

**Fiscal Year
2015**

**Military
Retirement
Fund
Audited
Financial
Report**

November 6, 2015



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Management's Discussion and Analysis
Summary of the Military Retirement System
For the Years Ended September 30, 2015 and 2014

REPORTING ENTITY

The reporting entity is the Department of Defense (DoD) Military Retirement Fund (MRF, or "Fund"). The Military Retirement System (MRS) provides benefits for military members' retirement from active duty and the reserves, disability retirement benefits, and survivor benefits. The MRF accumulates funds to finance, on an actuarial basis, the liabilities of DoD under military retirement and survivor benefit programs.

Within DoD, the operations of the MRS are jointly overseen by the:

- (1) Office of the Under Secretary of Defense (Comptroller) (OUSD(C)),
- (2) Defense Finance and Accounting Service (DFAS), and
- (3) Office of the Under Secretary of Defense for Personnel and Readiness (OUSD(P&R)).

DFAS is responsible for the accounting, investing, payment of benefits, and reporting of the MRF. The DoD Office of the Actuary (OACT) within OUSD(P&R) calculates the actuarial liability and funding requirements of the MRF. The Office of Military Personnel Policy within OUSD(P&R) issues policy related to MRS benefits. While the MRF does not have a specified Chief Financial Officer (CFO), the OUSD(C) has oversight of the MRF's financial reporting processes.

The Fund was established by Public Law (P.L.) 98-94 (currently Chapter 74 of Title 10, U.S.C.) starting October 1, 1984. The Fund is overseen by an independent, three-member Secretary of Defense-appointed DoD Board of Actuaries ("Board"). The Board is required to review valuations of the MRS, determine the method of amortizing unfunded liabilities, report annually to the Secretary of Defense, and report to the President and the Congress at least once every four years on the status of the MRF. OACT provides all technical and administrative support to the Board.

The Fund receives income from three sources: (1) normal cost payments from the Services and U.S. Treasury; (2) payment from the U.S. Treasury to amortize the unfunded liability; and (3) investment income.

During Fiscal Year (FY) 2015, the MRF received approximately \$19.7 billion in normal cost payments, a \$81.8 billion payment from the U.S. Treasury consisting of both an amortization and concurrent receipt payment, and earned approximately \$10.8 billion in investment income, net of premium/discount amortization and accrued inflation compensation. In comparison, in FY 2014 the MRF received approximately \$20.5 billion in normal cost payments, a \$79.2 billion payment from the U.S. Treasury consisting of both an amortization and concurrent receipt payment, and earned approximately \$17.1 billion in investment income, net of premium/discount amortization and accrued inflation compensation (see the Financial Performance Overview section for an explanation of the changes).

In FY 2015, the MRF paid approximately \$56.7 billion in benefits to military retirees and survivors compared to approximately \$55.6 billion in FY 2014.

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THE FUND

General Benefit Information

The MRS covers members of the Army, Navy, Marine Corps, and Air Force; however, most of the provisions also apply to retirement systems for uniformed service members of the Coast Guard (administered by the Department of Homeland Security), the Public Health Service (administered by the Department of Health and Human Services), and the National Oceanic and Atmospheric Administration (administered by the Department of Commerce). This report applies only to members in plans administered by the DoD.

The MRS is a funded, noncontributory, defined benefit plan that includes non-disability retired pay, disability retired pay, survivor annuity programs, and Combat-Related Special Compensation. The Service Secretaries may approve immediate non-disability retired pay at any age with credit of at least 20 years of active duty service. Reserve retirees must be at least 60 years old and have at least 20 qualifying years of service before retired pay commences; however, in some cases, the age can be less than 60 if the reservist performs certain types of active service. P.L. 110-181 provides for a 90-day reduction in the reserve retirement age from age 60 for every 3 months of certain active duty service served within a fiscal year for service after January 28, 2008 (not below age 50). There is no vesting of benefits before non-disabled retirement.

There are distinct non-disability benefit formulas related to four populations within the MRS.

- 1) Final Pay: Military personnel who first became members of a uniformed service before September 8, 1980, have retired pay equal to final basic pay times a multiplier (final basic pay refers to terminal pay of the member). The multiplier is equal to the product of 2.5% and years of service.
- 2) High-3: If the retiree first became a member of a uniformed service on or after September 8, 1980, the average of the highest 36 months of basic pay is used instead of final basic pay.
- 3) Career Status Bonus (CSB)/Redux: Those who first became a member of a uniformed service on or after August 1, 1986, may choose between a High-3 and CSB/Redux retirement. Those who elect CSB/Redux also have retired pay computed on a base of the average of their highest 36 months of basic pay and receive the CSB outlined below; however, their retired pay is 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. Members make this election during their fifteenth year of service and may receive the CSB of \$30,000 in either a lump sum or installments. Those who elect CSB/Redux must remain continuously on active duty until they complete 20 years of active duty service or forfeit a portion of the \$30,000 (exceptions include death and disability retirement).
- 4) Bipartisan Budget Act of 2013 (Ryan/Murray) with subsequent amendments (BBA 2013): Those who first became a member of a uniformed service after December 31, 2015, receive a lower cost-of-living adjustment (COLA) by one percent (e.g., 2% instead of 3%) for “working-age” (pre-age 62), non-disabled military retirees and their survivors, with a restoral at member age 62 and full COLAs thereafter. They may choose between a CSB/Redux retirement and BBA 2013 at their 15-year anniversary. The Consolidated Appropriations Act of 2014 amended the BBA to make it inapplicable to disability retirement accounts.

Retiree and annuitant pay are automatically adjusted annually by COLAs to protect the purchasing power of the initial benefit. Members first entering a uniformed service before August 1, 1986, and those entering on or after that date who do not elect CSB have their benefits adjusted by the percentage increase in the Consumer Price Index (CPI). This is commonly referred to as “full CPI protection.” One exception is for members

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entering after December 31, 2013 who are under BBA 2013, as described above. Benefits for members who entered on or after August 1, 1986, and who elect CSB are increased by the CPI minus 1% (except when the CPI increase is less than or equal to 1%, when it is increased by the full CPI). At age 62, or when the member would have been age 62 (for a survivor annuity), the benefits are restored to the amount that would have been payable had the full COLA been in effect. This restoral is in combination with the elimination of the penalty for retiring with less than 30 years of service; however, after this restoral, partial indexing (CPI minus 1%) continues for future benefit payments.

The FY 2011 National Defense Authorization Act (NDAA), P.L. 111-383, required that amounts of retired pay due to a retired member of the uniformed services shall be paid on the first day of each month beginning after the month in which the right to such pay accrues. This means that when the first day of the month falls on a non-business day (weekend / holiday), the pay must be paid the preceding business day. The law does not apply to survivor annuitant pay and Combat-Related Special Compensation. It will result in retirees receiving 13 payments in some fiscal years and 11 payments in others, with 12 payments occurring in most fiscal years.

Non-Disability Retirement from Active Service

The current retirement system allows for voluntary retirement at any age upon completion of at least 20 years of service, subject to Service Secretary's approval. The military retiree immediately receives retired pay calculated as base pay multiplied by the specified factor. "Base pay" is equal to terminal basic pay if the retiree first became a member of a uniformed service before September 8, 1980; for all other members, "base pay" is equal to the average of the highest 36 months of basic pay. The factor is equal to 2.5% multiplied by the number of years of service, rounded down to the nearest month.

Members who first entered a uniformed service on or after August 1, 1986, who elect CSB/Redux and who retire with less than 30 years of service, receive a temporary penalty until they reach the age of 62. This penalty reduces the factor used to compute retired pay by one percentage point for each full year of service under 30 years. For example, the multiplier for a 20-year retiree would be 40% (50% minus 10%, where 50% equals 20 years multiplied by 2.5%) of base pay. At age 62, retired pay is recomputed with the penalty removed (see Tables 1 and 2 on the following pages).

TABLE 1
MILITARY RETIREMENT SYSTEM PROPERTIES
 (FOR NONDISABILITY RETIREMENT FROM ACTIVE DUTY)

Benefit System	Final Pay	High-3 (HI-3)	Career Status Bonus (CSB)/Redux	Bipartisan Budget Act of 2013 (BBA 2013)
Applies to Member Who:	First became member of a uniformed service before September 8, 1980	(1) First became member of a uniformed service on or after September 8, 1980 and prior to August 1, 1986, and (2) first became a member on or after August 1, 1986 and prior to January 1, 2016 who elect not to accept the CSB at the 15-year anniversary	First became member of a uniformed service on or after August 1, 1986 and elect to accept the CSB with additional 5-year service obligation	First became member of a uniformed service after December 31, 2015 who elect not to accept the CSB at the 15-year anniversary
Retired Pay Computation Basis	Final basic pay rate	Highest 36 months of basic pay rate	Highest 36 months of basic pay rate	Highest 36 months of basic pay rate
Multiplier	2.5% per year of service	2.5% per year of service	2.5% per year of service less 1% for each year of service less than 30 (restored at age 62)	2.5% per year of service
Cost-of-Living Adjustment Mechanism	Full Clerical Worker Consumer Price Index (CPI-W)	Full CPI-W	Full CPI-W minus 1% (one-time catch-up at age 62)	Full CPI-W minus 1% prior to age 62 with a catch-up at 62 and full COLAs thereafter
Lump Sum Bonus	--	--	\$30,000 CSB payable at 15-year anniversary upon assumption of 5-year obligation to remain on continuous active duty	--

TABLE 2
MILITARY RETIREMENT SYSTEM MULTIPLIERS
 (FOR NONDISABILITY RETIREMENT FROM ACTIVE DUTY)

Years of Service	Final Pay / HI-3 / BBA 2013 Multiplier	CSB/Redux Multiplier	
		Before Age 62	After Age 62
20	50.0%	40.0%	50.0%
21	52.5	43.5	52.5
22	55.0	47.0	55.0
23	57.5	50.5	57.5
24	60.0	54.0	60.0
25	62.5	57.5	62.5
26	65.0	61.0	65.0
27	67.5	64.5	67.5
28	70.0	68.0	70.0
29	72.5	71.5	72.5
30	75.0	75.0	75.0
31	77.5	77.5	77.5
32	80.0	80.0	80.0
33	82.5	82.5	82.5
34	85.0	85.0	85.0
35	87.5	87.5	87.5
36	90.0	90.0	90.0
37	92.5	92.5	92.5
38	95.0	95.0	95.0
39	97.5	97.5	97.5
40	100.0	100.0	100.0
41	102.5	102.5	102.5
42	105.0	105.0	105.0

As of September 30, 2015, there were approximately 1.47 million non-disability retirees from active duty receiving approximately \$45.15 billion of retired pay. For comparison, as of September 30, 2014, there were approximately 1.47 million non-disability retirees from active duty receiving approximately \$44.02 billion of retired pay.

Management's Discussion and Analysis

Disability Retirement

A military member in an active component or on active duty for more than 30 days who is found unfit for duty is entitled to disability retired pay if the disability:

- 1) is incurred while entitled to basic pay;
- 2) is neither the result of the member's intentional misconduct nor willful neglect;
- 3) was not incurred during a period of unauthorized absence; and
- 4) either:
 - a. the member has at least 20 years of service; or
 - b. the disability is rated at least 30% under the Department of Veterans Affairs (VA) Schedule of Rating Disabilities and one of the following conditions is met:
 - i. the disability was not noted at the time of the member's entrance on active duty (unless clear and unmistakable evidence demonstrates that the disability existed before the member's entrance on active duty and was not aggravated by active military service);
 - ii. the disability is the proximate result of performing active duty;
 - iii. the disability was incurred in the line of duty in time of war or national emergency; or
 - iv. the disability was incurred in the line of duty after September 14, 1978.

Under certain conditions, members on active duty for 30 days or less or on inactive-duty training are also entitled to disability retired pay for disabilities incurred or aggravated in the line of duty.

In disability retirement, the member may elect to receive retired pay equal to either:

- 1) the accrued non-disability retirement benefit regardless of eligibility to retire; or
- 2) the computed base pay multiplied by the rated percent of disability.

Except for members with more than 30 years of service, the benefit cannot exceed 75% of base pay. The excess of the accrued non-disability retirement benefit over the disability pay is subject to federal income taxes if the member had service on or before September 24, 1975. Otherwise, disability retired pay is tax-exempt only for those disabilities that are combat or hazardous duty related. The base pay is equal to final basic pay if the retiree first became a member of a uniformed service before September 8, 1980; otherwise, 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, the member must be physically examined every 18 months for any change in disability, with a final determination made within five years. The temporary disability pay is calculated like the permanent disability retired pay, except the payment cannot be less than 50% of base pay.

Members who elected the CSB/Redux retirement option, but who retired for disability, are not subject to the reduced CSB/Redux retired pay multiplier and are awarded retired pay based on the disability retirement rules outlined above. However, such members continue to be subject to the reduced CPI (with age 62 restoration) as Career Status Bonus recipients.

Recent Congressional action has been directed toward the care of disabled retirees and veterans. P.L. 110-181 established the Physical Disability Board of Review (PDBR). The PDBR has the authority to reexamine the

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files of veterans medically separated with ratings under 30% between September 11, 2001, and December 31, 2009, and potentially offer disability retirements. The PDBR is expected to review files for approximately 77,000 veterans.

As of September 30, 2015 (FY 2015), there were approximately 112,000 disability retirees receiving approximately \$1.54 billion of retired pay. For comparison, as of September 30, 2014 (FY 2013), there were approximately 106,000 disability retirees receiving approximately \$1.47 billion of retired pay.

Reserve Retirement

Members of the reserves may retire after 20 qualifying years of creditable service; however, reserve retired pay is not payable until age 60 unless the member performs certain types of active duty or active service specified in NDAA 2008 (P.L. 110-181). In these cases, the age at which the reserve retiree may collect is reduced below age 60 by 3 months for every 90 days of such service performed, although there are constraints on when the service must have been performed. However, the age cannot go below 50, and eligibility for subsidized retiree health benefits remains at age 60 even if the eligibility age for receipt of retired pay is affected.

Reserve retired pay is computed as base pay multiplied by 2.5% for each year of service. If the reservist was first a member of a uniformed service 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 retired pay begins. If the reservist first became a member of the armed services on or after September 8, 1980, base pay is the average basic pay for the member's grade in the highest 36 months computed as if he/she was on active duty for the entire period preceding retired pay commencement. The years of service are determined using a point system, where 360 points convert to one year of service. Typically, one point is awarded for one day of active duty service (e.g. active duty training) or one inactive duty training (IDT) drill attendance. Reservists often perform two IDT periods in one day, thereby receiving two retirement points per day. In addition, 15 points are awarded for completion of one 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 generally cannot retire with less than 20 creditable years, although points earned in non- creditable years are used in the retirement calculation.

Beginning with years of service that include October 30, 2007, non-active duty points are limited to no more than 130 in any one year. Lower point limitations have applied in the past.

As of September 30, 2015, there were approximately 396,000 reserve retirees receiving approximately \$6.16 billion of retired pay. For comparison, as of September 30, 2014, there were approximately 388,000 reserve retirees receiving approximately \$5.90 billion of retired pay.

Survivor Benefits

Legislation originating in 1953 provided optional survivor benefits, later referred to as the Retired Servicemen's Family Protection Plan (RSFPP). The plan proved to be expensive to the participants and inadequate, since the survivor annuities were not adjusted for inflation and could not exceed 50% of retired pay. RSFPP was designed to be self-supporting in the sense that, on average, the present value of the premiums equaled the present value of the survivor annuity.

Management's Discussion and Analysis

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 or who retained RSFPP in conjunction with SBP.

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

The SBP survivor annuity is 55% of the member's base amount. The base amount is elected by the member, but cannot be less than \$300 or more than the member's full gross monthly retired pay, with one exception. If the member elects CSB/Redux and is subject to a penalty for service under 30 years in the calculation of retired pay, the maximum base amount is equal to the full retired pay without the penalty. However, the annuity for a survivor of a CSB/Redux retiree is subject to the reduced COLA.

When SBP started in 1972, survivor benefits for those 62 and older were reduced by the estimated amount of Social Security for which the survivor would be eligible based on the member's military pay. In 1985, that reduction formula was changed so all annuitants 62 and over received a reduced flat rate of 35% of the member's base amount. Beginning October 1, 2005, the reduced rate at age 62 was phased out in 5% increments. On April 1, 2008, the survivor benefit reduction at age 62 was fully eliminated and the rate of 55% of the member's elected base amount became the standard for all survivors, regardless of age.

Prior to FY 1987, the survivor annuity benefit for a surviving spouse who remarried before age 60 was suspended. In FY 1987, SBP changed to suspend benefits when the remarriage occurred at the age of 55. If the remarriage ends in divorce or death, the annuity is reinstated.

Members who died on active duty, or in the line of duty on or after September 11, 2001, are assumed to have retired with full disability on the day they died and to have elected full SBP coverage for spouses, former spouses, and/or children. Insurable interest elections may be applicable in some cases. These benefits have been improved and expanded over the history of the program.

The surviving spouse (or dependent children, if there is no surviving spouse or if the spouse subsequently dies) of a reservist who dies in the line of duty while performing IDT service is entitled to an SBP annuity based on the reservist's years of service.

SBP annuities generally are reduced by any VA survivor benefits (Dependency and Indemnity Compensation (DIC)), and all premiums relating to the reductions are returned to the survivor. The FY 2008 NDAA enacted, and the Family Smoking Prevention and Tobacco Control Act of 2009 (P.L. 111-31) revised, a temporary Special Survivor Indemnity Allowance (SSIA) that pays a monthly amount (\$50 in FY 2009 grading up to \$310 in FY 2017) to survivors with a DIC offset. The authority for the allowance ends in 2017.

The relationship between SBP and DIC has been the subject of litigation in the U.S. Court of Appeals. As a result of the "Sharp Case" ruling, the SBP benefit of survivors with entitlement to both DIC and SBP who remarry after age 57 is not reduced by DIC benefits received.

As with retired pay, SBP annuities and premiums are increased annually with COLAs. These COLAs are either full or partial CPI increases, depending on the benefit formula covering the member. If a member who elected

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the CSB dies before the age of 62, the survivor's benefit is subject to partial COLAs and his/her annuity increased, on what would have been 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 retired pay reductions applicable under SBP take effect for survivor coverage after a reservist turns 60 (or earlier if they have certain active service) and begins to receive retired pay. The Reserve Component Survivor Benefit Plan (RCSBP) provides annuities to survivors of reservists who die before age 60 (or earlier if they have certain active service) provided they attained 20 years of qualified service and elected to participate in the program (or were within their 90-day election window after receiving a letter confirming 20 years of credible service). However, if the death occurs either on active or inactive duty as described above, the survivor receives an annuity under SBP. The cost of RCSBP is borne completely by reservists through deductions from retired pay.

Beginning October 1, 2008, a "paid-up" provision eliminated the reduction in retired pay for premiums for SBP, RCSBP, and RSFPP coverage for participants age 70 or older whose retired pay had been reduced for at least 360 months.

On June 26, 2013, the Supreme Court ruled that Section 3 of the Defense of Marriage Act (DOMA) is unconstitutional. In complying with this decision, DoD has drafted guidance to make SBP benefits available to same-sex spouses of military members and retirees.

As of September 30, 2015, there were approximately 288,000 survivors of military members receiving approximately \$3.85 billion in annuity payments. For comparison, as of September 30, 2014, there were approximately 291,000 survivors of military members receiving approximately \$3.82 billion in annuity payments.

Temporary Early Retirement Authority (TERA)

The FY 1993 NDAA (P.L. 102-484) granted 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 was calculated in the usual way, except that there was a reduction of 1% 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 generally treated like regular military retirees for the purposes of other retirement benefits. This authority expired on September 1, 2002.

The FY 2012 NDAA (P.L. 112-81) reinstated TERA from January 2012 through December 2018, but without the qualified public service provision. The reinstatement of TERA is on a much smaller scale than the FY 1993 authority.

As of September 30, 2015, there were approximately 66,000 TERA retirees receiving approximately \$1,153 million in retired pay. For comparison, as of September 30, 2014, there were approximately 60,000 TERA retirees receiving \$1,014 million in retired pay.

Management's Discussion and Analysis

Cost-of-Living Increase

All non-disability retirement, disability retirement, and most survivor annuities are adjusted annually for inflation. COLAs are automatically scheduled to occur every 12 months, on December 1, 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 average 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. Many members receive a "partial" COLA on December 1 of their first year of retirement to reflect the fact that they were not retired for the full year. Members under the Final Pay benefit system may receive an additional one-time COLA adjustment in the first year of retirement to reflect the fact that an earlier retirement date would have been beneficial for them.

The benefits of retirees (and most survivors) are increased annually with the full COLA, with two exceptions. One is for those first entering the armed services on or after August 1, 1986, who elect the \$30,000 CSB. Their benefits are increased annually with a partial COLA equal to the full COLA minus 1% (except if the full COLA is less than or equal to 1%). 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. The second exception is for non-disabled retirees (and their survivors) entering the armed services on or after January 1, 2014, who decline the CSB and are under age 62 (or when the retiree would have been 62 in the case of survivors). This group also receives the full COLA minus 1%. Their benefits are restored at age 62, and thereafter they receive the full COLAs annually.

FUND RELATIONSHIPS

Department of Veterans Affairs Benefits

The 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 through December 31, 2003, were not fully additive. Since VA benefits are exempt from federal income taxes, it is often to the advantage of a member to elect them. Through calendar year 2003, retired pay earned from the DoD for military service was offset by any payment received from VA for a VA-rated disability. Beginning with NDAA 2004 (P.L. 108-136), a series of legislation has been enacted that increasingly reduces or eliminates the offset to military retired pay due to receipt of VA disability compensation. Members with a combined VA disability rating of 50% or greater who have at least 20 years of service will have their offset eliminated under the Concurrent Retirement and Disability Pay (CRDP) program. The CRDP program has a ten-year phase-in schedule that began in 2004; however, the offset is already fully eliminated for members whose disabilities are rated total (i.e., 100%) or make the individual unemployable. Members whose disability meets certain combat-related criteria can elect to receive payments against the offset under the Combat Related Special Compensation (CRSC) program. Under CRSC, members are not subject to a phase-in schedule, are not required to have at least 20 years of service, and are not required to have at least a 50% VA disability rating. Although CRSC amounts are calculated based on retired pay lost due to offset and are paid from the MRF, CRSC is not technically considered retired pay. CRSC payments are tax exempt. A member may not participate in both the CRDP and CRSC programs simultaneously, but may change from one to the other during an annual "open season."

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VA benefits also overlap DoD survivor benefits through the DIC program. DIC is payable to survivors of veterans who die from Service-connected causes. Although an SBP annuity must be reduced by the amount of any DIC benefit, all SBP premiums relating to the reduction in benefits are returned to the survivor. The FY 2008 NDAA enacted, and the Family Smoking Prevention and Tobacco Control Act of 2009 (P.L. 111-31) revised, a temporary Special Survivor Indemnity Allowance that pays a monthly amount (\$50 in FY 2009 grading up to \$310 in FY 2017) to survivors with a DIC offset. The authority for this allowance ends in 2017.

The offset relationship between SBP and DIC has been the subject of litigation in the U.S. Court of Appeals. As a result of the "Sharp Case" ruling, the SBP benefit of survivors with entitlement to both DIC and SBP who remarry after age 57 is not reduced by DIC benefits received.

Other Federal Service

For military retirement purposes, no credit is given for other federal service, except for TERA and 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 and Disability Fund in order to receive credit. Military service is not generally creditable under both systems (but is for reservists and certain disability retirees). Military retirees may qualify separately for Civil Service retirement and receive concurrent pay from both systems.

Retired Pay to Military Compensation

Basic pay is the only element of military compensation upon which non-disability retired pay is based and entitlement is determined. Basic pay is the principal element of military compensation that all members receive, but it is not representative of salary levels in the public and private sectors for comparative purposes. Reasonable comparisons can be made to regular military compensation (RMC). RMC is the sum of (1) basic pay; (2) the housing allowance, which varies by grade, location, and dependency status; (3) the subsistence allowance; and, (4) the tax advantages accruing to the housing and subsistence allowances because they are not subject to Federal income tax. Basic pay represents approximately 69% of RMC for all retirement eligible members. For the 20-year retiree, basic pay is approximately 67% of RMC. Consequently, a member retired with 20-years of service and entitled to 50% of basic pay only receives 33% of RMC. For a 30-year retiree, basic pay is approximately 72% of RMC and such member would be entitled to 75% of basic pay or 54% of RMC. Public Law 109-364 allows members, who retire after January 1, 2007, with greater than 30 years of service, to retire with entitlements exceeding 75% of basic pay. 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 these 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.

Management's Discussion and Analysis

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. Payments for these wage credits ended in 2002.

Members of the military are also required to pay the Hospital Insurance payroll tax, with the federal government contributing the matching employer contribution. Medicare eligibility occurs at age 65, or earlier if the employee is disabled.

SIGNIFICANT CHANGES

From FY 2014 to FY 2015

Changes in the MRF valuation during FY 2015 included:

- 1) New economic assumptions due to the Federal Accounting Standards Advisory Board (FASAB) financial reporting Statement of Federal Financial Accounting Standards 33 (SFFAS No. 33), discussed further in Note 7, "Military Retirement Benefit Liabilities";
- 2) Updated disabled retirement decrement rates

Items (1) – (2) are all classified as assumption changes in the actuarial valuation. Of the changes listed above, the new economic assumptions are the most substantial. SFFAS No. 33 requires the use of a yield curve based on marketable Treasury securities to determine the interest rates used to calculate actuarial liabilities for federal financial statements. Historical experience is the basis for expectations about future trends in marketable Treasury securities.

The yield curve was provided by the Treasury Office of Economic Policy (the series of Treasury spot rates was provided by the Office of Thrift Supervision in prior years). The DoD Board of Actuaries approved item (2) at their July 2015 meeting. Item (1) is prescribed and therefore the resulting economic assumptions will be different than those assumed by the DoD Board of Actuaries for funding calculations.

The liability reflects a NDAA 2015 amendment to the BBA 2013 that grandfathers those who first join prior to 1/1/2016 (the law previously grandfathered those hired prior to 1/1/2014).

Management's Discussion and Analysis

For FY 2016

In the current fiscal climate it is difficult to predict changes for any particular year. Over the next upcoming fiscal year the potential benefit changes with respect to the MRF include:

- 1) Reform of the MRS;
- 2) Budget Constraints (i.e., 'Sequestration');
- 3) Expansion of the SSIA;
- 4) Concurrent Receipt/DIC enhancements; and
- 5) Refinements to the mortality improvement scale (used to project death rates)

Regarding 1), the NDAA 2016 NDAA conference report released in late September 2015, includes major reform of military retirement benefits. Changes include reducing the pension multiplier from 2.5% to 2.0% per year of service; adding a TSP matching provision similar to FERS; adding additional continuation pay at 12 years of service; ends BBA 2013 and sunsets CSB retirement tiers; and providing retirees the option of converting a portion of their entitlement to a lump sum. Though the President subsequently vetoed the bill, it is possible that reform of military retirement will ultimately pass.

OACT will propose updates to the actuarial assumptions underlying the valuation of the MRS to more accurately reflect emerging plan experience as changes are implemented.

PERFORMANCE MEASURES

During FY 2015 and 2014, MRF made monthly disbursements to approximately 2.3 million retirees and annuitants.

There are many ways to measure the performance of a pension plan. Table 3 depicts a few common measures, specifically 1) Percent Funded, 2) Asset-to-Annuitant Liability Ratio, and 3) Effective Fund Yield. The last ten years are shown on the following page.

TABLE 3
MILITARY RETIREMENT SYSTEM
PERFORMANCE MEASURES

As of Sept. 30,	Percent Funded	Asset-to- Annuitant Liability Ratio	Effective Fund Yield
2015	38.5%	63.6%	1.8%
2014	34.9	57.9	3.2
2013	31.8	53.5	3.1
2012	29.0	49.2	2.9
2011	27.3	46.2	4.9
2010	25.6	43.2	3.2
2009	23.7	38.6	1.0
2008	22.0	35.4	6.2
2007	21.3	34.2	4.7
2006	21.6	34.5	5.9
2005	22.2	35.3	5.5
2004	22.5	36.9	5.4

NOTES:

- Percent Funded computed as total assets (from Balance Sheet) to actuarial accrued liability.
- Asset-to-Annuitant Liability Ratio computed as total assets (from Balance Sheet) to present value of future benefits for the annuitant population.
- Effective Fund Yield is the approximate fund yield over the course of the associated fiscal year.
- The MRF is invested solely in intragovernmental U.S. Treasury securities, with constraints to hold securities until maturity and invest with the primary objective of meeting the cash flow needs of the Fund. Therefore, the above measures should be used with caution when compared with other retirement funds and cited in the appropriate context.

PROJECTED LONG-TERM HEALTH OF THE FUND

The projected long-term health of the MRF is adequate due to the fact that it has three different sources of funding. The first two sources are appropriated funds:

- 1) Annual payments from Treasury to amortize the unfunded liability and pay the normal cost of the concurrent receipt benefits; and
- 2) Monthly normal cost payments from the Services to pay for the current years' service cost.

The third source of funding, earnings on investments, is projected to be an increasing contribution to the MRF due to an increasing fund balance. All three of these sources can be considered secure sources of funding, backed by the full faith and credit of the U.S. Government.

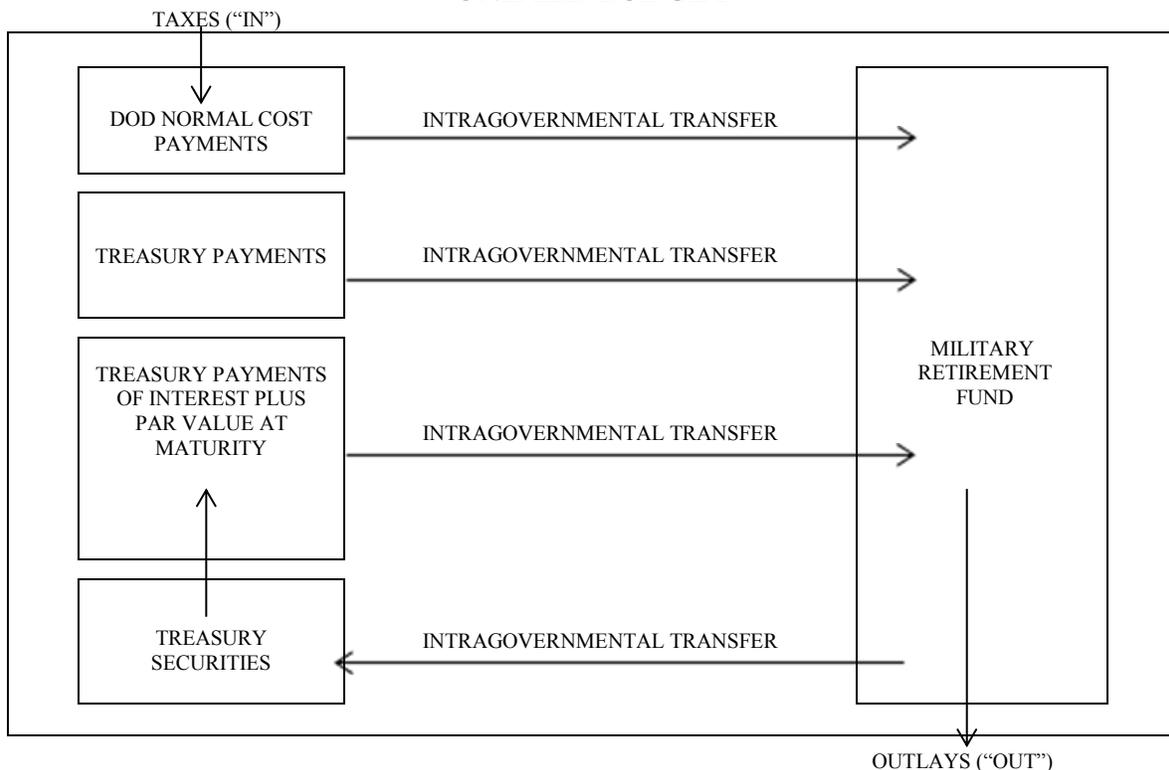
Management's Discussion and Analysis

MRF investment policy mandates that securities will be held to maturity. Occasionally, however, securities in the portfolio are liquidated prior to their stated maturity date. MRF has the authority to sell all or part of a security early to meet cash flow/benefit payment requirements. Historically, MRF holds cash in overnight securities in an amount equal to 110% of the following month's benefit. During FYs 2014 and 2015, all securities were held to maturity.

Unified Budget of the Federal Government

The MRF was created inside the Unified Budget of the federal government for the monies of the MRS. All three sources of fund income are intragovernmental transactions consisting of transfers from one government account to another. The only transactions in a particular year directly affecting the deficit of the Unified Budget are those passing in or out of the government, such as tax collections ("in") and beneficiary payments ("out"). These intragovernmental transfers are debits and credits within the federal budget, with no direct effect on the deficit. Just as in the pay-as-you-go method, the only transactions directly affecting the deficit in the retirement system accounting process are payments to retirees and survivors (i.e. outlays/payments). The purchase of securities by the Fund does increase the national debt, specifically the portion of the debt held by the government – the portion held by the public does not change. See Figure 1 below.

**FIGURE 1
UNIFIED BUDGET**



However, funding does have an effect on the DoD budget. With the normal cost payments (except for Concurrent Receipt) included in the DoD budget, policymakers now consider the impact on future retirement costs when they make manpower decisions, which could have a significant impact on future federal budgets.

Management's Discussion and Analysis

For example, if a decision were made today to double the size of the active duty and reserve forces, the DoD budget would automatically have an immediate increase in retirement obligations. Under the pay-as-you-go system, the retirement expenses would not necessarily be considered in the initial decision since they would not show up for 20 years.

The fact that MRF costs are fully recognized in advance provides greater benefit security over the long term. Also, when there is a retirement fund, the MRS is not as dependent on obtaining the necessary appropriation from Congress each year in order to pay benefits for that year. This can provide additional benefit security. As such, the existence of the Fund promotes a measure of “psychological security” for military members.

20-Year Projection

Table 4 (on the following page) presents a projection of contributions to and disbursements from the MRF. It includes the dollar amounts as a percent of payroll. The Fund is projected to remain solvent over the 20- year projection period. Further, as long as the funding sources continue making the required payments to the MRF in a timely fashion, the Fund is projected to remain solvent well beyond the 20-year projection horizon.

The following projections were made for FY 2015:

- Basic pay for FY 2015 was projected to be \$64.2 billion.
- Normal cost payments were projected to be \$26.1 billion.
- The unfunded liability amortization payment was projected to be \$75.6 billion.
- Investment income was projected to be \$33.5 billion.
- Fund disbursements for FY 2015 were projected to be \$56.6 billion.

TABLE 4
MILITARY RETIREMENT SYSTEM
PROJECTED FLOW OF PLAN ASSETS
(In Billions of Dollars and as a Proportion of Payroll)

Fiscal Year	Basic Payroll	Normal Cost Payments		Amortization of Unfunded Liability		Investment Income		Fund Disbursements		Fund Balance End of Year	
2016	\$63.3	\$26.1	(0.413)	\$79.29	(1.252)	\$38.0	(0.599)	\$57.8	(0.913)	\$709.1	(11.194)
2017	\$66.6	\$28.1	(0.422)	\$82.11	(1.232)	\$42.9	(0.644)	\$59.2	(0.889)	\$803.0	(12.052)
2018	\$68.3	\$28.8	(0.421)	\$84.20	(1.233)	\$48.1	(0.705)	\$60.7	(0.889)	\$903.4	(13.234)
2019	\$70.4	\$29.6	(0.421)	\$87.15	(1.238)	\$53.8	(0.764)	\$62.4	(0.887)	\$1,011.6	(14.366)
2020	\$72.7	\$30.6	(0.421)	\$90.20	(1.241)	\$59.9	(0.825)	\$64.3	(0.885)	\$1,128.0	(15.525)
2021	\$75.0	\$31.5	(0.420)	\$93.36	(1.245)	\$66.5	(0.886)	\$66.2	(0.883)	\$1,253.1	(16.709)
2022	\$77.4	\$32.5	(0.420)	\$96.62	(1.248)	\$73.5	(0.950)	\$68.3	(0.882)	\$1,387.4	(17.927)
2023	\$79.8	\$33.5	(0.420)	\$100.00	(1.253)	\$81.1	(1.015)	\$70.4	(0.882)	\$1,531.6	(19.188)
2024	\$82.3	\$34.5	(0.420)	\$103.50	(1.258)	\$89.1	(1.083)	\$73.2	(0.890)	\$1,685.5	(20.485)
2025	\$84.9	\$35.7	(0.420)	\$107.13	(1.261)	\$97.8	(1.151)	\$76.2	(0.897)	\$1,849.9	(21.781)
2026	\$87.7	\$36.8	(0.420)	\$110.88	(1.264)	\$107.0	(1.219)	\$78.9	(0.900)	\$2,025.6	(23.090)
2027	\$90.6	\$38.0	(0.419)	-\$12.51	(0.138)	\$109.8	(1.212)	\$81.8	(0.903)	\$2,079.2	(22.947)
2028	\$93.6	\$39.2	(0.419)	-\$12.95	(0.138)	\$112.7	(1.204)	\$84.7	(0.905)	\$2,133.5	(22.795)
2029	\$96.7	\$40.5	(0.419)	-\$13.40	(0.139)	\$115.6	(1.196)	\$87.6	(0.906)	\$2,188.7	(22.634)
2030	\$99.9	\$41.9	(0.419)	\$17.54	(0.176)	\$120.3	(1.204)	\$90.6	(0.907)	\$2,277.8	(22.802)
2031	\$103.2	\$43.2	(0.419)	\$21.05	(0.204)	\$125.4	(1.215)	\$93.7	(0.908)	\$2,373.7	(23.006)
2032	\$106.6	\$44.7	(0.419)	\$21.79	(0.204)	\$130.7	(1.225)	\$96.8	(0.908)	\$2,474.0	(23.204)
2033	\$110.2	\$46.2	(0.419)	\$22.55	(0.205)	\$136.2	(1.236)	\$100.2	(0.909)	\$2,578.7	(23.398)
2034	\$114.0	\$47.7	(0.419)	\$23.34	(0.205)	\$141.9	(1.245)	\$103.5	(0.908)	\$2,688.3	(23.587)
2035	\$118.0	\$49.4	(0.419)	\$8.33	(0.071)	\$147.1	(1.247)	\$106.6	(0.904)	\$2,786.5	(23.614)

Notes

- The preceding projections assume a long-term 5.5% interest rate each year.
- The projections will vary in the short-term depending on the actual economic experience.
- Note that the above projection is based on FY 2014 MRF methods and assumptions for funding purposes.
- The above Fund Disbursements do not include the effect of NDAA 2011 (retired pay date change).

Expected Problems

There are no foreseen major problems with respect to MRF that would require disclosure in the Management's Discussion and Analysis.

**FIGURE 2
INVESTMENTS**

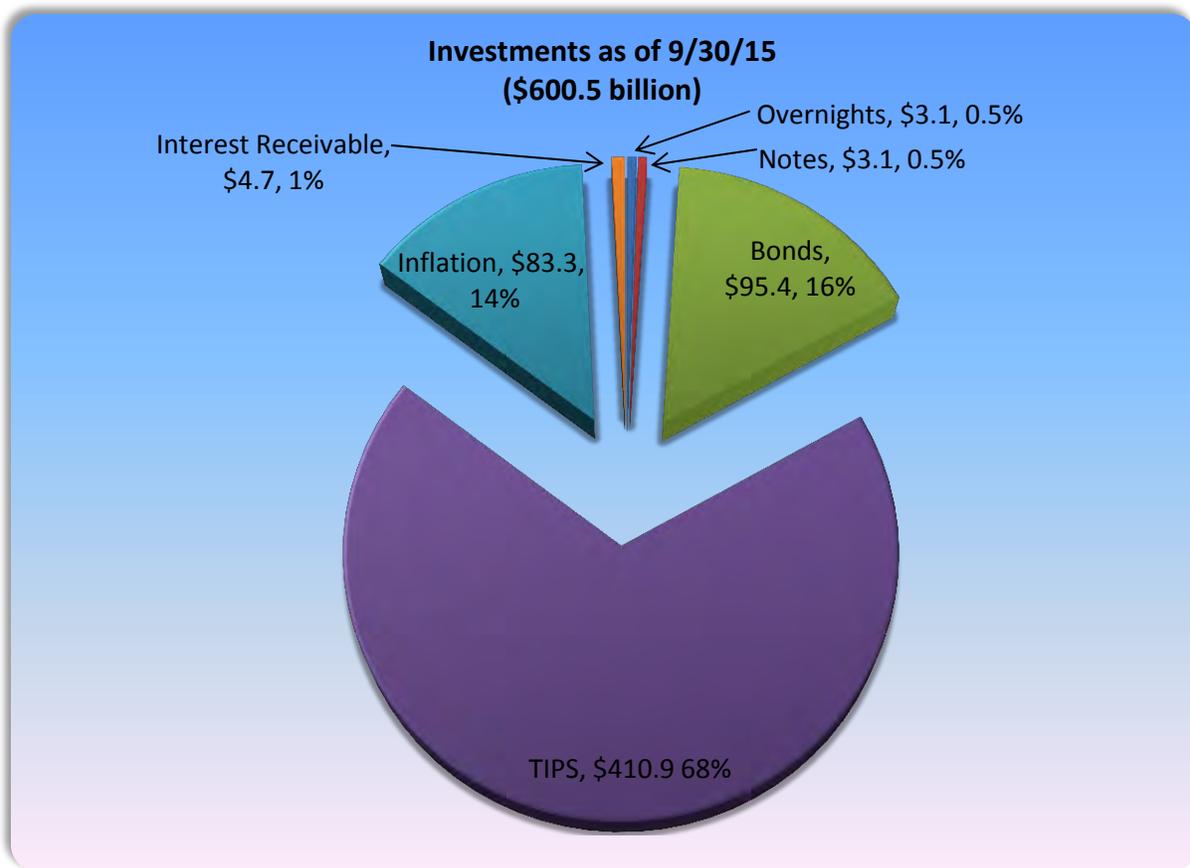


Figure 2 depicts the value (par, net of unamortized discount/premium) of investment holdings as of September 30, 2015.

Management Oversight

The Fund receives management oversight from the DoD Investment Board established in September 2003. The members of the Investment Board are the Director, DFAS; the Deputy CFO, OUSD(C); and a senior military member, currently the Director, Army Budget. The Investment Board meets twice each fiscal year to consider investment objectives, policies, performance, and strategies with the goal of maximizing MRF's investment income. The Investment Board reviews MRF's law and Department of Treasury guidelines to ensure MRF complies with broad policy guidance and public law. At the September 21, 2015 meeting, the Investment Board approved the FY 2016 investments recommended by the Investment Advisory Committee (a group of military reservists whose civilian expertise is investing). Additionally, there were 2 changes in the Investment Policy Statement that were approved, as noted on the following page.

Management's Discussion and Analysis

- 1) Floating Rate Notes are now a viable purchase consideration, and
- 2) The Investment Manager now has discretionary authority to reinvest receipts from interest payments and maturities that are not required to meet cash flow needs, without obtaining prior approval from the Investment Board (subject to constraints on the fund and dollar amount in question). The Investment Manager is required to report all instances of exercising this discretion at the next semiannual Investment Board meeting.

Anticipated Changes between the Expected and Actual Investment Rate of Return

The past decade has seen increased volatility in interest rates and equity markets, increasing deficits, volatility in the markets with regard to energy prices, elevated states of international conflict, increasing sovereign debt levels, unusual central banking monetary policy, and slow economic growth. These items have been a catalyst in the on-going discussion of implementing strong U.S. fiscal control and monetary policy among politicians. Active political management of the U.S. debt and annual deficit may create an opportunity to purchase Treasury market securities at higher rates of interest in the future. Conversely, uneasy equity markets tend to push participants toward government securities causing downward pressure on interest rates. There has also been a movement among private sector firms to increase pension plan investments in lower risk securities, driven in part by an area of modern corporate financial theory known as financial economics. An investment strategy has been developed to shift toward U.S. Treasury Inflation-Protected Securities (TIPS) to hedge against any future inflation.

The Fund receives investment income from a variety of U.S. Treasury-based instruments such as bills, notes, bonds and overnight investment certificates. U.S. Treasury bills are short-term securities with maturities of less than one year issued at a discount. U.S. Treasury notes are intermediate securities with maturities of one to ten years. U.S. Treasury bonds are long-term debt instruments with maturities of greater than ten years. Overnight certificates are interest-based market securities purchased from the U.S. Treasury maturing the next business day and accrue interest based on the Federal Reserve Bank of New York survey of Reserve repurchase agreement rates.

The Fund also invests in TIPS. TIPS are fixed-rate instruments designed to protect against inflation, with the principal amount indexed to the CPI by adjusting the CPI at issuance to the current CPI. As inflation increases, so does the principal amount.

Management's Discussion and Analysis

FINANCIAL PERFORMANCE OVERVIEW

Financial Data

Table 5 presents significant changes in the comparative financial statement information for the MRF.

TABLE 5
MILITARY RETIREMENT FUND
ANALYSIS OF FINANCIAL STATEMENTS

For the Years Ended September 30, 2015 and 2014
(\$ in Thousands)

	<u>2015</u>	<u>2014</u>	<u>Difference</u> <u>Increase / (Decrease)</u>	<u>%</u> <u>Change</u>
<i>BALANCE SHEETS</i>				
Intragovernmental:				
Fund Balance with Treasury	\$30,818	\$24,248	\$6,570	27%
Investments	\$600,462,119	\$544,929,929	\$55,532,190	10%
Accounts Receivable, Net	\$91,709	\$64,976	26,733	41%
Liabilities Not Covered by Budgetary Resources	\$1,037,222,138	\$1,086,957,281	(\$49,735,143)	(5%)
<i>STATEMENTS OF NET COST</i>				
Net Cost of Operations	(\$57,445,318)	(\$20,710,172)	(\$36,735,146)	(177%)

BALANCE SHEETS

-Fund Balance with Treasury: Fund Balance with Treasury increased \$6.6 million (27%), due to an additional \$50.0 million in month-end holdback to cover end of month payments posting on the last day of the month, offset by \$44.0 million in payments made on the last day of the quarter.

-Intragovernmental Securities, Net Investments: Total Intragovernmental Securities, Net Investments increased \$55.5 billion (10%) primarily due to the MRF purchase of \$65.3 billion in additional securities. The increase is due to normal growth in the MRF from contributions from the U.S. Treasury and the Military Services. The annual investment of these funds has a cumulative effect with an expectation that invested balances will continue growing to cover future benefits.

-Accounts Receivable, Net: Nonfederal Accounts Receivable increased by \$26.7 million (41%) primarily due to changes in the collection policy for Combat Related Special Compensation-Concurrent Receipt Disability Pay Debt. The Office of General Counsel has changed their opinion, allowing DFAS to attempt to collect overpayments from disabled veterans. As a result, an additional \$32.0 million in overpayments was recorded as receivables.

-Liabilities Not Covered by Budgetary Resources: Total Liabilities Not Covered by Budgetary Resources decreased \$49.7 billion (5%), primarily attributable to an increase of \$55.5 billion in investments received in FY 2015 and available to pay future benefits. Overall, the benefit liabilities did not increase, only the amount covered by budgetary resources. See Note 4, Investments for additional information about these changes.

STATEMENTS OF NET COST

-Net Cost of Operations: The Net Cost of Operations decreased \$36.7 billion (177%), primarily due to changes in the actuarial assumptions of \$31.0 billion. See Note 7, Military Retirement Benefit Liabilities, for additional information regarding the changes in actuarial assumption.

**FIGURE 3
TOTAL ASSETS**

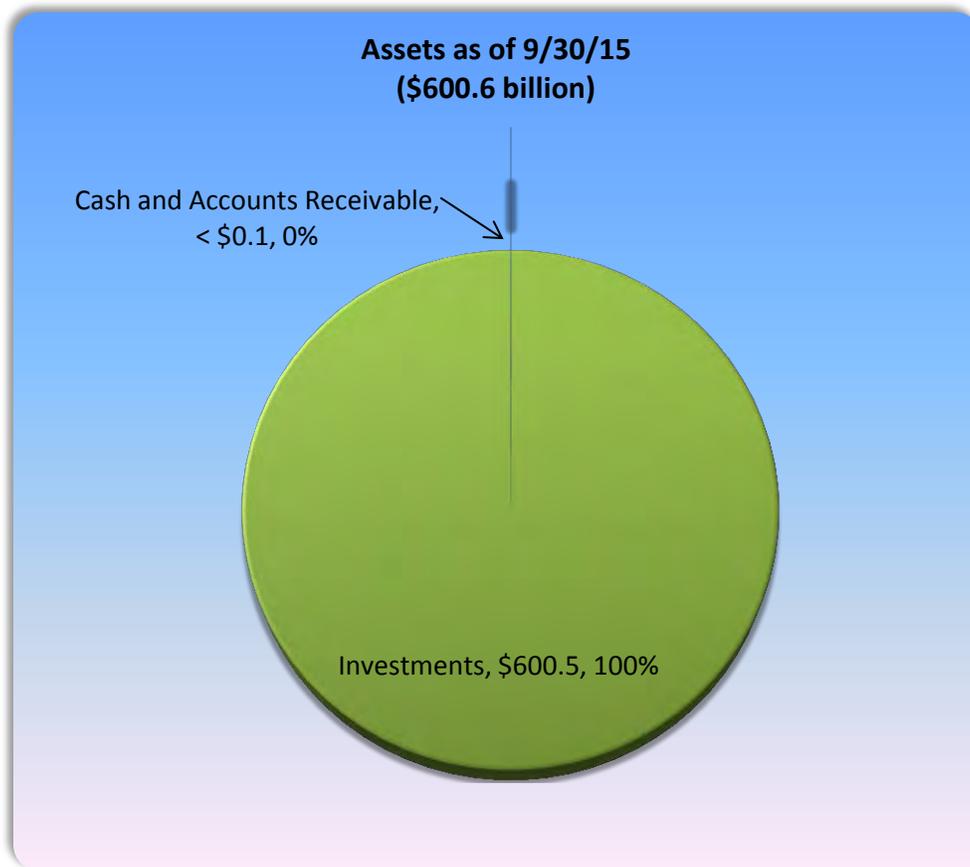


Figure 3 depicts the value of significant assets as of September 30, 2015.

Assets

Assets of \$600.6 billion shown in Figure 3 represent amounts that the MRF owns and manages. Assets increased \$55.5 billion, or 10%, from the end of FY 2014 to the end of FY 2015. This increase is attributable to purchasing new investments of \$65.3 billion with funds received from the U.S. Treasury payments, Service contributions, and interest received. The net increase in investments is related to expected normal growth to cover unfunded portions of future military retirement benefits. Funds not needed to pay current benefits are invested in U.S. Treasury securities or invested in overnight securities, as necessary, to make future benefit payments.

**FIGURE 4
TOTAL LIABILITIES**

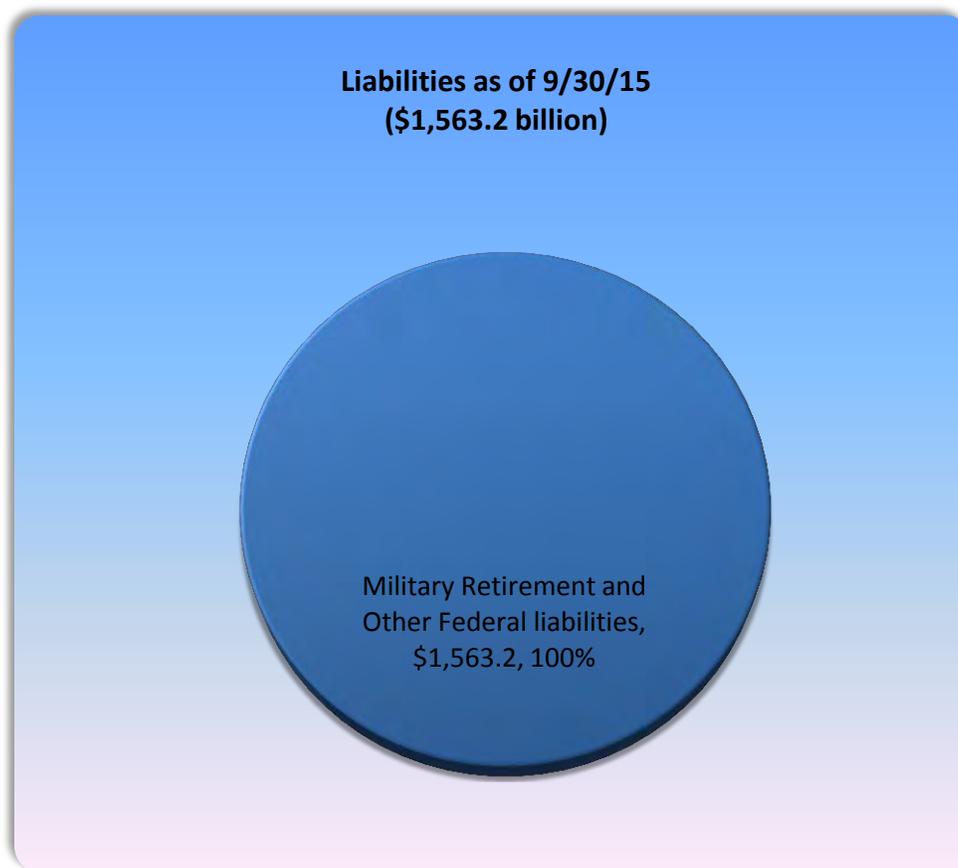


Figure 4 depicts the value of significant liabilities as of September 30, 2015.

Liabilities

Liabilities of \$1.6 trillion shown in Figure 4 represent liabilities related to military retirement pension benefits. The liabilities of the MRF primarily consist of actuarial liability for future benefit payments. Liabilities decreased \$1.9 billion, .1% from the end of FY 2014 to the end of FY 2015. This decrease is attributable to the decrease in the actuarial liability.

The MRF management is confident in the Fund's ability to meet its financial obligations. Of the \$1.6 trillion in liabilities, approximately \$526 billion (34%) is covered primarily by investments in U.S. Treasury securities (Figure 5). While the liability presents a negative financial position, the majority of the unfunded portion will come from annual appropriations external to DoD ensuring benefits are paid regardless of available assets. The initial unfunded actuarial liability, \$529 billion in 1984, is being amortized over 42 years and is expected to be fully funded through U.S. Treasury contributions by FY 2026. The current investments, the interest received on the investments, and the amortization of the initial liability will provide sufficient funds to cover the financial obligations of the MRF.

**FIGURE 5
FUNDED AND UNFUNDED LIABILITIES**

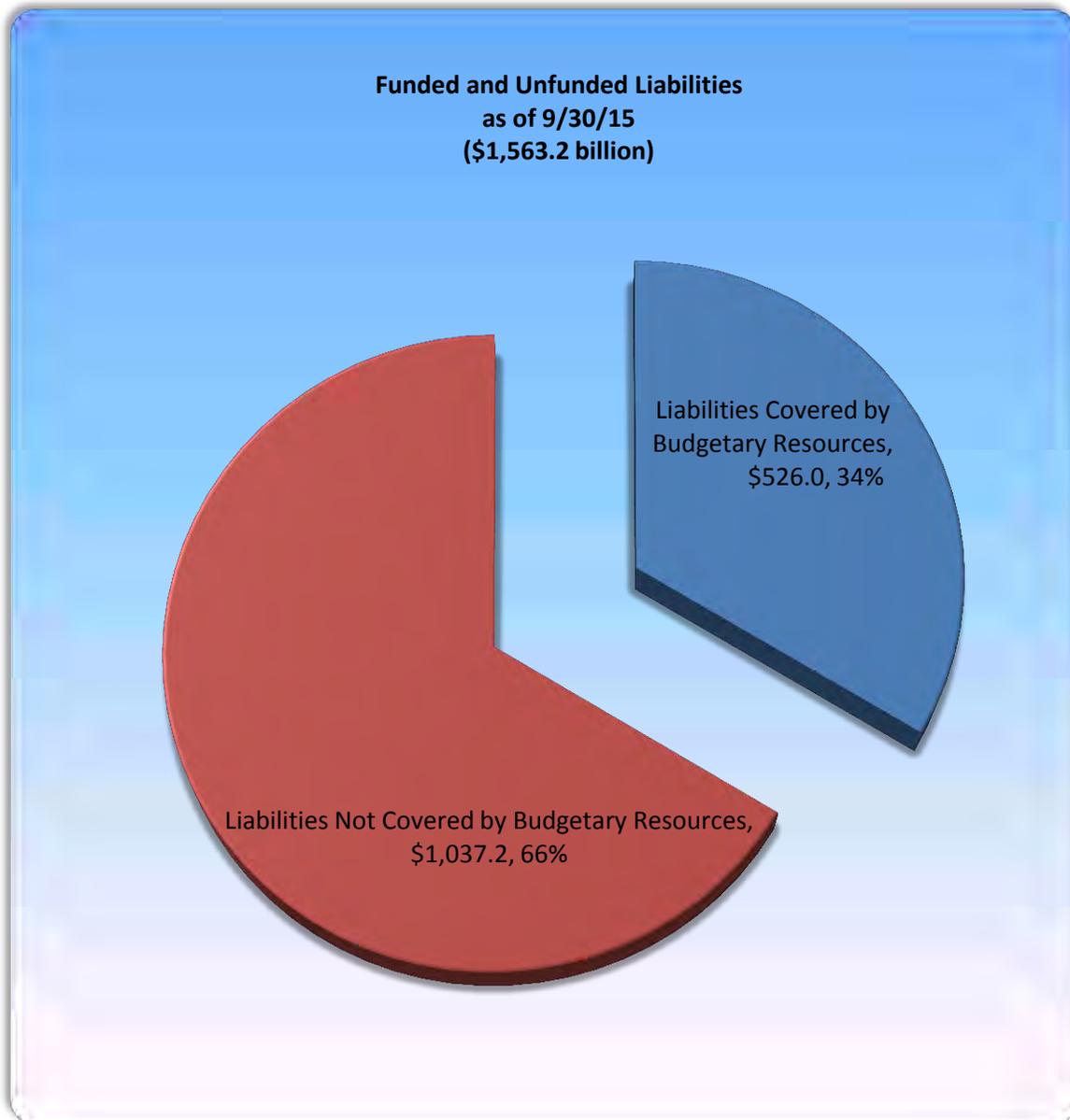


Figure 5 depicts the September 30, 2015, breakout of liabilities between those that are covered by budgetary resources and those that are not.

MANAGEMENT ASSURANCES

Agencies are required to provide certain assurances as to the status and effectiveness of the internal controls and financial management systems that support the preparation of the financial statements. In the context of the MRF Management's Discussion and Analysis, DoD, and not MRF, represents the legislative definition of an Agency. Beginning with FY 2006, as directed in Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, Appendix A, *Internal Control over Financial Reporting*, the 24 CFO Act agencies (including DoD), are required to provide a separate assessment of the effectiveness of the

Management's Discussion and Analysis

internal controls over financial reporting as a subset of the overall Federal Managers Financial Integrity Act (FMFIA) assurance statement. Currently, the Defense Finance and Accounting Service (DFAS) and the DoD Office of the Actuary (OACT) provide Statements of Assurance for systems and controls relied upon in the day to day operation of MRF. Additionally, an overarching MRF Statement of Assurance was issued for FY 2015 by the interim Management Control Senior Responsible Official. Future efforts to improve management oversight and internal controls for the fund include establishing a MRF Financial Management Committee. Procedures will be established to ensure adherence to the overarching statutory requirements of OMB 14-02, "Audit Requirements and Federal Financial Statements" (defining requirements for conducting and submitting FMFIA assessments and reports) and OMB A-123, "Management's Responsibility for Internal Control" (defining management's accountability for internal control in Federal agencies).

During 2015 (while under the current management structure), DFAS and OACT determined that the responsible MRF functions have effective internal controls to support effective and efficient programmatic operations and reliable financial reporting. In FY 2009, the service providers implemented corrective actions to become substantially compliant with applicable laws and regulations (FMFIA § 2). The current financial management system conforms to financial systems requirements and is substantially FMFIA compliant.

Under the current management arrangement, DFAS and OACT are responsible for appropriately establishing and maintaining effective internal control and financial management systems meeting the objectives of the FMFIA, subject to MRF operation. They conducted a functional assessment of the effectiveness of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, Management's Responsibility for Internal Control. Based on the results of this evaluation, the service providers can assure that MRF can provide reasonable assurance that internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations for FY 2015 were operating effectively and no material weaknesses were found in the design or operation of the internal controls.

Additionally under the current management process, DFAS and OACT conducted assessments of the effectiveness of internal control over financial reporting, including safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of these evaluations, DFAS and OACT can assure that MRF can provide reasonable assurance that its internal control over financial reporting as of 3rd Quarter, FY 2015 were operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

IMPROPER PAYMENTS INFORMATION ACT OF 2002 (PUBLIC LAW NO. 107-300)

The MRF public accounts receivable, \$91.7 million, consists mostly of improper payments to deceased retirees and survivors. This equates to less than 0.02% of the total assets and approximately 0.2% of the annual incurred benefit outlays.

The Improper Payments Information Act of 2002, as implemented by OMB Circular A-123, Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments, requires Federal agencies to review all programs and activities annually and identify those that may be susceptible to significant erroneous payments (i.e., programs with erroneous payments exceeding both \$10 million and 2.5% of program payments). The terms improper and erroneous are used interchangeably. An improper payment occurs when the funds go

Management's Discussion and Analysis

to the wrong recipient, the recipient receives the incorrect amount of funds, or the recipient receives payment for an ineligible service. Improper payments also include duplicate payments and payments for services not received.

Based on the individual assurances from DFAS and OACT, the MRF's risk assessment addresses the effectiveness of internal controls in place to prevent improper payments (such as prepayment reviews) as well as system weaknesses identified internally or by outside audit activities. While MRF's improper payment percentages are extremely low, numerous pre- and post-payment controls further minimize and eliminate improper payments.

Payments to deceased retirees continue to be the highest risk for improper payments in military retired pay. In certain situations, payment to deceased retirees is unavoidable due to payment cycle dates and the fact that notifying a payroll activity is not likely to be the first action for next-of-kin at the time of a retiree's passing. A review of confirmed payments to deceased retirees in FY 2008 indicated the Department recovered 96% of the overpayment amounts within 60 days, demonstrating the effectiveness of controls within the retired pay system once a retiree's death confirmation is received and processed for final disposition.

The MRF's control processes to prevent, identify, and reduce overpayments to deceased retirees include a series of periodic eligibility notifications, early detection data mining efforts, and partnerships with other Federal and state entities. The MRF takes a proactive approach, routinely comparing retired and annuity payroll master file databases to Social Security Administration "deceased" records and periodically comparing records with the Office of Personnel Management deceased files. "Ad hoc" death match file comparisons are also conducted with the VA's cemetery database files and with individual states (e.g., Texas, California, Florida) with sizable retiree and annuitant populations. Retirees identified as deceased in these comparisons must validate their continued eligibility, or the accounts are suspended.

Certifying officer legislation holds certifying and disbursing officers accountable for government funds. In accordance with section 2773a of title 10, U.S.C., pecuniary liability attaches automatically when there is a fiscal irregularity, i.e., (1) a physical loss of cash, vouchers, negotiable instruments, or supporting documents, or (2) an improper payment. Efforts to recover from a recipient must be undertaken in accordance with the debt collection procedures in Volume V, Chapters 29 and 30, of the DoD Financial Management Regulation.

LIMITATIONS OF THE FINANCIAL STATEMENTS

These financial statements have been prepared to report the financial position and results of operations for the MRF pursuant to the requirements of the Chief Financial Officers Act (CFO) of 1990. While the statements have been prepared from the books and records of MRF in accordance with the generally accepted accounting principles for federal entities and formats prescribed by OMB, the statements are in addition to 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 component of the U.S. Government, a sovereign entity. Unfunded liabilities reported in the financial statements cannot be liquidated without the enactment of an appropriation.



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

November 6, 2015

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

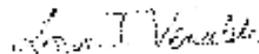
**SUBJECT: Independent Auditor's Report on the DoD Military Retirement Fund FY 2015
and FY 2014 Basic Financial Statements (Report No. DODIG-2016-008)**

We contracted with the independent public accounting firm of Kearney & Company to audit the financial statements of the Military Retirement Fund as of September 30, 2015, and 2014, and for the years then ended, and provide a report on internal controls over financial reporting and compliance with laws and regulations. The contract required that Kearney & Company conduct the audit in accordance with U.S. generally accepted government auditing standards (GAGAS), Office of Management and Budget audit guidance, and the Government Accountability Office/President's Council on Integrity and Efficiency, "Financial Audit Manual," July 2008. Kearney & Company's Independent Auditor's Report is attached.

Kearney & Company's audit resulted in an unmodified opinion. Kearney & Company concluded that the Military Retirement Fund Basic Financial Statements as of September 30, 2015, and 2014, and for the years then ended are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles. Kearney & Company's separate report on "Internal Controls Over Financial Reporting and Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements," did not identify any material weaknesses or significant deficiencies related to MRF internal controls over financial reporting or any instances of noncompliance with laws, regulations, contracts or grant agreements.

In connection with the contract, we reviewed Kearney & Company's reports and related documentation and discussed the audit results with Kearney & Company representatives. Our review, as differentiated from an audit in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the Military Retirement Fund financial statements, conclusions about the effectiveness of internal controls, conclusions as to whether the Military Retirement Fund's financial systems substantially complied with the "Federal Financial Management Improvement Act of 1996," or conclusions on whether the Military Retirement Fund complied with laws and regulations. Kearney & Company is responsible for the attached reports, dated November 6, 2015, and the conclusions expressed in these reports. However, our review disclosed no instances where Kearney & Company did not comply, in all material respects, with GAGAS.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945.



Lorin T. Venable, CPA
Assistant Inspector General
Financial Management and Reporting

Attachments: As stated



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INDEPENDENT AUDITOR'S REPORT

To:
The Under Secretary of Defense (Comptroller)/Deputy Chief Financial Officer
The Under Secretary of Defense for Personnel and Readiness
The Assistant Inspector General for Financial Management and Reporting

Report on the Financial Statements

We have audited the accompanying financial statements of the Military Retirement Fund (MRF), which comprise the balance sheets as of September 30, 2015 and 2014, the related Statements of Net Cost and Changes in Net Position, and the combined Statements of Budgetary Resources (hereinafter referred to as the "financial statements") for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MRF as of September 30, 2015 and 2014, and its net cost of operations, changes in net position, and budgetary resources for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, (hereinafter referred to as the "required supplementary information") be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by OMB and the Federal Accounting Standards Advisory Board (FASAB), who consider it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America. This consisted of inquiries of management about the methods of preparing the information and comparing it for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. Other information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements; accordingly, we do not express an opinion or provide any assurance on it.

Report on Internal Control, Compliance, and Other Matters

In accordance with *Government Auditing Standards* and OMB Bulletin No. 15-02, we have also issued a report, dated November 6, 2015, on our consideration of MRF's internal control over financial reporting and on our tests of MRF's compliance with provisions of applicable laws, regulations, contracts, and grant agreements, and other matters for the year ended September 30, 2015. The purpose of that report is to describe the scope of our testing of internal control over

Independent Auditor's Report _____



financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance and other matters. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 15-02 and should be considered in assessing the results of our audits.

A handwritten signature in blue ink that reads "Kearney & Company". The signature is written in a cursive, flowing style.

Alexandria, Virginia
November 6, 2015



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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE WITH LAWS, REGULATIONS, CONTRACTS AND GRANT AGREEMENTS

To:

The Under Secretary of Defense (Comptroller)/Deputy Chief Financial Officer
The Under Secretary of Defense for Personnel and Readiness
The Assistant Inspector General for Financial Management and Reporting

We have audited the financial statements of the Military Retirement Fund (MRF) as of and for the year ended September 30, 2015, and have issued our report thereon dated November 6, 2015. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered MRF's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MRF's internal control. Accordingly, we do not express an opinion on the effectiveness of MRF's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 15-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses or significant deficiencies. However, material weaknesses or significant deficiencies may exist that have not been identified.



We noted certain additional matters involving internal control over financial reporting that we will report to MRF's management in a separate letter.

Compliance with Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements

As part of obtaining reasonable assurance about whether MRF's financial statements are free from material misstatement, we tested its compliance with certain provisions of laws and regulations, contracts, and grant agreements. Noncompliance could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 15-02, including the provisions referred to in Section 803 (a) of the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions and did not test compliance with all laws and regulations applicable to MRF. However, providing an opinion on compliance with these provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 15-02.

The results of our tests of compliance with FFMIA disclosed no instances in which MRF's financial management systems did not comply substantially with the Federal Financial Management systems requirements, applicable Federal accounting standards, and application of the United States Standard General Ledger (USSGL) at the transaction level.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of MRF's internal control or compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 15-02 in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in blue ink that reads "Kearney & Company".

Alexandria, Virginia
November 6, 2015

**FY 2015 Military Retirement Fund Principal
Financial Statements**

DoD MRF Principal Financial Statements

Military Retirement Fund

BALANCE SHEETS

As of September 30, 2015 and 2014

(\$ in Thousands)

	<u>2015</u>	<u>2014</u>
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 30,818	\$ 24,248
Investments (Note 4)	600,462,119	544,929,929
Total Intragovernmental Assets	<u>600,492,937</u>	<u>544,954,177</u>
Accounts Receivable, Net (Note 5)	91,709	64,976
TOTAL ASSETS	<u>\$ 600,584,646</u>	<u>\$ 545,019,153</u>
LIABILITIES (Note 6)		
Intragovernmental:		
Other Liabilities (Note 8)	\$ 2,072	\$ 2,118
Total Intragovernmental Liabilities	<u>2,072</u>	<u>2,118</u>
Military Retirement and Other Federal Employment Benefits (Note 7)	1,563,159,162	1,565,038,960
Other Liabilities (Note 8)	241	222
TOTAL LIABILITIES	<u>\$ 1,563,161,475</u>	<u>\$ 1,565,041,300</u>
NET POSITION		
Cumulative Results of Operations - Other Funds	<u>(962,576,829)</u>	<u>(1,020,022,147)</u>
TOTAL NET POSITION	<u>\$ (962,576,829)</u>	<u>\$ (1,020,022,147)</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 600,584,646</u>	<u>\$ 545,019,153</u>

DoD MRF Principal Financial Statements

Military Retirement Fund

STATEMENTS OF NET COST

For the years ended September 30, 2015 and 2014

(\$ in Thousands)

	<u>2015</u>	<u>2014</u>
Program Costs (Note 10)		
Military Retirement Benefits		
Actuarial Non Assumption Costs	\$ 7,388,248	\$ 19,127,065
Other Program Costs	<u>56,802,279</u>	<u>55,449,713</u>
Total Gross Costs	\$ 64,190,527	\$ 74,576,778
(Less: Earned Revenue)	<u>(112,267,833)</u>	<u>(116,878,700)</u>
Net Cost before Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	(48,077,306)	(42,301,922)
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits (Note 7)	\$ <u>(9,368,012)</u>	\$ <u>21,591,750</u>
Net Program Costs Including Assumption Changes	\$ <u>(57,445,318)</u>	\$ <u>(20,710,172)</u>
Net Cost of Operations	<u><u>\$ (57,445,318)</u></u>	<u><u>\$ (20,710,172)</u></u>

DoD MRF Principal Financial Statements

Military Retirement Fund

STATEMENTS OF CHANGES IN NET POSITION

For the years ended September 30, 2015 and 2014

(\$ in Thousands)

	<u>2015</u>	<u>2014</u>
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	\$ (1,020,022,147)	\$ (1,040,732,319)
Beginning balances, as adjusted	(1,020,022,147)	(1,040,732,319)
Net Cost of Operations (+/-)	(57,445,318)	(20,710,172)
Net Change	57,445,318	20,710,172
Cumulative Results of Operations	(962,576,829)	(1,020,022,147)
Net Position	\$ (962,576,829)	\$ (1,020,022,147)

DoD MRF Principal Financial Statements

Military Retirement Fund

STATEMENTS OF BUDGETARY RESOURCES

For the years ended September 30, 2015 and 2014

(\$ in Thousands)

	<u>2015</u>	<u>2014</u>
Budgetary Resources:		
Appropriations (discretionary and mandatory)	\$ 56,829,039	\$ 55,451,489
Total Budgetary Resources	<u>\$ 56,829,039</u>	<u>\$ 55,451,489</u>
Status of Budgetary Resources:		
Obligations Incurred	\$ 56,829,039	\$ 55,451,489
Total Budgetary Resources	<u>\$ 56,829,039</u>	<u>\$ 55,451,489</u>
Change in Obligated Balance:		
Unpaid obligations:		
Unpaid obligations, brought forward, Oct 1	\$ 4,540,647	\$ 4,443,548
Obligations incurred	56,829,039	55,451,489
Outlays (gross) (-)	<u>(56,729,072)</u>	<u>(55,354,390)</u>
Unpaid obligations, end of year	<u>\$ 4,640,614</u>	<u>\$ 4,540,647</u>
Memorandum (non-add) entries:		
Obligated balance, start of year (+ or -)	<u>\$ 4,540,647</u>	<u>\$ 4,443,548</u>
Obligated balance, end of year (+ or -)	<u>\$ 4,640,614</u>	<u>\$ 4,540,647</u>
Budget Authority and Outlays, Net:		
Budget authority, gross (discretionary and mandatory)	\$ 56,829,039	\$ 55,451,489
Budget Authority, net (discretionary and mandatory)	<u>\$ 56,829,039</u>	<u>\$ 55,451,489</u>
Outlays, gross (discretionary and mandatory)	\$ 56,729,072	\$ 55,354,390
Outlays, net (discretionary and mandatory)	56,729,072	55,354,390
Distributed offsetting receipts (-)	<u>(75,562,000)</u>	<u>(72,885,000)</u>
Agency Outlays, net (discretionary and mandatory)	<u>\$ (18,832,928)</u>	<u>\$ (17,530,610)</u>

**FY 2015 Military Retirement Fund Footnotes to the
Principal Financial Statements**

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations for the Military Retirement Fund (MRF), as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the MRF in accordance with, and to the extent possible, U.S. generally accepted accounting principles (USGAAP) promulgated by the Federal Accounting Standards Advisory Board; the Office of Management and Budget (OMB) Circular No. A-136, "Financial Reporting Requirements"; and the Department of Defense (DoD) Financial Management Regulation (FMR). The accompanying financial statements account for all resources for which the MRF is responsible unless otherwise noted.

1.B. Mission of the Reporting Entity

The mission of MRF is to accumulate funds to finance, on an actuarially sound basis, the liabilities of DoD military retirement and survivor benefit programs. The MRF is a program for the payment of pensions to retired military personnel, annuities to eligible survivors, and special compensation for certain disabled retirees.

1.C. Appropriations and Funds

Public Law 98-94, The Defense Authorization Act of 1984, authorized MRF and provided a permanent, indefinite appropriation. Permanent authority becomes available based upon standing provisions of law without any further legislative action by the Congress after transmittal of the budget for each year.

The MRF is a nonrevolving trust fund. Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

1.D. Basis of Accounting

The MRF's financial management systems meet all full accrual accounting requirements. The MRF's accounting systems record transactions based on the U.S. Standard General Ledger (USSGL). Financial and nonfinancial feeder systems and processes are updated from legacy systems to collect and report financial information as required by USGAAP.

The financial statements and supporting footnotes are compiled from the underlying financial data and trial balances. The underlying data for the MRF is largely derived from budgetary transactions (obligations, disbursements, and collections) and proprietary transactions (assets and liabilities) and accruals made for major items such as pension liabilities.

1.E. Revenues and Other Financing Sources

Using methods and assumptions approved by the DoD Board of Actuaries, the DoD Office of the Actuary determines the amount of the contributions made to MRF. The Military Services make a monthly contribution, which is a percentage of basic pay, to cover accruing costs for currently active military members. The MRF also receives a U. S. Treasury warrant at the beginning of each fiscal year (1) to amortize unfunded liability and (2) to cover accruing costs for concurrent receipts (certain beneficiaries with combat-related injuries who are

DoD MRF Notes to the Principal Financial Statements _____

receiving payments from the Department of Veterans Affairs (VA)). In addition, interest is earned on investments. Funds from the contributions that exceed the amounts required to pay current year expenses are invested in long-term securities. These investments and their associated interest revenues will be used to cover future liabilities of MRF.

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of benefit expenses in the period incurred. The current financial management systems for MRF collect and record on full accrual accounting basis for liabilities and expenses of the fund.

1.G. Accounting for Intragovernmental Activities

The Treasury Financial Manual Part 2-Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government," provides guidance for reporting and reconciling intragovernmental balances. The MRF is able to reconcile balances pertaining to investments in federal securities.

The DoD's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements do not report any public debt, interest, or source of public financing, whether from issuance of debt or tax revenues.

1.H. Funds with the U.S. Treasury

The MRF's monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS) process MRF's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS submits reports to the U.S. Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. On a monthly basis, the MRF FBWT is reviewed and adjusted, as required, to agree with the U.S. Treasury accounts.

The U.S. Treasury allows MRF to be fully invested; therefore FBWT may be zero at various times during the fiscal year. Controls are in place to prevent abnormal balances at the U.S. Treasury.

1.I. Accounts Receivable

Accounts receivable from other federal entities or from the public include accounts receivable, claims receivable, and refunds receivable. Allowances for uncollectible accounts due from the public are based upon an analysis of actual collection experience by MRF during the previous three years. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies as receivables from other federal agencies are considered to be inherently collectible.

1.J. Investments in U.S. Treasury Securities

The MRF reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts (book value). Premiums or discounts are amortized over the term of the investment using the effective interest rate method. The MRF's intent is to hold investments to maturity unless they are needed to finance claims or

DoD MRF Notes to the Principal Financial Statements_____

otherwise sustain operations. Consequently, there is no provision for unrealized gains or losses on these securities.

The MRF invests in nonmarketable market-based U.S. Treasury securities, issued to federal agencies by the U.S. Treasury's Bureau of Fiscal Service. These securities are not traded on any financial exchange but are priced consistently with publicly traded U.S. Treasury securities. The MRF receives interest semiannually from the U.S. Treasury on the value of these securities.

1.K. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government", as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation", defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The MRF recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. The MRF reports death payment contingencies that result from DoD's responsibility to cover retiree benefits not paid by the VA during the month of death.

1.L. Net Position

Net position consists of cumulative results of operations. Cumulative results of operations represent the net of expenses, losses, and financing sources (including appropriations, revenue, and gains) since inception.

1.M. Military Retirement and Other Federal Employment Benefits

The Department applies SFFAS No. 33, "Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates," in selecting the discount rate and valuation date used in estimating actuarial liabilities. In addition, gains and losses from changes in long-term assumptions used to estimate the actuarial liability are presented separately on the Statement of Net Cost. Refer to Note 7, Military Retirement and Other Federal Employment Benefits and Note 10, General Disclosures Related to the Statement of Net Cost, for additional information.

1.N. Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and changes therein, disclosure of contingent assets and liabilities, and the actuarial present value of accumulated plan benefits at the date of the financial statements. Actual results could differ from those estimates.

1.O. Actuarial Information

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

DoD MRF Notes to the Principal Financial Statements _____

Note 2. Nonentity Assets				
As of September 30	2015		2014	
<i>(Amounts in thousands)</i>				
Nonfederal Assets				
Accounts Receivable	\$	2,072	\$	2,118
Total Nonfederal Assets		2,072		2,118
Total Nonentity Assets		2,072		2,118
Total Entity Assets		600,582,574		545,017,035
Total Assets	\$	600,584,646	\$	545,019,153

Information Related to Nonentity Assets

Nonentity assets are assets for which the MRF maintains stewardship accountability and responsibility to report but are not available for MRF’s operations.

Nonfederal Assets, Accounts Receivable, represent the amount of interest, penalties, and administrative charges to be collected by MRF on behalf of the U.S. Treasury. Once collected, this amount is transferred to the appropriate U.S. Treasury receipt account. This amount is offset by a corresponding custodial liability for MRF reported in Note 8, Other Liabilities.

DoD MRF Notes to the Principal Financial Statements _____

Note 3. Fund Balance with Treasury		
As of September 30	2015	2014
(Amounts in thousands)		
Fund Balances		
Trust Funds	\$ 30,818	\$ 24,248
Total Fund Balances	\$ 30,818	\$ 24,248
Fund Balances Per Treasury Versus Agency		
Fund Balance per Treasury	\$ 30,818	\$ 24,248
Fund Balance per <i>MRF</i>	30,818	24,248
Reconciling Amount	\$ 0	\$ 0
Status of Fund Balance with Treasury		
As of September 30	2015	2014
(Amounts in thousands)		
Unobligated Balance		
Unavailable	\$ 521,296,651	\$ 473,541,254
Obligated Balance not yet Disbursed	\$ 4,640,614	\$ 4,540,647
NonFBWT Budgetary Accounts	\$ (525,906,447)	\$ (478,057,653)
Total	\$ 30,818	\$ 24,248

Information Related to Status of Fund Balance with Treasury

The Status of Fund Balance with Treasury (FBWT) reflects the budgetary resources to support FBWT and is a reconciliation between budgetary and proprietary accounts. It primarily consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursement against current or future obligations.

Unobligated Balance is classified as available or unavailable and represents the cumulative amount of budgetary authority not set aside to cover outstanding obligations. The unavailable balance, consisting primarily of funds temporarily precluded from obligation by law, is invested in U.S. Treasury securities. The unobligated balance for the Military Retirement Fund (MRF) is restricted for use by the public law establishing the fund and becomes available without further congressional action.

Obligated Balance not yet Disbursed represents the amount of earned and accrued pension and annuity payments. The MRF balance represents benefits payable on September 30, 2015.

The MRF NonFBWT Budgetary Accounts balance represents investments in U.S. Treasury securities that are reflected in the MRF's budgetary resources, but are not part of the FBWT.

DoD MRF Notes to the Principal Financial Statements _____

Note 4. Investments and Related Interest

As of September 30	2015			
	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net

(Amounts in thousands)

Intragovernmental Securities

Nonmarketable, Market-Based

Military Retirement Fund

\$	620,997,164	Effective Interest	\$	(25,237,896)	\$	595,759,268	\$	640,927,115
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Total Nonmarketable, Market-Based

	620,997,164			(25,237,896)		595,759,268		640,927,115
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Accrued Interest

	4,702,851					4,702,851		4,702,851
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Total

Intragovernmental Securities

\$	625,700,015		\$	(25,237,896)	\$	600,462,119	\$	645,629,966
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As of September 30

2014

Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
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Intragovernmental Securities

Nonmarketable, Market-Based

Military Retirement Fund

\$	560,971,265	Effective Interest	\$	(20,188,779)	\$	540,782,486	\$	588,892,326
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Total Nonmarketable, Market-Based

	560,971,265			(20,188,779)		540,782,486		588,892,326
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Accrued Interest

	4,147,443					4,147,443		4,147,443
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Total

Intragovernmental Securities

\$	565,118,708		\$	(20,188,779)	\$	544,929,929	\$	593,039,769
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Information Regarding Investments and Related Interest

The MRF purchases and redeems nonmarketable market-based U.S. Treasury securities that fluctuate in tandem with the current selling price of the equivalent marketable security on the open market. The MRF purchases securities with the intent to hold until maturity; therefore, balances are not adjusted to market value.

The cash generated from investments is deposited in the U.S. Treasury, which uses the cash for general government purposes. The U.S. Treasury securities are issued to the MRF as evidence of its receipts and are an asset to the MRF and a liability to the U.S. Treasury. Since MRF and the U.S. Treasury are both parts of the Federal Government, these assets and liabilities offset each other from the standpoint of the Federal Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Governmentwide financial statements.

The U.S. Treasury securities provide MRF with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When MRF requires redemption of these securities to make expenditures, the

DoD MRF Notes to the Principal Financial Statements _____

government will finance them from accumulated cash balances, by raising taxes or other receipts, borrowing from the public or repaying less debt, or curtailing other expenditures. The Federal Government uses the same method to finance all other expenditures.

At the semiannual meetings, the Department of Defense Investment Board approves the strategy for the type of securities purchased by MRF. These securities can include U.S. Treasury bills, notes, bonds, inflation-protected securities, and overnight certificates. The U.S. Treasury bills are short-term securities with maturities of one year or less and are purchased at a discount. The U.S. Treasury notes have maturities of at least one year, but not more than ten years, and are purchased at either a discount or premium. The U.S. Treasury bonds are long-term securities with maturities of ten years or more and are purchased at either a discount or premium. The U.S. Treasury Inflation-Protected-Securities (TIPS) provide protection against inflation and are purchased at either a discount or premium. The TIPS principal increases with inflation and decreases with deflation, as measured by the Consumer Price Index. When TIPS mature, the U.S. Treasury pays the adjusted principal or original principal, whichever is greater. The TIPS amount includes inflation compensation as well as the par value of the securities. Overnight securities are short-term securities, purchased at face value, that mature the next business day and earn interest at the daily Federal Reserve repurchase agreement rate.

The cost of the U.S. Treasury Securities is displayed in the following table.

(Amounts in thousands)		FY 2015 COST		FY 2014 COST
Notes	\$	3,509,531	\$	6,630,938
Bonds		98,331,077		42,293,176
TIPS		516,057,882		506,921,211
Overnight Securities		<u>3,098,674</u>		<u>5,125,940</u>
Total Cost	\$	<u>620,997,164</u>	\$	<u>560,971,265</u>

DoD MRF Notes to the Principal Financial Statements _____

Note 5. Accounts Receivable

As of September 30	2015		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in thousands)			
Nonfederal Receivables (From the Public)	\$ 102,128	\$ (10,419)	\$ 91,709
Total Accounts Receivable	\$ 102,128	\$ (10,419)	\$ 91,709

As of September 30	2014		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Nonfederal Receivables (From the Public)	\$ 68,737	\$ (3,761)	\$ 64,976
Total Accounts Receivable	\$ 68,737	\$ (3,761)	\$ 64,976

Information Related to Accounts Receivable

The accounts receivable represent the MRF's claim for payment from military retirees or their survivors for erroneous amounts previously paid. The MRF only recognizes an allowance for uncollectible amounts from the public. Claims with other federal agencies are resolved in accordance with the Intragovernmental Business Rules.

Note 6. Liabilities Not Covered by Budgetary Resources

As of September 30	2015	2014
(Amounts in thousands)		
Nonfederal Liabilities		
Military Retirement and Other Federal Employment Benefits	1,037,221,897	1,086,957,059
Other Liabilities	241	222
Total Nonfederal Liabilities	\$ 1,037,222,138	\$ 1,086,957,281
Total Liabilities Not Covered by Budgetary Resources	\$ 1,037,222,138	\$ 1,086,957,281
Total Liabilities Covered by Budgetary Resources	\$ 525,939,337	\$ 478,084,019
Total Liabilities	\$ 1,563,161,475	\$ 1,565,041,300

DoD MRF Notes to the Principal Financial Statements _____

Information Related to Liabilities Not Covered by Budgetary Resources

The MRF Liabilities Not Covered by Budgetary Resources amount represents actuarial liabilities for pension benefits for which assets are not yet available. Refer to Note 7, Military Retirement Benefit Liabilities, for additional details and disclosures.

Nonfederal Other Liabilities represent contingent liabilities payable by the Department of Defense for estimated death payments. These liabilities cover the retiree benefits not paid by the Department of Veterans Affairs during the month of death. This amount is also reported on Note 8, Other Liabilities.

Note 7. Military Retirement Benefit Liabilities				
As of September 30	2015			
	Liabilities	(Less: Assets Available to Pay Benefits)		Unfunded Liabilities
(Amounts in thousands)				
Pension and Health Benefits				
Military Retirement Pensions	\$ 1,558,518,548	\$ (521,296,651)	\$	1,037,221,897
Total Pension and Health Benefits	\$ 1,558,518,548	\$ (521,296,651)	\$	1,037,221,897
Other Benefits				
Other	4,640,614	(4,640,614)		0
Total Other Benefits	\$ 4,640,614	\$ (4,640,614)	\$	0
Total Military Retirement and Other Federal Employment Benefits:	\$ 1,563,159,162	\$ (525,937,265)	\$	1,037,221,897
As of September 30	2014			
	Liabilities	(Less: Assets Available to Pay Benefits)		Unfunded Liabilities
(Amounts in thousands)				
Pension and Health Benefits				
Military Retirement Pensions	\$ 1,560,498,313	\$ (473,541,254)	\$	1,086,957,059
Total Pension and Health Benefits	\$ 1,560,498,313	\$ (473,541,254)	\$	1,086,957,059
Other Benefits				
Other	4,540,647	(4,540,647)		0
Total Other Benefits	\$ 4,540,647	\$ (4,540,647)	\$	0
Total Military Retirement and Other Federal Employment Benefits:	\$ 1,565,038,960	\$ (478,081,901)	\$	1,086,957,059

DoD MRF Notes to the Principal Financial Statements

As of September 30	2015		2014	
	Military Retirement Pensions		Military Retirement Pensions	
(Amounts in thousands)				
Beginning Actuarial Liability	\$	1,560,498,313	\$	1,519,779,498
Plus Expenses:				
Normal Cost		31,174,997		32,462,431
Interest Cost		66,560,581		64,858,317
Plan Amendments		22,667		(21,733)
Experience Losses (Gains)		(33,771,753)		(22,572,915)
Other factors		(1)		(1)
Subtotal: Expenses before Losses (Gains) from Actuarial Assumption Changes		63,986,491		74,726,099
Actuarial losses/ (gains)/ due to:				
Changes in trend assumptions		0		0
Changes in assumptions other than trend		(9,368,012)		21,591,750
Subtotal: Losses (Gains) from Actuarial Assumption Changes		(9,368,012)		21,591,750
Total Expenses	\$	54,618,479	\$	96,317,849
Less Benefit Outlays		56,598,244		55,599,034
Total Changes in Actuarial Liability	\$	(1,979,765)	\$	40,718,815
Ending Actuarial Liability	\$	1,558,518,548	\$	1,560,498,313

Each year the actuarial liability is expected to increase with the normal cost, decrease with benefit outlays, and increase with the interest cost, resulting in an expected increase of \$41.1 billion in the actuarial liability in FY 2015.

The September 30, 2015, actuarial liability includes changes due to assumptions, benefit changes, and experience. The new assumptions include updated disabled retiree decrement rates, and lower interest, Cost of Living Adjustment (COLA), across-the board salary interest assumptions under SFFAS No. 33 (4.1% compared to 4.3% last year interest last year, 2.1% compared to 2.4% COLA last year, and 2.3% compared to 2.5% salary last year). The net effect of these new assumptions is a decrease in the September 30, 2015, actuarial liability of \$9.4 billion ((\$20.0) billion of this is due to the changed SFFAS No. 33 long-term economic assumptions, and \$10.6 billion is due to the updated disabled retiree decrement rates) –refer to below table. The benefit change loss of \$22.7 million is due to the delaying of the Bipartisan Budget Act of 2013 (Ryan/Murray) with subsequent amendments by 2 years (from applying to those entering after 12/31/2013 to 12/31/2015). The experience gain of \$33.8 billion reflects economic experience being different from that assumed, as well as the new population on which the September 30, 2015, actuarial liability is based.

<u>New Assumptions</u>	<u>Increase/Decrease</u>
SFFAS No. 33 Long-Term Economic	\$ (20.0) billion
Updated Disabled Retiree Decrements	<u>10.6 billion</u>
Total decrease in actuarial liability	\$ 9.4 billion

DoD MRF Notes to the Principal Financial Statements

Information Related to Military Retirement Benefit Liabilities

The MRF accumulates funds used to pay pensions to retired military personnel and annuities to their survivors. The Military Retirement System is a single-employer, defined benefit plan.

The schedules above reflect two distinct types of liabilities related to Military Retirement and Other Federal Employment Benefits. The line entitled "Military Retirement Pensions" represents the actuarial liability for future pension benefits not yet paid, i.e., the present value of future benefits less the present value of future normal costs. The line entitled "Other" represents retirement benefits currently due and payable.

This schedule also computes "unfunded liabilities", i.e. liabilities not covered by budgetary resources. The assets presented in this schedule differ from those reported on the balance sheet. The balance sheet assets consist primarily of investments, the value of which is based on the fully amortized cost or "book value" of the securities (see Note 4, Investments and Related Interest). The value of assets available to pay benefits presented in the above schedule is based on investments and unamortized premiums. The difference between investments and assets available to pay benefits is the premium on U.S. Treasury Securities. At the time of purchase, budgetary funding is reduced by the premium on U.S. securities because the premium on securities is no longer a budgetary resource.

Effective FY 2010, the MRF implemented requirements of SFFAS No. 33, which directs that the interest rate, underlying inflation rate, and other economic assumptions be consistent with one another. A change in the interest rate may cause other assumptions to change as well. For the September 30, 2015, financial statement valuation, the application of SFFAS No. 33 required the DoD Office of the Actuary (OACT) to set the long-term inflation (CPI) and salary increase assumptions to be consistent with the underlying Treasury spot rates used in the valuation.

The MRF actuarial liability is calculated at the end of each fiscal year.

Actuarial Cost Method

Per statute, the MRF is funded using the Aggregate Entry-Age Normal (AEAN) method. Per the Federal Accounting Standards Advisory Board (FASAB), AEAN is also used to compute the actuarial liabilities reported above. AEAN is a method whereby the costs of future retirement and survivor benefits for a new-entrant cohort are spread over the projected salaries of that group.

Revenues

The MRF receives revenues from three sources: (1) interest earnings on MRF assets, (2) monthly contributions from the Military Services, and (3) an annual contribution from the U.S. Treasury. The contribution from the U.S. Treasury is paid into the MRF at the beginning of each fiscal year and represents the amortization of the unfunded liability for service performed before October 1, 1984, as well as the amortization of subsequent actuarial gains and losses. Starting October 1, 2004, Public Law 108-136 requires a Treasury contribution for the normal cost amount for the concurrent receipt provisions under Sections 1413a and 1414 in addition to the unfunded liability amortization payment. The DoD Board of Actuaries (the Board) approves methods and assumptions used to determine the amounts for contributions by the U.S. Treasury and the Military Services, and the Secretary of Defense directs the Secretary of Treasury to make the required payment.

DoD MRF Notes to the Principal Financial Statements

Assumptions

The Board sets the long-term economic assumptions for each valuation performed for funding purposes. Prior to FY 2010, the same long-term assumptions were used for the financial statement valuations. The distinction between the two different valuations is discussed below.

	Inflation (CPI)	Salary	Interest
Fiscal Year 2014 financial statement valuation	2.4%	2.5%	4.3%
Fiscal Year 2014 funding valuation	3.0%	3.5%	5.5%
Fiscal Year 2015 financial statement valuation	2.1%	2.3%	4.1%
Fiscal Year 2015 funding valuation	2.75%	3.25%	5.25%

Note that the term “interest” refers here to the interest rate used to discount cash flows. The terms “interest rate” and “discount rate” are often used interchangeably in this context.)

The difference in the long-term assumptions between funding and financial statement valuations is attributable to SFFAS No. 33. This applicable financial statement standard is discussed further below. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on a blend of actual experience and future expectations. Because of reporting deadlines, the current year actuarial present value of projected plan benefits for the MRF financial statement is rolled forward from the prior year valuation results as reported in the OACT report “Valuation of the Military Retirement System” using accepted actuarial methods. Modifications are made as necessary to adjust liabilities to a financial statement basis.

In the selection of the valuation date, SFFAS No. 33 allows for actuarial liabilities to be rolled forward from the prior year valuation results. The effects of changes during the year in major factors such as actual pay raises and cost of living adjustments have been incorporated in the roll-forward adjustment. In calculating the FY 2015 “roll-forward” actuarial liability, the following assumptions were used:

	Inflation (CPI)	Salary	Interest
Fiscal Year 2015	1.7% (actual)	1.0% (actual)	4.3%
Fiscal Year 2016	0.0% (estimated)	1.3% (estimated)	4.1%
Long-Term	2.1%	2.3%	4.1%

For purposes of the Fund’s financial reporting, this roll-forward process is applied annually.

Contributions to the MRF are calculated so as to maintain the Fund on an actuarially sound basis. This means there will be sufficient funds to make all benefit payments to eligible recipients each year, and the Fund balance is projected to eventually equal the actuarial liability; i.e., all unfunded liabilities are liquidated. In order to accomplish this objective, normal costs are calculated to fully fund the current year projected liability for military personnel. In addition, amortization payments are calculated to fund liabilities that were present at plan inception (initial unfunded liability) and any emerging actuarial gains or losses. Because of “sequestration,” the Office of Management and Budget (OMB) required a \$651 million reduction to the actuarially determined contribution made to the MRF at the beginning of FY 2015. However, the Board chose to amortize this shortfall over one year as an experience loss, effectively putting MRF funding at the beginning of FY 2016 back to where it would have been without the sequestration reduction.

DoD MRF Notes to the Principal Financial Statements

The initial unfunded liability of the program was amortized over a 50-year period through the FY 2007 payment. At its August 2007 meeting, the Board decided to decrease the period over which the initial unfunded liability is fully amortized by 8 years. The Board's decision was made to ensure, at a minimum, the amortization payment covered the interest on the unfunded actuarial liability. Therefore, starting with the FY 2008 payment, the initial unfunded liability is being amortized over a 42-year period, with the last payment expected to be made October 1, 2025. All subsequent gains and losses experienced by the system are amortized over a period determined by a weighted average using 30 years for the new gain or loss and the remaining period for the existing unamortized balance. Chapter 74 of Title 10, United State Code (U.S.C.), requires the Board approve the methods and assumptions used to (1) compute actuarial costs and liabilities for funding purposes, (2) amortize the initial unfunded liability, and (3) amortize all actuarial gains and losses. The Board is a Federal Advisory Committee appointed by the Secretary of Defense.

DoD complies with SFFAS No. 33, "Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates." The standard requires the separate presentation of gains and losses from changes in long-term assumptions used to estimate liabilities associated with pensions, other retirement and other postemployment benefits. The SFFAS No. 33 also provides a standard for selecting the discount rate and valuation date used in estimating these liabilities. SFFAS No. 33, as published on October 14, 2008, by FASAB requires the use of a yield curve based on marketable U.S. Treasury securities to determine the discount rates used to calculate actuarial liabilities for federal financial statements. Historical experience is the basis for expectations about future trends in marketable U.S. Treasury securities.

The statement is effective for periods beginning after September 30, 2009, and applies to information provided in general purpose federal financial statements. It does not affect statutory or other special-purpose reports, such as pension or Other Retirement Benefit reports. It requires a minimum of five periodic rates for the yield curve input and consistency in the number of historical rates used from period to period. It permits the use of a single average interest rate if the resulting present value is not materially different from what would be obtained using the yield curve.

OACT annually performs two MRF valuations. The primary one is for funding purposes—this valuation is governed by Chapter 74 of Title 10 U.S.C. and must use methods and assumptions approved by the Board. The other is for financial statement purposes and is governed by FASAB standards. For the September 30, 2015, financial statement valuation, OACT determined a single equivalent interest rate of 4.1% by using a 10-year average of quarterly zero coupon Treasury spot rates. These spot rates are from the U.S. Department of the Treasury-Office of Economic Policy's 10-year Average Yield Curve for Treasury Nominal Coupon Issues (TNC yield curve) representing average rates from April 1, 2005, through March 31, 2015. The same spot rate data source was used in production of last year's financial statements. In the summer of 2015, the Board approved an interest rate of 5.25% for the September 30, 2015, funding valuation, which differs from the SFFAS equivalent rate by 115 basis points. Using the SFFAS No. 33 long-term economic assumptions (as compared to Board assumptions) increases the MRF actuarial liability by 6.8%.

Military Services Contributions

The contributions from the Military Services are the product of basic pay and normal cost percentages (NCPs) determined in accordance with the methods and assumptions approved by the Board. Basic pay generally increases each year, and on January 1, 2015, there was a 1.0% across-the-board basic pay increase. The NCPs

DoD MRF Notes to the Principal Financial Statements_____

for FY 2015 were promulgated by the Board in their July 2013 letter: 32.2% (full-time) and 22.5% (part-time). The NCPs for FY 2016 were originally promulgated by the Board in their July 2014 letter (and later revised in their July 2015 letter): 31.4% (full-time) and 23.0% (part-time). The above NCPs are based on the Board's funding valuation, not the financial statement valuation, and are calculated without regard to the concurrent receipt provisions of Sections 1413a and 1414 of Title 10, U.S.C.

Market Value of Investments

The market value of MRF's nonmarketable, market-based securities as of September 30, 2015, totaled \$645.6 billion. This amount is also reported on Note 4, Investments and Related Interest.

DoD MRF Notes to the Principal Financial Statements _____

Note 8. Other Liabilities					
As of September 30		2015			
		Current Liability		Noncurrent Liability	Total
(Amounts in thousands)					
Intragovernmental					
Custodial Liabilities	\$	2,072	\$	0	\$ 2,072
Total Intragovernmental Other Liabilities		2,072		0	2,072
Nonfederal					
Contingent Liabilities		241		0	241
Total Nonfederal Other Liabilities		241		0	241
Total Other Liabilities	\$	2,313	\$	0	\$ 2,313
As of September 30		2014			
		Current Liability		Noncurrent Liability	Total
(Amounts in thousands)					
Intragovernmental					
Custodial Liabilities	\$	2,118	\$	0	\$ 2,118
Total Intragovernmental Other Liabilities		2,118		0	2,118
Nonfederal					
Contingent Liabilities		222		0	222
Total Nonfederal Other Liabilities		222		0	222
Total Other Liabilities	\$	2,340	\$	0	\$ 2,340

Information Related to Other Liabilities

Intragovernmental Custodial Liabilities represent a liability for the MRF comprised of interest, penalties, and administrative charges to be collected on behalf of U.S. Treasury. This amount is also reported as a nonfederal accounts receivable on Note 2, Nonentity Assets.

Nonfederal Other Liabilities represent contingent liabilities payable by the Department of Defense for estimated death payments. These liabilities cover the retiree benefits not paid by the Department of Veterans Affairs during the month of death. This amount is also reported on Note 6, Liabilities not Covered by Budgetary Resources, and disclosed in Note 9, Commitments and Contingencies.

Note 9. Commitments and Contingencies

Information Related to Commitments and Contingencies

Currently there are no known contingent liabilities pending legal action.

The MRF has an estimated contingent liability of \$241 thousand that is measurable and probable and, therefore, has been recorded in the accounting records. These liabilities cover the retiree benefits not paid by the Department of Veterans Affairs during the month of death. This amount is also reported on Note 8, Other Liabilities.

Note 10. Disclosures Related to the Statements of Net Cost

Intragovernmental Costs and Exchange Revenue

As of September 30	2015	2014
(Amounts in thousands)		
Military Retirement Benefits		
Gross Cost		
Nonfederal Cost	\$ 64,190,527	\$ 74,576,778
Total Cost	<u>\$ 64,190,527</u>	<u>\$ 74,576,778</u>
Earned Revenue		
Intragovernmental Revenue	\$ (112,267,833)	\$ (116,878,700)
Total Revenue	<u>\$ (112,267,833)</u>	<u>\$ (116,878,700)</u>
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	\$ (9,368,012)	\$ 21,591,750
Total Net Cost	<u>\$ (57,445,318)</u>	<u>\$ (20,710,172)</u>

Information Related to the Statements of Net Cost

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Federal Government and are supported by an appropriation or another means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity.

Intragovernmental costs and revenue represent transactions made between two reporting entities within the federal government. Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

DoD MRF Notes to the Principal Financial Statements _____

Intragovernmental Earned Revenue is comprised of the following amounts:

Intragovernmental Earned Revenues for Program Costs

(Amounts in thousands)	FY 2015	FY 2014
1. Military Service Contributions as a Percentage of Base Pay	\$ 19,690,800	\$ 20,531,800
2. Annual Treasury Unfunded Liability Payment	75,562,000	72,885,000
3. Annual Treasury Normal Cost Payment	6,197,440	6,337,452
4. Interest on Investments	10,817,593	17,124,448
Total	\$ <u>112,267,833</u>	\$ <u>116,878,700</u>

The MRF complies with SFFAS No. 33, Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates.

Note 11. Disclosures Related to the Statements of Changes in Net Position

Reconciliation of Appropriations on the Statement of Budgetary Resources to Appropriations Received on the Statement of Changes in Net Position

As of September 30	2015	2014
(Amounts in thousands)		
Appropriations, Statement of Budgetary Resources	\$ 56,829,039	\$ 55,451,489
Appropriations Received, Statement of Changes in Net Position	0	0
Total Reconciling Amount	\$ 56,829,039	\$ 55,451,489
Items Reported in Net Cost of Operations, Statement of Changes in Net Position		
Trust and Special Fund Receipts	\$ 56,829,039	\$ 55,451,489
Total Reconciling Items	\$ 56,829,039	\$ 55,451,489

There was a difference of \$56.8 billion between Appropriations Received on the Statement of Changes in Net Position (SCNP) and Appropriations on the Statement of Budgetary Resources (SBR). The MRF records contributions as revenue on the SCNP, while contributions are recorded as Appropriations on the SBR. This is in accordance with Office of Management and Budget reporting requirements.

Note 12. Disclosures Related to the Statements of Budgetary Resources

As of September 30

Information Related to the Statements of Budgetary Resources

The Military Retirement Fund (MRF) reported \$56.8 billion of direct obligations that are exempt from apportionment based on Public Law 98-94, The Defense Authorization Act of 1984.

The Statement of Budgetary Resources (SBR) includes intraentity transactions because the statements are presented as combined.

Public Law 98-94, *The Defense Authorization Act of 1984*, authorized MRF and provided a permanent, indefinite appropriation.

The MRF's unobligated balances of budget authority represent the portion of trust fund receipts collected in the current fiscal year that exceeds (1) the amount needed to pay benefits or other valid obligations and (2) the receipts temporarily precluded from obligation by law. At the end of each fiscal year, the unobligated balance is reclassified as "precluded from obligation", withdrawn as budgetary resources, and not presented on the SBR. The receipts, however, are assets of MRF and are available for obligation as needed in the future.

There was a difference of \$56.8 billion between Appropriations Received on the Statement of Changes in Net Position (SCNP) and Appropriations on the SBR. The MRF records contributions as revenue on the SCNP, while contributions are recorded as Appropriations on the SBR. This is in accordance with Office of Management and Budget reporting requirements. Refer to Note 11, Disclosures Related to the Statement of Changes in Net Position for further information.

There are no material differences between amounts reported on the SBR and the SF 133, Report on Budget Execution.

DoD MRF Notes to the Principal Financial Statements _____

Note 13. Reconciliation of Net Cost of Operations to Budget

As of September 30

(Amounts in thousands)

Resources Used to Finance Activities:

Budgetary Resources Obligated:

	2015	2014
Obligations incurred	\$ 56,829,039	\$ 55,451,489
Obligations net of offsetting collections and recoveries	\$ 56,829,039	\$ 55,451,489
Less: Offsetting receipts (-)	(75,562,000)	(72,885,000)
Net obligations	\$ (18,732,961)	\$ (17,433,511)
Total resources used to finance activities	\$ (18,732,961)	\$ (17,433,511)

Resources Used to Finance Items not Part of the Net Cost of Operations:

Resources that fund expenses recognized in prior Periods (-)	(1,979,746)	0
Total resources used to finance items not part of the Net Cost of Operations	\$ (1,979,746)	\$ 0
Total resources used to finance the Net Cost of Operations	\$ (20,712,707)	\$ (17,433,511)

Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:

Components Requiring or Generating Resources in Future Period:

Other (+/-)	0	40,718,831
Total components of Net Cost of Operations that will Require or Generate Resources in future periods	\$ 0	\$ 40,718,831

Components not Requiring or Generating Resources:

Other (+/-)		
Trust Fund Exchange Revenue	\$ (36,705,833)	\$ (43,993,700)
Cost of Goods Sold	0	0
Operating Material and Supplies Used	0	0
Other	(26,778)	(1,792)
Total Components of Net Cost of Operations that will not Require or Generate Resources	\$ (36,732,611)	\$ (43,995,492)
Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	\$ (36,732,611)	\$ (3,276,661)
Net Cost of Operations	\$ (57,445,318)	\$ (20,710,172)

DoD MRF Notes to the Principal Financial Statements _____

Information Related to the Reconciliation of Net Cost of Operations to Budget

The following note schedule lines are presented as combined instead of consolidated due to intraagency budgetary transactions not being eliminated:

- Obligations Incurred.
- Obligations Net of Offsetting Collections and Recoveries.
- Less: Offsetting Receipts.
- Net Obligations.

Components not Requiring or Generating Resources – Other displays the change in accounts receivable since the beginning of both FY 2015 and FY 2014. These amounts represent refunds receivable and changes in bad debt for erroneous payments to military retirees or their survivors.

Components Requiring or Generating Resources in Future Periods - Other represents the change in future funded expenses that will not become due and payable until an annuitant becomes entitled to receive benefit payment.

Note 14. Subsequent Events

Subsequent events have been evaluated from the balance sheet date through November 6, 2015 which is the date of the financial statements were available to be issued. Management determined that there were no other items to disclose as of September 30, 2015.