabilities	$532,631,427	$512,681,704
3. Total Liabilities Not Covered by Budgetary Resources:	$532,631,971	$512,681,704
4. Total Liabilities Covered by Budgetary Resources:	$157,850,594	$151,852,792
5. Total Liabilities:	$690,482,565	$664,534,496

6. Other Information:

As discussed in Note 7, Line 1a. Other Intragovernmental Liabilities, $544 represents a custodial liability for the collection of penalties, fines, and administrative fees from overpayments of benefits to military retirees and survivors.

As discussed in Note 8, Line 2. Other Liabilities of $147 represents a contingent liability for death payments to military retirees.

NOTE 7 . OTHER LIABILITIES:

($ In Thousands)	FY 00	FY 99
1. Intragovernmental:		
a. Other Liabilities	$544	$0
Total Intragovernmental Other Liabilities	$544	$0
2. Nonfederal:		
a. Accrued Funded Payroll and Benefits	$2,898,327	$2,794,213
b. Other Liabilities	147	136
c. Total Nonfederal Other Liabilities	$2,898,474	$2,794,349
3. Total Other Liabilities	$2,899,018	$2,794,349

4. Other Information Pertaining to Other Liabilities:

Footnotes

Line 1.a, Intragovernmental Liabilities Other of $544 is a custodial liability. Custodial liability is the accounts receivable balance owed to Treasury from penalties, fines, and administration fees related to benefit overpayments made to military retirees during FY 2000. The custodial liability SGL account 2980 is presented on the Intragovernmental: Other Liability line of the balance sheet. The custodial liability amount is the difference between SGL account 1360, Penalties, Fines and Administration Fees Receivable, and SGL account 1369, Allowance for Loss on Penalties, Fines and administration fees. This is the first year that the Military Retirement Fund has determined the value of accounts 1360, 1369, and 2980. The custodial liability amount for FY 99 could not be determined for comparative purposes, because accounts 1360 and 1369 were recorded in the total receivable amount of $25,326.

As discussed in Note 8, Nonfederal Accrued Funded Payroll and Benefits of $2,898,327 are pension entitlements due and payable to military retirees and survivors.

As disclosed in Note 8, Line 2, Nonfederal Other Liabilities of $147 is the contingent liability for death payments to beneficiaries.

NOTE 8. COMMITMENTS AND CONTINGENCIES:

Disclosures Related to Commitments and Contingencies:

($ In Thousands)	**FY 00**	**FY 99**
1. Other Liabilities Covered by Budgetary Resources:		
With the Public:	$2,898,327	$2,794,213
Total:	$2,898,327	$2,794,213
2. Other Liabilities Not Covered by Budgetary Resources:		
With the Public		
Death Payment Contingencies	$147	$136
Total:	$147	$136

3. 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 9. MILITARY RETIREMENT BENEFITS AND OTHER EMPLOYMENT-RELATED ACTUARIAL LIABILITIES:

($ In Thousands)

Major Program Activities	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability
FY 00				
Military Retirement Pensions	$687,583,547	6.25%	$154,952,267	$532,631,280
Total:	$687,583,547		$154,952,267	$532,631,280
FY 99				
Total:	$661,740,147	6.25%	$149,058,579	$512,681,568

1. Other Information:

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

   b. The Military Retirement System is a single-employer, defined benefit plan. Administrative costs of the Fund are not ascertainable. Projected revenues into the Fund, authorized by PL 98-94, come from three sources: interest earnings on Fund assets, monthly Department of Defense contributions, and annual contributions from the Secretary of Treasury. The monthly Department of Defense contributions are determined as a percentage (set by the Board of Actuaries) of basic pay. The contribution from the Secretary of Treasury is paid into the Fund at the beginning of each fiscal year, and represents the amortization of the unfunded liability for service performed prior to October 1, 1984, as well as the amortization of actuarial gains and losses that have arisen since then. The Board of Actuaries determines the Secretary of Treasury's contribution, and the Secretary of Defense directs the Secretary of Treasury to make the payment.

   The same long-term economic assumptions were used in both the FY 2000 and FY 1999 valuations. Along with the 6.25 percent assumed annual interest rate, the long-term annual increase in the 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 2000 and 2001, the actual inflation rates of 2.4 percent and 3.5 percent, and the actual salary increases of 4.8 percent and 3.7 percent were used. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience.

   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 DoD Office of the Actuary's valuation of the Military Retirement System. For purposes of the Fund's financial reporting, this process is applied annually.

NOTE 10. FOOTNOTE DISCLOSURES RELATED TO THE STATEMENTS OF NET COST:

($ In Thousands)	FY 00	FY 99
Earned Revenue for Program Costs:		
1. Service Contributions as a Percentage of Base Pay	$ 11,402,375	$ 10,416,871
2. Annual Unfunded Liability Payment	15,302,000	15,250,000
3 Interest on Investments	12,746,631	12,352,215
Total	$39,451,006	$38,019,086

NOTE 10A: BENEFIT PROGRAM EXPENSE:

($ In Thousands)	FY 00	FY 99
1. Service Cost	$11,402,375	$10,416,871
2. Period Interest on the Benefit Liability	40,696,769	41,191,898
3. Prior (or past) Service Cost	0	4,090,184
4. Period Actuarial Gains or Losses	(2,209,260)	(7,929,607)
5. Gains/Losses Due to Changes in Medical Inflation Rate Assumption	0	0
6. Total Benefit Program Expense	$49,889,884	$47,769,346

NOTE 11. FOOTNOTE DISCLOSURES RELATED TO THE STATEMENTS OF FINANCING:

($ In Thousands)

The FY 00 amount of $4,139 represents uncollectible accounts receivable from military retirees and survivors. The amount of uncollectible accounts receivable for FY 99 totaled $1,474. The increase in the change in the allowance for uncollectible accounts receivable between FY 00 and FY 99 is the result of a change in the calculation. In FY 99 the computation for the allowance for bad debts used was to divide current write-off amount by the receivable amount resulting in a write off percentage. The write-off percentage was then applied to the net accounts receivable balance. The FY 00 calculation for the allowance for uncollectibles is discussed in Note 5.

The FY 99 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). In FY 99, refunds receivable were not shown as a negative undelivered order on the SF 133, but as a decrease to the unobligated balance.

Account 6790, "Other Expenses not Requiring Budgetary Resources," is a non-budgetary expense account created when the over-payment of benefits are made to military retirees and survivors. The $104 amount recorded in 6790 is the difference between account 1316 at the end of the prior year and at the end of the current year. A review of account 6790 is conducted to determine what portion of the account is uncollectible from the military retirees. The uncollectible amount is written off to account 1319, Allowance for Bad Debts. For comparative purposes the FY 99 statements have been restated to record the correct balance in this account in FY 99.

NOTE 12: OTHER DISCLOSURES:

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

($ In Thousands)		FY 00	FY 99
A.	Beginning of Year Accrued Liability	$661,740,147	$644,323,704
B.	Normal Cost Liability	11,402,375	10,416,871
C.	Plan Amendment Liability	0	4,090,184
D.	Assumption Change Liability	8,865,569	1,607,493
E.	Benefit Outlays	(32,912,053)	(31,960,396)
F.	Interest on Pension Liability	40,696,769	41,191,898
G.	Actuarial Loss (Gain)	(2,209,260)	(7,929,607)
H.	End-of-Year Accrued Liability (A+B+C+D+E+F+G)	$687,583,547	$661,740,147
I.	Net Change in Actuarial Liabilities (B+C+D+E+F+G)	$25,843,400	$ 17,416,443

Other Information:

Each year the Accrued Liability is expected to increase with the normal cost, decrease with benefit outlays, and increase with the interest cost. In the absence of (1) actuarial gains or losses or (2) plan benefit or assumption changes, an increase of $19,187,000 in the Accrued Liability was expected during FY 00. The September 30, 2000 Accrued Liability includes changes due to (1) the adoption by the Retirement Board of Actuaries of new demographic assumptions and (2) an experience gain. The new assumptions include permanent disability retiree death and other loss rates, updated mortality improvement factors, and restructured promotion and merit increase scales arising from reform of basic pay rates mandated by the FY 00 DoD Authorization Act. The Plan Amendment Liability (Line C.), which is identical to Line 3 in Note 10A, 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 2000. The combined effect of the actuarial assumption changes is an increase in the September 30, 2000 Accrued Liability of $8,865,569 on Line D. A net experience gain of $2,209,260 on Line G, which is identical to Line 4 in Note 10A, reflects primarily the new population on which the September 30, 2000 roll-forward is based.

Footnotes

DoD MILITARY RETIREMENT FUND

REQUIRED SUPPLEMENTARY INFORMATION

DoD
Military Retirement Fund
Intragovernmental Transactions
For the Year Ended September 30, 2000

($ In Thousands)

Schedule, Part A Intragovernmental Asset Balances Which Reflect Entity Amount with Other Federal Agencies	Treasury Index	Fund Balance with Treasury	Accounts Receivable:	Investments:
Department of the Treasury	20	$20,640		$162,628,640
Total		$20,640		$162,628,640

Schedule, Part B
Not Applicable

Schedule, Part C DoD Intragovernmental Revenues and Related Costs with Other Federal Agencies	Treasury Index	Earned Revenue
Department of the Treasury	20	$12,746,631
Department of the Navy	17	4,080,964
Department of the Army	21	4,169,713
Department of the Air Force	57	3,151,698
Other Defense Organizations	97	15,302,000
Total		$39,451,006

Required Supplementary Information

DoD MILITARY RETIREMENT FUND

OTHER ACCOMPANYING INFORMATION

Other Information

TABLE 1

MILITARY RETIREMENT SYSTEM
ACTUARIAL STATUS INFORMATION
AS OF SEPTEMBER 30, 2000 AND 1999

($ In Thousands)

	FY 2000	FY 1999
1. Present value of future benefits		
a. Annuitants now on roll	$441,646,986	$424,159,636
b. Non-retired reservists	54,254,562	51,640,247
c. Active duty personnel [1]	279,037,689	270,498,887
d. Total	$774,939,237	$746,298,770
2. Present value of future normal cost contributions	$87,355,690	$84,558,623
3. Actuarial accrued liability	$687,583,547	$661,740,147
4. Assets [2]	$154,952,267	$149,058,579
5. Unfunded accrued liability	$532,631,280	$512,681,568

1 The future benefits of active duty personnel who are projected to retire as reservists are counted on line 1-b.

2 The assets available to pay benefits are determined using the amortized cost method (book value) of valuation.

Other Information

DoD MILITARY RETIREMENT FUND

INDEPENDENT AUDITORS' REPORTS

Independent Auditors’ Reports

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

February 1, 2001

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

SUBJECT: Endorsement of the Unqualified Opinion on the FY 2000 Military Retirement Fund Financial Statements (Project No. D2000FH-0233.000)

In accordance with the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, the Inspector General (IG), DoD, is responsible for auditing the Military Retirement Fund (MRF) Financial Statements. For FY 2000, 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.

Unqualified Audit Opinion. We concur with the Deloitte & Touche LLP unqualified opinion dated February 1, 2001, that the FY 2000 MRF Financial Statements and accompanying notes present fairly, in all material respects, the MRF financial position as of September 30, 2000, and its net cost, changes in net position, budgetary resources, and reconciliation of budgetary resources to net cost for the year then ended. The financial statements were prepared in conformity with accounting principles generally accepted in the United States of America.

We concur with the Deloitte & Touche LLP report on internal controls over financial reporting in connection with the audit of the FY 2000 MRF Financial Statements, which stated:

> A certain matter involving the internal controls over financial reporting was considered to be a reportable condition. Specifically, the general electronic data processing (EDP) controls at the computer processing locations used by the MRF 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. Although a reportable condition, Deloitte & Touche LLP believed that the reportable condition was not a material weakness.

As part of obtaining reasonable assurance about whether the MRF financial statements are free of material misstatement, tests were performed of the MRF's 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 Bulletin 01-02, "Audit Requirements for Federal Financial Statements," October 16, 2000. The results of these tests performed by Deloitte & Touche LLP disclosed instances of noncompliance that are required to be reported. Specifically, the noncompliance concerns are the following.

- EDP systems utilized by the MRF that are not fully compliant with OMB Circular A-127, "Financial Management Systems."

- The general ledger system utilized by the MRF is not transaction based or derived from an integrated financial system.

Audit Responsibilities. We are responsible for obtaining reasonable assurance about whether the Principal Statements are fairly presented and free of material misstatement, in conformity with accounting principles generally accepted in the United States of America.

To help fulfill these responsibilities, we contracted with Deloitte & Touche LLP to perform the financial statement audit in accordance with generally accepted Government auditing standards; OMB Bulletin No. 01-02; 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

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Deloitte
& Touche

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, 2000 and 1999, 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 auditing standards generally accepted in the United States of America, 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. 01-02, *Audit Requirements for Federal Financial Statements*. 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, 2000 and 1999, and its net cost, changes in net position, budgetary resources and reconciliation of budgetary obligations to net cost for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying required supplementary information is not a required part of the basic financial statements but is supplementary information required by the OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended. 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. Such supplementary and other information have 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*, we have also issued our report dated February 1, 2001 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 should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

February 1, 2001

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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, 2000, and have issued our report thereon dated February 1, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, 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. 01-02, *Audit Requirements for Federal Financial Statements.*

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 a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. 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 Bulletin 01-02. 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. 01-02, 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. While the general ledger system utilized by the Fund 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 1, 2001