



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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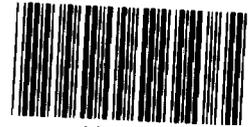
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APRIL 11, 1979

The Honorable Edmund S. Muskie
Chairman, Committee on Budget
United States Senate

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Dear Mr. Chairman:

Last year, the Congress took certain legislative actions to express its concern over the significant and growing financial liabilities of Federal retirement systems. On June 26, 1978, *passed* the Senate adopted a resolution (S. Res. 244) requiring the Secretary of the Treasury to conduct a complete study of certain Federal and District of Columbia retirement programs to determine their financing methods, the extent of their unfunded liabilities, and any actions necessary to insure their solvency. In addition, legislation was enacted (Public Law 95-595, November 4, 1978), which subjected pension plans established or maintained by the Federal Government, its agencies and instrumentalities, to annual financial reporting requirements similar to those applicable to private pension plans under the Employee Retirement Income Security Act of 1974.

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The General Accounting Office fully supported these actions. As you may know, we have *been since 1974* issued a series of reports since 1974 on Federal retirement matters. Certain of these reports 1/ have stressed the need for recognition and funding of the full cost of retirement benefits for the Federal work force.]

We reported that the Congress is not being provided realistic and consistent information on the costs of Federal retirement programs and, as a consequence, its ability to make sound fiscal and legislative decisions on

1/"Federal Retirement Systems: Unrecognized Costs, Inadequate Funding, Inconsistent Benefits" (FPCD-77-48, August 3, 1977).

"Need for Overall Policy and Coordinated Management of Federal Retirement Systems" (FPCD-78-49, December 29, 1978).

Letter Report

FPCD-79-49
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establishing, amending, or funding retirement and agency programs is inhibited. Moreover, we reported that a lack of full recognition of the cost of currently accruing retirement benefits results in an understatement of the cost of Government programs, including subsidies to agencies whose operations are intended to be self-supporting.

To emphasize the significance and magnitude of unrecognized retirement costs, we have prepared, for your information in considering the fiscal year 1980 budget, estimates of the amounts by which agencies' proposed budget authority is understated because they are not being charged the full cost of their employees' retirement benefits. We have included these estimates for three major Government pension plans--the civil service, military services, and Foreign Service retirement systems. 7/C

Civil service retirement system

The costs of benefits accruing each year under the civil service retirement system are understated because the system's "normal cost" is calculated on a "static" basis, whereby no consideration is given to the effect of future general pay increases and annuity cost-of-living adjustments on ultimate benefit payments. Benefits payable under the system are based on employees' average annual earnings during their 3 highest-paid years, and, after retirement, bi-annual adjustments are made to compensate retirees for increases in the cost of living. Pay increases and annuity adjustments add significantly to the retirement system's liability.

The static normal cost of the system is currently estimated to be 13.66 percent of pay, which is about equal to the combined rate of contributions being made to the retirement fund by agencies and their employees (generally 7 percent of pay each). However, the Office of Management and Budget (OMB) has estimated that the "dynamic" normal cost of the system is 27.4 percent of pay, assuming that future pay increases and interest on fund investments will average 1.5 percent and 2.5 percent, respectively, above the future rate of inflation. Based on this OMB estimate, Federal agencies should be contributing 20.4 percent of their covered employees' pay to the fund (27.4 percent less 7 percent employee

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contributions) if their budgets are to reflect the full cost to the Government of benefits accruing under the system.

The total payroll for employees covered by the system is estimated to be about \$48.6 billion during fiscal year 1980. At 20.4 percent of pay, the estimated cost to the Government of benefits accruing during the year will be \$9.9 billion--\$6.5 billion more than the \$3.4 billion agencies will contribute based on the covered payroll. The following table shows the amounts we estimate should be added to the proposed fiscal year 1980 budget authority for each of the 12 departments to reflect their share of retirement system costs.

<u>Department</u>	<u>Costs at 20.4 percent of pay</u>	<u>Costs included in proposed budget</u>	<u>Additional amounts needed</u>
	----- (millions) -----		
Agriculture	\$ 303.1	\$ 104.0	\$ 199.1
Commerce	119.9	41.1	78.8
Defense	2,325.1	797.8	1,527.3
Energy	118.3	40.6	77.7
Health, Education, and Welfare	279.8	96.0	183.8
Housing and Urban Development	74.1	25.4	48.7
Interior	208.0	71.3	136.7
Justice	211.0	72.4	138.6
Labor	101.8	34.9	66.9
State	48.8	16.7	32.1
Transportation	330.6	113.4	217.2
Treasury	<u>395.2</u>	<u>135.6</u>	<u>259.6</u>
Totals	<u>\$4,515.7</u>	<u>\$1,549.2</u>	<u>\$2,966.5</u>

The remaining \$3.5 billion (\$6.5 billion less \$3.0 billion) in unrecognized costs are applicable to the Postal Service (\$1.4 billion) and other Federal agencies and instrumentalities (\$2.1 billion).

Military retirement system

This system operates on a pay-as-you-go basis. A fund is not maintained and benefit payments are financed through

annual congressional appropriations. As a result, the Department of Defense budget reflects the cost of retirement benefits earned in prior years but does not include any accrual of retirement costs for current military personnel.

At our request, the Department of Defense calculated the dynamic normal cost of the system using the economic assumptions followed by OMB for the civil service system. The normal cost was estimated to be 37.1 percent of military basic pay, excluding survivor benefits and benefits for reserve personnel.

✕ The proposed fiscal year 1980 budget for the Department of Defense includes \$18.1 billion in basic pay for active military personnel. At a normal cost of 37.1 percent of pay, the cost of retirement benefits accruing during the year would be \$6.7 billion.

Under the Foreign Service retirement system

Under this system, employees contribute 7 percent of pay and the Government contributes the difference between the system's normal cost and employee contributions. Currently, the system's actuary estimates normal cost to be 21.75 percent of pay, 14.75 percent of which represents the Government's share. The actuary includes assumptions for future annuity cost-of-living adjustments in the normal cost calculations but makes no assumptions regarding future pay raises. Using OMB's economic assumptions, the system's actuary estimated the dynamic normal cost to be 30.7 percent of pay.

The proposed fiscal year 1980 budget includes \$45.2 million as the Government's share of the system's currently accruing retirement costs. This amount is based on the 21.75 percent normal cost estimate and a fiscal year 1980 payroll of \$306.8 million for personnel covered by the system. However, based on the same payroll, but a normal cost of 30.7 percent, the Government's share for fiscal year 1980 would be \$72.7 million--\$27.5 million more than contained in the proposed budget.

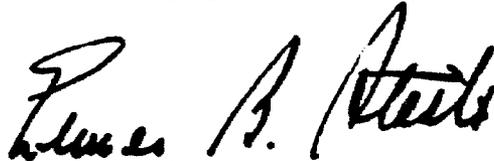
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Conclusion
Benefits accruing under Federal retirement systems represent a large and growing long-term financial commitment of the U.S. Government. Full recognition of these growing liabilities as they accrue is essential not only

in determining and allocating the cost of Government operations, ~~but also~~ ^{and} in determining the present and future financial condition of the United States. However, because accruing benefit costs are not fully recognized, the costs of Government programs are understated and large unfunded liabilities have been created. I believe and am sure you would agree that the Congress, Federal employees, and the taxpayers should not be misled by unrealistic estimates of retirement costs.

We trust this information will be of interest to you. This letter is also being sent to the ranking minority Member of your Committee and to the Chairman and ranking minority Member of the Committee on the Budget, House of Representatives.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James A. Steeds". The signature is written in a cursive style with a large initial "J".

Comptroller General
of the United States