Audit Report

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INSPECTOR GENERAL, DOD, OVERSIGHT OF THE AUDIT
OF THE MILITARY RETIREMENT TRUST FUND
FINANCIAL STATEMENTS FOR FY 1998

Report Number 99-104 | March 5, 1999

Office of the Inspector General
Department of Defense

AQI99-11- 2162

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Acronyms

DFAS	Defense Finance and Accounting Service
GAO	General Accounting Office
MRTF	Military Retirement Trust Fund

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

March 5, 1999

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 Military Retirement Trust Fund Financial Statements for FY 1998 (Report No. 99-104)

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 Trust Fund Financial Statements for FY 1998. We have also included the "Department of Defense Military Retirement Trust Fund Annual Financial Report, Fiscal Year 1998." It also includes the reports issued by Deloitte & Touche LLP: the "Independent Auditors' Report" (the opinion 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 Trust Fund Financial Statements for FY 1998 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. 99-104 **March 5, 1999**
(Project No. 8FH-6036)

Inspector General, DoD, Oversight of the Audit of the Military Retirement Trust Fund Financial Statements for FY 1998

Executive Summary

Introduction. An audit of the Military Retirement Trust 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 the audit of the Military Retirement Trust Fund Financial Statements for FY 1998 to Deloitte & Touche LLP, an independent certified public accounting firm.

Audit Objective. Our objective was to determine the accuracy and completeness of the Deloitte & Touche LLP audit of the Military Retirement Trust Fund Financial Statements for FY 1998 See Appendix A for a discussion of the audit process.

Unqualified Opinion. Deloitte & Touche LLP issued an "Independent Auditors' Report," February 19, 1999, expressing an unqualified opinion on the DoD Military Retirement Trust Fund Financial Statements for FY 1998. 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 Trust 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 Trust Fund Annual Financial Report, Fiscal Year 1998" (the financial statements) is Exhibit 4.

Deloitte & Touche LLP did not detect any material weaknesses in internal controls during the audit. However, the Defense Finance and Accounting Service Cleveland Center, Cleveland, Ohio, reported an internal control weakness. The Defense Retiree and Annuitant System had not been reconciled with Military Department personnel systems. The last Military Department to complete the reconciliation process, the Navy, did so in December 1998.

The Deloitte & Touche LLP review noted general electronic data processing control weaknesses at the computer processing locations used by the Military Retirement Trust Fund. Control weaknesses included deficiencies in the design and operation of access controls, security policies and procedures, and program change controls that could adversely affect the ability of the Military Retirement Trust Fund to record, process, and summarize financial information. 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.

Compliance With Laws and Regulations. Deloitte & Touche LLP reviewed the Military Retirement Trust Fund compliance with laws and regulations in order to determine whether the financial statements were free of material misstatements. Deloitte & Touche LLP noted that the electronic data processing systems used by the Military Retirement Trust Fund were not fully compliant with Office of Management and Budget 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 audit procedures identified deficiencies in the design and operation of electronic data processing 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

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

Management Comments. Because this report contains no recommendations, written comments are not required. If management wishes to comment, we should receive the comments by March 31, 1999.

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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 Trust Fund (MRTF) Financial Statements for FY 1998 were to be prepared in accordance with the Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended November 29, 1998. Footnote 1 of the MRTF Financial Statements for FY 1998 discusses the significant accounting policies used in preparing the financial statements.

Unqualified Audit Opinion. On February 19, 1999, Deloitte & Touche LLP issued an unqualified opinion, endorsed by the Inspector General, DoD, on the MRTF Financial Statements for FY 1998. The Deloitte & Touche LLP report stated that the accompanying financial statements present fairly, in all material respects, the financial position of the MRTF as of September 30, 1998, and its net cost, changes in net position, budgetary resources and reconciliation of net costs to budgetary obligations for the year then ended, in conformity with the basis of accounting described in Note 1 of the financial statements.

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 MRTF. 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.

Objective

Our objective was to determine the accuracy and completeness of the Deloitte & Touche LLP audit of the MRTF Financial Statements for FY 1998.

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 MRTF Financial Statements for FY 1998. 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 (GAO), 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.

Audit Period and Standards. We performed this audit to oversee the financial statement audit performed by Deloitte & Touche LLP. Our oversight audit was performed from August 10, 1998, through March 1, 1999, 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.

DoD-Wide Corporate-Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Department of Defense has established 6 DoD-wide corporate-level performance objectives and 14 goals for meeting these objectives. This report pertains to the achievement of the following objectives and goals.

> **Objective:** Fundamentally reengineer the Department and achieve a 21st century infrastructure. **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas **(DoD-6)**

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

> **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 GAO has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management high-risk area.

Summary of Prior Coverage

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

Appendix B. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations

Office of Management and Budget
General Accounting Office
  National Security and International Affairs Division
    Technical Information Center

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

March 1, 1999

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 1998 Military Retirement Trust Fund (Project No. 8FH-6036)

In accordance with the Chief Financial Officers Act of 1990, the Inspector General (IG), DoD, is responsible for auditing the Military Retirement Trust Fund (MRTF) financial statements. For FY 1998, we contracted with Deloitte & Touche LLP to audit the MRTF 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 1998 MRTF Financial Statements, dated February 17, 1999, is at Exhibit 1.

We concur with the Deloitte & Touche LLP report on the FY 1998 MRTF Financial Statements, which stated:

- The Principal Statements were reliable in all material respects.
- Management fairly stated that internal controls in place on September 30, 1998, 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 1998 MRTF Financial Statements and accompanying notes present fairly, in all material respects, the MRTF financial position as of September 30, 1998, 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 the basis of accounting described 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, 1996. 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 MRTF, 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
1900 M Street NW
Washington, DC 20036-3568

Telephone (202) 955-4000
Facsimile (202) 955-4294

INDEPENDENT AUDITORS' REPORT

To the Inspector General of the
Department of Defense

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

We conducted our audit 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 by OMB Memorandum 99-08. 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 audit provides a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Trust Fund prepares its financial statements in conformity with the hierarchy of accounting principles and standards approved by the principals of the Federal Accounting Standards Advisory Board. This hierarchy is a comprehensive basis of accounting other than generally accepted accounting principles.

As described in Note 1 to the financial statements, the basis of presentation of the accompanying 1998 financial statements is substantially different than that used in FY 1997.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the DoD Military Retirement Trust Fund as of September 30, 1998, and its net cost, changes in net position, budgetary resources and reconciliation of net costs to budgetary obligations for the year then ended, in conformity with the basis of accounting described in Note 1 to the financial statements.

In accordance with *Government Auditing Standards* and OMB Bulletin No. 98-08 as amended by OMB Memorandum 99-08, we have also issued our report dated February 17, 1999, on our consideration of the Trust Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Deloitte & Touche LLP

February 17, 1999

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"

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Touche

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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 Trust Fund (the Trust Fund) as of and for the year ended September 30, 1998, and have issued our report thereon dated February 17, 1999. 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 by OMB Memorandum 99-08.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Trust 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 Trust 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 none of the reportable conditions described below is a material weakness.

1. The Defense Finance and Accounting Service (DFAS) Cleveland reported one uncorrected internal control weakness related to the Trust Fund in the 1998 Annual Statement of Assurance. The Defense Retiree and Annuitant System (DRAS) had not been reconciled with Military Department personnel systems. This weakness was first identified in 1995 and corrective action was subsequently taken to establish a reconciliation process for the Army,

Air Force, and Marine Corps. The reconciliation process for the Navy was not completed until December 1998.

2. The general electronic data processing (EDP) controls at the computer processing locations used by the Trust 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 Trust 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 Trust 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 by OMB Memorandum 99-08, and that are described below.

1. The EDP systems utilized by the Trust 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 Trust 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 U. S. 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. Standard General Ledger.

Distribution

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

Deloitte & Touche LLP

February 17, 1999

Deloitte &
Touche

Exhibit 4. “Department of Defense Military Retirement Trust Fund Annual Financial Report, Fiscal Year 1998”

Department of Defense
Military Retirement Trust Fund

Annual Financial Report

Fiscal Year 1998

DoD
MILITARY RETIREMENT
TRUST FUND

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DoD MILITARY RETIREMENT TRUST FUND

OVERVIEW

SUMMARY OF THE MILITARY RETIREMENT SYSTEM

As of September 30, 1998

Description of the Reporting Entity

The reporting entity is the Office of the Undersecretary of Defense for Personnel and Readiness, one of whose missions is to oversee the accounting, investing, and reporting of the Military Retirement Trust Fund (the Fund). In FY 1998, the Fund paid out approximately $31 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 1998, the Fund received $10 billion in normal cost payments, a $15 billion unfunded liability amortization payment, and $12 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.

Overview

The military retirement system applies to members of the Army, Navy, Marine Corps, and Air Force. However, most of the provisions also apply to retirement systems for members of the Coast Guard (administered by the Department of Transportation), officers of the Public Health Service (administered by the Department of Health and Human Services), and officers of the National Oceanic and Atmospheric Administration (administered by the Department of Commerce). 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. Military personnel who first became members of the Armed Services before September 8, 1980 have retired pay equal to (terminal basic pay) times (a multiplier). The multiplier is equal to (2.5 percent) times (years of service) and is limited to 75 percent. If the retiree first became a member of the Armed Services on or after September 8, 1980, the average of the highest 36 months of basic pay is used instead of terminal basic pay. Members first entering the Armed Services on or after August 1, 1986 are subject to a penalty if they retire with less than 30 years of service; at age 62, their retired pay is recomputed without the penalty.

Overview

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 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, 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 1998, 1.33 million nondisability retirees from active duty were paid $25.77 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 1998, 111,000 disability retirees were paid $1.43 billion.

Reserve Retirement

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

In FY 1998, 228,000 reserve retirees were paid $2.32 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.

Overview

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 when the member first entered the Armed Services. If the member dies before age 62 and the survivor is subject to partial COLAs, the survivor's annuity is increased (on the member's 62nd birthday) to the amount that would have been payable had full COLAs been in effect. Partial COLAs continue annually thereafter.

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

In FY 1998, 234,000 surviving families were paid $1.70 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, 1998, there were 52,000 TERA retirees receiving retired pay at an annual rate of $615 million.

Cost-of-Living Increases

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

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

The benefits of retirees (and their survivors) first entering the Armed Services before August 1, 1986 are annually increased with the full COLA; all other benefits are annually increased with a partial COLA 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 died from Service-connected causes. Although an SBP annuity must be reduced by the amount of any DIC benefit, all SBP premiums relating to the reduction in benefit are returned to the survivor.

Interrelationship with Other Federal Service

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

Relationship of Retired Pay to Military Compensation

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

Social Security Benefits

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

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

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

Members of the military are also required to pay the Hospital Insurance (HI) payroll tax, with the Federal Government contributing the matching employer contribution. Medicare eligibility occurs at age 65, or earlier if the employee is disabled. Entitlement to Medicare 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 1998, 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 thirteen years:

a. September 30, 1998 = .34567
b. September 30, 1997 = .32200
c. September 30, 1996 = .31314
d. September 30, 1995 = .30375
e. September 30, 1994 = .30306
f. September 30, 1993 = .28314
g. September 30, 1992 = .27018
h. September 30, 1991 = .25127

i. September 30, 1990 = .21878
j. September 30, 1989 = .19549
k. September 30, 1988 = .16211
l. September 30, 1987 = .11431
m. 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, 1998 was 8.2%.

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

DoD MILITARY RETIREMENT TRUST FUND

PRINCIPAL STATEMENTS

Principal Statements

Department of Defense
Military Retirement Trust Fund
BALANCE SHEET
As of September 30, 1998
($ in Thousands)

		FY 1998
ASSETS		
1. **Entity Assets:**		
A. Intragovernmental		
1. Fund Balance with Treasury (Note 2)	$	20,971
2. Investments, Net (Note 4)		149,855,263
3. Accounts Receivable, Net (Note 5)		0
4. Other Assets (Note 6)		0
B. Total Intragovernmental		149,876,234
C. Investments, Net (Note 4)		0
D. Accounts Receivable, Net (Note 5)		25,738
E. Loans Receivable and Related Foreclosed Property, Net (Note 7)		0
F. Cash and Other Monetary Assets (Note 3)		0
G. Inventory and Related Property, Net (Note 8)		0
H. General Property, Plant and Equipment, Net (Note 9)		0
I. Stewardship Assets (National Defense PP&E, etc.)		N/A
J. Other Assets (Note 6)		0
K. **Total Entity Assets**		149,901,972
2. Non-Entity Assets:		
A. Intragovernmental		
1. Fund Balance with Treasury (Note 2)	$	0
2. Accounts Receivable, Net (Note 5)		0
3. Other Assets (Note 6)		0
B. Total Intragovernmental		0
C. Accounts Receivable, Net (Note 5)		0
D. Cash and Other Monetary Assets (Note 3)		0
E. Other Assets (Note 6)		0
F. **Total Non-Entity Assets**		0
3. **Total Assets**	$	149,901,972

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
Military Retirement Trust Fund
BALANCE SHEET
As of September 30, 1998
($ in Thousands)

		FY 1998
LIABILITIES		
4. Liabilities Covered by Budgetary Resources:		
A. Intragovernmental		
1. Accounts Payable	$	0
2. Environmental Cleanup (Note 11)		0
3. Debt (Note 10)		0
4. Other Liabilities (Notes 11, 12, and 15)		0
B. Total Intragovernmental		0
C. Accounts Payable		0
D. Liabilities for Loan Guarantees		0
E. Military Retirement Benefits and Other Employment Related Actuarial Liabilities (Note 13)		147,178,531
F. Environmental Cleanup (Note 11)		0
G. Other Liabilities (Notes 11, 12, and 15)		2,723,441
H. Total Liabilities Covered by Budgetary Resources		149,901,972
5. Liabilities Not Covered by Budgetary Resources:		
A. Intragovernmental		
1. Accounts Payable		0
2. Debt (Note 10)		0
3. Environmental Cleanup (Note 11)		0
4. Other Liabilities (Notes 11, 12, and 15)		0
B. Total Intragovernmental		0
C. Accounts Payable		0
D. Debt (Note 10)		0
E. Military Retirement Benefits and Other Employment Related Actuarial Liabilities (Note 13)		497,145,173
F. Environmental Cleanup (Note 11)		0
G. Other Liabilities (Notes 11, 12, and 15)		127
H. Total Liabilities Not Covered by Budgetary Resources		497,145,300
6. Total Liabilities	$	647,047,272
NET POSITION		
7. Unexpended Appropriations (Note 14)	$	0
8. Cumulative Results of Operations		(497,145,300)
9. Total Net Position		(497,145,300)
10. Total Liabilities and Net Position	$	149,901,972

The accompanying notes are an integral part of these statements.

Department of Defense
Military Retirement Trust Fund
STATEMENT OF NET COST
For the period ending September 30, 1998
($ in Thousands)

		FY 1998
1. Program Costs		
A. Intragovernmental	$	0
B. With the Public		33,842,108
C. Total Program Cost		33,842,108
D. Less: Earned Revenues		(37,771,030)
E. Net Program Costs	$	(3,928,922)
2. Costs Not Assigned to Programs		0
3. Less: Earned Revenues Not Attributable to Programs		0
4. Deferred Maintenance (Note 17)		0
5. Net Cost of Operations	$	(3,928,922)

Additional information included in Note 16.

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
Military Retirement Trust Fund
STATEMENT OF CHANGES IN NET POSITION
For the period ending September 30, 1998
($ in Thousands)

		FY 1998
1. Net Cost of Operations	$	(3,928,922)
2. Financing Sources (Other than Exchange Revenues):		
A. Appropriations Used		0
B. Taxes (and Other Non-exchange Revenue)		0
C. Donations (Non-exchange Revenue)		0
D. Imputed Financing		0
E. Transfers-In		0
F. Transfers-Out		0
3. Net Results of Operations (Line 2 less Line 1)		3,928,922
4. Prior Period Adjustments (Note 18)		0
5 Net Change in Cumulative Results of Operations		3,928,922
6. Increase (Decrease) in Unexpended Appropriations		0
7. Change in Net Position		3,928,922
8. Net Position-Beginning of Period		(501,074,222)
9. Net Position-End of Period	$	(497,145,300)

Additional information included in Note 18.

The accompanying notes are an integral part of these statements.

Department of Defense
Military Retirement Trust Fund
STATEMENT OF BUDGETARY RESOURCES
For the period ending September 30, 1998
($ in Thousands)

		FY 1998
BUDGETARY RESOURCES		
1. Budget Authority	$	37,773,868
2. Unobligated Balance - Beginning of Period		136,412,829
3. Net Transfers Prior-Year Balance, Actual (+/-)		0
4. Spending Authority from Offsetting Collections		0
5. Adjustments		0
6. Total Budgetary Resources	$	174,186,697
STATUS OF BUDGETARY RESOURCES		
7. Obligations Incurred	$	31,233,467
8. Unobligated Balances - Available		142,953,230
9. Unobligated Balances - Not Available		0
10. Total Status of Budgetary Resources	$	174,186,697
OUTLAYS		
11. Obligations Incurred	$	31,233,467
12. Less: Spending Authority From Offsetting Collections & Adjustments		0
13. Obligated Balance, Net - Beginning of Period		2,606,084
14. Obligated Balance Transferred, Net		0
15. Less: Obligated Balance, Net - End of Period		(2,697,703)
16. Total Outlays	$	31,141,848

Additional information included in Note 19.

The accompanying notes are an integral part of these statements.

Principal Statements

Department of Defense
Military Retirement Trust Fund
STATEMENT OF FINANCING
For the period ending September 30, 1998
($ in Thousands)

		FY 1998
1. OBLIGATIONS AND NONBUDGETARY RESOURCES:		
A. Obligations Incurred	$	31,233,467
B. Less: Spending Authority for Offsetting Collections and Adjustments		0
C. Donations Not in the Entity's Budget		0
D. Financing Imputed for Cost Subsidies		0
E. Transfers-In (Out)		0
F. Exchange Revenue Not in the Entity's Budget		(37,771,030)
G. Other		0
H. Total Obligations as Adjusted and Nonbudgetary Resources	$	(6,537,563)
2. RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS:		
A. Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Received or Provided		0
B. Costs Capitalized on the Balance Sheet		0
C. Financing Sources That Fund Costs of Prior Periods		0
D. Other		0
E. Total Resources That Do Not Fund Net Costs of Operations		0
3. COSTS THAT DO NOT REQUIRE RESOURCES:		
A. Depreciation & Amortization		0
B. Revaluation of Assets & Liabilities		0
C. Other		0
D. Total Costs That Do Not Require Resources		0
4. Financing Sources Yet to be Provided		2.608.641
5. Net Cost of Operations	$	(3,928.922)

Additional information included in Note 20.

The accompanying notes are an integral part of these statements.

DoD MILITARY RETIREMENT TRUST FUND

FOOTNOTES TO THE PRINCIPAL STATEMENTS

Footnotes

reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could inpact the amounts reported and disclosed herein.

NOTE 2. FUND BALANCES WITH TREASURY:

($ in Thousands)

	Trust Funds	Revolving Funds	Appropriated Funds	Other Fund Types	Total
A. Entity Fund and Account Balances:					
Unobligated Balance Available					
Available	$142,953,231	0	0	0	$142,953,231
Restricted	0	0	0	0	0
Reserve for Anticipated	0	0	0	0	0
Obligated Balance, Net	2,697,703	0	0	0	2,697,703
Unfunded Contract Authority	0	0	0	0	0
Unused Borrowing Authority	0	0	0	0	0
Other	(145,629,963)	0	0	0	(145,629,963)
Total Entity Treasury Balance	$20,971	0	0	0	$20,971
B. Non-Entity Fund and Account Balance	0	0	0	0	0

C. Other Information: Securities are redeemed to cover expenses. "Other" represents the value of investments, net; as discussed in Note 4.A.

NOTE 3. CASH, FOREIGN CURRENCY AND OTHER MONETARY ASSETS: Not applicable

NOTE 4. INVESTMENTS, NET:

($ in Thousands)

	(1) Cost	(2) Amortization Method	(3) Amortized Premium/ (Discount)	(4) Investments Net
A. Intragovernmental Securities:				
(1) Marketable	0		0	0
(2) Non-Marketable Par Value	0		0	0
(3) Non-Marketable Market Based	$153,401,460	Effective Interest	$7,771,497	$145,629,963
Subtotal	$153,401,460		$7,771,497	$145,629,963
(4) Accrued Interest	4,225,300			4,225,300
Total	$157,626,760		$7,771,497	$149,855,263
B. Other Securities:				
Not applicable	0		0	0
Subtotal	0		0	0
C. Total	$157,626,760		$7,771,497	$149,855,263

D. Other Information: The Market Value of comparable Treasury securities as of September 30, 1998, is $173,616,650. The calculated yields match up with yields in published security tables of U.S. Treasury securities.

NOTE 5. ACCOUNTS RECEIVABLE, NET:
($ in Thousands)

	(1) Gross Amount Due	(2) Allowance for Estimated Uncollectibles	(3) Net Amount Due
A. Entity Receivables:			
Intragovernmental	0	0	0
With the Public	$25,738	0	$25,738
B. Non-Entity Receivables:			
Intragovernmental	0	0	0
With the Public	0	0	0

C. Allowance Method Used: Not applicable

D. Other Information: Accounts Receivable With the Public represents Refunds Receivable of overpayments of benefits.

NOTE 6. OTHER ASSETS: Not applicable

NOTE 7. DIRECT LOANS AND LOAN GUARANTEES, NON-FEDERAL BORROWERS: Not applicable

NOTE 8. INVENTORY AND RELATED PROPERTY: Not applicable

NOTE 9. GENERAL PROPERTY, PLANT, AND EQUIPMENT (PP&E), NET: Not applicable

NOTE 10. DEBT: Not applicable

NOTE 11.B. OTHER LIABILITIES:
($ in Thousands)

1. Other Liabilities Covered by Budgetary Resources

	Noncurrent Liability	Current Liability	Total
(a) Intragovernmental: Not applicable			
(b) With the Public			
(1) Accrued Funded Payroll and Benefits	0	0	0
(2) Advances from Others	0	0	0
(3) Deferred Credits	0	0	0
(4) Deposit Funds and Suspense Accounts	0	0	0
(5) Other Liabilities	0	$2,723,441	$2,723,441
Total	0	$2,723,441	$2,723,441

2. Other Information: Accrued entitlement benefits for military retirees and survivors.

3. Other Liabilities Not Covered by Budgetary Resources: Not Applicable

NOTE 12. LEASES: Not applicable

NOTE 13. PENSIONS AND OTHER ACTUARIAL LIABILITIES:
($ in Thousands)

Major Program Activities	(1) Actuarial Present Value of Projected Plan Benefits	(2) Assumed Interest Rate (%)	(3) Assets Available to Pay Benefits	(4) Unfunded Actuarial Liability
A. Pension and Health Benefits				
1. Military Retirement Pensions	$644,323,704	6.5	$147,178,531	$497,145,173
2. Military Retirement Health Benefits	0		0	0
B. Insurance/Annuity Programs:				
1. Not Applicable	0		0	0
C. Other:				
1. Not Applicable	0		0	0
D. Total Lines A+B+C:	$644,323,704		$147,178,531	$497,145,173

E. Other Information:

1. Actuarial Cost Method Used: Aggregate entry-age normal method.
2. Assumptions: The Military Retirement System is a single-employer, defined benefit plan. Administrative costs are not borne by the Trust Fund. 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, as well as the amortization of unfunded liabilities resulting from gains and losses since then. The annual interest rate is assumed to be 6.5%. The long-term inflation rate is assumed to be 3.5%; the long-term annual salary increase is assumed to be 4.0%. For fiscal years 1998 and 1999, the actual inflation rates of 2.1% and 1.3%, and the actual salary increases of 2.8% and 3.6% were used. Other assumptions, such as mortality and retirement rates, are developed from actual experience.

NOTE 14. UNEXPENDED APPROPRIATIONS: Not applicable

NOTE 15. CONTINGENCIES :
($ in Thousands)

This represents the Death Payment Contingency of $127; Not Covered by Budgetary Resources.

NOTE 16. FOOTNOTE DISCLOSURES RELATED TO THE STATEMENT OF NET COST :
($ in Thousands)

The amount of $33,842,108 shown on Line 1.C. of the Statement of Net Cost is different than that of Line 11 on the Statement of Budgetary Resources. The amount of $31,233,467 on Line 11 does not include the net changes in Actuarial Liabilities of $2,608,632 and Death Payment Contingencies of $9. Line 1.D., 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 16G: BENEFIT PROGRAM EXPENSE:
($ in Thousands)

DoD Military Retirement Trust Fund
For the year ended September 30, 1998

1.	Service Cost	$10,420,687
2.	Period Interest on the Benefit Liability	$41,045,712
3.	Prior (or Past) Service Cost	0
4.	Period Actuarial (Gains) or Losses	($17,624,300)

NOTE 16H: GROSS COST AND EARNED REVENUE BY BUDGET FUNCTIONAL CLASSIFICATION:
($ in Thousands)

	Budget Function Code	Gross Cost	Earned Revenue	Net Cost
A. Department of Defense Military: Not Applicable				
B. Water Resources by US Army Corps of Engineers: Not Applicable				
C. Pollution Control and Abatement by US Army Corps of Engineers: Not Applicable				
D. Federal Employee Retirement and Disability by DoD Military Retirement Trust Fund	602	$33,842,108	$37,771,030	($3,928,922)
E. Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund: Not Applicable				
Total		$33,842,108	$37,771,030	($3,928,922)

NOTE 17. DEFERRED MAINTENANCE ON PROPERTY, PLANT, AND EQUIPMENT: Not applicable

NOTE 18. FOOTNOTE DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION: Not applicable

NOTE 19. FOOTNOTE DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES: Not applicable

NOTE 20. FOOTNOTE DISCLOSURES RELATED TO THE STATEMENT OF FINANCING :
($ in Thousands)

Guidance from OMB (Circular No. A-34), requires Revenue and Financing Sources designated as "available" to be placed on Line 1.A. of the Report on Budget Execution. The difference between line 1. A. of the Report on Budget Execution and the amount shown on Line 1.F. of the Statement of Financing is ($2,839). The difference is due to the decrease in Accrued Interest Receivable, which is explained in Note 22. Line 4. "Financing Sources Yet to be Provided" has a balance of $2,608,641 that is made up of the net changes in the Actuarial Liability of $2,608,632 and the Death Payment Contingency of $9.

NOTE 21. FOOTNOTE DISCLOSURES RELATED TO THE STATEMENT OF CUSTODIAL ACTIVITY: Not applicable

NOTE 22. INTER-AGENCY ELIMINATIONS:
($ in Thousands)

DoD Military Retirement Trust Fund	Column A Accounts Receivable With Other Federal Entities	Column B Revenue With Other Federal Entities	Column C Unearned Revenue From Other Federal Entities
Part A. DoD Eliminations of Seller Activity With Other Federal Agencies Arrayed by DoD Entities	N/A	$12,234,182	N/A
Total	N/A	$12,234,182	N/A
Part B. DoD Eliminations of Seller Activity Arrayed By Other Federal Agencies			
Department of the Treasury (TI 20)	N/A	$12,234,182	N/A
Total	N/A	$12,234,182	N/A

Other Information: For securities purchased on October 1, 1986, and subsequent, discount and premium are amortized through account 97X8097.2, Earnings on Investments. The amortization of discount and premium for securities purchased prior to October 1, 1986, is reported to Treasury by changing the Preclosing Unexpended Balance for account 97X8097.941 on report FMS 2108. Gains and losses on securities sold are also reported through account 97X8097.2. A total of $12,357,964 was reported to account 97X8097.2 during fiscal year 1998. Amortization of ($123,782) was reported to Treasury via the FMS 2108. These two amounts equal $12,234,182 as reported in Column B, above.

The Statement of Financing, Line 1.F., shows Exchange Revenue Not in the Entity's Budget totaling $37,771,030. The Report on Budget Execution, Line 1, shows $37,773,869. The difference of $2,839 is attributable to a decrease in Accrued Interest Receivable as shown below:

Interest collected (cash)	$13,593,437
Amortized Premium	(1,427,882)
Amortized Discount	68,627
Subtotal	$12,234,182
Decrease in Accrued Interest Receivable	(2,839)
Total Interest	$12,231,343

NOTE 23. OTHER DISCLOSURES:
($ in Thousands)

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

A. Beginning of Year Accrued Liability	$641,715,072
B. Normal Cost Liability	10,420,687
C. Plan Amendment Liability	0
D. Benefit Outlays	(31,233,467)
E. Interest on Pension Liability	41,045,712
F. Actuarial Loss (Gain)	(17,624,300)
G. End-of-Year Accrued Liability (A+B+C+D+E+F)	$644,323,704
H. Net Change in Actuarial Liabilities (B+C+D+E+F)	$ 2,608,632

Other Information. The interest on the pension liability (Line E) is calculated as a full year of interest on the beginning-of-year accrued liability (Line A) and one-half year of interest on the normal cost liability and the benefit outlays (Lines B and D). A bill has been introduced in the U.S. Congress to improve pay and retirement equity for members of the Armed Forces. The proposed legislation would increase basic pay rates, enhance retirement options, and provide certain other benefits. No effect has been given in the accompanying financial statements for the impact of the proposed legislation.

Footnotes

DoD
MILITARY RETIREMENT
TRUST FUND

SUPPLEMENTAL FINANCIAL
AND
MANAGEMENT INFORMATION

Supplemental ____

TABLE 1

MILITARY RETIREMENT SYSTEM
ACTUARIAL STATUS INFORMATION
SEPTEMBER 30, 1998
($ in thousands)

	Sept 30, 1998
1. Present value of future benefits	
a. Annuitants now on roll	$425,783,099
b. Non-retired reservists	$26,138,048
c. Active duty personnel [1]	$272,972,526
d. Total	$724,893,673
2. Present value of future normal cost contributions	$80,569,969
3. Actuarial accrued liability	$644,323,704
4. Assets [2]	$147,178,531
5. Unfunded accrued liability	$497,145,173

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.

Supplemental ______________________________

DoD MILITARY RETIREMENT TRUST FUND

AUDIT OPINION

Audit Opinion

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

March 1, 1999

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 1998 Military Retirement Trust Fund (Project No. 8FH-6036)

In accordance with the Chief Financial Officers Act of 1990, the Inspector General (IG), DoD, is responsible for auditing the Military Retirement Trust Fund (MRTF) financial statements. For FY 1998, we contracted with Deloitte & Touche LLP to audit the MRTF 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 1998 MRTF Financial Statements, dated February 17, 1999, is at Exhibit 1.

We concur with the Deloitte & Touche LLP report on the FY 1998 MRTF Financial Statements, which stated:

- The Principal Statements were reliable in all material respects.
- Management fairly stated that internal controls in place on September 30, 1998, 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 1998 MRTF Financial Statements and accompanying notes present fairly, in all material respects, the MRTF financial position as of September 30, 1998, 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 the basis of accounting described 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, 1996. 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 MRTF, 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
1900 M Street NW
Washington, DC 20036-3568

Telephone: (202) 955-4000
Facsimile: (202) 955-4294

INDEPENDENT AUDITORS' REPORT

To the Inspector General of the
Department of Defense

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

We conducted our audit 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 by OMB Memorandum 99-08. 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 audit provides a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Trust Fund prepares its financial statements in conformity with the hierarchy of accounting principles and standards approved by the principals of the Federal Accounting Standards Advisory Board. This hierarchy is a comprehensive basis of accounting other than generally accepted accounting principles.

As described in Note 1 to the financial statements, the basis of presentation of the accompanying 1998 financial statements is substantially different than that used in FY 1997.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the DoD Military Retirement Trust Fund as of September 30, 1998, and its net cost, changes in net position, budgetary resources and reconciliation of net costs to budgetary obligations for the year then ended, in conformity with the basis of accounting described in Note 1 to the financial statements.

In accordance with *Government Auditing Standards* and OMB Bulletin No. 98-08 as amended by OMB Memorandum 99-08, we have also issued our report dated February 17, 1999, on our consideration of the Trust Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Deloitte & Touche LLP

February 17, 1999

Deloitte Touche
Tohmatsu

Exhibit 5. Management Representation Letter

THE OFFICE OF THE UNDER SECRETARY OF DEFENSE
4000 DEFENSE PENTAGON
WASHINGTON, DC 20301-4000

17 FEBRUARY 1999

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 audit of the balance sheet, statement of net cost, statement of changes in net position, statement of budgetary resources and statement of financing of the Department of Defense Military Retirement Trust Fund (MRTF) as of September 30, 1998 and for the year 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 MRTF as of September 30, 1998 and the results of its operations, its budgetary resources, and its financing in conformity with the basis of accounting discussed in Note 1 to the financial statements.

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

1. The financial statements referred to above are fairly presented in conformity with and the basis of accounting discussed in Note 1 to the financial statements, that is the hierarchy of accounting principles and standards recommended by the Federal Accounting Standards Advisory Board (FASAB) and issued by the Director of the Office of Management and Budget and the Comptroller General of the United States.

2. The MRTF has made available to you all:

   a. Financial records and related data for all financial transactions of the MRTF. The records, books and accounts, as provided to you, record the financial and fiscal operations of the MRTF.

   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 valuation reports and other reports prepared by the Chief Actuary for the MRTF.

3. Management has identified, and disclosed to you, all laws and regulations that have a direct and material effect on the determination of financial statement amounts.

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 FASAB Interpretation No. 2.

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

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

9. We have the intent and ability to commit the necessary resources to complete our year 2000 remediation plan on a timely basis, and such remediation plan addresses all mission critical systems. We have no information that indicates that a significant vendor may be unable to sell to the MRTF; a significant customer may be unable to purchase from the MRTF; or a significant service provider may be unable to provide services to the MRTF, in each case because of year 2000 compliance problems.

10. We are responsible for follow-up on all prior years audit findings. We have prepared a summary schedule of prior year findings reporting the status of our efforts in implementation of the prior-year's corrective action plan.

11. 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.

12. The following, to the extent applicable, have been properly recorded or disclosed in 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 MRTF is contingently liable.

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

13. There have been no:

   a. Changes in the method or significant assumptions used to determine the actuarial present value of accumulated plan benefits.

   b. Unusual or infrequent events or transactions, including amendments to the MRTF, occurring after the latest benefit information date but before issuance of the financial statements that might affect the usefulness of the financial statements when assessing the MRTF's present and future ability to pay benefits.

14. There are no:

   a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.

   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 MRTF).

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

16. There are no transactions that have not been properly recorded in the accounting records underlying the financial statements.

17. In preparing the financial statements in conformity with the basis of accounting discussed in Note 1 to the financial statements, 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.

18. 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 MRTF 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.

19. The MRTF 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.

20. The MRTF 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.

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

22. The MRTF 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.

23. No events have occurred subsequent to September 30, 1998 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 LLP
1900 M Street, N.W.
Washington, DC 20036

Exhibit 6. Legal Representation Letter

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

GENERAL COUNSEL

January 15, 1999

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING DEPARTMENT OF DEFENSE

SUBJECT: LEGAL REPRESENTATION LETTER FOR AUDITORS CONCERNING THE DEPARTMENT OF DEFENSE FISCAL YEAR 1998 MILITARY RETIREMENT TRUST FUND FINANCIAL STATEMENTS

REFERENCES: (a) Assistant Inspector General for Auditing Memorandum dated November 30, 1998, Subject: Legal Representation Letter for the FY 1998 Military Retirement Trust Fund Financial Statement Audit (Project No. 8FH-6036)

(b) Statement of Federal Financial Accounting Standard No. 5, "Accounting for Contingencies," December 1995

(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, 1998 and from the period September 30, 1998 through December 29, 1998. In addition, reference (a) requests that a final legal representation letter, effective no earlier than February 15, 1999, be submitted not later than March 1, 1999. 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 requested in reference (a), a copy of this memorandum is being sent to Deloitte & Touche LLP, this year's auditors for the Military Retirement Trust Fund. As reflected subparagraph (a) of the attached e-mail message, the inquiry concerning breach of fiduciary responsibilities pertaining to the Trust Fund and actions brought by the Trust Fund on behalf of Trust Fund participants is no longer expected. As reflected in subparagraph (b) of the attached message, the materiality threshold used in this memorandum will be $100 million.

As 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, 1998 and from the period September 30, 1998 through December 29, 1998.

As 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 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, 1998 and from the period September 30, 1998 through December 29, 1998, 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 legal 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 legal 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 29, 1998, and covers matters that existed as of September 30, 1998 and for the period September 30, 1998 to December 29, 1998, 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 legal supervision after the date of the memorandum to be submitted in February, 1999.

Judith Miller
Judith A. Miller

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

GENERAL COUNSEL

23 FEB 1999

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING DEPARTMENT OF DEFENSE

SUBJECT: LEGAL REPRESENTATION LETTER FOR AUDITORS CONCERNING THE DEPARTMENT OF DEFENSE FISCAL YEAR 1998 MILITARY RETIREMENT TRUST FUND FINANCIAL STATEMENTS

REFERENCES:

(a) Assistant Inspector General for Auditing Memorandum dated February 10, 1999, Subject: Final Updated Legal Representation Letter for the FY 1998 Military Retirement Trust Fund Financial Statement Audit (Project No. 8FH-6036)

(b) Assistant Inspector General for Auditing Memorandum dated November 30, 1998, Subject: Legal Representation Letter for the FY 1998 Military Retirement Trust Fund Financial Statement Audit (Project No. 8FH-6036)

(c) Legal Representation Letter For Auditors Concerning The Department of Defense Fiscal Year 1998 Military Retirement Trust Fund Financial Statements, dated January 15, 1999

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 (b), an interim legal representation letter, reference (c), was submitted to your Office. A copy of that response is attached.

I am aware of no fact or circumstance between the date of the interim letter, January 15, 1999, and the effective date specified in reference (a), February 17, 1999, that would call for any change to reference (c). Accordingly, reference (c) remains valid and may be considered to be the final updated legal representation letter for the Military Retirement Trust Fund.

Judith Miller

Judith A. Miller

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

F. Jay Lane
Salvatore D. Guli
David F. Vincent
Thomas J. Winter
Lisa Y. Johnson
Gregory P. Guest
Susanne B. Allen

INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Inspector General, DOD, Oversight of the Audit of the Military Retirement Trust Fund Financial Statements for FY 1998

B. DATE Report Downloaded From the Internet: 08/26/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ Preparation Date 08/26/99

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