
Office of Inspector General

**Actuarial Estimates
For Retired Pay and Health Care Cost**

U.S. Coast Guard

Report Number: FE-1998-151
Date Issued: June 2, 1998





Memorandum

**U.S. Department of
Transportation**
Office of the Secretary
of Transportation
Office of Inspector General

Subject: **INFORMATION:** Report on Actuarial Estimates for
Retired Pay and Health Care Cost, U.S. Coast Guard
Report Number: FE-1998-151

Date: June 2, 1998

From: 
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**Deputy Assistant Inspector General for Financial,
Economic, and Information Technology**

Reply to JA-20:x61496
Attn Of:

To: Chief of Staff
U.S. Coast Guard

BACKGROUND AND OBJECTIVE

This report provides the study results of the U.S. Coast Guard (Coast Guard) actuarial model for estimating liabilities for retired pay and medical benefits. The study was conducted by the Hay Group, under contract with the Office of Inspector General, as part of our audit of the Department of Transportation (DOT) Fiscal Year (FY) 1997 Consolidated Financial Statements. The principal objective of the study was to determine whether the methodology used by the Coast Guard contractor to calculate liabilities and annual actuarial activity of the Coast Guard military retirement system was reasonable and reliable as of September 30, 1996.

RESULTS

Coast Guard reported an actuarial liability of \$14 billion for Military Retired Pay and Health Care Cost. The Hay Group study showed the Coast Guard's estimate contained at least four technical errors. The nature and magnitude of the errors were such that the Hay Group could not conduct a complete audit, or estimate the potential impact of the errors. These errors primarily occurred because the Coast Guard contractor incorrectly applied actuarial assumptions. For example, the contractor assumed people with 19 years of service would leave the Coast Guard without retiring. Correction of the most severe errors would have increased the total liability by \$1.3 billion. Details describing these errors are in the Hay Group report dated March 25, 1998 (attachment). Other errors may still exist.

The Hay Group noted that actuarial valuations of large-scale complex pension plans are performed using well-tested and peer-reviewed systems, which usually take years to develop. However, the Coast Guard contractor used an untested

program, developed over a few months, to calculate the actuarial valuation. Also, when a contractor accepts an actuarial assignment that was previously done by another contractor, it is standard practice to reproduce the prior estimate to assure consistency from year to year. The contractor also should be able to explain differences. The Coast Guard contractor did not do this review.

The Coast Guard contractor did not compare active and retired populations to Department of Defense (DoD) active and retired military populations as recommended in our previous report regarding the estimate for the FY 1996 financial statements. Although the Hay Group agreed that using the DoD assumptions was the most appropriate method in absence of such a review, standard actuarial practice is to review pension plan assumptions every 3 to 5 years to determine if they are reasonable.

We are making two recommendations based on the Hay Group report, and repeating one recommendation from our prior report.

RECOMMENDATIONS

We recommend the Coast Guard Chief of Staff:

1. Require the contractor to follow standard actuarial practices when preparing the actuarial estimate for the Coast Guard's retired pay and health care cost.
2. Develop a valid FY 1998 actuarial estimate for Coast Guard's retired pay and health care cost liability.
3. As recommended in our prior report, review all actuarial assumptions including a comparison of the active and retired populations to the DoD active and retired military populations prior to developing the actuarial estimate for the FY 1998 financial statements.

Management Response

The Coast Guard concurred with the Hay Group results, although there were some disagreements between the contractors. The Coast Guard's contractor has since corrected the four technical errors pointed out by the Hay Group, resulting in an increase of \$1.5 billion in the actuarial liability. The Hay Group recommendations have been incorporated into a statement of work for the development of a FY 1998 actuarial estimate for both military retired pay and associated health care cost.

Office of Inspector General Comments

Actions taken are reasonable and no response is required.

We sincerely appreciate the cooperation of Coast Guard officials. If you have any questions, please call me or James Childers at (202) 366-1496.

Attachment

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The attachment to this report is available from:

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