How...

# ASRS Employees Deliver Service With PRIDE!

## PROFESSIONALISM

*We promote, strive for and expect individuals, teams, and divisions to possess professional qualities and skills to lead the organization.*

- Displays a friendly, respectful and courteous demeanor even when confronted by adversity
- Has proactive and responsive approach to internal and external customer needs
- Possesses good communication and active listening skills
- Is a trusted contributor (manager, leader, SME, analyst, teammate)
- Takes personal accountability • Has subject matter expertise
- Has critical thinking skills • Has an honest, fair, non-judgmental mind-set
- Is adaptable to beneficial change • Adheres to the ASRS Code of Conduct

## RESULTS

*We treasure the achievements of individuals, teams, divisions and the agency that energize the organization.*

- Meets goals and objectives
- Completes projects
- Produces quality work products
- Satisfies customers
- Attains individual accomplishments
- Manages risks successfully

## IMPROVEMENT

*We appreciate individuals, teams or divisions who drive the agency forward with new,innovative ideas and solutions.*

- Promotes new ideas
- Enhances outcomes and performance
- Solves problems
- Enhances morale
- Improves relationships
- Increases efficiency, effectiveness or reduces costs

## DIVERSITY

*We recognize that utilizing different talents, strengths and points of view, strengthens the agency and helps propel outcomes greater than the sum of individual contributors.*

- Encourages an attitude of openness and a free flow of ideas and opinions
- Treats others with dignity and respect
- Works effectively to accomplish goals with teams comprised of dissimilar individuals
- Recognizes and promotes skills in others attained on and off the job

## EXCELLENCE

*We celebrate individuals, teams and divisions who exceed expectations and deliver service with a PRIDE that permeates the organization.*

- Surpasses member, stakeholder and associate expectations
- Demonstrates a willingness to go the extra mile to engender a positive public image
- Embraces change in a manner that inspires others
- Accepts responsibility and challenges with enthusiasm
- Takes a personal interest in promoting teamwork through effective use of communication (verbal, non-verbal, written and technological techniques)
- Creates a motivated, healthy and productive work environment that celebrates and rewards the accomplishments of others

ARIZONA STATE
RETIREMENT SYSTEM

**ARIZONA STATE RETIREMENT SYSTEM**

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*Paul Matson*
*Director*

# AGENDA

## NOTICE OF A COMBINED PUBLIC MEETING AND POSSIBLE EXECUTIVE SESSION OF THE ARIZONA STATE RETIREMENT SYSTEM OPERATIONS AND AUDIT COMMITTEE

3300 North Central Avenue, 14th Floor Conference Room
Phoenix, AZ 85012

August 9, 2016
10:30 a.m.

Pursuant to A.R.S. § 38-431.02, notice is hereby given to the Trustees of the Arizona State Retirement System (ASRS) Operations and Audit Committee (OAC) and to the general public that the ASRS OAC will hold a meeting open to the public on Tuesday, August 9, 2016, beginning at 10:30 a.m. Arizona Time, in the 14th Floor Conference Room of the ASRS office, 3300 North Central Avenue, Phoenix, AZ 85012. Trustees of the Committee may attend either in person or by telephone conference call.

This is a regularly scheduled meeting of the OAC; however, due to possible attendance by other ASRS Board Trustees, this meeting may technically become a meeting of the Board or one of its committees. Actions taken will be consistent with OAC governance procedures. Actions requiring Board authority will be presented to the full Board for final decision.

The Chair may take public comment during any agenda item. If any member of the public wishes to speak to a particular agenda item, they should complete a Request to Speak form indicating the item and provide it to the Committee Administrator.

Pursuant to A.R.S. § 38-431.03(A)(3), the ASRS OAC may vote to go into executive session, which will not be open to the public, for the purpose of obtaining legal advice on any item on the agenda.

This meeting will be teleconferenced to the ASRS Tucson office conference room at 4400 E. Broadway Boulevard, Suite 200, Tucson, Arizona 85711. The conference call to Tucson will be disconnected after 15 minutes if there are no attendees in the Tucson audience.

The agenda for the meeting is as follows:

1. Call to Order; Roll Call; Opening Remarks ........................................................ Mr. Jeff Tyne
OAC Chair

2. Approval of the Minutes of the May 27, 2016, Public Meeting of the OAC .......... Mr. Jeff Tyne

3. Presentation, Discussion, and Appropriate Action Regarding an ASRS Risk Assessment of Agency Budget Administration and Human Resources Development..... Mr. Anthony Guarino
   Deputy Director and Chief Operations Officer
   ........ Ms. Martha Rozen
   Chief of Administrative Services
   ........ Ms. Lisa King
   Strategic Planning Policy Analyst

4. Presentation, Discussion, and Appropriate Action Regarding the ASRS Compensation Strategies and Staffing Conditions for Fiscal Years 2016 and 2017 ....... Mr. Anthony Guarino
   ........ Ms. Martha Rozen
   ........ Ms. Tracy Darmer
   Human Resources Manager

5. Presentation, Discussion, and Appropriate Action Regarding ASRS Budget Related Topics Including:
   a. Presentation of the ASRS Appropriated Budget and the ASRS Administrative and Investment Spending Plans for FY 2016 and FY 2017.
   b. Presentation of the ASRS Appropriated and Continuously Appropriated Budget Request and the ASRS Administrative and Investment Spending Plan for FY 2018.

   ........ Mr. Paul Matson
   Director
   ........ Mr. Anthony Guarino
   ........ Ms. Martha Rozen
   ........ Mr. Russ Levine
   Procurement and Budget Manager

6. Presentation, Discussion, and Appropriate Action Regarding the ASRS Internal Audit Self-Assessment ........ Mr. Anthony Guarino
   ........ Mr. Bernard Glick
   Chief Internal Auditor

7. Presentation, Discussion, and Appropriate Action Regarding the Internal Audit Quarterly Update ........ Mr. Anthony Guarino
   ........ Mr. Bernard Glick

8. Review of Recently Conducted Audits
   - City of Nogales – Employer Audit
   - Mohave Community College – Employer Audit
   - Sacaton Elementary School District – Employer Audit
   - Buckeye Elementary School District – Employer Audit

   ........ Mr. Anthony Guarino
   ........ Mr. Bernard Glick

9. Presentation, Discussion, and Appropriate Action Regarding ASRS Retiree Health Insurance Including:
   a. Philosophy and Goals
   b. Cost Allocation and Pricing Methodology Options
   c. Retrospective Rate Agreement and Distribution Methodology Options
   ........ Mr. Paul Matson
   ........ Mr. Anthony Guarino
   ........ Mr. Dave King
   Assistant Director, Member Services Division
   ........ Mr. Frank Perri
   Benefits Program Administrator
   ........ Mr. Brian Crockett
   Sr. Strategic Planning Analyst
   ........ Mr. Tim Upson
   Mercer Consultant

10. Requests for Future Agenda Items........ Mr. Jeff Tyne
    ........ Mr. Anthony Guarino

11. Call to the Public ........ Mr. Jeff Tyne

    Those wishing to address the ASRS Committee are required to complete a Request to Speak form before the meeting indicating their desire to speak. Request to Speak forms are available at the sign-in desk and should be given to the Committee Administrator. Trustees of the Committee are prohibited by A.R.S. § 38-431.01(G) from discussing or taking legal action on matters raised during an open call to the public unless the matters are properly noticed for discussion and legal action. As a result of public comment, the Committee Chair may direct staff to study and/or reschedule the matter for discussion and decision at a later date.

12. Adjournment of the OAC

A copy of the agenda background material provided to the OAC Trustees (with the exception of material relating to possible executive sessions) is available for public inspection at the ASRS offices located at 3300 North Central Avenue, 14th Floor, Phoenix, Arizona and 4400 East Broadway Boulevard, Suite 200, Tucson, Arizona. The agenda is subject to revision up to 24 hours prior to meeting. These materials are also available on the ASRS website (https://www.azasrs.gov/web/BoardCommittees.do) approximately 48 hours prior to the meeting.

Persons(s) with disabilities may request a reasonable accommodation such as a sign language interpreter or alternate formats of this document by contacting Tracy Darmer, ADA Coordinator at (602) 240-5378 in Phoenix, at (520) 239-3100, ext. 5378 in Tucson or 1-800-621-3778, ext. 5378 outside metro Phoenix or Tucson. Requests should be made as early as possible to allow time to arrange the accommodations.

Dated August 3, 2016

ARIZONA STATE RETIREMENT SYSTEM

| | |
|---|---|
| *Signed Copy on File* | *Signed Copy on File* |
| Melanie Alexander | Anthony Guarino |
| Committee Administrator | Deputy Director and Chief Operations Officer |

# Agenda Item #2

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*Paul Matson*
*Director*

**MINUTES OF A PUBLIC MEETING OF THE**
**ARIZONA STATE RETIREMENT SYSTEM**
**OPERATIONS AND AUDIT COMMITTEE**

**HELD ON**
**Friday, May 27, 2016**
**11:00 a.m., Arizona Time**

The Operations and Audit Committee (OAC) of the Arizona State Retirement System (ASRS) met in public session in the 14th Floor Conference Room of the ASRS Office, 3300 North Central Avenue, Phoenix, Arizona 85012. Mr. Jeff Tyne, Chair, called the meeting to order at 11:25 a.m.

The meeting was teleconferenced to the ASRS office at 4400 E. Broadway, Tucson, Arizona 85711.

**1. Call to Order; Roll Call; Opening Remarks**

Present: Mr. Jeff Tyne, Chair
Mr. Clark Partridge, Vice Chair
Dr. Richard Jacob

A quorum of the Committee was present for the purpose of conducting business.

**2. Approval of the Minutes of the April 12, 2016 and April 19, 2016 Public Meetings and Executive Sessions of the OAC**

**Motion:** Dr. Richard Jacob moved to approve the minutes of the April 12, 2016 and April 19, 2016 public meetings and executive sessions of the OAC. Mr. Clark Partridge seconded the motion.

By a vote of 3 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

**3. Presentation, Discussion, and Appropriate Actions Regarding the Results of the 2016 ASRS Retiree Survey**

Mr. Anthony Guarino, Deputy Director and Chief Operations Officer, introduced the topic and noted this was staff's first attempt at conducting a retiree survey. Mr. Guarino added that although it was not without incident, the ASRS was able to retrieve useful data from the survey. Mr. Guarino turned the presentation over to Mr. Jeremiah Scott, Sr. Strategic Planning Analyst.

Mr. Scott provided the Committee with a summary of the issues encountered with the survey. It was determined the cause of the issues was the agency's bandwidth. There were too many retirees attempting to take the survey simultaneously; therefore, management made the decision to close the survey down after three days. It was determined; however, there was enough useable data received. Mr. Scott reviewed the survey results with the Committee.

Throughout the presentation, Mr. Scott, Mr. Guarino and Mr. Paul Matson, Director, responded to questions from the Committee. The Committee members offered suggestions for added information to the survey.

Mr. Scott concluded by advising the Committee another survey will be conducted next year. Adjustments will be made to ensure we don't encounter the same performance issues as this year. In addition, modification to some of the questions will be done to obtain more useable data.

## 4. Presentation, Discussion, and Appropriate Action Regarding the ASRS Retiree Health Insurance Contract Renewal

Mr. Anthony Guarino introduced the topic and turned the presentation over to Mr. Dave King, Assistant Director, Member Services Division.

Mr. King opened the presentation by giving credit to the representatives from Mercer who assisted throughout the renewal process and to Mr. Pat Klein, Assistant Director, External Affairs Division, who was instrumental in beginning to steer the healthcare in this direction many years ago. Mr. King shared that the primary focus of this year's renewal was affordability of a pre-65 health plan. Research showed that people were choosing outside sources based on cost. Mr. King added that many options were considered, such as the Affordable Care Act Marketplace, seeking bids through an RFP and engaging UnitedHealthCare (UHC) to offer more affordable options for pre-65 retirees at a lower premium. The efforts resulted in UHC offering a number of new plans for pre-65 retirees at a lower premium with varying benefit levels and premium costs.

Mr. King reviewed the costs and benefits of each of the new plans to be offered and responded to questions from the Committee.

## 5. Presentation, Discussion, and Appropriate Action Regarding the Analysis of ASRS Benefit Estimates Compared to Actual Annuities

Mr. Anthony Guarino introduced this topic. This topic was brought before the Committee based on an appeal heard at the April 29, 2016, Board meeting where the appellant questioned the reliability of the ASRS' benefit estimates versus actual benefits paid. The Board requested that staff conduct an analysis and present the results to the OAC. Mr. Guarino turned the presentation over to Mr. Brian Crockett, Sr. Strategic Planning Analyst.

Mr. Crockett opened the presentation by advising the Committee the benefit estimates used for the analysis were from members applying for retirement online. Although members can obtain benefit estimates online periodically throughout their career, those estimates are generated in real time and the data is not stored; therefore, was not used for this analysis. In this analysis, 5,063 estimates were reviewed with approximately 75% being within 2% of the actual annuity paid. There are a number of assumptions that factor into this, including but not limited to: pay remaining the same until the retirement date, the balance of contract payments for service purchase being paid in its entirety, etc. In reviewing the differences equaling greater than 10%, the circumstances were such that the ASRS would have had no ability to predict, such as a service purchase request being submitted after the benefit estimate was completed.

Mr. Crockett responded to questions from the Committee. The Committee expressed the importance of this not being referred to as "errors" but rather as differences in assumptions. The Committee also feels it is important to present this to the full Board so they have a clear understanding of the process and the differences in the assumptions that cause the differences between the benefit estimates and the actual annuities and requested this topic be placed on the next Board meeting agenda.

## 6. Review of Recently Conducted Audits

Mr. Bernard Glick reviewed the following audits conducted by the Internal Audit Division (IAD).

- **City of Eloy – Employer Audit**

  The IAD had five findings from the City of Eloy audit. The employer agreed with the findings and IAD's recommendations.

- **McNary Elementary School District – Employer Audit**

  The IAD had no findings from the McNary Elementary School District audit.

- **Superior Unified School District – Employer Audit**

  The IAD had six findings from the Superior Unified School District audit. The employer agreed with the findings and IAD's recommendations.

- **ASRS New Retiree and Survivor Benefits – Internal Processes**

  The IAD had no findings from the ASRS New Retiree and Survivor Benefits audit.

- **2015 Agency Compliance Follow-Up**

  The IAD presented the Committee with an agency compliance follow-up for 2015. The IAD reviewed four previously conducted audits: Long Term Disability (LTD); Spreadsheet Review; Investment Management Trading System; and Qualifying Domestic Relations Orders (QDROs). Mr. Glick reported all findings were resolved for the LTD, Spreadsheet Review and the Investment Management Trading System. The QDROs audit findings are partially resolved at this time.

## 7. Request for Future Agenda Items

No requests were made.

## 8. Call to the Public

There were no members of the public in Phoenix or Tucson.

## 9. Adjournment of the OAC

**Motion:** Dr. Richard Jacob moved to adjourn the meeting at 12:22 p.m. Mr. Clark Partridge seconded the motion.

By a vote of 3 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

Respectfully Submitted,

ARIZONA STATE RETIREMENT SYSTEM

| | |
|---|---|
| Melanie Alexander<br>Committee Administrator | Anthony Guarino<br>Deputy Director and Chief Operations Officer |

# Agenda Item #3

ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

# MEMORANDUM

**TO:** The Arizona State Retirement System (ASRS) Operations and Audit Committee (OAC)

**FROM:** Mr. Anthony Guarino, Deputy Director and Chief Operations Officer
Enterprise Risk Management (ERM) Committee

**DATE:** August 1, 2016

**RE:** **Agenda Item #3:** Presentation, Discussion and Appropriate Action Regarding an ASRS Risk Assessment of Agency Budget Administration and Human Resources Development

## Purpose

Staff will provide the OAC with a risk assessment focusing on the agency budget administration and human resources development functions and the strategic goal to ensure consistent, high performance within the agency by supporting an effective operating cost structure and a workforce that reflects agency values.

## Recommendation

Informational only, no action required.

## Background

Since 2007, the ASRS has conducted risk assessments and devised control strategies based on principles espoused by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. The COSO reports, *Enterprise Risk Management – Integrated Framework: Executive Summary Framework*, dated September 2004 and *Internal Control – Integrated Framework: Framework and Appendices*, dated May 2013, are considered authoritative sources and promote an enterprise-wide, integrated risk management approach. The principles, as adopted by the ASRS, are intended to provide the ASRS Director and Board reasonable assurance the ASRS is taking appropriate steps to manage and mitigate risk according to its priorities.

The ASRS has organized an Enterprise Risk Management (ERM) Steering Committee, led by the Deputy Director and Chief Operations Officer and staffed with senior managers, to take an iterative approach and continuously assess the risks and threats facing the agency. Committee decisions and activities are monitored by the agency's Chief Internal Auditor, who has a direct reporting relationship with the ASRS Director and OAC Chair.

The ERM Committee's most recent focus has been on risks that threaten agency budget administration and human resources development functions.

# Enterprise Risk Management (ERM) OAC Presentation

Focus on Agency Budget Administration and Human Resources Development

August 2016

# Section One

Strategic Goal and Objectives

# ASRS Strategic Goal #4:

Ensure consistent, high performance within the agency by supporting an effective operating cost structure and a workforce that reflects agency values

Business functions included in Goal #4:

- Budget Administration (addressed in this presentation)
- Human Resources Development (addressed in this presentation)
- Training and Development
- PRIDE Initiative
- Contracts and Procurement
- Facilities Management

# Applicable Strategic Objectives:

## Budget Administration

1. Develop, complete, and deliver to the Governor's Office, on or before the established deadline, a budget request designed to support strategic priorities and meet agency goals and objectives.
2. Maintain a budget that is fiscally conservative, responsive to changes in service demand and flexible enough to address concerns such as inflation, changes in technology, opportunity for efficiencies, and similar matters.
3. Provide regular reports to Executive (monthly) and Senior Management (quarterly) regarding the appropriated operating budget for the current fiscal year. The report should include expenditures made to date, current forecasts through the end of the fiscal year, and actions recommended to address strategic priorities or mitigate risks that have been identified.

## Human Resources Development

1. Complete 90 percent or higher of authorized recruitments in 60 days or less.
2. Maintain a rolling average annual turnover rate of 18 percent or less.
3. Provide a quarterly report to Senior Managers that analyzes recruitment and turnover statistics within the agency, anticipates future trends and risks, and provides recommendations, if necessary, to mitigate risks that have been identified.
4. Provide a semi-annual report to Senior Managers that analyzes current classification and compensation structures within the agency, highlights current risks, anticipates future risk events, and provides recommendations, if necessary, to mitigate risks that have been identified.
5. Analyze employee survey results and work with managers or other established workgroups to identify, develop and implement strategies to improve employee satisfaction, retention and work environment.
6. Provide continuing education to management and staff regarding employment laws, rules, and regulations to ensure compliance.

## Risk Mitigation

1. In conjunction with the agency risk management program, take appropriate steps and provide reasonable assurance to Executive Management and the Board that consistent, high performance is achieved by supporting an effective operating cost structure and a workforce reflecting the agency values

# Section Two
# (Executive Summary)

Significant Risks and Control Strategies

# Significant Risks and Strategies–Budget Administration
(Appendix B, pages 1 and 2)

| Risk/Threat | Risk Rankings | | Control Evaluation as of June 2016 | Management Strategy for risk and Internal Audit |
|---|---|---|---|---|
| 4. Lack of autonomy over the annual operating budget (appropriations) causes insufficient funding resulting in an inability to support agency strategic objectives | **Tolerance:** Medium | **Impact:** Moderate | Current Controls:<br>Staff maintains strong relationships with executive and legislative branches, including JLBC and OSPB analysts. A formalized budget process and ongoing Director and Board oversight are in place. The agency has sufficient flexibility within the control structure to ensure support of most agency priorities. Specific expenditures are not subject to legislative appropriation. | **Accept** the anticipated risk levels |
| | **Controls:** Some Vulnerability | **Likelihood:** Some Likelihood | Future Actions:<br>Management will continue to monitor the lack of autonomy in these two areas:<br>• AZ state personnel system limits compensation and constrains classifications<br>• OSPB/JLBC recommends and the legislature enacts the budget | |

# Significant Risks and Strategies–Human Resources Development
(Appendix B, page 5)

<table>
<tr><th>Risk/Threat</th><th colspan="2">Risk Rankings</th><th>Control Evaluation as of July 2016</th><th>Management Strategy for risk and Internal Audit</th></tr>
<tr><td rowspan="2">3. Total compensation (salaries and benefits) is insufficient to attract needed staff</td><td>Tolerance: Medium</td><td>Impact: Moderate</td><td>Current Controls:<br>The compensation strategies allow for hiring incentives. ASRS offers tuition assistance and professional certification coverage. Current compensation strategies in use allow greater latitude with regard to salary adjustments, variable compensation and offers for new hires and promotions. Medical and dental benefits are substantially subsidized by the ASRS and the State offers an attractive benefits program.</td><td rowspan="2">Evaluate the anticipated risk levels</td></tr>
<tr><td>Controls: Some Vulnerability</td><td>Likelihood: Some Likelihood</td><td>Future Actions:<br>• The ASRS HR staff is exploring changes to grade salary ranges<br>• Management should consider:<br>○ Challenges still exist as market compensation for certain positions, like IT and Accounting positions, may be greater than the current grade salary range<br>○ Compensation for some classifications remains below market<br>○ AZ state personnel system manages compensation and classifications resulting in a lack of autonomy<br>○ Development of and budgeting for a salary administration plan</td></tr>
</table>

# Significant Risks and Strategies–Human Resources Development (Appendix B, page 5)

| Risk/Threat | Risk Rankings | | Control Evaluation as of July 2016 | Management Strategy for risk and Internal Audit |
|---|---|---|---|---|
| 4. Total compensation (salaries and benefits) is insufficient to retain needed staff | **Tolerance:** Medium | **Impact:** Major | Current Controls:<br>Current compensation strategies in use allow greater latitude with regard to salary adjustments, variable compensation (incentives) and offers for promotions. ASRS offers tuition assistance and professional certification coverage. HRIS provides a total compensation summary; medical and dental benefits are substantially subsidized by the ASRS and the State offers an attractive benefits program. | **Evaluate** the anticipated risk levels |
| | **Controls:** Some Vulnerability | **Likelihood:** Some Likelihood | Future Actions:<br>• Management should consider:<br>○ AZ state personnel system manages compensation and classifications resulting in a lack of autonomy<br>○ Development of and budgeting for a salary administration plan | |

# Significant Risks and Strategies–Human Resources Development (Appendix B, page 7)

<table>
<tr><th>Risk/Threat</th><th colspan="2">Risk Rankings</th><th>Control Evaluation as of July 2016</th><th>Management Strategy for risk and Internal Audit</th></tr>
<tr><td rowspan="2">7. Lack of autonomy over personnel actions results in delays, loss of staff, staff dissatisfaction, etc.</td><td>Tolerance: Medium</td><td>Impact: Moderate</td><td>Current Controls:<br>A good relationship exists with ADOA with established communication channels. ASRS has strong documentation to support requests. An experienced, seasoned ASRS HR Team manages personnel actions.</td><td rowspan="2">Evaluate the anticipated risk levels</td></tr>
<tr><td>Controls: Some Vulnerability</td><td>Likelihood: Some Likelihood</td><td>Future Actions:<br>Management should consider:<br>• ADOA Shared Services turnover has impacted workflow and turnaround times<br>• Turnaround times for reviews and approvals (from ADOA) are unpredictable<br>• ASRS will continue to explore opportunities to improve results and outcomes in the relationship with ADOA<br>• Effective February 2015, the State of Arizona has imposed a hiring freeze. Recruitment for mission critical positions may proceed, however recruitments are delayed. ADOA is reviewing the role they play with regard to personnel actions and how to make processes more efficient and timely.<br>• ADOA is continuing to review and update its classification/compensation system<br>• External auditor (OAG) report cited the lack of autonomy that may not be best practice</td></tr>
</table>

# Section Three

Ranking Criteria

# Rankings: IMPACT

*Measures the impact should the risk occur*

## Minor

**Indicates a risk occurrence would create no noticeable:**

### Disruption to normal operations

- Vacancy and/or turnover rate causes a minor impact to ability to meet strategic objectives
- Miss recruitment turnaround for non-critical positions (example: external/internal staff can cover temporarily)
- Inability to attract and retain staff of sufficient quality has a minor impact on the ability to meet goals and objectives and perform according to PRIDE values
- Reports and analysis to Senior Management occur every 4 – 6 months
- Classification and compensation reports to Senior Managers occur every 7 – 9 months
- Takes > 6 months to address negative EE survey feedback
- Takes 1 year < 1.5 years to provide continuing education

### Financial impact

- Impact to Investment Management, General Accounting, budget, disbursements, contribution collection/accounting, and 3rd party vendor as defined in their areas of the risk assessment

### Reputation/public image damage

- Inability to recruit and retain adequate personnel creates a minor impact to our ability to meet goals and objectives and provide adequate customer service

## Moderate

**Indicates a risk occurrence could create a modest:**

### Disruption to normal operations

- Vacancy and/or turnover rate causes a moderate impact to ability to meet strategic objectives
- Miss recruitment turnaround for some critical positions (example: External/internal staff can cover some tasks but not all)
- Inability to attract and retain staff of sufficient quality has a moderate impact on the ability to meet goals and objectives and perform according to PRIDE values
- Reports and analysis to Senior Management occur every 7 – 9 months
- Classification and compensation reports to Senior Managers occur every 10 – 12 months
- Takes 9 < 12 months to address negative EE survey feedback
- Takes 1.5 < 2 years to provide continuing education

### Financial impact

- Impact to Investment Management, General Accounting, budget, disbursements, contribution collection/accounting, and 3rd party vendor as defined in their areas of the risk assessment

### Reputation/public image damage

- Inability to recruit and retain adequate personnel creates a moderate impact to our ability to meet goals and objectives and provide adequate customer service

## Major

**Indicates a risk occurrence could create a significant:**

### Disruption to normal operations

- Vacancy and/or turnover rate causes a major impact to ability to meet strategic objectives
- Miss recruitment turnaround for numerous critical positions (example: External/internal staff can cover few tasks)
- Inability to attract and retain staff of sufficient quality has a major impact on the ability to meet goals and objectives and perform according to PRIDE values
- Reports and analysis to Senior Management occur > 10 months
- Classification and compensation reports to Senior Managers occur > 12 months
- Takes > 12 months to address negative EE survey feedback
- Takes > 2 years to provide continuing education

### Financial impact

- Impact to Investment Management, General Accounting, budget, disbursements, contribution collection/accounting, and 3rd party vendor as defined in their areas of the risk assessment

### Reputation/public image damage

- Inability to recruit and retain adequate personnel creates a major impact to our ability to meet goals and objectives and provide adequate customer service

# Rankings: CONTROLS

*Strengthen controls to lessen risk*

| Strong | Some Vulnerability | Weak |
|---|---|---|
| **Indicates the controls in place are strong and will mitigate manageable risk**<br>• Staff engagement in Board, Governor's Office and Legislative budget approval processes support risk mitigation of staff issues (Budget only)<br>• Duties and responsibilities are clearly delineated between the Board and Director<br>• Staff engagement with the OAC ensures appropriate follow-up regarding staff issues (HR and Budget only)<br>• Goals and objectives are clearly defined and supported by the organizational structure<br>• Performance is analyzed, measured, reported<br>• Staff duties, responsibilities defined<br>• SMEs in place<br>• Rules, policies, SOPs in place (HR, Training and Budget only)<br>• State mandated personnel system supports ASRS's strategic goals and objectives (HR only)<br>• Communication channels established<br>• Agency practices are reviewed by outside legal counsel specializing in employment law (HR only)<br>• Agency practices, compensation and benefits are researched and compared to industry best practices and market forces (HR only)<br>• IA verifies control adequacy (HR and Training only)<br>• Staff follows up on audit issues (HR and Training only) | **Indicates the controls in place have areas of vulnerability that may not, or may not always, mitigate manageable risk**<br>• Missing some elements of strong controls<br>• External factors that create risks may be evolving faster than the agency can mitigate<br>• Not all elements of proper governance are in place | **Indicates the controls in place are not adequate to mitigate manageable risk**<br>• Missing many elements of strong controls<br>• Subject matter expertise is substandard<br>• Goals and objectives are unclear<br>• Performance is not analyzed, measured, or reported<br>• External factors that create risks are known to be evolving faster than the agency can mitigate<br>• Proper governance not in place |

# Rankings: TOLERANCE

| High | Medium | Low |
|---|---|---|
| Indicates a general acceptance of risk usually because the likelihood of a risk event with a major impact is small | Indicates an acceptance that a risk event could occur because the cost or effort for stronger controls may outweigh benefit | Indicates the risk should be eliminated to the extent possible because of a low risk appetite or the likelihood of major impact |

# Rankings: LIKELIHOOD

*Probability that the risk identified would or would not occur*

| Not Likely | Some Likelihood | Likely |
|---|---|---|
| **Indicates the risk will probably not occur**<br>• Risk event can usually be controlled<br>• Strong controls/low tolerance<br>• Not likely to occur in the next year<br>• Adequate degree of autonomy over budget and staffing decisions | **Indicates there is some probability the risk will occur**<br>• Risk event cannot always be controlled<br>• Missing some elements of strong controls/some tolerance<br>• Changes might occur in the external environment<br>• Some lack of autonomy over budget and staffing decisions | **Indicates it is probable the risk will occur**<br>• Risk event cannot be controlled<br>• Missing numerous elements of strong controls/high tolerance<br>• Changes likely to occur in the external environment<br>• Significant lack of autonomy over budget and staffing decisions |

# Appendix A

Enterprise Risk Management Process

# Enterprise Risk Management

- **Enterprise Risk Management (ERM) Committee:**
  - Led by the Deputy Director and comprised of Senior Managers
  - Under the oversight of the OAC
  - Communicates activities and findings to the Director
  - Works collaboratively with Internal Audit
  - Produces risk assessments and control strategies

- **Risk:** Any event that impacts, impedes, or interferes with the agency's ability to achieve its strategic priorities, goals, and objectives

- Risk management process conducted in accordance with principles espoused by the Committee of Sponsoring Organizations (COSO)

  *"Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives."*

# COSO Components of ERM

- **Control Environment** (Board, Executive and Senior Management set tone, philosophy, risk appetite)
- **Risk Assessment** (Iterative process for identifying/analyzing risks to achieving goals/objectives and determining how risks should be managed)
- **Control Activities** (Actions established to ensure risk mitigation)
- **Information and Communication** (Enables the Board, management, staff, and other stakeholders to understand internal control responsibilities and day-to-day control activities)
- **Monitoring** (Ongoing evaluations to ensure internal control components are present and functioning)

COSO Framework – May 2013

# Risk Assessment Steps

- The risk assessment document groups major functions according to the agency's strategic plan
- Workgroups [comprised of Senior Managers and subject matter experts (SMEs)]:
  - Identify risks to achieving the strategic goals and objectives
  - Rank the risks and controls using a heat chart
  - Identify current risk control strategies
  - Identify control strategies under development/consideration
- ERM Committee:
  - Establishes the control environment, including the general internal control structure, tolerance levels, and risk parameters (impacts, likelihood)
  - Reviews the findings of SME workgroups; identifies control gaps
  - Ensures risk mitigation responsibilities and strategies are clearly identified
  - Monitors administration and progress
- Director and OAC receive periodic updates from the ERM Committee

# Appendix B

Risk Assessment for Budget Administration AND
Human Resources Development

# Budget Administration Risk Assessment

| Risk/Threat | Risk Rankings | | Control Evaluation – June 2016 | Management Strategy for risk and IA |
|---|---|---|---|---|
| 1. Insufficient budget staff to meet objectives | **Tolerance:** Low | **Impact:** Moderate | Current Controls: Senior and Executive management meets on a monthly basis with HR to review staffing levels and risks of missing objectives. Outcomes are reported to the Board and are considered in future budget cycles. ASD has sufficient cross-training to assist as needed. | **Accept** the anticipated risk levels |
| | **Controls:** Strong | **Likelihood:** Not Likely | Future Actions: No additional actions planned | |
| 2. Staff is not properly trained to prepare the ASRS budget request or does not deliver it by the established deadline | **Tolerance:** Low | **Impact:** Moderate | Current Controls: Staff is cross-trained to ensure budget objectives are met. A formalized budget process and ongoing Director and Board oversight are in place. Staff has a high level of expertise and management has a high level of familiarity and involvement. Governor's Office of Strategic Planning and Budget directs the budget request process; OSPB provides templates, training and guidance. If necessary, an extension may be requested. | **Accept** the anticipated risk levels |
| | **Controls:** Strong | **Likelihood:** Not Likely | Future Actions: Management should consider creating an SOP | |
| 3. Budget appropriation is not enacted into law at the start of a fiscal year | **Tolerance:** Medium | **Impact:** Moderate | Current Controls: An alternate strategy, ASRS Interim Plan for continuation of basic service operations pending FY state budget approval, has been developed to ensure critical operations continue. | **Accept** the anticipated risk levels |
| | **Controls:** Some Vulnerability | **Likelihood:** Not Likely | Future Actions: The ASRS Interim Plan for continuation of basic service operations pending FY state budget approval plan will be reviewed as needed. | |
| 4. Lack of autonomy over the annual operating budget (appropriations) causes insufficient funding resulting in an inability to support agency strategic objectives | **Tolerance:** Medium | **Impact:** Moderate | Current Controls: Staff maintains strong relationships with executive and legislative branches, including JLBC and OSPB analysts. A formalized budget process and ongoing Director and Board oversight are in place. The agency has sufficient flexibility within the control structure to ensure support of most agency priorities. Specific expenditures are not subject to legislative appropriation. | **Accept** the anticipated risk levels |

| Risk/Threat | Risk Rankings | | Control Evaluation – June 2016 | Management Strategy for risk and IA |
|---|---|---|---|---|
| | **Controls:** Some Vulnerability | **Likelihood:** Some Likelihood | Future Actions:<br>Management will continue to monitor the lack of autonomy in these two areas:<br>• AZ state personnel system limits compensation and constrains classifications<br>• OSPB/JLBC recommends and the legislature enacts the budget | |
| 5. Misuse of administrative expenditures resulting in reputation damage and/or harm to the trust fund | **Tolerance:** Low | **Impact:** Major | Current Controls:<br>An approval workflow within the Financial Management System (MUNIS) is established. There is strong segregation of duties within the expenditure cycle. A frequent reconciliation of MUNIS to state accounting system is conducted. There are monthly reports submitted to external and internal resources. ADOA General Accounting reviews agency expenditures periodically. Monthly ADOA-designed self-reviews are conducted. | **Accept** the anticipated risk levels |
| | **Controls:** Strong | **Likelihood:** Not Likely | Future Actions:<br>No additional actions planned | |
| 6. Inaccurate budget monitoring, evaluation, reporting, and forecasting resulting in poor decisions by management | **Tolerance:** Low | **Impact:** Major | Current Controls:<br>Tools (pro-forma budget models, salary forecasting, etc.) and processes (i.e. segregation of duties, MUNIS, etc.) are established. The staff has strong experience. The Director and Chief Operations Officer oversee dedicated personnel who monitor, evaluate, forecast, and report monthly to the executives and the Board. External controls are also in place (e.g., state accounting system, Governor's Office of Strategic Planning and Budget). | **Accept** the anticipated risk levels |
| | **Controls:** Strong | **Likelihood:** Not Likely | Future Actions:<br>No additional actions planned | |
| 7. Spreadsheets contain incorrect formulas and/or data | **Tolerance:** Low | **Impact:** Moderate | Current Controls:<br>Multiple verification steps are followed. At least two staff members separately perform calculations. Results are compared for discrepancies and against information provided in other state agency systems to identify variances. | **Accept** the anticipated risk levels<br><br>IA will perform a quality review |
| | **Controls:** Strong | **Likelihood:** Not Likely | Future Actions:<br>No additional actions planned | |

| Risk/Threat | Risk Rankings | | Control Evaluation – June 2016 | Management Strategy for risk and IA |
|---|---|---|---|---|
| 8. Market forces/trends outpace/exceed the budget (appropriations) resulting in an inability to support agency strategic objectives | **Tolerance:** Medium | **Impact:** Moderate | Current Controls: Staff maintains strong relationships with executive and legislative branches, including JLBC and OSPB analysts. A formalized budget process and ongoing Director and Board oversight are in place. The agency has sufficient flexibility within the control structure to ensure support of most agency priorities. Specific expenditures are not subject to legislative appropriation. Continuous process improvement as outlined in the Strategic Plan model is in place to reduce costs and reallocate resources. SMEs work with Senior and Executive Management to assess goods/services/job market movements. | **Accept** the anticipated risk levels |
| | **Controls:** Some Vulnerability | **Likelihood:** Some Likelihood | Future Actions: No additional actions planned | |
| 9. The budget is not cost efficient and effective | **Tolerance:** Low | **Impact:** Moderate | Current Controls: The agency compares itself to peers using CEM Benchmarking and results are reported each year. Strategic decisions (i.e. resource reallocation, workflow improvements, prioritization of projects, etc.) are reviewed at weekly SMT/EMT meetings and based on agency goals/objectives, return on investment analysis, peer comparisons, and member and employee satisfaction. Budgets and resources are reviewed and approved by senior and executive management, the Board, and JLBC/OSPB. | **Evaluate** the anticipated risk levels |
| | **Controls:** Some Vulnerability | **Likelihood:** Some Likelihood | Future Actions: A Six Sigma trained Analyst is examining MSD and FSD processes to identify potential areas for improvement in cost effectiveness/efficiency | |

## Human Resources Development Risk Assessment

<table>
<tr><th>Risk/Threat</th><th colspan="2">Risk Rankings</th><th>Control Evaluation – July 2016</th><th>Management Strategy for risk and IA</th></tr>
<tr><td rowspan="2">1. Staff/resources are not deployed in a manner that maximizes efficiency and effectiveness</td><td>Tolerance:<br>Medium</td><td>Impact:<br>Moderate</td><td>Current Controls:<br>HR prepares a staffing report and presents to SMT, EMT and the Board monthly which highlights staffing concerns that could impact strategic objectives. SMT meets weekly to address staffing needs as needed. Divisions assess and reallocate internal resources within proper classifications to meet demand. Additional reviews for staff realignment are conducted as needed and within budget/hiring constraints established during the budget process. HR conducts periodic reviews of PDQs to ensure accuracy. Operations reports are presented monthly to the Board.</td><td rowspan="2">Accept the current risk levels</td></tr>
<tr><td>Controls:<br>Strong</td><td>Likelihood:<br>Not Likely</td><td>Future Actions:<ul><li>Project is underway pilot testing a Six Sigma type approach to evaluating process (and staffing) inefficiencies</li><li>Management should consider:<ul><li>Establishing clearer objectives and metrics</li><li>Identifying potential staffing realignment at the conclusion of IT development</li></ul></li></ul></td></tr>
<tr><td rowspan="2">2. Methods used to communicate job opportunities are inadequate to attract enough qualified candidates</td><td>Tolerance:<br>Low</td><td>Impact:<br>Moderate</td><td>Current Controls:<br>Post all positions on www.azstatejobs.gov and IQ; may speak with the hiring manager and/or research current best practices for more specialty posting options for specialized jobs. Posting on www.azstatejobs.gov automatically posts job opportunities on diverse websites. A budget reserve is set aside yearly to ensure sufficient funds for paid advertising. HR personnel monitor responses to postings and immediately proceed to alternate posting options as needed. HR staff utilizes social media to post job opportunities. Staff explores professional affiliations to expand job posting opportunities at reduced cost.</td><td rowspan="2">Accept the anticipated risk levels</td></tr>
<tr><td>Controls:<br>Strong</td><td>Likelihood:<br>Not Likely</td><td>Future Actions:<br>No additional actions planned</td></tr>
</table>

<table>
<tr><th>Risk/Threat</th><th colspan="2">Risk Rankings</th><th>Control Evaluation – July 2016</th><th>Management Strategy for risk and IA</th></tr>
<tr><td rowspan="2">3. Total compensation (salaries and benefits) is insufficient to attract needed staff</td><td>Tolerance: Medium</td><td>Impact: Moderate</td><td>Current Controls:<br>The compensation strategies allow for hiring incentives. ASRS offers tuition assistance and professional certification coverage. Current compensation strategies in use allow greater latitude with regard to salary adjustments, variable compensation and offers for new hires and promotions. Medical and dental benefits are substantially subsidized by the ASRS and the State offers an attractive benefits program.</td><td rowspan="2">Evaluate the anticipated risk levels</td></tr>
<tr><td>Controls: Some Vulnerability</td><td>Likelihood: Some Likelihood</td><td>Future Actions:<br>• The ASRS HR staff is exploring changes to grade salary ranges<br>• Management should consider:<br>o Challenges still exist as market compensation for certain positions, like IT and Accounting positions, may be greater than the current grade salary range<br>o Compensation for some classifications remains below market<br>o AZ state personnel system manages compensation and classifications resulting in a lack of autonomy<br>o Development of and budgeting for a salary administration plan</td></tr>
<tr><td rowspan="2">4. Total compensation (salaries and benefits) is insufficient to retain needed staff</td><td>Tolerance: Medium</td><td>Impact: Major</td><td>Current Controls:<br>Current compensation strategies in use allow greater latitude with regard to salary adjustments, variable compensation (incentives) and offers for promotions. ASRS offers tuition assistance and professional certification coverage. HRIS provides a total compensation summary; medical and dental benefits are substantially subsidized by the ASRS and the State offers an attractive benefits program.</td><td rowspan="2">Evaluate the anticipated risk levels</td></tr>
<tr><td>Controls: Some Vulnerability</td><td>Likelihood: Some Likelihood</td><td>Future Actions:<br>• Management should consider:<br>o AZ state personnel system manages compensation and classifications resulting in a lack of autonomy<br>o Development of and budgeting for a salary administration plan</td></tr>
</table>

| Risk/Threat | Risk Rankings | | Control Evaluation – July 2016 | Management Strategy for risk and IA |
|---|---|---|---|---|
| 5. Demands on HR greater than staff availability | **Tolerance:** Medium | **Impact:** Moderate | Current Controls:<br>Senior and Executive management meets on a monthly basis with HR to review staffing levels and risks of missing objectives. Outcomes are reported to the Board and are considered in future budget cycles. HR staff has depth of knowledge and years of experience and are cross-trained in all HR functions. Other ASD staff can assist in non-confidential areas. HR communicates workload challenges to upper management in a timely manner for direction. In an emergency situation, ADOA Shared Services may be able to provide temporary support. | **Accept** the anticipated risk levels |
| | **Controls:** Some Vulnerability | **Likelihood:** Some Likelihood | Future Actions:<br>No additional actions planned | |
| 6. ASRS work environment is unsatisfactory in order to attract and/or retain needed staff | **Tolerance:** Low | **Impact:** Moderate | Current Controls:<br>ASRS invests in and delivers leadership development and other training opportunities and has a safe, attractive work environment. The PRIDE Initiative sets the tone for the agency with Work Environment and IQ workgroups specifically focused on work environment issues. Employees are surveyed and follow up is conducted. Satisfaction survey questions ask staff if they have tools and equipment to complete their job (responses have been affirmative). Management and employees are engaged in the work environment and issues are addressed timely. Staff is encouraged to share new ideas. Agency is focused on communication (e.g., IQ, Ask Paul and Anthony, etc.). HR has an open-door policy for staff to report work environment issues. HR conducts exit interviews for voluntary separations and that information is shared as needed at the discretion of HR. | **Evaluate** the anticipated risk levels |
| | **Controls:** Some Vulnerability | **Likelihood:** Some Likelihood | Future Actions:<br>• Project is underway pilot testing a Six Sigma type approach to evaluating process (and staffing) inefficiencies<br>• Results from the FY16 ASRS Employee Satisfaction Survey and State of AZ survey will be evaluated<br>• HR is implementing the Workforce Planning initiative to ensure/prepare future leaders and identifying essential competencies for ongoing development | |

| Risk/Threat | Risk Rankings | | Control Evaluation – July 2016 | Management Strategy for risk and IA |
|---|---|---|---|---|
| | | | • HR is examining exit interview best practices (tools, how use data, etc.) | |
| 7. Lack of autonomy over personnel actions results in delays, loss of staff, staff dissatisfaction, etc. | **Tolerance:** Medium | **Impact:** Moderate | Current Controls:<br>A good relationship exists with ADOA with established communication channels. ASRS has strong documentation to support requests. An experienced, seasoned ASRS HR Team manages personnel actions. | **Evaluate** the anticipated risk levels |
| | **Controls:** Some Vulnerability | **Likelihood:** Some Likelihood | Future Actions:<br>Management should consider:<br>• ADOA Shared Services turnover has impacted workflow and turnaround times<br>• Turnaround times for reviews and approvals (from ADOA) are unpredictable<br>• ASRS will continue to explore opportunities to improve results and outcomes in the relationship with ADOA<br>• Effective February 2015, the State of Arizona has imposed a hiring freeze. Recruitment for mission critical positions may proceed, however recruitments are delayed. ADOA is reviewing the role they play with regard to personnel actions and how to make processes more efficient and timely.<br>• ADOA is continuing to review and update its classification/compensation system<br>• External auditor (OAG) report cited the lack of autonomy that may not be best practice | |
| 8. Spreadsheets are used to track and report turnover, salaries and recruitment TAT and may contain errors | **Tolerance:** Low | **Impact:** Minor | Current Controls:<br>Reports are created in Excel and are stored in the public drive. A separation of duties includes one person creates the reports, at least one supervisor reviews the reports and data is verified/compared to HRIS as applicable. Monthly reports are presented and reviewed by SMT and EMT. | **Accept** the anticipated risk levels<br><br>Management recommends IA conduct quality reviews |
| | **Controls:** Strong | **Likelihood:** Not Likely | Future Actions:<br>Management should consider:<br>• Investigating if HRIS can provide reports directly | |

| Risk/Threat | Risk Rankings | | Control Evaluation – July 2016 | Management Strategy for risk and IA |
|---|---|---|---|---|
| 9. HR fails to timely communicate staffing indicators with Board, Executive and Senior Managers | **Tolerance:** Low | **Impact:** Minor | Current Controls:<br>HR staff is cross-trained. Monthly reports are presented and reviewed by SMT and EMT and are included in the Board packet. | **Accept** the anticipated risk levels |
| | **Controls:** Strong | **Likelihood:** Not Likely | Future Actions:<br>No additional actions planned | |
| 10. Staff are not compliant with federal and state employment laws, rules, and policies | **Tolerance:** Low | **Impact:** Major | Current Controls:<br>HR staff has depth of knowledge and years of experience and are cross-trained in all HR functions. HR staff attends regular HR training. HR and ADOA conduct training for supervisors and New Employee Orientation (NEO) training for all staff. HR proactively provides updates, refreshers, and trainings as needed to ensure compliance. HR has an open-door policy so staff can report issues and HR acts promptly to address/resolve. Federal and state workplace posters are prominently displayed and updated as applicable. Code of Conduct is reviewed annually, presented to staff, and acknowledgement form is completed by employees. Supervisors are required to work with HR on personnel issues to ensure consistency, fairness, and compliance with federal and state employment laws and state personnel system rules. | **Accept** the anticipated risk levels |
| | **Controls:** Strong | **Likelihood:** Some Likelihood | Future Actions:<br>• HR will continue to compare ADOA's supervisory training to ASRS's training to ensure that relevant topics are covered<br>• HR will develop targeted in-house modules for delivery | |

# Agenda Item #4

# ARIZONA STATE RETIREMENT SYSTEM

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*Paul Matson*
*Director*


## MEMORANDUM

**TO:** The Arizona State Retirement System (ASRS) Operations and Audit Committee (OAC)

**FROM:** Mr. Paul Matson, Director
Mr. Anthony Guarino, Deputy Director and Chief Operations Officer
Ms. Martha Rozen, Chief of Administrative Services
Ms. Tracy Darmer, Human Resources Manager

**DATE:** August 1, 2016

**RE:** **Agenda Item #4**: Presentation, Discussion, and Appropriate Action Regarding the ASRS Compensation Strategies and Staffing Conditions for Fiscal Years 2016 and 2017

**Purpose**

To review the ASRS Compensation Strategies and Staffing Conditions for Fiscal Years 2016 and 2017.

**Background**

In August 2014, information was presented to the ASRS Board of Trustees outlining the criticality of access to qualified staff as one of three keys that influence the agency's ability to optimize operational capacity and performance at the ASRS.

A cornerstone of the ASRS strategic model is that making a purposeful investment in attracting and retaining the right complement of qualified professionals and providing a positive work environment leads to greater achievement. The strategic goal is to ensure consistent, high performance by supporting an effective operating structure and a workforce that reflects agency values.

While the ASRS recognizes several key risks related to staffing and that these risks cannot be completely eliminated, management has implemented the following control strategies to mitigate them to a manageable level:

- Prioritize recruitments and balance business needs with the costs of attracting and retaining qualified staff.
- Utilize a variety of compensation strategies – approved variable pay incentive plans as well as base pay adjustments – to remain competitive.
- Review position classification and compensation levels and anticipate adjustments necessary to achieve business objectives and/or retain key staff with invaluable historical knowledge of ASRS programs and systems.
- Sponsor the PRIDE Initiative with workgroups specifically focused on work environment issues.

These strategies appear to be working:

- The ASRS approach to recruitment is resulting in higher caliber employees – leading to more internal advancement and reduced talent acquisition costs. In Fiscal Year 2016, there were a total of 22 internal transfers and promotions, 16 of which included an increase in base salary. The average increase in base salary was $6,670 or 12.81% for those 16 base salary increases.

- The PRIDE Initiative has taken hold at the ASRS. In the 2016 employee survey, when rating their team and ASRS leadership on each of the five PRIDE values, employees returned positive ratings of at least 84% in every category. Ratings for their own team ranged from 90% to 94% positive and those for the Deputy Director and Director were between 90% and 98% positive.
- Agency turnover is low to moderate. During Fiscal Year 2016, there were a total of 39 separations from the agency as compared to 22 separations during Fiscal Year 2015. Annual turnover, as of June 30, 2016, is 16%. And the most recent employee survey results (conducted in June 2016) reflect 90 percent of staff view working at the ASRS as a long-term career choice.

## Base Salary Adjustment History

From September 2009 (FY 2010) through September 2012 (FY 2013), the ASRS was exempt from the State Personnel System as a result of legislation enacted during the 2009 Legislative session.

Effective with Personnel Reform legislation on September 29, 2012, the ASRS was required to obtain approval from the Arizona Department of Administration (ADOA) for any base salary adjustments for most positions. The only exclusions are the agency Director, Deputy Director, or equivalent positions (at the ASRS, this includes the Chief Investment Officer), and all requests must adhere to the classification and salary ranges determined by ADOA.

Effective July 1, 2015, new guidelines issued by ADOA allow agencies the authority to make base salary adjustments without ADOA approval. The requirement remains that these adjustments must be reported to ADOA on an annual basis.

The table below shows the ASRS-initiated base salary adjustments from FY 2012 (exempt from the State Personnel System) to present (no longer exempt, effective September 29, 2012):

**ASRS History of Salary Adjustments – through June 30, 2016**

| Fiscal Year | Average Number of Filled Positions | Number of Base Salary Increases | Average Amount of Increases | Average % of Increases | Dollar Amount of Increases as % of Agency EE Salary Total |
|---|---|---|---|---|---|
| 2012 | 230 | 212 | $2441 | 4.63% | 4.459% |
| 2013 | 220 | 9 | $7475 | 8.81% | 0.551% |
| 2014 | 233 | 14 | $8928 | 7.96% | 0.945% |
| 2015 | 230 | 32 | $6362 | 11.12% | 1.596% |
| 2016 | 228 | 120 | $4186 | 8.51% | 3.837% |

### Affected Positions by Division

FY 2012

During the time period that the ASRS was exempt from the State Personnel System, classifications and compensation were reviewed internally and the ASRS implemented an agency-wide motivation and retention plan that resulted in increases to base salaries for many ASRS employees in FY 2012.

FY 2013
Director's Office – 2
Member Services Division – 1
Investment Management Division – 3
Management Support Services – 1
External Affairs Division – 1
Technology Services Division – 1

FY 2014
Director's Office – 2
Member Services Division – 1
Financial Services Division – 1
Administrative Services Division – 1
External Affairs Division – 1
Technology Services Division – 8

FY 2015
Director's Office – 1
Member Services Division – 9
Financial Services Division – 13
Administrative Services Division – 3
Internal Audit – 1
External Affairs Division – 1
Technology Services Division – 4

FY 2016
Director's Office – 1
Strategic Planning – 4
Member Services Division – 20
Investment Management Division – 4
Management Support Services – 5
Financial Services Division – 60
Administrative Services Division – 8
Internal Audit – 4
External Affairs Division – 2
Technology Services Division – 12

**Variable Payment History in the ASRS**

In accordance with the guidelines set forth by ADOA, the variable compensation strategies used by the ASRS over the past four fiscal years have included goal-based incentives, spot incentives, and meritorious service leave awards. These strategies did not result in changes to employees' base salaries, but rather, were one-time payments. The strategies employed are defined as follows:

- Spot Incentives were awarded in recognition of extraordinary achievements that go beyond the everyday work approach and that result in efficiencies, cost savings, or improved productivity. This investment in ASRS staff has been shown to provide motivation for innovative thinking and to enhance employee satisfaction and engagement.
- Goal-Based Incentives (awarded beginning in FY 2014) have given ASRS management the opportunity to recognize and reward employees based on their contributions to the achievement of the priorities, goals, and objectives outlined in the ASRS Five-Year Strategic Plan and Operational Goals and Objectives.

- Meritorious Service Leave Awards were used to acknowledge an employee for exemplary service and performance. The ASRS Employee PRIDE Rewards and Recognition Program is used to guide the implementation of this incentive and to motivate the workforce.

**ASRS Variable Payment Results**

| Fiscal Year | Average Number of Filled Positions | Number of Employees Receiving Spot Incentives | Average Amount of Spot Incentives per Employee | Number of Employees Receiving Goal-Based Incentives | Average Amount of Goal-Based Incentives per Employee | Number of Employees Receiving Meritorious Service Leave Awards | Average Amount of Meritorious Service Leave Awards (in hours) per Employee |
|---|---|---|---|---|---|---|---|
| 2013 | 224 | 192 | $601 | N/A | N/A | 6 | 8 |
| 2014 | 229 | 91 | $465 | 180 | $1112 | 18 | 7.78 |
| 2015 | 230 | 92 | $450 | 169 | $1217 | 16 | 8.75 |
| 2016 | 228 | 95 | $480 | 177 | $1087 | 6 | 8 |

## Staffing Conditions – Turnover

Ongoing analysis indicates the primary reasons for employee turnover at the ASRS are those related to personal changes, rather than dissatisfaction with the work environment. Specifically, personal factors such as relocation, commuting distance, and retirement are more often mentioned in resignation letters and exit interviews than reasons such as management, pay, and work situation.

Technology Services Division: Certain vacancies have proven to be more difficult to fill than others. Positions in the Technology Services Division (TSD), which require uniquely specialized skills and expertise, continue to take more time to successfully fill. The initial search phase and the interview process which follows typically run 2-3 times longer than recruitments for positions outside of TSD. In calendar year 2015, the average time from initial posting to employee start date for 9 TSD positions was 229 days while the same process averaged 61 days for 25 non-TSD positions. And in the first 6 months of calendar year 2016, the average time from initial posting to employee start date for 4 TSD positions was 143 days while the same process averaged 62 days for 24 non-TSD positions.

Financial Services Division: As for vacancies in the Financial Services Division (FSD), positions in Benefits Accounting and Membership Accounting tend to be completed well within the 60 day strategic goal. However, the General Accounting positions in higher grades can take additional days. In calendar year 2015, the average time from initial posting to employee start date for 17 FSD positions was 55 days while the same process averaged 121 days for 17 non-FSD positions (this includes TSD positions). And in the first 6 months of calendar year 2016, the average time from initial posting to employee start date for 11 FSD positions was 48 days while the same process averaged 81 days for 17 non-FSD positions. The Human Resources Department is monitoring FSD turnover, recruitment lead times, and market salary data to identify trends and propose potential solutions.

## Current Hiring Freeze

Due to the State's current economic situation and Governor Doug Ducey's stated efforts to shrink the size of Arizona State government, effective February 1, 2015, the ADOA, on instruction from Governor Ducey, implemented a hiring freeze for all executive agencies, boards, and commissions.

Exceptions to the hiring freeze are made on the basis of positions which are deemed vital to and directly involved in providing for the health or safety of the public or of state employees, directly involved in the collection or investment of state revenues, or otherwise deemed "mission critical." A request to designate a vacant position as mission critical requires justification and approval of the ASRS Director and recruitment for such a position may occur only after approval has been obtained from the ASRS Director. Within those guidelines, the ASRS has been instructed that it may fill only 60% of positions which were vacant as of February 1, 2015, and which have become vacant after that date. We have been averaging approximately 25 vacancies per month from February 1, 2015 to June 30, 2016, and staffing levels will continue to fluctuate above and below the imposed head count.

To date, Human Resources, along with business program areas, have conducted successful recruitments for 66 positions, 27 of which have been filled with internal candidates and the other 39 vacancies were filled with external candidates. At this time, there are 19 additional vacant positions designated by the ASRS Director as mission critical and external recruitments for 18 of those are currently underway. Of these vacancies, 10 are Retirement Advisor Senior positions in the Member Advisory Center.

**ASRS Recruitments – February 1, 2015 through June 30, 2016**

| | Filled | In Process | On Hold |
|---|---|---|---|
| TSD Recruitments | 14 | 0 | 0 |
| Non-TSD Recruitments | 52 | 18 | 1 |

## Conclusions

The ASRS is operating at an effective capacity and is able to achieve its priorities, goals and objectives.

Further, ASRS performance and capacity compare favorably to industry peers. The ASRS will continue to utilize approved compensation strategies and, with changes to the administration of base salary adjustments as well as variable compensation strategies, has enjoyed increased autonomy in these functions. These changes have resulted in the increased ability to achieve the agency’s goal of retaining a highly professional and capable staff who exemplify the ASRS values and vision.

Although vacancies in TSD and in some higher-level FSD positions continue to take longer to fill than those in other areas, recruitments have been completed successfully with the implementation of strategies to cast a wider net for applicants with the appropriate combination of skills, experience, and certification. As needed, external resources are utilized to ensure an appropriate complement of staff to complete planned projects.

Due to the natural course of employee movement, and taking into account the addition in FY 2016 of five full-time appropriated positions to the ASRS workforce, it is anticipated that there will be ongoing recruitment activities for mission-critical positions during the hiring freeze.

# Agenda Item #5

# ARIZONA STATE RETIREMENT SYSTEM

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*Paul Matson*
*Director*


## MEMORANDUM

**TO:** The Arizona State Retirement System (ASRS) Operations and Audit Committee (OAC)

**FROM:** Mr. Anthony Guarino, Deputy Director and Chief Operations Officer
Ms. Martha N. Rozen, Chief of Administrative Services
Mr. Russ Levine, Procurement and Budget Program Manager

**DATE:** August 1, 2016

**RE:** **Agenda Item #5**: Presentation, Discussion, and Appropriate Action Regarding ASRS Budget Related Topics Including:
a. Presentation of the ASRS Appropriated Budget and the ASRS Administrative and Investment Spending Plans for FY 2016 and FY 2017.
b. Presentation of the ASRS Appropriated and Continuously Appropriated Budget Request and the ASRS Administrative and Investment Spending Plan for FY 2018.

**Purpose**
To review the ASRS Appropriated and Continuously Appropriated Budgets and the ASRS Administrative and Investment Spending Plans for Fiscal Years (FY) 2016 - 2018.

**Recommendation**
Staff recommends that the OAC accept and forward to the ASRS Board an appropriated budget request for FY 2018 in the amount of $24,884,200, an administrative spending plan of $31,659,200, within a total spending plan of $238,923,200.

**A. FY 2016 and FY 2017 Appropriated Budget and Spending Plans**
Effective budget planning and administration is a key cornerstone of the ASRS Strategic Plan. While the ASRS recognizes the key risks related to budget administration, through a formalized budget process, and in partnership with the executive and legislative branches, the ASRS has been able to ensure sufficient funding to support the agency strategic objectives.

The spending plans for FYs 2016 and 2017 were structured to continue implementation of a service paradigm that reduces manual transactions by further supporting system and technology modernizations and re-engineering of processes. Specifically, the ASRS appropriated budget and spending plans included the following:

- Appropriated funding for the Oracle Forms and Reports Modernization project that will allow the ASRS to achieve a standard set of technology for our business infrastructure and create additional efficiencies ($2,270,000 in FY 2016 and $2,070,000 in FY 2017).
- Continuously appropriated funding for the first two years of the ASRS Benefit Disbursement project that will allow the ASRS to reduce the annual costs, over time, for all categories of disbursements. Expenditures will include FTE time, external resources, and equipment purchases ($638,000 in FY 2016 and $910,500 In FY 2017).
- Appropriated funding to support enhanced technology risk management strategies with dedicated resources and tools ($870,800 for FY 2016 and $661,200 for FY 2017).

- Appropriated funding for a compensation plan focused on rewarding non-investment staff for performance in achieving established goals, reducing risk and costs, and improving efficiency, productivity, and the member experience. ($262,000 in FY 2016 and $262,000 in FY 2017).

- Investment continuously appropriated expenditures for the ASRS investment management program expenses, including investment management fees, consulting and legal fees, data subscriptions and analytics services, staff base salaries and employer related expenses, and custodial banking administrative and external financial service fees. In FY 2017, expenditures include travel, education and training, rent, and other operational costs ($162,927,000 in FY 2016 and $190,400,000 In FY 2017).

See Schedules A-C for a summary of the ASRS Administrative and Investment Spending Plans for FYs 2016 and 2017.

**B. <u>FY 2018 Appropriated Budget Request and Spending Plan</u>**
In accordance with the guidelines set by the Governor, the ASRS must develop, prepare, and submit a one-year budget request for FY 2018 that reflects only the essential needs to meet the purpose and mission of the agency. The ASRS FY 2018 appropriated budget request is in alignment with the strategic vision, goals and objectives encompassed in the ASRS Strategic Plan and will enable the ASRS to meet established goals while maintaining an effective operating cost structure and budget and demonstrating a commitment to fiscal prudence.

The ASRS FY 2018 appropriated budget request includes the following reductions:

- Decrease in funding resulting from targeted management appropriation reductions
  - Amount: $230,000
  - Expenditure Categories: Other Operating Expenses
  - Budget Source: Lump-Sum Base Operating

  By focusing on its vision to be an industry-wide leader and on the achievement of measurable goals and objectives, the ASRS has been able to provide service to members in a more cost effective, productive, timely and reliable manner.

  This request represents approximately a 1% reduction of the ASRS appropriated operating budget and 0.8% reduction of the ASRS total appropriated budget.

- Decrease in funding for the administration of the ASRS Long Term Disability (LTD) Program
  - Amount: $300,000
  - Expenditure Categories: LTD Administration
  - Budget Source: LTD Administration Appropriations

  The ASRS LTD Program provides ASRS active members with a monthly benefit designed to partially replace income lost during periods of total disability resulting from a qualifying illness or injury. The administrative costs associated with the program are paid from the LTD Program Trust Fund, which is funded by employee and employer contributions.

  In FY 2017, the ASRS contracted with a different third-party administrator, Broadspire Services, Inc. to manage the LTD program. In addition, the number of ASRS members receiving an LTD benefit has declined over the last three fiscal years. The ASRS anticipates that the combination of these factors will result in lower administrative costs.

This request represents approximately a 10.7% reduction of the LTD Administration appropriated budget and 1.1% reduction of the ASRS total appropriated budget.

The ASRS FY 2018 appropriated budget request also includes the following decrease from the FY 2017 approved appropriations:

- Decrease in funding of the five-year Oracle Forms and Reports Modernization project
  - Amount: $2,070,000
  - Expenditure Categories: Special Line Item Appropriations
  - Budget Source: Non-lapsing Special Line Item Appropriations

  The FY 2017 approved budget included the final portion of a total associated funding requirement of $10,214,500 for this project that will allow the ASRS to achieve a standard set of technology for its business infrastructure and create additional efficiencies.

See Schedules D-F for a summary of the FY 2018 Appropriated Budget Request and associated detail.

*Continuously Appropriated Funding Projections*
The ASRS investment and administrative costs are expended in accordance with statute. A.R.S. § 38-721(C) provides that specific expenditures are continuously appropriated in the amount deemed necessary by the Board. The following expenses complement ASRS operations and service functions:

- **Investment management fees and related consulting fees necessary to meet the Board's investment objectives** - includes investment management fees (both external and internal), investment related consulting and legal fees, data subscriptions and services, custodial banking administrative fees, and financial service fees.

  - Internal Investment Management – ASRS Investment Management Division staff base salaries and employer-paid expenses (benefits and payroll taxes), travel, education and training, rent, and other operational costs.

  - Investment Management, Transactional and Other Fees (Public Markets) – Quarterly investment management fees are calculated based on the market value of the investments, using the assumption of an 8% annual rate of return less estimated net cash flows of 2.5%. Accordingly, the fees are directly correlated with both investment performance as well as net cash flows. Transactional and other fees include foreign taxes and commissions on derivatives and other incidental costs.

  - Investment Management, Performance Incentive and Other Fees (Private Markets) – Quarterly fees are comprised of two components:

    1. Investment management fees – These fees are calculated based on the percentage of committed capital to the program, which increases each year based on the pacing plan approved by the Private Markets Investment Committee. These fees are correlated to capital commitments in the program.

    2. Performance incentive and other fees – Performance incentive fees include incentives and carried interest, which are only paid upon successful performance of the manager after other return hurdles are met. Other fees are the ASRS proportional share of the transactional and operational cost of the underlying investment structure, if incurred. Performance incentive and other fees are only

paid if earned or incurred, and therefore may vary each quarter.

Budgetary estimates of private markets performance incentive fees are forthcoming. The ASRS Financial Services Division is completing industry research to finalize accounting methodology and presentation.

- **Rent** – includes costs associated with rent required as tenants for occupancy at 3300 N Central Avenue in Phoenix and in the leased office space in Tucson.

- **Actuarial consulting fees** – includes costs associated with actuarial services related to plan design, administration and valuations.

- **Retiree Payroll** – includes costs associated with administering retiree pension benefits and disbursements, including third-party payroll administration fees, postage and benefit-related consulting fees.

See Schedules G-I for a summary of the FY 2018 Continuously Appropriated Funding Projections and associated detail.

**Conclusion**

For FY 2018, these requested items result in an annual net decrease to the ASRS Appropriated Budget of 9.4%, a 0.5% net decrease to the ASRS Total Administrative Spending Plan and an 8.9% net increase to the ASRS Investment Spending Plan.

Attachments

*Agenda Item 3.a*

| | |
|---|---|
| Schedule A: | ASRS Administrative and Investment Spending Estimate FY 2016 |
| Schedule B: | FY 2017 ASRS Base Operating Budget Overview |
| Schedule C: | ASRS Administrative and Investment Spending Plan FY 2017 |

*Agenda Item 3.b*

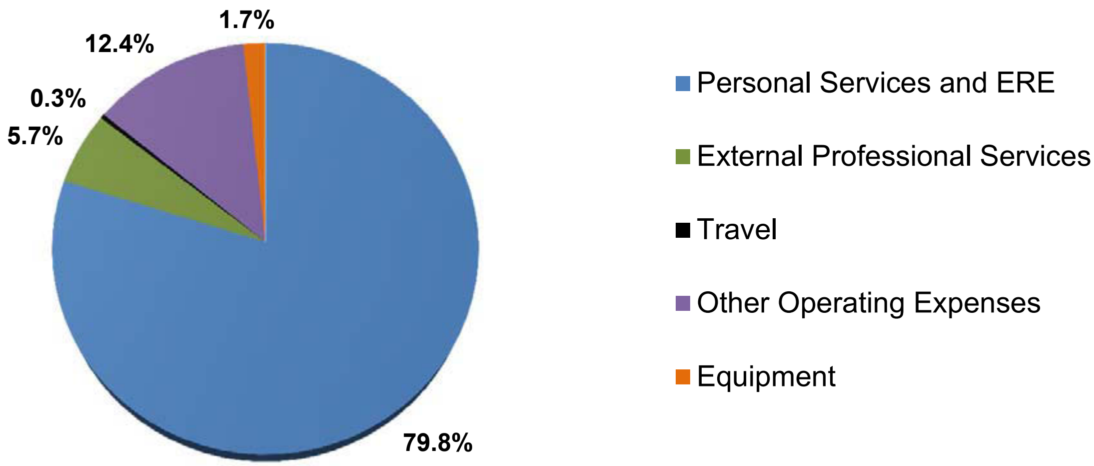
| | |
|---|---|
| Schedule D: | ASRS Total Appropriated Budget Request FY 2018 |
| Schedule E: | Appropriated Budget Detail: Reductions |
| Schedule F: | Appropriated Budget Detail: Oracle Forms and Reports Modernization |
| Schedule G: | ASRS Continuously Appropriated Funding Projections |
| Schedule H: | Continuously Appropriated Funding Detail: ASRS Benefit Disbursement Project |
| Schedule I: | ASRS Administrative and Investment Spending Plan FY 2018 |

# ASRS Administrative and Investment Spending Estimate
# FY 2016
**(Dollars In Thousands)**

| | Base Operating Appropriations + | Long Term Disability Appropriations + | Oracle Modernization Special Legislative Appropriations + | Other Prior Year Special Legislative Appropriations + | Administrative Continuous Appropriations = | Administrative Subtotal + | Investment Continuous Appropriations = | Total |
|---|---|---|---|---|---|---|---|---|
| **Personal Services (PS) and Employee Related Expenses (ERE)** | | | | | | | | |
| PS (Wages and Salaries) | 12,017.3 | | 385.6 | | 575.0 | 12,977.9 | 1,248.0 | 14,225.9 |
| ERE (Employer costs for Benefits, Taxes and ADOA Admin. Fees) | 4,701.7 | | 119.0 | | 206.0 | 5,026.7 | 357.0 | 5,383.7 |
| Variable Compensation Strategies | 262.0 | | | | | 262.0 | | 262.0 |
| Investment Incentive Compensation Plan | 264.7 | | | | | 264.7 | | 264.7 |
| **Total PS and ERE** | **17,245.7** | **-** | **504.6** | **-** | **781.0** | **18,531.3** | **1,605.0** | **20,136.3** |
| **External Professional Services** | | | | | | | | |
| External Investment Management Expenses* | | | | | | - | 153,098.5 | 153,098.5 |
| Custodial Banking Services | | | | | | - | 1,179.5 | 1,179.5 |
| LTD Program Administration | | 2,312.0 | | | | 2,312.0 | | 2,312.0 |
| Software Programming Costs | 1,130.0 | | 404.5 | | 657.0 | 2,191.5 | | 2,191.5 |
| Actuary & Benefit Consulting | | | | | 242.0 | 242.0 | | 242.0 |
| Consulting | 295.0 | | | | | 295.0 | 3,741.0 | 4,036.0 |
| Legal Fees | 342.0 | | | | 28.0 | 370.0 | 1,661.0 | 2,031.0 |
| Pension Payroll Disbursement Services | | | | | 1,543.0 | 1,543.0 | | 1,543.0 |
| Other Outside Services | 140.0 | | | | | 140.0 | | 140.0 |
| **Total External Professional Services** | **1,907.0** | **2,312.0** | **404.5** | **-** | **2,470.0** | **7,093.5** | **159,680.0** | **166,773.5** |
| **Travel, Other Operating & Equipment** | | | | | | | | |
| Software Licenses & Support | 1,200.0 | | | | | 1,200.0 | | 1,200.0 |
| Equipment & Furniture | 630.8 | | | | 3.0 | 633.8 | | 633.8 |
| Telephone | 330.0 | | | | | 330.0 | | 330.0 |
| Postage and Delivery | 210.0 | | | | 167.0 | 377.0 | | 377.0 |
| Insurance | 327.1 | | | | | 327.1 | | 327.1 |
| Operating Supplies | 134.5 | | | | | 134.5 | | 134.5 |
| Repair & Maintenance | 86.0 | | | | | 86.0 | | 86.0 |
| Dues & Subscriptions | 114.5 | | | | | 114.5 | 1,642.0 | 1,756.5 |
| Education & Training | 105.0 | | | | | 105.0 | | 105.0 |
| Travel | 95.7 | | | | | 95.7 | | 95.7 |
| External Printing | 75.0 | | | | | 75.0 | | 75.0 |
| Office Rent | | | | | 1,576.0 | 1,576.0 | | 1,576.0 |
| **Total Travel, Other Operating & Equipment** | **3,308.6** | | **-** | **-** | **1,746.0** | **5,054.6** | **1,642.0** | **6,696.6** |
| **TOTAL** | **22,461.3** | **2,312.0** | **909.1** | **-** | **4,997.0** | **30,679.4** | **162,927.0** | **193,606.4** |
| **APPROPRIATED/BUDGETED AMOUNTS** | **22,911.6** | **2,800.0** | **2,270.0** | | | | | |
| **$$ DIFFERENCE (BUDGETED LESS ACTUAL)** | 450.30 | 488.00 | Non-Lapsing | Non-Lapsing | | | | |
| **% DIFFERENCE UNDER BUDGET** | 2.0% | 17.4% | | | | | | |

*Budgetary estimates of private markets performance incentive fees are forthcoming. ASRS Financial Services Division is completing industry research to finalize accounting methodology and presentation.

# FY 2017
# ASRS Base Operating Budget Overview




| | | |
|---|---|---|
| **Personal Services and Employee Related Expenditures (ERE)** | | **$ 18,052,300** |
| • Salaries and wages (including leave and overtime) paid to employees; Trustee per diem | $ 13,025,000 | |
| • Variable Compensation Strategies Plan payments to employees | $ 262,000 | |
| • Investment Incentive Compensation Plan | $ 250,000 | |
| • Employer costs for employee benefits (ERE), including FICA, Retirement, Workers' Compensation, Health, Dental, and Life Insurance, Retiree Accumulated Sick Leave charges, Personnel Division charges (Average ASRS ERE rate represents 38% of agency's personal services subtotal.) | $ 4,515,300 | |
| **External Professional Services** | | **$ 1,292,400** |
| • Information Technology Support and Business Applications | $ 600,000 | |
| • Consulting | $ 290,000 | |
| • Legal Fees - external legal counsel, Arizona Office of Administrative Hearings fees, Office of the Attorney General charges | $ 271,000 | |
| • Other professional services | $ 131,400 | |
| **Travel** | | **$ 79,000** |
| • In-state travel for Member and Employer Outreach Teams, staff and Trustees | $ 30,000 | |
| • Out-of-state travel to pension industry and educational conferences | $ 49,000 | |
| **Other Operating Expenses** | | **$ 2,801,000** |
| • Software licenses and maintenance support | $ 1,363,000 | |
| • Telecommunications | $ 355,000 | |
| • Postage and delivery | $ 210,000 | |
| • ADOA Risk Management insurance premiums | $ 309,000 | |
| • Other operating supplies and expenditures | $ 134,500 | |
| • Equipment repair and maintenance | $ 105,000 | |
| • Professional dues, books and subscriptions | $ 129,500 | |
| • Education, training and conferences ($105,000), employee tuition assistance ($15,000) | $ 120,000 | |
| • External printing and mailing newsletters | $ 75,000 | |
| **Equipment and Furniture** | | **$ 389,500** |
| • Agency furniture purchases/replacement | $ 39,500 | |
| • Network, server, PC, and related devices replacement and additions | $ 350,000 | |
| **Base Operating Budget Total** | | **$ 22,614,200** |

# ASRS Administrative and Investment Spending Plan
# FY 2017
**(Dollars In Thousands)**

| | Base Operating Appropriations + | Long Term Disability Appropriations + | Oracle Modernization Special Legislative Appropriations + | Other Prior Year Special Legislative Appropriations + | Administrative Continuous Appropriations = | Administrative Subtotal + | Investment Continuous Appropriations = | Total |
|---|---|---|---|---|---|---|---|---|
| **Personal Services (PS) and Employee Related Expenses (ERE)** | | | | | | | | |
| PS (Wages and Salaries) | 13,025.0 | | 713.1 | | 701.0 | 14,439.1 | 1,163.0 | 15,602.1 |
| ERE (Employer costs for Benefits, Taxes and ADOA Admin. Fees) | 4,515.3 | | 221.1 | | 256.0 | 4,992.4 | 349.0 | 5,341.4 |
| Variable Compensation Strategies | 262.0 | | | | | 262.0 | | 262.0 |
| Investment Incentive Compensation Plan | 250.0 | | | | | 250.0 | | 250.0 |
| **Total PS and ERE** | **18,052.3** | **-** | **934.2** | **-** | **957.0** | **19,943.5** | **1,512.0** | **21,455.5** |
| **External Professional Services** | | | | | | | | |
| External Investment Management Expenses* | | | | | | - | 180,040.0 | 180,040.0 |
| Custodial Banking Services | | | | | | - | 1,440.0 | 1,440.0 |
| LTD Program Administration | | 2,200.0 | | | | 2,200.0 | | 2,200.0 |
| Software Programming Costs | 600.0 | | 781.6 | | 505.0 | 1,886.6 | | 1,886.6 |
| Actuary & Benefit Consulting | | | | | 390.0 | 390.0 | | 390.0 |
| Consulting | 290.0 | | | | | 290.0 | 4,416.0 | 4,706.0 |
| Legal Fees | 271.0 | | | | | 271.0 | 925.0 | 1,196.0 |
| Pension Payroll Disbursement Services | | | | | 1,623.0 | 1,623.0 | | 1,623.0 |
| Other Outside Services | 131.4 | | | | | 131.4 | | 131.4 |
| **Total External Professional Services** | **1,292.4** | **2,200.0** | **781.6** | **-** | **2,518.0** | **6,792.0** | **186,821.0** | **193,613.0** |
| **Travel, Other Operating & Equipment** | | | | | | | | |
| Software Licenses & Support | 1,363.0 | | | | | 1,363.0 | | 1,363.0 |
| Equipment & Furniture | 389.5 | | | | 230.0 | 619.5 | | 619.5 |
| Telephone | 355.0 | | | | | 355.0 | | 355.0 |
| Postage and Delivery | 210.0 | | | | 85.0 | 295.0 | | 295.0 |
| Insurance | 309.0 | | | | | 309.0 | | 309.0 |
| Operating Supplies | 134.5 | | | | | 134.5 | 10.0 | 144.5 |
| Repair & Maintenance | 105.0 | | | | | 105.0 | | 105.0 |
| Dues & Subscriptions | 129.5 | | | | | 129.5 | 1,982.0 | 2,111.5 |
| Education & Training | 120.0 | | | | | 120.0 | 15.0 | 135.0 |
| Travel | 79.0 | | | | | 79.0 | 15.0 | 94.0 |
| External Printing | 75.0 | | | | | 75.0 | | 75.0 |
| Office Rent | | | | | 1,500.0 | 1,500.0 | 45.0 | 1,545.0 |
| **Total Travel, Other Operating & Equipment** | **3,269.5** | | **-** | **-** | **1,815.0** | **5,084.5** | **2,067.0** | **7,151.5** |
| **TOTAL** | **22,614.2** | **2,200.0** | **1,715.8** | **-** | **5,290.0** | **31,820.0** | **190,400.0** | **222,220.0** |
| **APPROPRIATED/BUDGETED AMOUNTS** | **22,614.2** | **2,800.0** | **2,070.0** | | | | | |
| **$$ DIFFERENCE (BUDGETED LESS ACTUAL)** | - | 600.00 | Non-Lapsing | Non-Lapsing | | | | |
| **% DIFFERENCE UNDER BUDGET** | 0.0% | 21.4% | | | | | | |

*Budgetary estimates of private markets performance incentive fees are forthcoming. ASRS Financial Services Division is completing industry research to finalize accounting methodology and presentation.

# Total Appropriated Budget Request
# FY 2018

| | FY 2016 Appropriations | FY 2017 Appropriations | Total Request FY 2018 Appropriations |
|---|---|---|---|
| Personal Services & Employee Related Expenditures | 18,155,400 | 18,052,300 | 18,052,300 |
| External Professional Services | 1,292,400 | 1,292,400 | 1,292,400 |
| Travel | 79,900 | 79,000 | 79,000 |
| Other Operating Expenses | 2,732,800 | 2,801,000 | 2,571,000 |
| Equipment | 651,100 | 389,500 | 389,500 |
| **Base Operating Budget Subtotal** | **22,911,600** | **22,614,200** | **22,384,200** |
| **Long Term Disability Program Administration (LTD)** | **2,800,000** | **2,800,000** | **2,500,000** |
| **Total Appropriated Operating Budget** | **25,711,600** | **25,414,200** | **24,884,200** |
| **Special Line Item Appropriations**<br>PIJ: Oracle Forms and Reports (IT Modernization Project) | **2,270,000** | **2,070,000** | **-** |
| **Total Appropriated Budget** | **27,981,600** | **27,484,200** | **24,884,200** |

| Changes to Appropriations | FY 2017 Change relative to FY 2016 Total Appropriated Budget | | FY 2018 Change relative to FY 2017 Total Appropriated Budget | |
|---|---|---|---|---|
| FY 17 - Remove One-Time Purchases of Equipment | $ (216,600) | -0.8% | $ - | 0.0% |
| FY 17 - Statewide Adjustments (reduce employer HI costs; increase accounting system charges) | $ (80,800) | -0.3% | $ - | 0.0% |
| FY 18 - Targeted Base Operating Reduction | $ - | 0.0% | $ (230,000) | -0.8% |
| FY 18 - LTD Administration Fees | $ - | 0.0% | $ (300,000) | -1.1% |
| FY 17 & FY 18 - PIJ: Oracle Forms and Reports (IT Modernization Project) | $ (200,000) | -0.7% | $(2,070,000) | -7.5% |
| **Subtotals** | $ (497,400) | -1.8% | $(2,600,000) | -9.4% |

Schedule D

# Appropriated Budget Detail: Reductions
# FY 2018

**Objective: To demonstrate the ASRS commitment to achieving efficiencies through maximizing resources and exercising fiscal prudence.**

| | | FY 2017 Appropriations | FY 2018 Funding Request |
|---|---|---|---|
| **Other Operating Expenses** | | **2,801,000** | **2,571,000** |
| Software support and maintenance, printing, postage, and other operating expenditures | | | |
| **OTHER OPERATING EXPENSES FY 2017 and FY 2018 APPROPRIATED BUDGET** | | **2,801,000** | **2,571,000** |
| | **DIFFERENCE** | **$** | **(230,000)** |
| | **% REDUCTION OF BASE OPERATING BUDGET APPROPRIATIONS** | | -1.0% |
| **Long Term Disability (LTD) Administration** | | **2,800,000** | **2,500,000** |
| Administration costs of the LTD program | | | |
| **LTD FY 2017 and FY 2018 APPROPRIATED BUDGET** | | **2,800,000** | **2,500,000** |
| | **DIFFERENCE** | **$** | **(300,000)** |
| | **% REDUCTION OF LTD ADMINISTRATION APPROPRIATIONS** | | -10.7% |
| **Special Line Item Appropriations** | | **2,070,000** | **-** |
| PIJ: Oracle Forms and Reports (IT Modernization Project) Personal Services & ERE and External Professional Services Resources | | | |
| **SPECIAL LINE ITEMS FY 2017 and FY 2018 APPROPRIATED BUDGET** | | **2,070,000** | **-** |
| | **DIFFERENCE** | **$** | **(2,070,000)** |
| | **% REDUCTION OF SLI APPROPRIATIONS** | | -100.0% |
| | **TOTAL DIFFERENCE** | **$** | **(2,600,000)** |

# Appropriated Budget Detail: Oracle Forms and Reports Modernization
# FY 2018

| Objective: Evolve legacy technologies to newer open standards-based technologies and re-engineer business processes to increase productivity, reduce costs, mitigate risks, improve member satisfaction and improve service turnaround time to members. | FY 2014 | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2019 | Project Totals |
|---|---|---|---|---|---|---|---|
| **APPROPRIATED BUDGET** | 1,390,000 | 4,484,500 | 2,270,000 | 2,070,000 | - | - | 10,214,500 |
| **ACTUAL AND ESTIMATED SPEND** | 1,117,400 | 1,736,200 | 909,100 | 1,715,800 | 1,968,000 | 2,768,000 | 10,214,500 |

# ASRS Continuously Appropriated Funding Projections
## (Dollars In Thousands)

| | FY 2016 Estimated | FY 2017 Projection | FY 2018 Projection |
|---|---|---|---|
| ***Investment Management Expenses*** | | | |
| Custodial Banking, Security Lending and Master Cash STIF Fees | 3,091 | 3,340 | 3,340 |
| Internal Investment Management (Salaries and Benefits) | 1,605 | 1,512 | 1,512 |
| Internal Investment Management (Travel, Education and Training, Rent, and Other Operational Expenses) | - | 85 | 85 |
| Public Markets | | | |
| External Investment Management Fees | 54,116 | 55,931 | 62,253 |
| Transactional and Other Fees | 4,071 | 4,000 | 4,000 |
| Private Markets | | | |
| Private Debt and Equity Management Fees | 52,000 | 58,997 | 65,902 |
| Private Debt and Equity Performance Incentive and Other Fees | * | * | * |
| Real Estate, Farmland and Timber and Infrastructure Management Fees | 30,000 | 27,195 | 28,165 |
| Real Estate, Farmland and Timber and Infrastructure Performance Incentive and Other Fees | * | * | * |
| Opportunistic Debt and Equity Management Fees | 11,000 | 32,017 | 34,402 |
| Opportunistic Debt and Equity Performance Incentive and Other Fees | * | * | * |
| *Subtotal Investment Management Expenses* | 155,883 | 183,077 | 199,659 |
| ***Investment Related Consulting, Legal and Information Services*** | | | |
| Investment Consulting Services | 3,660 | 4,301 | 4,414 |
| Investment Related Legal Services | 1,661 | 925 | 925 |
| Investment Electronic Information Services | 1,642 | 1,982 | 2,151 |
| External Financial Consulting Services | 81 | 115 | 115 |
| *Subtotal Investment Related Consulting, Legal and Information Services* | 7,044 | 7,323 | 7,605 |
| **Subtotal Investment Continuous Appropriations** | 162,927 | 190,400 | 207,264 |
| Rent | 1,576 | 1,500 | 1,500 |
| Actuarial Annual Consulting Fees | 203 | 350 | 350 |
| Actuarial Special Projects (Benefits Consulting Services, FY18: 5 Yr. Experience Study) | 39 | 40 | 85 |
| ASRS Benefit Disbursement Project (PIJ) | 638 | 911 | 716 |
| Retiree Payroll (Disbursement Administration) | 2,541 | 2,489 | 2,556 |
| **Subtotal Administrative Continuous Appropriations** | 4,997 | 5,290 | 5,207 |
| **Continuously Appropriated Funding Totals** | **167,924** | **195,690** | **212,471** |

*Budgetary estimates are forthcoming. ASRS Financial Services Division is completing industry research to finalize accounting methodology and presentation.

# ASRS Continuously Appropriated Funding Detail: ASRS Benefit Disbursement Project

| Objective: Development of platform and disbursement-related processes to administer the entire benefit cycle in-house, which includes benefit calculations, electronic payment transmission, printing and mailing paper checks and remittance advices, and tax withholding and reporting. | FY 2016 | FY 2017 | FY 2018 | FY 2019 | FY 2020 | Project Totals |
|---|---|---|---|---|---|---|
| **TOTALS - FY 2016 to FY 2020, PIJ FUNDING PROJECTION** | **950,400** | **658,100** | **676,800** | **696,000** | **35,500** | **3,016,800** |
| **ACTUAL AND ESTIMATED SPEND** | **638,000** | **910,500** | **716,400** | **716,400** | **35,500** | **3,016,800** |

# ASRS Administrative and Investment Spending Plan
## FY 2018
### (Dollars In Thousands)

| | Base Operating Appropriations + | Long Term Disability Appropriations + | Oracle Modernization Special Legislative Appropriations + | Other Prior Year Special Legislative Appropriations + | Administrative Continuous Appropriations = | Administrative Subtotal + | Investment Continuous Appropriations = | Total |
|---|---|---|---|---|---|---|---|---|
| **Personal Services (PS) and Employee Related Expenses (ERE)** | | | | | | | | |
| PS (Wages and Salaries) | 13,025.0 | | 713.0 | | 701.0 | 14,439.0 | 1,163.0 | 15,602.0 |
| ERE (Employer costs for Benefits, Taxes and ADOA Admin. Fees) | 4,515.3 | | 221.0 | | 256.0 | 4,992.3 | 349.0 | 5,341.3 |
| Variable Compensation Strategies | 262.0 | | | | | 262.0 | | 262.0 |
| Investment Incentive Compensation Plan | 250.0 | | | | | 250.0 | | 250.0 |
| **Total PS and ERE** | **18,052.3** | **-** | **934.0** | **-** | **957.0** | **19,943.3** | **1,512.0** | **21,455.3** |
| **External Professional Services** | | | | | | | | |
| External Investment Management Expenses* | | | | | | - | 196,622.0 | 196,622.0 |
| Custodial Banking Services | | | | | | - | 1,440.0 | 1,440.0 |
| LTD Program Administration | | 2,100.0 | | | | 2,100.0 | | 2,100.0 |
| Software Programming Costs | 600.0 | | 1,034.0 | | 505.0 | 2,139.0 | | 2,139.0 |
| Actuary & Benefit Consulting | | | | | 435.0 | 435.0 | | 435.0 |
| Consulting | 290.0 | | | | | 290.0 | 4,529.0 | 4,819.0 |
| Legal Fees | 271.0 | | | | | 271.0 | 925.0 | 1,196.0 |
| Pension Payroll Disbursement Services | | | | | 1,686.0 | 1,686.0 | | 1,686.0 |
| Other Outside Services | 131.4 | | | | | 131.4 | | 131.4 |
| **Total External Professional Services** | **1,292.4** | **2,100.0** | **1,034.0** | **-** | **2,626.0** | **7,052.4** | **203,516.0** | **210,568.4** |
| **Travel, Other Operating & Equipment** | | | | | | | | |
| Software Licenses & Support | 1,273.0 | | | | | 1,273.0 | | 1,273.0 |
| Equipment & Furniture | 389.5 | | | | 36.0 | 425.5 | | 425.5 |
| Telephone | 355.0 | | | | | 355.0 | | 355.0 |
| Postage and Delivery | 160.0 | | | | 88.0 | 248.0 | | 248.0 |
| Insurance | 309.0 | | | | | 309.0 | | 309.0 |
| Operating Supplies | 74.5 | | | | | 74.5 | 10.0 | 84.5 |
| Repair & Maintenance | 105.0 | | | | | 105.0 | | 105.0 |
| Dues & Subscriptions | 129.5 | | | | | 129.5 | 2,151.0 | 2,280.5 |
| Education & Training | 120.0 | | | | | 120.0 | 15.0 | 135.0 |
| Travel | 79.0 | | | | | 79.0 | 15.0 | 94.0 |
| External Printing | 45.0 | | | | | 45.0 | | 45.0 |
| Office Rent | | | | | 1,500.0 | 1,500.0 | 45.0 | 1,545.0 |
| **Total Travel, Other Operating & Equipment** | **3,039.5** | | **-** | **-** | **1,624.0** | **4,663.5** | **2,236.0** | **6,899.5** |
| **TOTAL** | **22,384.2** | **2,100.0** | **1,968.0** | **-** | **5,207.0** | **31,659.2** | **207,264.0** | **238,923.2** |
| **APPROPRIATED/BUDGETED AMOUNTS** | **22,384.2** | **2,500.0** | | | | | | |
| **$$ DIFFERENCE (BUDGETED LESS ACTUAL)** | - | 400.00 | Non-Lapsing | Non-Lapsing | | | | |
| **% DIFFERENCE UNDER BUDGET** | 0.0% | 16.0% | | | | | | |

*Budgetary estimates of private markets performance incentive fees are forthcoming. ASRS Financial Services Division is completing industry research to finalize accounting methodology and presentation.

# Agenda Item #6

ARIZONA STATE RETIREMENT SYSTEM

**Internal Audit Division**

SELF-ASSESSMENT WITH INDEPENDENT EXTERNAL VALIDATION REPORT

*[July 8, 2016]*

It is our opinion that the Arizona State Retirement System's Chief Internal Auditor performed an adequate Self-Assessment with Independent Validation (SAIV) and that the internal audit activity generally conforms with the Institute of Internal Auditors' (IIA) *Definition of Internal Auditing, Code of Ethics*, and *International Standards for the Professional Practice of Internal Auditing (Standards) effective January 1, 2013*.

Bernard Glick
**Bernard Glick**
**ASRS Chief Auditor**

Bridget E Feeley
**Bridget Feeley**
**PSPRS Director of Internal Audit**

# *Arizona State Retirement System*

**Internal Audit Division**

**SELF-ASSESSMENT WITH INDEPENDENT EXTERNAL VALIDATION REPORT**

***Executive Summary***

The **Arizona State Retirement System** has conducted a quality assurance Self-Assessment with Independent Validation of the internal audit activity. Our review was based on the Institute of Internal Auditors (IIA) guidelines in the performance of the Self-Assessment with Independent Validation.

We evaluated the extent of the Arizona State Retirement System Internal Audit Division's conformance with the IIA's *Definition of Internal Auditing, Code of Ethics, and Standards (Effective January 1, 2013)*. The *Self-Assessment with Independent Validation* was for the period of **July 1, 2015** through **June 30, 2016.**

***Bridget Feely of PSPRS*** performed an on-site *validation* between July 7th and 8th, 2016. During this period, she tested the Internal Audit Division's conformance with the IIA's *Definition of Internal Auditing, Code of Ethics, and Standards (Effective January 1, 2013).*

In performing the *Self-Assessment with Independent Validation* we used the IIA's basis for the determination of conformance as described below:

- **<u>Generally Conforms</u>:** means the evaluator has concluded that the relevant structures, policies, and procedures of the activity, as well as the processes by which they are applied, conform with the requirements of the IIA's *Definition of Internal Auditing, Code of Ethics* and *Standards* in all material respects. This means that there is general conformity to a majority of the IIA's *Definition of Internal Auditing, Code of Ethics,* and *Standards*. There may be significant opportunities for improvement, but these should not represent situations where the activity has not implemented the IIA's *Definition of Internal Auditing, Code of Ethics* and *Standards in* such a manner that it's not applying them effectively, or is not achieving their stated objectives.

- **<u>Partially Conforms</u>:** means the evaluator has concluded that the activity is making good-faith efforts to be in conformity with the requirements of the IIA's *Definition of Internal Auditing, Code of Ethics,* and *Standards*, but has fallen short of achieving some of their major objectives. These will usually represent some significant opportunities for improvement in effectively applying the IIA's *Definition of Internal Auditing, Code of Ethics* and *Standards* and/or achieving their objectives.

- **Does Not Conform:** means the evaluator has concluded that the activity is not aware of, is not making good-faith efforts to be in conformity with, or is failing to achieve many/all of the objectives of the IIA's *Definition of Internal Auditing, Code of Ethics,* and *Standards*. These deficiencies will usually have a significant negative impact on the activity's effectiveness and its potential to add value to the organization. They may also represent significant opportunities for improvement, including actions by senior management or the governing authority.

Our report includes the Chief Internal Auditor's and external validator's concurrence and comments, and any actions planned necessary for the Internal Audit Department to build a more effective internal audit organization. Presented on the following pages are the results of the *Self-Assessment with Independent Validation*, by assessment area:

We take this opportunity to acknowledge the valuable assistance offered by the external validator.

Internal Audit Division

SELF-ASSESSMENT WITH INDEPENDENT EXTERNAL VALIDATION REPORT

**IIA Attribute Standards:**

**1000 – Purpose, Authority, and Responsibility**

The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the *Standards*. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.

**Interpretation:**

*The internal audit charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. The internal audit charter establishes the internal audit activity's position within the organization, including the nature of the chief audit executive's functional reporting relationship with the board; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Final approval of the internal audit charter resides with the board.*

**1000.A1** – The nature of assurance services provided to the organization must be defined in the internal audit charter. If assurances are to be provided to parties outside the organization, the nature of these assurances must also be defined in the internal audit charter.

**1000.C1** – The nature of consulting services must be defined in the internal audit charter.

**1010 – Recognition of the Definition of Internal Auditing, the Code of Ethics, and the *Standards* in the Internal Audit Charter**

The mandatory nature of the Definition of Internal Auditing, the Code of Ethics, and the *Standards* must be recognized in the internal audit charter. The chief audit executive should discuss the Definition of Internal Auditing, the Code of Ethics, and the *Standards* with senior management and the board.

**Chief Audit Executive/Chief Internal Auditor:**

The Internal Audit Department generally conforms without exceptions noted.

**External Reviewer/Validator:**

I concur.

1100 – Independence and Objectivity
The internal audit activity must be independent, and internal auditors must be objective in performing their work.

**Interpretation:**
*Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the chief audit executive has direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship. Threats to independence must be managed at the individual auditor, engagement, functional, and organizational levels.*

*Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others. Threats to objectivity must be managed at the individual auditor, engagement, functional, and organizational levels.*

**1110 – Organizational Independence**
The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

**Interpretation:**
*Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:*

- *Approving the internal audit charter;*
- *Approving the risk based internal audit plan;*
- *Approving the internal audit budget and resource plan;*
- *Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters;*
- *Approving decisions regarding the appointment and removal of the chief audit executive;*
- *Approving the remuneration of the chief audit executive; and*
- *Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.*

**1110.A1** – The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results.

**1111 – Direct Interaction with the Board**
The chief audit executive must communicate and interact directly with the board.
**1120 – Individual Objectivity**
Internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest.

**Interpretation:**

***Conflict of interest*** *is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest. Such competing interests can make it difficult to fulfill his or her duties impartially. A conflict of interest exists even if no unethical or improper act results. A conflict of interest can create an appearance of impropriety that can undermine confidence in the internal auditor, the internal audit activity, and the profession. A conflict of interest could impair an individual's ability to perform his or her duties and responsibilities objectively.*

**1130 – Impairment to Independence or Objectivity**

If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment.

**Interpretation:**

***Impairment*** *to organizational independence and individual objectivity may include, but is not limited to, personal conflict of interest, scope limitations, restrictions on access to records, personnel, and properties, and resource limitations, such as funding.*

*The determination of appropriate parties to which the details of an impairment to independence or objectivity must be disclosed is dependent upon the expectations of the internal audit activity's and the chief audit executive's responsibilities to senior management and the board as described in the internal audit charter, as well as the nature of the impairment.*

**1130.A1** – Internal auditors must refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an internal auditor provides assurance services for an activity for which the internal auditor had responsibility within the previous year.

**1130.A2** – Assurance engagements for functions over which the chief audit executive has responsibility must be overseen by a party outside the internal audit activity.

**1130.C1** – Internal auditors may provide consulting services relating to operations for which they had previous responsibilities.

**1130.C2** – If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure must be made to the engagement client prior to accepting the engagement.

**Chief Audit Executive/Chief Internal Auditor:**

The Internal Audit Department generally conforms without exceptions noted.

**External Reviewer/Validator:**

I concur.

**1200 – Proficiency and Due Professional Care**
Engagements must be performed with proficiency and due professional care.

**1210 – Proficiency**
Internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively must possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.

**Interpretation:**
*Knowledge, skills, and other competencies is a collective term that refers to the professional proficiency required of internal auditors to effectively carry out their professional responsibilities. Internal auditors are encouraged to demonstrate their proficiency by obtaining appropriate professional certifications and qualifications, such as the Certified Internal Auditor designation and other designations offered by The Institute of Internal Auditors and other appropriate professional organizations.*

**1210.A1** – The chief audit executive must obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part of the engagement.

**1210.A2** – Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.

**1210.A3** – Internal auditors must have sufficient knowledge of key information technology risks and controls and available technology-based audit techniques to perform their assigned work. However, not all internal auditors are expected to have the expertise of an internal auditor whose primary responsibility is information technology auditing.

**1210.C1** – The chief audit executive must decline the consulting engagement or obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part of the engagement.

**1220 – Due Professional Care**
Internal auditors must apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care does not imply infallibility.

**1220.A1** – Internal auditors must exercise due professional care by considering the:

- Extent of work needed to achieve the engagement's objectives;
- Relative complexity, materiality, or significance of matters to which assurance procedures are applied;
- Adequacy and effectiveness of governance, risk management, and control processes;
- Probability of significant errors, fraud, or noncompliance; and
- Cost of assurance in relation to potential benefits.

## IIA Attribute Standards (Continued):

**1220.A2** – In exercising due professional care internal auditors must consider the use of technology-based audit and other data analysis techniques.

**1220.A3** – Internal auditors must be alert to the significant risks that might affect objectives, operations, or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified.

**1220.C1** – Internal auditors must exercise due professional care during a consulting engagement by considering the:

- Needs and expectations of clients, including the nature, timing, and communication of engagement results;
- Relative complexity and extent of work needed to achieve the engagement's objectives; and
- Cost of the consulting engagement in relation to potential benefits.

**1230 – Continuing Professional Development**
Internal auditors must enhance their knowledge, skills, and other competencies through continuing professional development.

**Chief Audit Executive/Chief Internal Auditor:**

The Internal Audit Department generally conforms without exceptions noted.

**External Reviewer/Validator:**

I concur.

**1300 – Quality Assurance and Improvement Program**
The chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity.

**Interpretation:**
*A quality assurance and improvement program is designed to enable an evaluation of the internal audit activity's conformance with the Definition of Internal Auditing and the Standards and an evaluation of whether internal auditors apply the Code of Ethics. The program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement.*

**1310 – Requirements of the Quality Assurance and Improvement Program**
The quality assurance and improvement program must include both internal and external assessments.

**1311 – Internal Assessments**
Internal assessments must include:

- Ongoing monitoring of the performance of the internal audit activity; and

- Periodic self-assessments or assessments by other persons within the organization with sufficient knowledge of internal audit practices.

**Interpretation:**
*Ongoing monitoring is an integral part of the day-to-day supervision, review, and measurement of the internal audit activity. Ongoing monitoring is incorporated into the routine policies and practices used to manage the internal audit activity and uses processes, tools, and information considered necessary to evaluate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards.*

*Periodic assessments are conducted to evaluate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards.*

*Sufficient knowledge of internal audit practices requires at least an understanding of all elements of the International Professional Practices Framework.*

**1312 – External Assessments**
External assessments must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organization. The chief audit executive must discuss with the board:

- The form and frequency of external assessment; and
- The qualifications and independence of the external assessor or assessment team, including any potential conflict of interest.

**Interpretation:**
*External assessments can be in the form of a full external assessment, or a self-assessment with independent validation.*

*A qualified assessor or assessment team demonstrates competence in two areas: the professional practice of internal auditing and the external assessment process. Competence can be demonstrated through a mixture of experience and theoretical learning. Experience gained in organizations of similar size, complexity, sector or industry, and technical issues is more valuable than less relevant experience. In the case of an assessment team, not all members of the team need to have all the competencies; it is the team as a whole that is qualified. The chief audit executive uses professional judgment when assessing whether an assessor or assessment team's evaluation demonstrates sufficient competence to be qualified.*
*An independent assessor or assessment team means not having either a real or an apparent conflict of interest and not being a part of, or under the control of, the organization to which the internal audit activity belongs.*

**1320 – Reporting on the Quality Assurance and Improvement Program**
The chief audit executive must communicate the results of the quality assurance and improvement program to senior management and the board.

**Interpretation:**
*The form, content, and frequency of communicating the results of the quality assurance and improvement program is established through discussions with senior management and the board and considers the responsibilities of the internal audit activity and chief audit executive as contained in the internal audit charter. To demonstrate conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards, the results of external and periodic internal assessments are communicated upon completion of such assessments and the results of ongoing monitoring are communicated at least annually. The results include the assessor's or assessment team's evaluation with respect to the degree of conformance.*

**1321 – Use of "Conforms with the *International Standards for the Professional Practice of Internal Auditing*"**
The chief audit executive may state that the internal audit activity conforms with the *International Standards for the Professional Practice of Internal Auditing* only if the results of the quality assurance and improvement program support this statement.

**Interpretation:**
*The internal audit activity conforms with the Standards when it achieves the outcomes described in the Definition of Internal Auditing, Code of Ethics, and Standards. The results of the quality assurance and improvement program include the results of both internal and external assessments. All internal audit activities will have the results of internal assessments. Internal audit activities in existence for at least five years will also have the results of external assessments.*

**1322 – Disclosure of Nonconformance**
When nonconformance with the Definition of Internal Auditing, the Code of Ethics, or the *Standards* impacts the overall scope or operation of the internal audit activity, the chief audit executive must disclose the nonconformance and the impact to senior management and the board.

**Chief Audit Executive/Chief Internal Auditor:**

The Internal Audit Department partially conforms. The Chief Auditor made many attempts in communications with APPFA requesting a QAR. He was unaware of the provision for a self Assessment with independent evaluation. However, The Auditor General, during their"sunset review" of the ASRS found no evidence that internal audit were not following IIA standards. Additionally, our external auditors during their annual internal control review found no such evidence of failure to follow IIA standards. For the past three years we have done field work for the external auditors and if they felt we were not meeting standards would not have allowed internal audit to do their field work.

**External Reviewer/Validator:**

I concur.

**IIA Performance Standards:**

**IIA Performance Standards:**

**2000 – Managing the Internal Audit Activity**
The chief audit executive must effectively manage the internal audit activity to ensure it adds value to the organization.

**Interpretation:**
*The internal audit activity is effectively managed when:*

- *The results of the internal audit activity's work achieve the purpose and responsibility included in the internal audit charter;*
- *The internal audit activity conforms with the Definition of Internal Auditing and the Standards; and*
- *The individuals who are part of the internal audit activity demonstrate conformance with the Code of Ethics and the Standards.*

*The internal audit activity adds value to the organization (and its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management, and control processes.*

**2010 – Planning**
The chief audit executive must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization's goals.

**Interpretation:**
*The chief audit executive is responsible for developing a risk-based plan. The chief audit executive takes into account the organization's risk management framework, including using risk appetite levels set by management for the different activities or parts of the organization. If a framework does not exist, the chief audit executive uses his/her own judgment of risks after consideration of input from senior management and the board. The chief audit executive must review and adjust the plan, as necessary, in response to changes in the organization's business, risks, operations, programs, systems, and controls.*

**2010.A1** – The internal audit activity's plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the board must be considered in this process.

**2010.A2** – The chief audit executive must identify and consider the expectations of senior management, the board, and other stakeholders for internal audit opinions and other conclusions.

**2010.C1** – The chief audit executive should consider accepting proposed consulting engagements based on the engagement's potential to improve management of risks, add value, and improve the organization's operations. Accepted engagements must be included in the plan.

**2020 – Communication and Approval**
The chief audit executive must communicate the internal audit activity's plans and resource requirements, including significant interim changes, to senior management and the board for

review and approval. The chief audit executive must also communicate the impact of resource limitations.

**2030 – Resource Management**
The chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan.

**Interpretation:**
*Appropriate refers to the mix of knowledge, skills, and other competencies needed to perform the plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimizes the achievement of the approved plan.*

**2040 – Policies and Procedures**
The chief audit executive must establish policies and procedures to guide the internal audit activity.

**Interpretation:**
*The form and content of policies and procedures are dependent upon the size and structure of the internal audit activity and the complexity of its work.*

**2050 – Coordination**
The chief audit executive should share information and coordinate activities with other internal and external providers of assurance and consulting services to ensure proper coverage and minimize duplication of efforts.

**2060 – Reporting to Senior Management and the Board**
The chief audit executive must report periodically to senior management and the board on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan. Reporting must also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the board.

**Interpretation:**
*The frequency and content of reporting are determined in discussion with senior management and the board and depend on the importance of the information to be communicated and the urgency of the related actions to be taken by senior management or the board.*

**2070 – External Service Provider and Organizational Responsibility for Internal Auditing**
When an external service provider serves as the internal audit activity, the provider must make the organization aware that the organization has the responsibility for maintaining an effective internal audit activity.

**Interpretation**
*This responsibility is demonstrated through the quality assurance and improvement program which assesses conformance with the Definition of Internal Auditing, the Code of Ethics, and the Standards.*

**IIA Performance Standards (Continued):**

**Chief Audit Executive/Chief Internal Auditor:**

The Internal Audit Department generally conforms without exceptions noted.

**External Reviewer/Validator:**

I concur.

**2100 – Nature of Work**
The internal audit activity must evaluate and contribute to the improvement of governance, risk management, and control processes using a systematic and disciplined approach.

**2110 – Governance**
The internal audit activity must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

- Promoting appropriate ethics and values within the organization;
- Ensuring effective organizational performance management and accountability;
- Communicating risk and control information to appropriate areas of the organization; and
- Coordinating the activities of and communicating information among the board, external and internal auditors, and management.

**2110.A1** – The internal audit activity must evaluate the design, implementation, and effectiveness of the organization's ethics-related objectives, programs, and activities.

**2110.A2** – The internal audit activity must assess whether the information technology governance of the organization supports the organization's strategies and objectives.

**2120 – Risk Management**
The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes.

**Interpretation:**
*Determining whether risk management processes are effective is a judgment resulting from the internal auditor's assessment that:*

- *Organizational objectives support and align with the organization's mission;*
- *Significant risks are identified and assessed;*
- *Appropriate risk responses are selected that align risks with the organization's risk appetite; and*
- *Relevant risk information is captured and communicated in a timely manner across the organization, enabling staff, management, and the board to carry out their responsibilities.*

*The internal audit activity may gather the information to support this assessment during multiple engagements. The results of these engagements, when viewed together, provide an understanding of the organization's risk management processes and their effectiveness.*

*Risk management processes are monitored through ongoing management activities, separate evaluations, or both.*

**2120.A1** – The internal audit activity must evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the:

- Achievement of the organization's strategic objectives;
- Reliability and integrity of financial and operational information;
- Effectiveness and efficiency of operations and programs;
- Safeguarding of assets; and
- Compliance with laws, regulations, policies, procedures, and contracts.

**2120.A2** – The internal audit activity must evaluate the potential for the occurrence of fraud and how the organization manages fraud risk.

**2120.C1** – During consulting engagements, internal auditors must address risk consistent with the engagement's objectives and be alert to the existence of other significant risks.

**2120.C2** – Internal auditors must incorporate knowledge of risks gained from consulting engagements into their evaluation of the organization's risk management processes.

**2120.C3** – When assisting management in establishing or improving risk management processes, internal auditors must refrain from assuming any management responsibility by actually managing risks.

**2130 – Control**
The internal audit activity must assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement.

**2130.A1** – The internal audit activity must evaluate the adequacy and effectiveness of controls in responding to risks within the organization's governance, operations, and information systems regarding the:

- Achievement of the organization's strategic objectives;
- Reliability and integrity of financial and operational information;
- Effectiveness and efficiency of operations and programs;
- Safeguarding of assets; and
- Compliance with laws, regulations, policies, procedures, and contracts.

## IIA Performance Standards (Continued):

**2130.C1** – Internal auditors must incorporate knowledge of controls gained from consulting engagements into evaluation of the organization's control processes.

**Chief Audit Executive/Chief Internal Auditor:**

The Internal Audit Department generally conforms without exceptions noted.

**External Reviewer/Validator:**

I concur.

**2200 – Engagement Planning**
Internal auditors must develop and document a plan for each engagement, including the engagement's objectives, scope, timing, and resource allocations.

**2201 – Planning Considerations**
In planning the engagement, internal auditors must consider:

- The objectives of the activity being reviewed and the means by which the activity controls its performance;
- The significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level;
- The adequacy and effectiveness of the activity's governance, risk management, and control processes compared to a relevant framework or model; and
- The opportunities for making significant improvements to the activity's governance, risk management, and control processes.

**2201.A1** – When planning an engagement for parties outside the organization, internal auditors must establish a written understanding with them about objectives, scope, respective responsibilities, and other expectations, including restrictions on distribution of the results of the engagement and access to engagement records.

**2201.C1** – Internal auditors must establish an understanding with consulting engagement clients about objectives, scope, respective responsibilities, and other client expectations. For significant engagements, this understanding must be documented.

**2210 – Engagement Objectives**
Objectives must be established for each engagement.

**2210.A1** – Internal auditors must conduct a preliminary assessment of the risks relevant to the activity under review. Engagement objectives must reflect the results of this assessment.

**2210.A2** – Internal auditors must consider the probability of significant errors, fraud, noncompliance, and other exposures when developing the engagement objectives.

**2210.A3** – Adequate criteria are needed to evaluate governance, risk management, and controls. Internal auditors must ascertain the extent to which management and/or the board has established adequate criteria to determine whether objectives and goals have been accomplished. If adequate, internal auditors must use such criteria in their evaluation. If inadequate, internal auditors must work with management and/or the board to develop appropriate evaluation criteria.

**2210.C1** – Consulting engagement objectives must address governance, risk management, and control processes to the extent agreed upon with the client.

**2210.C2** – Consulting engagement objectives must be consistent with the organization's values, strategies, and objectives.

**2220 – Engagement Scope**
The established scope must be sufficient to achieve the objectives of the engagement.

**2220.A1** – The scope of the engagement must include consideration of relevant systems, records, personnel, and physical properties, including those under the control of third parties.

**2220.A2** – If significant consulting opportunities arise during an assurance engagement, a specific written understanding as to the objectives, scope, respective responsibilities, and other expectations should be reached and the results of the consulting engagement communicated in accordance with consulting standards.

**2220.C1** – In performing consulting engagements, internal auditors must ensure that the scope of the engagement is sufficient to address the agreed-upon objectives. If internal auditors develop reservations about the scope during the engagement, these reservations must be discussed with the client to determine whether to continue with the engagement.

**2220.C2** – During consulting engagements, internal auditors must address controls consistent with the engagement's objectives and be alert to significant control issues.

**2230 – Engagement Resource Allocation**
Internal auditors must determine appropriate and sufficient resources to achieve engagement objectives based on an evaluation of the nature and complexity of each engagement, time constraints, and available resources.

**2240 – Engagement Work Program**
Internal auditors must develop and document work programs that achieve the engagement objectives.

**2240.A1** – Work programs must include the procedures for identifying, analyzing, evaluating, and documenting information during the engagement. The work program must be approved prior to its implementation, and any adjustments approved promptly.

**2240.C1** – Work programs for consulting engagements may vary in form and content depending upon the nature of the engagement.

**Chief Audit Executive/Chief Internal Auditor:**

The Internal Audit Department generally conforms without exceptions noted.

**External Reviewer/Validator:**

I concur.

**2300 – Performing the Engagement**
Internal auditors must identify, analyze, evaluate, and document sufficient information to achieve the engagement's objectives.

**2310 – Identifying Information**
Internal auditors must identify sufficient, reliable, relevant, and useful information to achieve the engagement's objectives.

**Interpretation:**
*Sufficient information is factual, adequate, and convincing so that a prudent, informed person would reach the same conclusions as the auditor. Reliable information is the best attainable information through the use of appropriate engagement techniques. Relevant information supports engagement observations and recommendations and is consistent with the objectives for the engagement. Useful information helps the organization meet its goals.*

**2320 – Analysis and Evaluation**
Internal auditors must base conclusions and engagement results on appropriate analyses and evaluations.

**2330 – Documenting Information**
Internal auditors must document relevant information to support the conclusions and engagement results.

**2330.A1** – The chief audit executive must control access to engagement records. The chief audit executive must obtain the approval of senior management and/or legal counsel prior to releasing such records to external parties, as appropriate.

**2330.A2** – The chief audit executive must develop retention requirements for engagement records, regardless of the medium in which each record is stored. These retention requirements must be consistent with the organization's guidelines and any pertinent regulatory or other requirements.

**2330.C1** – The chief audit executive must develop policies governing the custody and retention of consulting engagement records, as well as their release to internal and external parties. These policies must be consistent with the organization's guidelines and any pertinent regulatory or other requirements.

**2340 – Engagement Supervision**
Engagements must be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed.

**Interpretation:**
*The extent of supervision required will depend on the proficiency and experience of internal auditors and the complexity of the engagement. The chief audit executive has overall responsibility for supervising the engagement, whether performed by or for the internal audit activity, but may designate appropriately experienced members of the internal audit activity to perform the review. Appropriate evidence of supervision is documented and retained.*

**Chief Audit Executive/Chief Internal Auditor:**

The Internal Audit Department generally conforms without exceptions noted.

**External Reviewer/Validator:**

I concur.

**2400 – Communicating Results**
Internal auditors must communicate the results of engagements.

**2410 – Criteria for Communicating**
Communications must include the engagement's objectives and scope as well as applicable conclusions, recommendations, and action plans.

**2410.A1** - Final communication of engagement results must, where appropriate, contain the internal auditors' opinion and/or conclusions. When issued, an opinion or conclusion must take account of the expectations of senior management, the board, and other stakeholders and must be supported by sufficient, reliable, relevant, and useful information.

**Interpretation:**
*Opinions at the engagement level may be ratings, conclusions, or other descriptions of the results. Such an engagement may be in relation to controls around a specific process, risk, or business unit. The formulation of such opinions requires consideration of the engagement results and their significance.*

**2410.A2** – Internal auditors are encouraged to acknowledge satisfactory performance in engagement communications.

**2410.A3** – When releasing engagement results to parties outside the organization, the communication must include limitations on distribution and use of the results.

**2410.C1** – Communication of the progress and results of consulting engagements will vary in form and content depending upon the nature of the engagement and the needs of the client.

**2420 – Quality of Communications**
Communications must be accurate, objective, clear, concise, constructive, complete, and timely.

**Interpretation:**
*Accurate communications are free from errors and distortions and are faithful to the underlying facts. Objective communications are fair, impartial, and unbiased and are the result of a fair-minded and balanced assessment of all relevant facts and circumstances. Clear communications are easily understood and logical, avoiding unnecessary technical language and providing all significant and relevant information. Concise communications are to the point and avoid unnecessary elaboration, superfluous detail, redundancy, and wordiness. Constructive communications are helpful to the engagement client and the organization and lead to improvements where needed. Complete communications lack nothing that is essential to the target audience and include all significant and relevant information and observations to support recommendations and conclusions. Timely communications are opportune and expedient, depending on the significance of the issue, allowing management to take appropriate corrective action.*

**2421 – Errors and Omissions**
If a final communication contains a significant error or omission, the chief audit executive must communicate corrected information to all parties who received the original communication.

**2430 – Use of "Conducted in Conformance with the *International Standards for the Professional Practice of Internal Auditing*"**
Internal auditors may report that their engagements are "conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*", only if the results of the quality assurance and improvement program support the statement.

**2431 – Engagement Disclosure of Nonconformance**
When nonconformance with the Definition of Internal Auditing, the Code of Ethics or the *Standards* impacts a specific engagement, communication of the results must disclose the:

- Principle or rule of conduct of the Code of Ethics or *Standard(s)* with which full conformance was not achieved;
- Reason(s) for nonconformance; and
- Impact of nonconformance on the engagement and the communicated engagement results.

**2440 – Disseminating Results**
The chief audit executive must communicate results to the appropriate parties.

**Interpretation:**
*The chief audit executive is responsible for reviewing and approving the final engagement communication before issuance and for deciding to whom and how it will be disseminated. When the chief audit executive delegates these duties, he or she retains overall responsibility.*

## IIA Performance Standards (Continued):

**2440.A1** – The chief audit executive is responsible for communicating the final results to parties who can ensure that the results are given due consideration.

**2440.A2** – If not otherwise mandated by legal, statutory, or regulatory requirements, prior to releasing results to parties outside the organization the chief audit executive must:

- Assess the potential risk to the organization;
- Consult with senior management and/or legal counsel as appropriate; and
- Control dissemination by restricting the use of the results.

**2440.C1** – The chief audit executive is responsible for communicating the final results of consulting engagements to clients.

**2440.C2** – During consulting engagements, governance, risk management, and control issues may be identified. Whenever these issues are significant to the organization, they must be communicated to senior management and the board.

**2450 – Overall Opinions**
When an overall opinion is issued, it must take into account the expectations of senior management, the board, and other stakeholders and must be supported by sufficient, reliable, relevant, and useful information.

**Interpretation:**
*The communication will identify:*

- *The scope, including the time period to which the opinion pertains;*
- *Scope limitations;*
- *Consideration of all related projects including the reliance on other assurance providers;*
- *The risk or control framework or other criteria used as a basis for the overall opinion; and*
- *The overall opinion, judgment, or conclusion reached.*

*The reasons for an unfavorable overall opinion must be stated.*

## Chief Audit Executive/Chief Internal Auditor:

The Internal Audit Department generally conforms without exceptions noted.

## External Reviewer/Validator:

I concur.

**2500 – Monitoring Progress**
The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.

**2500.A1** – The chief audit executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

**2500.C1** – The internal audit activity must monitor the disposition of results of consulting engagements to the extent agreed upon with the client.

**Chief Audit Executive/Chief Internal Auditor:**

The Internal Audit Department generally conforms without exceptions noted.

**External Reviewer/Validator:**

I concur.

**2600 – Communicating the Acceptance of Risks**
When the chief audit executive concludes that management has accepted a level of risk that may be unacceptable to the organization, the chief audit executive must discuss the matter with senior management. If the chief audit executive determines that the matter has not been resolved, the chief audit executive must communicate the matter to the board.

**Interpretation:**
*The identification of risk accepted by management may be observed through an assurance or consulting engagement, monitoring progress on actions taken by management as a result of prior engagements, or other means. It is not the responsibility of the chief audit executive to resolve the risk.*

**Chief Audit Executive/Chief Internal Auditor:**

The Internal Audit Department generally conforms without exceptions noted.

**External Reviewer/Validator:**

I concur.

# *IIA Code of Ethics*

## Principles

Internal auditors are expected to apply and uphold the following principles:

### 1. Integrity

The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.

### 2. Objectivity

Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments

### 3. Confidentiality

Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

### 4. Competency

Internal auditors apply the knowledge, skills, and experience needed in the performance of internal audit services.

## Rules of Conduct

### 1. Integrity

Internal auditors:

- 1.1. Shall perform their work with honesty, diligence, and responsibility.
- 1.2. Shall observe the law and make disclosures expected by the law and the profession.
- 1.3. Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.

**FCIAA (Continued):**

- 1.4. Shall respect and contribute to the legitimate and ethical objectives of the organization.

2. **Objectivity**
   Internal auditors:

- 2.1. Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.
- 2.2. Shall not accept anything that may impair or be presumed to impair their professional judgment.
- 2.3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

3. **Confidentiality**
   Internal auditors:

- 3.1. Shall be prudent in the use and protection of information acquired in the course of their duties.
- 3.2. Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

4. **Competency**
   Internal auditors:

- 4.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.
- 4.2. Shall perform internal audit services in accordance with the *International Standards for the Professional Practice of Internal Auditing.*
- 4.3. Shall continually improve their proficiency and the effectiveness and quality of their services.

**Chief Audit Executive/Chief Internal Auditor:**

The Internal Audit Department generally conforms without exceptions noted.

**External Reviewer/Validator:**

I concur.

# TOOL 19
# *STANDARDS*
# EVALUATION SUMMARY

(Circle Evaluator's Decision)

| | | | | |
|---|---|---|---|---|
| **OVERALL EVALUATION** | GC | PC | DNC | |
| **ATTRIBUTE STANDARDS** | GC | PC | DNC | |
| **1000 Purpose, Authority, and Responsibility (Charter)** | GC | PC | DNC | |
| **1100 Independence and Objectivity** | GC | PC | DNC | |
| 1110 Organizational Independence | GC | PC | DNC | |
| 1120 Individual Objectivity | GC | PC | DNC | |
| 1130 Impairments to Independence or Objectivity | GC | PC | DNC | |
| **1200 Proficiency and Due Professional Care** | GC | PC | DNC | |
| 1210 Proficiency | GC | PC | DNC | |
| 1220 Due Professional Care | GC | PC | DNC | |
| 1230 Continuing Professional Development | GC | PC | DNC | |
| **1300 Quality Assurance/Improvement Program** | GC | PC | DNC | |
| 1310 Quality Program Assessments | GC | PC | DNC | |
| 1311 Internal Assessments | GC | PC | DNC | |
| 1312 External Assessments | GC | PC | DNC | |
| 1320 Reporting Quality Assurance & Improvement Program | GC | PC | DNC | |
| 1321 Use of "Conforms with IIA Standards" | GC | PC | DNC | |
| 1322 Disclosure of Nonconformance | GC | PC | DNC | NA |
| **PERFORMANCE STANDARDS** | GC | PC | DNC | |
| **2000 Managing the Internal Audit Activity** | GC | PC | DNC | |
| 2010 Planning | GC | PC | DNC | |
| 2020 Communication and Approval | GC | PC | DNC | |
| 2030 Resource Management | GC | PC | DNC | |
| 2040 Policies and Procedures | GC | PC | DNC | |
| 2050 Coordination | GC | PC | DNC | |
| 2060 Reporting to the Board and Senior Management | GC | PC | DNC | |
| 2070 External Service Provider & Organizational Responsibility | GC | PC | DNC | NA |
| **2100 Nature of Work** | GC | PC | DNC | |
| 2110 Governance | GC | PC | DNC | |
| 2120 Risk Management | GC | PC | DNC | |
| 2130 Control | GC | PC | DNC | |
| **2200 Engagement Planning** | GC | PC | DNC | |
| 2201 Planning Considerations | GC | PC | DNC | |
| 2210 Engagement Objectives | GC | PC | DNC | |
| 2220 Engagement Scope | GC | PC | DNC | |
| 2230 Engagement Resource Allocation | GC | PC | DNC | |
| 2240 Engagement Work Program | GC | PC | DNC | |

(Circle Evaluator's Decision)

| | | | | |
|---|---|---|---|---|
| **2300 Performing the Engagement** | GC | PC | DNC | |
| 2310 Identifying Information | GC | PC | DNC | |
| 2320 Analysis and Evaluation | GC | PC | DNC | |
| 2330 Documenting Information | GC | PC | DNC | |
| 2340 Engagement Supervision | GC | PC | DNC | |
| **2400 Communicating Results** | GC | PC | DNC | |
| 2410 Criteria for Communicating | GC | PC | DNC | |
| 2420 Quality of Communications | GC | PC | DNC | |
| 2421 Errors and Omissions | GC | PC | DNC | NA |
| 2430 Use of Conducted in Conformance w/ Standards | GC | PC | DNC | |
| 2431 Engagement Disclosure of Nonconformance | GC | PC | DNC | NA |
| 2440 Disseminating Results | GC | PC | DNC | |
| **2500 Monitoring Progress** | GC | PC | DNC | |
| **2600 Communicating the Acceptance of Risks** | GC | PC | DNC | |
| IIA *Code of Ethics* | GC | PC | DNC | |
| IIA *Definition of Internal Auditing* | GC | PC | DNC | |

BRIDGET E FEELEY

Evaluator's name/signature Bridget E Feeley Date 7-8-16

# TOOL 19
# *STANDARDS*
# EVALUATION SUMMARY

| | (Circle Evaluator's Decision) | | |
|---|---|---|---|
| OVERALL EVALUATION | GC | PC | DNC |
| | | | |
| ATTRIBUTE STANDARDS | GC | PC | DNC |
| | | | |
| **1000 Purpose, Authority, and Responsibility (Charter)** | GC | PC | DNC |
| | | | |
| **1100 Independence and Objectivity** | GC | PC | DNC |
| 1110 Organizational Independence | GC | PC | DNC |
| 1120 Individual Objectivity | GC | PC | DNC |
| 1130 Impairments to Independence or Objectivity | GC | PC | DNC |
| | | | |
| **1200 Proficiency and Due Professional Care** | GC | PC | DNC |
| 1210 Proficiency | GC | PC | DNC |
| 1220 Due Professional Care | GC | PC | DNC |
| 1230 Continuing Professional Development | GC | PC | DNC |
| | | | |
| **1300 Quality Assurance/Improvement Program** | GC | PC | DNC |
| 1310 Quality Program Assessments | GC | PC | DNC |
| 1311 Internal Assessments | GC | PC | DNC |
| 1312 External Assessments | GC | PC | DNC |
| 1320 Reporting Quality Assurance & Improvement Program | GC | PC | DNC |
| 1321 Use of "Conforms with IIA Standards" | GC | PC | DNC |
| 1322 Disclosure of Nonconformance | GC | PC | DNC |
| | | | |
| PERFORMANCE STANDARDS | GC | PC | DNC |
| | | | |
| **2000 Managing the Internal Audit Activity** | GC | PC | DNC |
| 2010 Planning | GC | PC | DNC |
| 2020 Communication and Approval | GC | PC | DNC |
| 2030 Resource Management | GC | PC | DNC |
| 2040 Policies and Procedures | GC | PC | DNC |
| 2050 Coordination | GC | PC | DNC |
| 2060 Reporting to the Board and Senior Management | GC | PC | DNC |
| 2070 External Service Provider & Organizational Responsibility | GC | PC | DNC N/A |
| | | | |
| **2100 Nature of Work** | GC | PC | DNC |
| 2110 Governance | GC | PC | DNC |
| 2120 Risk Management | GC | PC | DNC |
| 2130 Control | GC | PC | DNC |
| | | | |
| **2200 Engagement Planning** | GC | PC | DNC |
| 2201 Planning Considerations | GC | PC | DNC |
| 2210 Engagement Objectives | GC | PC | DNC |
| 2220 Engagement Scope | GC | PC | DNC |
| 2230 Engagement Resource Allocation | GC | PC | DNC |
| 2240 Engagement Work Program | GC | PC | DNC |

(Circle Evaluator's Decision)

| | | | |
|---|---|---|---|
| **2300 Performing the Engagement** | **GC** | **PC** | **DNC** |
| 2310 Identifying Information | GC | PC | DNC |
| 2320 Analysis and Evaluation | GC | PC | DNC |
| 2330 Documenting Information | GC | PC | DNC |
| 2340 Engagement Supervision | GC | PC | DNC |
| **2400 Communicating Results** | **GC** | **PC** | **DNC** |
| 2410 Criteria for Communicating | GC | PC | DNC |
| 2420 Quality of Communications | GC | PC | DNC |
| 2421 Errors and Omissions | GC | PC | DNC |
| 2430 Use of Conducted in Conformance w/ Standards | GC | PC | DNC |
| 2431 Engagement Disclosure of Nonconformance | GC | PC | DNC N/A |
| 2440 Disseminating Results | GC | PC | DNC |
| **2500 Monitoring Progress** | **GC** | **PC** | **DNC** |
| **2600 Communicating the Acceptance of Risks** | **GC** | **PC** | **DNC** |
| IIA *Code of Ethics* | **GC** | **PC** | **DNC** |
| IIA *Definition of Internal Auditing* | **GC** | **PC** | **DNC** |

Evaluator's name/signature Bernard [signature] Date 7/7/16

# Agenda Item #7

**STATUS OF INTERNAL AUDITS**
**FOR THE 12 MONTHS ENDED (June 2016 )**

| 2015/16 AUDITS | HOURS BUDGETED | ACTUAL HOURS WORK YTD | PERCENT OF HOURS UTILIZED | ESTIMATED HOURS REMAINING | ESTIMATED TOTAL HOURS WHEN COMPLETE | EXPLANATION OF ACTUAL HOURS THAT EXCEED BUDGET BY MORE THAN 10% |
|---|---|---|---|---|---|---|
| Service Purchase Invoices | 150 | 154 | 103% | (4) | 154 | |
| Investment Trade Tickets | 0 | 0 | 0% | 0 | 0 | |
| Fraud Hotline/Internal Investigations | 200 | 153 | 100% | 47 | 153 | |
| Employer Audits | 3,200 | 3,233 | 101% | (33) | 3,233 | |
| Pension/Survivor Final Audit | 200 | 207 | 104% | (7) | 207 | |
| Refunds Processing | 150 | 159 | 106% | (9) | 159 | |
| Audit Follow-up | 150 | 160 | 107% | (10) | 160 | |
| Census Data GASB 68 | 300 | 389 | 130% | (89) | 389 | overlap 2 in one year |
| Software Licensing | 150 | 160 | 107% | (10) | 160 | |
| WEB Services Post Implementation | 0 | 0 | 0% | 0 | 0 | Removed from plan |
| Procurement Bid Process | 0 | 0 | 0% | 0 | 0 | Removed from plan |
| Management Fees-Agency | 400 | 213 | 0% | 187 | 213 | Removed from plan |
| QDROs | 100 | 100 | 100% | 0 | 100 | |
| TOTALS | 5,000 | 4,928 | | 72 | 4,928 | |
| OTHER THAN AUDITS | | | | | | |
| Member Statement Testing | 100 | 100 | 100% | 0 | 100 | |
| Director Requests | 200 | 95 | 48% | 105 | 95 | |
| Requested Audits/Other* | 200 | 120 | 60% | 80 | 120 | peer review |
| TOTALS | 500 | 315 | | 185 | 315 | |
| GRAND TOTAL | 5,500 | 5,243 | | 257 | 5,243 | |

# Agenda Item #8

# City of Nogales Audit

# A REPORT TO THE
# ARIZONA STATE RETIREMENT SYSTEM
# OPERATIONS AND AUDIT COMMITTEE

**ARIZONA STATE RETIREMENT SYSTEM**
**EMPLOYER AUDITS**

**CITY OF NOGALES**

**MAY 19, 2016**

The audit of the City of Nogales was completed on May 19, 2016, for the period July 1, 2014, through June 30, 2015.

The preliminary audit objectives were to determine whether the City of Nogales is in compliance with Arizona Revised Statutes (A.R.S.) governing the following:

- Eligible compensation and required contributions reported to the ASRS.
- Accurate and timely enrollment of all eligible employees.
- Reporting and remitting of the employees' and employer's share of contributions.
- Medical and dental insurance premium benefits payable to retired employees.
- Retirees' return to work.

## SUMMARY OF FINDINGS:

Based on the results of the work performed to meet the above audit objectives, there were no findings presented to the City of Nogales.

## BACKGROUND

The City of Nogales joined the ASRS on July 1, 1970, by executing an Application and Social Security 218 Agreement. The City of Nogales currently has approximately 180 employees contributing to the ASRS.

## DESCRIPTION OF AUDIT WORK PERFORMED

The audit work performed during this engagement was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*. The audit work completed consisted of an examination of the employer's payroll and personnel records for the time period July 1, 2014, to June 30, 2015. The auditor reviewed pertinent documentation and interviewed the City of Nogales personnel from the Human Resources and Payroll departments. The auditor performed substantive tests of the employees' employment and payroll records to provide sufficient assurance that the employer is accurately reporting and remitting ASRS retirement and Long Term Disability (LTD) contributions. The following audit tests were performed:

- Review of the employer payroll records and related ASRS reports.
- Review of employees' time and payroll records to determine eligibility.
- Review of the noncontributing employees' personnel and payroll records to determine compliance with the 20 hour, 20 week eligibility criteria.
- Review of the retired employees' medical and dental insurance premium benefit.
- Determine compliance with A.R.S. § 38-766.01 by reviewing the hours and weeks worked and other criteria of retired employees who returned to work.

- Determine compliance with A.R.S. § 38-766.02 requirement to pay an ACR on all retirees who have returned to work in any capacity in a position ordinarily filled by an employee.
- Other detailed testing as required to meet the audit objectives.

**AUDITOR COMMENTS:**

The City of Nogales personnel were cooperative, informative and helpful in providing FY 2015 time reports, payroll records, and other information necessary to effectively complete the ASRS audit.

# Mohave Community College Audit

# A REPORT TO THE ARIZONA STATE RETIREMENT SYSTEM OPERATIONS AND AUDIT COMMITTEE

## ARIZONA STATE RETIREMENT SYSTEM EMPLOYER AUDITS

## MOHAVE COMMUNITY COLLEGE

## MAY 5, 2016

The audit of Mohave Community College was completed on May 5, 2016, for the period July 1, 2014, through June 30, 2015.

The preliminary audit objectives were to determine whether the Mohave Community College is in compliance with Arizona Revised Statutes (A.R.S.) governing the following:

- Eligible compensation and required contributions reported to the ASRS.
- Accurate and timely enrollment of all eligible employees.
- Reporting and remitting of the employees' and employer's share of contributions.
- Medical and dental insurance premium benefits payable to retired employees.
- Retirees' return to work.

## SUMMARY OF FINDINGS:

Based on the results of the work performed to meet the above audit objectives, the following statements summarize the findings presented to Mohave Community College:

1. **Mohave Community College did not remit all of the Alternate Contribution Rate (ACR) for all its retirees who have returned to work.**
2. **Mohave Community College remitted contributions on ineligible compensation for 12 employees.**
3. **Mohave Community College did not ensure that all retirees returning to direct employment complied with the requirement that they acknowledge in writing the conditions under which they were returning to work.**
4. **Mohave Community College did not comply with all statutes regarding ASRS health insurance supplements.**
5. **Mohave Community College did not report all demographic information for its members.**

## BACKGROUND

Mohave Community College joined the ASRS on July 1, 1971, by executing an Application and Social Security 218 Agreement. Mohave Community College currently has approximately 350 employees contributing to the ASRS.

## DESCRIPTION OF AUDIT WORK PERFORMED

The audit work performed during this engagement was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*. The audit work completed consisted of an examination of the employer's payroll and personnel records for the time period July 1, 2014, to June 30, 2015. The auditor reviewed pertinent documentation and interviewed Mohave Community College personnel from the Human Resources and Payroll departments. The auditor performed substantive tests of the employees' employment and payroll records to provide sufficient assurance that the employer is accurately reporting and remitting ASRS retirement and Long Term Disability (LTD) contributions. The following audit tests were performed:

- Review of the employer payroll records and related ASRS reports.
- Review of employees' time and payroll records and, if needed, personnel records to determine compliance with the 20 hour, 20 week eligibility criteria.
- Review of the retired employees' medical and dental insurance premium benefit.
- Review of the hours and weeks worked and other criteria of retired employees who returned to work to determine compliance with A.R.S. § 38-766.01.
- Review of ACR payments made on behalf of all retirees who have returned to work in any capacity in a position ordinarily filled by an employee to determine compliance with A.R.S. § 38-766.02.
- Other detailed testing as required to meet the audit objectives.

**AUDITOR COMMENTS:**

Mohave Community College personnel were cooperative, informative and helpful in providing FY 2015 time reports, payroll records, and other information necessary to effectively complete the ASRS audit. Audit findings and recommendations were discussed and issues resolved in a timely manner.

# A REPORT TO THE
# ARIZONA STATE RETIREMENT SYSTEM
# OPERATIONS AND AUDIT COMMITTEE

**ARIZONA STATE RETIREMENT SYSTEM**
**EMPLOYER AUDITS**

**MOHAVE COMMUNITY COLLEGE**

**FINDINGS AND RECOMMENDATIONS**

**MAY 5, 2016**

**FINDING 1:**

**Mohave Community College (College) did not remit all of the Alternate Contribution Rate (ACR) for all its retirees who have returned to work.**

A.R.S. § 38-766.02 requires that an employer "shall pay contributions at an alternate contribution rate on behalf of a retired member who returns to work in any capacity in a position ordinarily filled by an employee of the employer." The College reported compensation and paid ACR for 22 retirees. Five other eligible retirees were not reported.

The employer should have paid $23,935 for 27 retirees, but paid $21,976 for 22 retirees, for a payment compliance rate of 92%.

The ACR owed should be paid through the ASRS web site so that the exact accrued interest can be determined with the payment when it is made.

The gross eligible earnings and estimated employer ACR payments as determined by this audit are as follows:

| | |
|---|---|
| **Total Retirees' Unreported Gross Earnings** | **$20,467** |
| **Employer ACR Contributions** | **1,959** |
| **Estimated Interest Due** | **155** |
| **Total Estimated Due ASRS** | **$ 2,114** |

**Recommendations:**

1. The College should pay the back-ACR payments through the online system that will calculate interest owed up to the date of payment.

2. The College should pay all current and future ACR amounts owed in a timely manner.

**Employer Response:**

Mohave Community College acknowledges this finding. In order to avoid future occurrences, MCC will institute a new process wherein all new employee retirement status is checked against the ASRS database to verify retiree status for the purpose of remitting correct ACR contributions.

**FINDING 2:**

**Mohave Community College remitted contributions on ineligible compensation for 12 employees.**

A.R.S. § 38-711(23) defines an employee eligible to be a member in part as an employee who is "engaged to work at least twenty weeks in each fiscal year and at least twenty hours each week." This is the basis for what is called the 20/20 eligibility criteria. The employees identified in the audit did not meet the 20/20 eligibility criteria and therefore were not eligible to participate in ASRS.

A.R.S. § 38-738(A) provides for a refund of ineligible earnings. "If more than the correct amount of employer or member contributions is paid into ASRS by an employer through a mistake of fact, ASRS shall return those contributions to the employer if the employer requests return of the contributions within one year after the date of overpayments."

The employer had 350 active members in fiscal year 2015. Those members paid $1,490,154 in retirement contributions.

The gross ineligible earnings, employer and employee pension and LTD contributions as determined by this audit are as follows:

| | |
|---|---|
| **Total Ineligible Gross Earnings** | **$196,444** |
| **Ineligible Member Pension Contributions** | **18,792** |
| **Ineligible Member LTD Contributions** | **557** |
| **Ineligible Employer Pension Contributions** | **18,793** |
| **Ineligible Employer LTD Contributions** | **557** |
| **Total Estimated to be Credited to Employer** | **$38,699** |

**Recommendations:**

1. The employer should verify the correct accounts and amounts with ASRS contribution accounting when requesting a credit for these ineligible payments.

2. The employer should return the employees' contributions to each individual employee.

3. The employer should review its records to see if any employees contributed on ineligible compensation in other years not covered by the audit, such as the current year, and request a credit for those ineligible amounts, as well.

**Employer Response:**

Mohave Community College acknowledges this finding. In order to avoid future occurrences, MCC has updated staff understanding of the dual employee criteria for grandfathered employees and will apply said criteria consistently.

**FINDING 3:**

> **Mohave Community College did not ensure that all retirees returning to direct employment complied with the requirement that they acknowledge in writing the conditions under which they were returning to work.**

A.R.S. § 38-766.01 provides the guidelines for retirees who wish to return to work without suspension of benefits. A.R.S. § 38-766.01(C) states "the retired member shall acknowledge this section in writing and file the acknowledgement with the employer within thirty days of returning to work."

The ASRS requires that retirees and employers provide a written acknowledgement to the ASRS. A.R.S. § 38-766.02(E) states, "an employer of a retired member shall submit any reports, data, paperwork or materials that are requested by ASRS." The ASRS requires that retirees returning to direct employment in a position ordinarily filled by an employee of the employer complete an online return to work form that states the retiree's intended weekly hours and number of weeks of expected employment. The employer is required to review this form and accept it provided that the employer agrees with the retiree's expected hours and weeks of work. This form may not be accessible when the retiree begins employment if the retiree's retirement has not been finalized, so the retiree may have to monitor his or her account until the form becomes available.

At the beginning of field work, the College had written documentation for some, but not all, of its retirees who had returned to work. Twenty seven retirees were working after retirement in direct employment. Twenty-six of these did not have proper written documentation at the beginning of field work, and the College obtained seven additional forms before the end of field work. Seven other retirees are no longer employed by the College.

**Recommendation:**

The College should ensure that all retirees working 20/20 in direct employment complete the online return to work form within 30 days of returning to work. Retirees working in direct employment under 20/20 should complete the online return to work form within 30 days of returning to work or within 30 days of having access to the form, whichever is later, to acknowledge in writing the conditions under which they are returning to work.

**Employer Response:**

Mohave Community College acknowledges this finding. In order to avoid future occurrences, MCC will institute a new process wherein the retirement status of all new employees is checked against the ASRS database for verification. Any new employee who is found to be a retired member of ASRS will be required to complete the return to work form before being allowed to begin the work assignment.

**FINDING 4:**

**Mohave Community College did not comply with all statutes regarding ASRS health insurance supplements.**

A.R.S. § 38-783, states, in part, "the board shall pay from ASRS assets part of the…coverage of any health and accident insurance for each retired contingent annuitant or disabled member of ASRS if the member…elects to participate in a health and accident insurance program provided or administered by an employer or paid for, in whole in part, by an employer to an insurer."

Seven retirees were receiving health insurance supplements during the month tested. Four of these retirees were properly receiving supplements for the health coverage they were enrolled in. During our testing we noted that:

1. One retiree was enrolled in family medical insurance, but was not receiving a health insurance supplement. The underpayment totaled $12,480.

2. Three retirees were receiving single health insurance supplements, but were not participating in the employer's health insurance coverage. The overpayment totaled $13,080.

3. The net overpayment is $600.

**Recommendations:**

1. The College should contact the ASRS to ensure that these discrepancies are resolved.

2. The College should complete any necessary change/delete forms needed so that the retirees will receive any health insurance supplements they are eligible for and none that they are not eligible for.

3. The College should timely submit any change or delete forms for retired members who have a change in participating in the employer's medical and dental insurance to avoid future over or under payments.

**Employer Response:**

Mohave Community College acknowledges this finding. Beginning in July, 2016, Mohave Community College will no longer offer retiree benefits, effectively eliminating this issue.

**FINDING 5:**

**Mohave Community College did not report all demographic information for its members.**

A.R.S. § 38-715 establishes the requirements to maintain the books and processing records of the ASRS. A.R.S. § 38-737 says that employer contributions will be determined by the ASRS actuary every year. The actuary requires full demographic information in order to make an accurate calculation of the contribution rate.

The College reported contributions for 350 members in fiscal year 2015, most of whom had all required demographic information. At the beginning of the audit the College was informed that it had two members who were missing one or more of the following items of demographic information: date of birth, marital code, gender and address. The error rate was under 1%. The College was requested to provide this information, and supplied the missing information more than a month after the request was made for updated information.

**Recommendation:**

The College should ensure that all newly hired eligible members complete online enrollment prior to submitting contributions so that this information will be collected for all new employees.

**Employer Response:**

Mohave Community College acknowledges this finding. In order to avoid future occurrences, MCC will increase vigilance in monitoring employee ASRS enrollment forms for complete demographic information.

# Sacaton ESD Audit

# A REPORT TO THE ARIZONA STATE RETIREMENT SYSTEM OPERATIONS AND AUDIT COMMITTEE

## ARIZONA STATE RETIREMENT SYSTEM
## EMPLOYER AUDITS

## SACATON ELEMENTARY SCHOOL DISTRICT

## JULY 12, 2016

The audit of Sacaton Elementary School District (ESD) was completed on July 12, 2016, for the period July 1, 2014, through June 30, 2015.

The preliminary audit objectives were to determine whether the Sacaton ESD is in compliance with Arizona Revised Statutes (A.R.S.) governing the following:

- Eligible compensation and required contributions reported to the ASRS.
- Accurate and timely enrollment of all eligible employees.
- Reporting and remitting of the employees' and employer's share of contributions.
- Medical and dental insurance premium benefits payable to retired employees.
- Retirees' return to work.

## SUMMARY OF FINDINGS:

Based on the results of the work performed to meet the above audit objectives, the following statements summarize the findings presented to Sacaton ESD:

1. **Sacaton ESD did not remit ASRS contributions for one employee who was engaged to work at least 20 hours per week for at least 20 weeks in one or more fiscal years.**

2. **Sacaton ESD did not remit all of the Alternate Contribution Rate (ACR) for all its retirees who have returned to work.**

3. **Sacaton ESD remitted contributions on ineligible compensation for three employees.**

4. **Sacaton ESD reported pay dates as pay period end dates, which made the determination of the reporting date off by six days.**

5. **Sacaton ESD did not ensure that all retirees returning to direct employment complied with the requirement that they acknowledge in writing the conditions under which they were returning to work.**

6. **Sacaton ESD did not report all demographic information for its members.**

## BACKGROUND

Sacaton ESD joined the ASRS on July 1, 1969, by executing an Application and Social Security 218 Agreement. Sacaton ESD currently has approximately 120 employees contributing to the ASRS.

## DESCRIPTION OF AUDIT WORK PERFORMED

The audit work performed during the engagement was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*. The audit work completed consisted of an examination of the employer's payroll and personnel records for the time period July 1, 2014, to June 30, 2015. The auditor reviewed pertinent documentation and interviewed Sacaton ESD personnel from the Human Resources and Payroll departments. The auditor performed substantive tests of the employees' employment and payroll records to provide sufficient assurance that the employer is accurately reporting and remitting ASRS retirement and Long Term Disability (LTD) contributions. The following audit tests were performed:

- Review of the employer payroll records and related ASRS reports.
- Review of employees' time and payroll records and, if needed, personnel records to determine compliance with the 20 hour, 20 week eligibility criteria.
- Review of the retired employees' medical and dental insurance premium benefit.
- Review of the hours and weeks worked and other criteria of retired employees who returned to work to determine compliance with A.R.S. § 38-766.01.
- Review of ACR payments made on behalf of all retirees who have returned to work in any capacity in a position ordinarily filled by an employee to determine compliance with A.R.S. § 38-766.02.
- Other detailed testing as required to meet the audit objectives.

**AUDITOR COMMENTS:**

Sacaton ESD personnel were cooperative, informative and helpful in promptly providing fiscal year 2015 time reports, payroll records, and other information necessary to effectively complete the ASRS audit. Records for additional years were provided as needed. Audit findings and recommendations were discussed and issues resolved in a timely manner.

# A REPORT TO THE ARIZONA STATE RETIREMENT SYSTEM OPERATIONS AND AUDIT COMMITTEE

## ARIZONA STATE RETIREMENT SYSTEM EMPLOYER AUDITS

## SACATON ELEMENTARY SCHOOL DISTRICT

## FINDINGS AND RECOMMENDATIONS

**JULY 12, 2016**

**FINDING 1:**

**Sacaton Elementary School District (ESD) did not remit ASRS contributions for one employee who was engaged to work at least 20 hours per week for at least 20 weeks in a fiscal year.**

A.R.S. § 38-711(23) defines an employee eligible to be a member in part as an employee who is "engaged to work at least twenty weeks in each fiscal year and at least twenty hours each week." This is the basis for what is called the 20/20 eligibility criteria. A.R.S. § 38-736 states that member "contributions are required as a condition of employment and shall be made by payroll deductions. Member contributions shall begin simultaneously with membership in ASRS."

The District reported contributions for 116 members in fiscal year 2015. The District remitted $563,343 in contributions on $4,907,044 of eligible compensation. One employee of the District worked at least 20 hours per week for 20 or more weeks during the fiscal year without paying contributions when he first became eligible and through the end of the fiscal year. This employee should have been participating in the ASRS when he was engaged to work these hours, and no later than the period when he actually reached the twentieth week of working 20 or more hours.

Retirement and LTD contributions will be due to the ASRS on the eligible compensation as calculated from time and pay records of the noncontributing employee. The ASRS Financial Services Division will generate an invoice for the employee for his portion after payment is made by the District.

The gross unreported earnings, employer and employee contributions and accrued interest due as determined by this audit are as follows:

| | |
|---|---|
| **Total Unreported Eligible Gross Earnings** | **$12,600** |
| **Member Contributions** | **1,462** |
| **Employer Contributions** | **1,462** |
| **Estimated Interest Due** | **242** |
| **Total Estimated Due ASRS** | **$ 3,166** |

**Recommendations:**

1. The employer should notify each eligible employee when there is a change in eligibility status. ASRS contributions should be withheld from an employee's earnings when the employee is engaged to work at least 20 weeks in each fiscal year and at least 20 hours per week (20/20 eligibility criteria) or when his or her status changes and he or she is reasonably expected to do so. For those employees who work irregularly from one week to the next, contributions should be withheld no later than the beginning of the twentieth week of working 20 or more hours.

2. The employer should have all eligible noncontributing employees complete the ASRS online enrollment and beneficiary forms, if applicable, so that contributions will be properly processed.

3. The employer should not change employees from eligible to ineligible until the end of the fiscal year. An eligible employee generally does not become ineligible during a fiscal year.

4. The employer should remit the employer retirement contributions, LTD contributions and interest, as calculated and billed.

5. The employer should distribute to the employee the invoice that will be generated for the employee's retirement and LTD contributions.

**Employer Response:**

Sacaton Schools will carefully monitor each employee, especially the part time substitute teachers, to keep track of their time and calculate when they pass the 20/20 eligibility criteria. At that time the school will begin ASRS contributions for those employees and continue throughout the rest of the fiscal year.

Each new employee will be expected to fill out the online enrollment process with ASRS at the time they fill out the required benefit paperwork. A computer will be made available for them to use at that time and the payroll clerk will verify that an account has been set up.

As soon as the Sacaton Schools receive the billing for this finding we will remit payment to ASRS. We will also distribute the invoice to the employee as soon as we receive it from ASRS.

**FINDING 2:**

**Sacaton ESD did not remit all of the Alternate Contribution Rate (ACR) for all its retirees who have returned to work.**

A.R.S. § 38-766.02 requires that an employer "shall pay contributions at an alternate contribution rate on behalf of a retired member who returns to work in any capacity in a position ordinarily filled by an employee of the employer." The District reported compensation and paid ACR for seven retirees. However, one of the retirees had the first two pay periods omitted. This retiree and one other also had performance pay omitted. One retiree did not have compensation reported until reaching 20/20 eligibility. One other eligible retiree who was working as a part-time substitute was not reported at all. The remaining retirees had all eligible compensation properly reported.

The employer should have paid $86,040 for eight retirees, but paid $83,280 for seven retirees, for a payment compliance rate of about 96%.

The ACR owed should be paid through the ASRS web site so that the exact accrued interest can be determined with the payment when it is made.

The gross eligible earnings and estimated employer ACR payments as determined by this audit are as follows:

| | |
|---|---|
| **Total Retirees' Unreported Gross Earnings** | **$38,791** |
| **Employer ACR Contributions** | **3,555** |
| **Estimated Interest Due** | **142** |
| **Total Estimated Due ASRS** | **$ 3,697** |

**Recommendations:**

1. The District should pay the back ACR payments through the online system that will calculate interest owed up to the date of payment.

2. The District should continue paying all current and future ACR amounts owed in a timely manner.

**Employer Response:**

Sacaton Schools will question each employee as to their ASRS status when they sign their benefit paperwork. The payroll department will then initiate the paperwork to ensure that ACR payments are made to ASRS for the wages earned by the qualified retired ASRS employees.

Sacaton Schools will pay the unreported gross ACR earnings interest when the invoice is received from ASRS.

**FINDING 3:**

**Sacaton ESD remitted contributions on ineligible compensation for three employees.**

A.R.S. § 38-711(23) defines an employee eligible to be a member in part as an employee who is "engaged to work at least twenty weeks in each fiscal year and at least twenty hours each week." This is the basis for what is called the 20/20 eligibility criteria. Two of the employees identified in the audit did not meet the 20/20 eligibility criteria and therefore were not eligible to participate in ASRS.

A.R.S. § 38-711(7) defines compensation. A.R.S. § 38-711(7)(a) excludes, for a 36-month calculation, "termination pay whether the payments are made in one payment or by installments over a period of time." The third employee with ineligible contributions was a member who had termination payments for accrued vacation or sick pay, or both, included as regular wages in every pay period from January 2013, through June 2015. The ineligible compensation also included reimbursements and the non-cash value of a car provided. Termination payments can be included for members whose membership began before January 1, 1984, but the member will receive the higher calculation of the highest 60 months with termination pay or the highest 36 months of compensation without the termination pay included. The termination pay must be separately identified as such so that the two calculations can be made, but these termination payments had originally been reported as regular wages. After removing the termination payments from regular compensation and performing the 36-month and 60-month calculations with the new amounts, the higher benefit was the 36-month calculation without the termination payments. Therefore, the contributions for the termination payments as well as the other ineligible amounts will be credited back to the employer.

A.R.S. § 38-738(A) provides for a refund of ineligible earnings. "If more than the correct amount of employer or member contributions is paid into the ASRS by an employer through a mistake of fact, the ASRS shall return those contributions to the employer if the employer requests return of the contributions within one year after the date of overpayments."

The employer had 116 active members in fiscal year 2015. The District reported $4,907,044 in eligible wages and paid $563,343 in contributions on those wages.

The gross ineligible earnings, employer and employee pension and LTD contributions as determined by this audit are as follows:

| | |
|---|---|
| **Total Ineligible Gross Earnings** | **$ 53,703** |
| **Ineligible Member Pension Contributions** | **6,086** |
| **Ineligible Member LTD Contributions** | **99** |
| **Ineligible Employer Pension Contributions** | **6,086** |
| **Ineligible Employer LTD Contributions** | **99** |
| **Total Estimated to be Credited to Employer** | **$ 12,370** |

**Recommendations:**

1. The employer should verify the correct amounts with ASRS contribution accounting before requesting a credit for these ineligible payments.

2. The employer should return the employees' contributions to each individual employee.

3. The employer should review its records to see if any employees contributed on ineligible compensation in other years not covered by the audit, such as the current year, and request a credit for those ineligible amounts.

**Employer Response:**

Sacaton Schools will review contributions made to ASRS to ensure that ASRS payments are not made for ineligible earnings. We will work with the County to make sure that correct payments are made. This will include a review of FY 2015-16.

We will apply the credits for ineligible earnings to our account and pay the employees their share of the credits.

**FINDING 4:**

**Sacaton Elementary School District reported pay dates as pay period end dates, which made the determination of the reporting date off by six days.**

A.R.S. § 38-736(B) states that the "employer shall pay the member contributions required of members on account of compensation earned." It is not to be reported on the basis of when it was paid, but when it was earned. This reporting requirement helps to ensure that members receive proper service credit for months in which they work. In addition, interest is charged to employers who delay payments of contributions, so delaying the reporting date gives the employer additional days to report and make payment without incurring interest charges.

The misreported dates were traced to Pinal County. ASRS representatives contacted county representatives to inform them of this reporting error. The county has already taken steps to correct this in future fiscal years.

**Recommendation:**

The employer should report the correct pay period ending date to the county for the accrual of compensation, rather than the payroll paid date.

**Employer Response:**

Sacaton Schools will work with the County to ensure that the correct pay period ending date is used for the ASRS payments.

**FINDING 5:**

> **Sacaton ESD did not ensure that all retirees returning to direct employment complied with the requirement that they acknowledge in writing the conditions under which they were returning to work.**

A.R.S. § 38-766.01 provides the guidelines for retirees who wish to return to work without suspension of benefits. A.R.S. § 38-766.01(C) states "the retired member shall acknowledge this section in writing and file the acknowledgement with the employer within thirty days of returning to work."

The ASRS requires that retirees and employers provide a written acknowledgement to the ASRS. A.R.S. § 38-766.02(E) states, "an employer of a retired member shall submit any reports, data, paperwork or materials that are requested by ASRS." The ASRS requires that retirees returning to direct employment in a position ordinarily filled by an employee of the employer complete an online return to work form that states the retiree's intended weekly hours and number of weeks of expected employment. The employer is required to review this form and verify that the employer agrees with the retiree's expected hours and weeks of work. This form may not be accessible when the retiree begins employment if the retiree's retirement has not been finalized, so a retiree returning to employment that does not meet 20/20 eligibility may have to monitor his or her account until the form becomes available.

At the beginning of field work, the District had written documentation for some, but not all, of its retirees who had returned to work. Ten retirees were working after retirement in direct employment. Seven of these did not have proper written documentation at the beginning of field work, and the District did not have any of these retired members complete proper forms before the end of field work.

**Recommendations:**

The District should ensure that all retirees working in direct employment complete the online return to work form within 30 days of returning to direct 20/20 employment. Retirees returning to direct employment that is less than 20/20 should also complete the online form within 30 days of returning to direct employment, unless they do so before their retirement is finalized. Retirees who return to employment less than 20/20 before their retirements are finalized should complete the form within 30 days of having access to the form.

**Employer Response:**

Sacaton Schools will have each employee who is retired with ASRS log on to their account and fill out the return to work form indicating their intent of employment with the District.

**FINDING 6:**

**Sacaton ESD did not report all demographic information for its members.**

A.R.S. § 38-716(1) requires employers to cooperate and collaborate with ASRS and follow all ASRS procedures to ensure the proper enrollment of members in the system. Members who properly enroll provide the ASRS with enough personal and demographic data to properly identify them and to communicate with them as needed. This also helps to make their accounts more secure. A.R.S. § 38-737 says that employer contributions will be determined by the ASRS actuary every year. The actuary requires full demographic information in order to make an accurate calculation of the contribution rate.

The District reported contributions for 116 members in fiscal year 2015, most of whom had all required demographic information. At the beginning of the audit the District was informed that it had seven employees who were missing one or more of the following items of demographic information: date of birth, marital code, gender or address. The error rate was around 6%. The District supplied the missing information before the end of field work.

**Recommendations:**

The District should continue to ensure that all newly hired eligible members complete online enrollment prior to submitting contributions so that this information will be collected for all new employee members.

**Employer Response:**

Each new employee will be expected to fill out the online enrollment process with ASRS at the time they fill out the required benefit paperwork. A computer will be made available for them to use at that time and the payroll clerk will verify that an account has been set up.

# Buckeye ESD Audit

# A REPORT TO THE
# ARIZONA STATE RETIREMENT SYSTEM
# OPERATIONS AND AUDIT COMMITTEE

**ARIZONA STATE RETIREMENT SYSTEM**
**EMPLOYER AUDITS**

**BUCKEYE ELEMENTARY SCHOOL DISTRICT**

**JULY, 2016**

The audit of Buckeye Elementary School District was completed on July 26, 2016 for the period July 1, 2014 through June 30, 2015.

The preliminary audit objectives were to determine whether the Buckeye Elementary School District is in compliance with Arizona Revised Statutes (A.R.S.) governing the following:

- Eligible compensation and required contributions reported to the ASRS.
- Accurate and timely enrollment of all eligible employees.
- Reporting and remitting of the employees' and employer's share of contributions.
- Medical and dental insurance premium benefits payable to retired employees.
- Retirees' return to work.

## SUMMARY OF FINDINGS

Based on the results of the work performed to meet the above audit objectives, the following statements summarize the findings presented to Buckeye Elementary School District:

1. **Buckeye Elementary School District applied and remitted contributions on one employee's option to sell back accumulated leave.**

2. **Buckeye Elementary School District did not remit the alternate contribution (ACR) due on all eligible wages for four of its returned to work retirees.**

## BACKGROUND

Buckeye Elementary School District joined the ASRS on July 1, 1962, by executing an Application and Social Security 218 Agreement. Buckeye Elementary School District currently has approximately 550 employees contributing to the ASRS.

## DESCRIPTION OF AUDIT WORK PERFORMED

The audit work performed during this engagement was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing.* The audit work completed consisted of an examination of the employer's payroll and personnel records for the time period July 1, 2014 through June 30, 2015. The auditor reserves the right to expand the scope of the audit when circumstances dictate discrepancies with ASRS statues. The auditor reviewed pertinent documentation and interviewed personnel from the Human Resources and Payroll departments. The auditor performed substantive tests of the employees' employment and payroll records to provide sufficient assurance that the employer is accurately reporting and remitting ASRS retirement and Long Term Disability (LTD) contributions. The following audit tests were performed:

- Review of the employer payroll records and related ASRS reports.
- Review of employees' time and payroll records to determine eligibility.
- Review of the noncontributing employees' personnel and payroll records to determine compliance with the 20 hour, 20 week eligibility criteria.
- Review of the retired employees' medical and dental insurance premium benefit.
- Determine compliance with A.R.S. § 38-766.01 by reviewing the hours and weeks worked and other criteria of retired employees who returned to work.
- Determine compliance with A.R.S. § 38-766.02 requirement to pay an ACR on all retirees who have returned to work in any capacity in a position ordinarily filled by an employee.
- Other detailed testing as required to meet the audit objectives.

## AUDITOR COMMENTS:

Buckeye Elementary School District personnel were cooperative, informative and helpful in providing FY 2015 time reports, payroll records, and other information necessary to effectively complete the ASRS audit. Audit findings and recommendations were discussed and issues resolved in a timely manner.

# A REPORT TO THE ARIZONA STATE RETIREMENT SYSTEM OPERATIONS AND AUDIT COMMITTEE

**ARIZONA STATE RETIREMENT SYSTEM**
**EMPLOYER AUDITS**

**BUCKEYE ELEMENTARY SCHOOL DISTRICT**

**<u>FINDINGS AND RECOMMENDATIONS</u>**

**July, 2016**

## FINDING 1:

**Buckeye Elementary School District applied and remitted contributions on one employee's option to sell back accumulated leave.**

A.R.S. § 38-711 paragraph 7 subdivision (c) states that compensation "does not include payment, at the members option, in lieu of fringe benefits that are normally paid for or provided by the employer." Buckeye Elementary School District remitted contributions on one employee who exercised their option to sell back accumulated leave.

The gross earnings and employer and employee contributions to be credited to the employer's account, as determined by this audit are as follows:

| | |
|---|---|
| **Total Gross Earnings** | **$12,158** |
| **Member Contributions** | **1,410** |
| **Employer Contributions** | **1,410** |
| **Total Credit** | **$2,820** |

### Recommendations:

1. Buckeye Elementary School District should contact its contributions accounting representative at the ASRS to make arrangements to take this available credit.

2. Contributions should not be withheld on payments, at the employee's option, in lieu of fringe benefits that are normally paid for or provided by the employer.

3. Buckeye Elementary School District should look at other fiscal years to determine whether contributions were withheld on payments to employee's option to sell back fringe benefits.

### Employer Response:

Buckeye Elementary School District will coordinate with our ASRS representative to take the available credit. Going forward Buckeye Elementary School District will not withhold contributions on payments, at the Employee's option, in lieu of fringe benefits normally paid for or provided by us. There are no previous fiscal years for Employee option to sell back fringe benefits.

## FINDING 2:

**Buckeye Elementary School District did not remit the alternate contribution due on all eligible wages for four of its returned to work retirees.**

A.R.S. § 38-766.02 provides the guidelines for payment of the alternate contribution rate (ACR) for retirees who work after retirement. According to the statute, "an employer shall pay contributions at an alternate contribution rate on behalf of a retired member who returns to work in any capacity in a position ordinarily filled by an employee." The ACR is to be "applied to the compensation, gross salary or contract fee of a retired member who meets the requirements of this section."

Buckeye Elementary School District had four return to work retirees where no alternate contribution was remitted on all eligible wages.

The estimated alternate contribution due, excluding interest, as determined by this audit is as follows:

| | |
|---|---|
| **Total Gross Earnings** | **$11,835** |
| **Total Estimated Alternate Contribution Due** | **$1,133** |

**Recommendation:**

1. Buckeye Elementary School District should contact its contributions accounting representative at the ASRS to make arrangements for payment, including interest, of the alternate contribution due.

**Employer Response:**

Buckeye Elementary School District will contact our representative at ASRS to make arrangements for payment, including interest, for the alternate contribution rate.

# Agenda Item #9

# ARIZONA STATE RETIREMENT SYSTEM

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*Paul Matson*
*Director*


## MEMORANDUM

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**TO:** The Arizona State Retirement System (ASRS) Operations and Audit Committee (OAC)

**FROM:** Mr. Paul Matson, Director
Mr. Anthony Guarino, Deputy Director and Chief Operations Officer
Mr. Dave King, Assistant Director, Member Services
Mr. Frank Perri, Benefits Program Administrator
Mr. Brian Crockett, Sr. Strategic Planning Analyst

**DATE:** August 1, 2016

**RE:** **Agenda Item #9:** Presentation, Discussion, and Appropriate Action Regarding ASRS Retiree Health Insurance Including:

a. Philosophy and Goals
b. Cost Allocation and Pricing Methodology Options
c. Retrospective Rate Agreement and Distribution Methodology Options

**Purpose**
To discuss and potentially approve the ASRS Retiree Health Insurance Program philosophy and goals, cost allocation and pricing methodology options for determining premiums, and retrospective rate agreement distribution methodologies for determining future payments of prior reimbursements.

**Recommendation**
To determine and recommend to the Board an ASRS philosophy, a cost allocation methodology for determining future premiums, and a method for distributing retrospective rate agreement balances.

**Background**
Beginning in 2011, and applicable to subsequent plan years, the ASRS negotiated an annual "medical loss ratio" agreement with UnitedHealthcare (UHC), our retiree medical plans provider. This agreement provides a maximum level of retention by UHC of 7% of total plan revenues. From this retention, UHC pays all administrative, legal and marketing expenses, staff salaries, and other company expenses. Remaining revenues from the 7% are deemed to be profit for UHC.

This agreement stipulates that 93% of plan revenues be used for plan expenses associated with medical, hospital, prescription medications, and ancillary medical services. If these plan expenses do not result in the agreed-to 93% medical loss ratio (plan expenses / total revenues), then the ASRS receives a reimbursement of unused revenue up to the 93% level. If plan expenses exceed the 93% loss ratio, UHC's 7% is decreased until all plan expenses are paid.

Though the ASRS has been receiving increasing funds because of this agreement, this is not the objective. It is desired that the health care provider underwrite each of its retiree medical plans so that premiums are paid by our members for the benefits they receive annually. However, the effective use, analysis, and management of medical management programs (such as case management, disease management, chronic obstructive pulmonary disease, cancer support, and coronary artery disease programs), utilization, medical trends expense, and drug costs play a significant role in each year's financial outcome, with future retrospective rate agreement receipts therefore likely.

The ASRS has experienced retrospective reimbursements that otherwise would have been retained by UHC, due to several factors including:

- Conservative underwriting methodologies in setting premium rates.
- The Centers for Medicare and Medicaid Services (CMS) gave credit to UHC in a greater percent than usually expected due to UHC's ability to effectively manage health care costs and in UHC's favorable containment/outcome activities.

ASRS staff reviewed several options for implementing an Integrated Case Underwriting methodology. The attached document *'Cost Allocation and Pricing Methodology Options'*, outlines the options and provides benefits as well as the concerns of the options.

ASRS also staff reviewed several options regarding the potential uses of the RRA funds. The attached document, '*Retrospective Rate Agreement and Distribution Methodology Options',* outlines the options and provides benefits as well as the concerns of the options.

# #9a. Philosophy & Goals

# Proposed ASRS Health Insurance Philosophy

For the sole benefit of all eligible retirees, the ASRS will offer Health Insurance plans which will have the following characteristics, individually and in aggregate:

- Cost Competitive, with respect to the marketplace
- Accessible, with respect to the provider network
- Meaningful, with respect to benefit coverage
- Efficient, with respect to initial enrollment, and ongoing in-plan navigation

This *Health Insurance Philosophy* will be utilized to both help guide the ASRS in developing Health Insurance plans, and to also allow for the development of high standard performance metrics.

The current goal related to ASRS Health Insurance is included below:

*"Provide health, disability, and supplemental defined contribution programs that are accessible, affordable, reliable, and efficiently run."*

# #9b. Cost Allocation & Pricing Methodology Options

## Key ASRS Definitions

*Whole Case Underwriting (WCU)*

Whole case underwriting aggregates the entire enrolled population in order to determine a single rate (often referred to as a blended rate) which then applies to all retiree categories applicable to Medicare and non-Medicare retirees. The benefit structure under WCU is typically identical. In other words, there is a single plan design and a single premium charged for each enrollee.

In an active workforce environment, WCU results in younger employees subsidizing older employees, since the medical costs are lower for younger people than for older people. In a retiree group, WCU results in older retirees subsidizing younger retirees, since Medicare payments in the plan more than offset the cost differential between younger people and older people.

*Integrated Case Underwriting (ICU) – An ASRS Term*

Integrated case underwriting aggregates segments of the enrolled population in order to mitigate differences between premiums charged to different groups. There are still multiple rates, but the rates determined incorporate at least some cross-subsidization among groups. Different plans may be offered, so the plan design can be different with ICU, which is not the case for WCU.

In an active workforce environment, ICU results in younger employees subsidizing older employees, since the medical costs are lower for younger people than for older people. In a retiree group, ICU results in older retirees subsidizing younger retirees, since Medicare payments in the plan more than offset the cost differential between younger people and older people.

ICU may be thought of as a partial case of WCU.

## Background

The concept of ICU at the ASRS was implemented between 2005 and 2007.

Between those years, the ASRS tried to implement high deductible health plans ($1,500 and $1,000 deductible plans) for non-Medicare retirees in order to lower premiums. At the time, the high deductible plan was poorly received by retirees.

There has been some cross-subsidization between urban and rural non-Medicare groups enrolled in the same PPO plan. At the request of the legislature, the ASRS maintained some disparity between the premiums to assist rural non-Medicare retirees who didn’t have an HMO option.

To keep non-Medicare premiums more affordable while maintaining a plan that offered some value, cross-subsidization using Senior Supplement plan premiums began. This occurred in conjunction with an 8.1% increase in Senior Supplement plan premiums in 2007, bringing the monthly premium to $342 which has remained in effect until plan year 2016, when the premium was reduced to $337.

As far as the concept of whole case underwriting is concerned, it existed in 2001, but under a different scenario. The Senior Supplement plan along with the non-Medicare HMO and PPO plans were considered one insurance plan for purposes of the Arizona Department of Insurance (AZDOI).

Though premiums were determined separately, the plans used a basic health insurance provider delivery system as specified by PacifiCare, the health insurance provider at the time, which the AZDOI accepted. In this respect, PacifiCare only had to conduct one filing for all three plans and considered this approach to be whole case underwriting. That approach is different than what exists today. Today, for purposes of the Retrospective Rate Adjustment Agreement which began in 2011, the ASRS looks at the whole retiree health care program to determine a single medical loss ratio for purposes of any potential refund of premium.

Since 2011, UnitedHealthcare, the current health insurance provider, has utilized an ICU approach. The ICU allows the different costs and risks among the various groups of retirees to be aggregated in order to mitigate risk (a standard insurance practice) and mitigate premium differentials between plans.

UHC does underwrite its three main plans (Medicare Advantage, Senior Supplement, and non-Medicare) separately and sets initial premiums accordingly, but then looks at the whole group for purposes of the Retrospective Rate Adjustment Agreement and the 93% medical loss ratio target.

Given the significant changes in the medical industry and the differences in risk profiles of the various plans, there has not been a formulaic approach utilized to date. Rather, the approach utilized has focused on achieving the following:

- Increase Affordability for all Retirees
- Limit the Magnitude of Cross Subsidizations
- Limit Incentives that Encourage Premature Retirements
- Limit Incentives for Migration between Plans
- Mitigate Premium Differentials
- Aggregate Risk Profiles

**<u>Options Considered</u>**

In general, the following options exist with respect to how ICU can be utilized. Each option is followed by a brief description and benefits and concerns of the option.

1. *<u>No Application of ICU</u>*

   *Description & Benefit:* In this case there would be no cross subsidizations between Plans, and, as a result, each Plan would be self-funding at each point in time and premium rates would reflect actual costs for those members in each Plan.

   *Concerns:* Those Plans that do not receive either Medicare revenue streams or employer subsidizations would become more expensive for (pre-65) retirees.

   By not aggregating the membership of the various Plans, the three smaller risk groups may result in marginally higher premium volatility.

   Retirees would be subject to significantly different premium levels for similar levels of benefits.

2. *Partial Application of ICU*

   *Description & Benefit:* In this case there would be partial cross subsidizations between Plans. This could result in less intra-Plan and extra-Plan premium volatility, as well as currently increasing the affordability for pre-65 retirees who do not have access to an employer subsidized Plan. In the current market-place, partial application of ICU allows the future status (Medicare eligible) of a retiree to subsidize the current status (non-Medicare eligible) of the retiree.

   A reasonable partial ICU level would be an amount that would be limited within the following parameters:

   - Not to exceed a 15% expected increase in the premiums for any Plan, compared to the premiums with no ICU for the same respective Plan.
   - Not to exceed a 20% expected decrease in the premiums of any Plan, compared to the premiums with no ICU for the same respective Plan.

   ICU could be utilized within the parameters above if both of the following exist:

   - The premium level of one or more plans is considered very high in absolute dollar terms, relative to the average ASRS pension payment.
   - The premium differences between plans is considered very high in absolute dollar terms, relative to the average ASRS pension payment.

   *Concerns:* Adverse Impact - Mitigating the differences between actual plan costs and premiums paid by members may marginally increase utilization of the more costly plans, and also marginally encourage active employees to retiree when they cannot afford the actual, unsubsidized, cost of medical coverage.

   Equity - Partial ICU could appear somewhat inequitable to those retirees who are paying premiums above those who would be required to obtain Plan-level price equilibrium.

   Sustainability - If retirees are paying somewhat above-market rates for Plan benefits in order to cross-subsidize other retirees, membership in the subsidizing Plan could somewhat decrease and reduce the sustainability of the Plan while also reducing the amount available for cross-subsidization.

3. *Complete Application of ICU*

   *Description & Benefit:* In this case, ICU effectively becomes WCU. This would result in the same premium levels for each retiree choosing the same benefit level.

   *Concerns:* Adverse Impact - Mitigating the differences between actual plan costs and premiums paid by members may marginally increase utilization of the more costly Plans, and also encourage active employees to retiree when they cannot afford the actual, unsubsidized, cost of medical coverage.

   Equity - Complete ICU could appear inequitable to those retirees who are paying premiums above those who would be required to obtain Plan-level price equilibrium.

Sustainability - If retirees are paying above-market rates for plan benefits in order to cross-subsidize other retirees, membership in the subsidizing Plan could decrease and reduce the sustainability of the Plan while also reducing the amount available for cross-subsidization.

## <u>Option for Initial Consideration</u>

***Option 2: Partial Application of ICU***

The following ordered factors were utilized in determining the initial option for consideration:

1. Increase affordability for all retirees who do not receive Center for Medicare/Medicaid Services (CMS) payments or employer subsidies
2. Limit the magnitude of cross subsidizations
3. Limit incentives that encourage premature retirements
4. Limit incentives for migration between plans
5. Mitigate premium differentials
6. Aggregate risk profiles

## <u>Authorizations</u>

*Interpretations:* The Director will be responsible for interpreting and implementing a policy that will be developed to reflect the Board's decision.

*Amendments & Modifications:* Amendments and modifications of the policy will require Board approval.

# #9c. Retrospective Rate Agreement & Distribution Methodology Options

## Background

The ASRS has incorporated an annual one-way Retrospective Rate Agreement (RRA) requirement within the retiree medical benefits program contract, currently with UnitedHealthcare (UHC) ("program vendor") since 2011. The RRA requires that aggregate revenues, including Center for Medicare/Medicaid Services (CMS) payments, health insurance premiums paid by members enrolled in an ASRS eligible medical plan ("members") and any other revenue sources, above a certain expense threshold, be refunded to the ASRS. The contractual requirement uses a ratio referred to as the "medical loss ratio" (MLR), which is currently set at a 93% threshold.

The ASRS' purpose for including the RRA requirement was to require that aggregate revenues in excess of the costs of the medical services provided to ASRS retirees would be refunded to the ASRS if they exceed a certain threshold. In other words, if the aggregate revenues received by the retiree medical benefits provider exceed the aggregate costs of the services provided to members, plus an amount for expenses, overhead, and profit, then the excess would be refunded to the ASRS for the benefit of retirees rather than be retained by the retiree medical benefits provider and thereby added to corporate profits.

The current (2015) and past RRAs have provided a maximum level of retention by UHC of 7% of total plan revenues. From this retention, UHC pays all administrative, legal, and marketing expenses, staff salaries, and other company expenses. Remaining revenues from the 7% are deemed to be profit for UHC.

As a result, 93% of plan revenues are to be used for plan expenses associated with medical, hospital, prescription medications, and ancillary services and treatments. If these plan expenses do not result in the 93% MLR (plan expenses/total revenues), then the ASRS receives a reimbursement of unused revenue up to the 93% level. If plan expenses exceed the 93% loss ratio however, then UHC's 7% is decreased until all plan expenses are paid, reflecting the one-way nature of the RRA.

## Status

Since the 2011 plan year, the ASRS has received annual reimbursements. As of December 31, 2015, the RRA account balance is approximately $102,675,745.

The RRA account balance is recorded in the ASRS' financial statements, but is specifically excluded from the funded status of any of the ASRS programs because the RRA account balance is associated with the medical benefit programs. As such, expending funds from the account balance would not impact any funded status calculation or cause an impact on current or projected contribution rates.

**RRA Funds Generated by Plan**

| Calendar Year | Medicare Advantage HMO | Medicare Senior Supplement | Non-Medicare In-State Choice and Out-of-State Choice Plus | Total RRA Refund |
|---|---|---|---|---|
| 2011 | $12,953,384 | $12,657,048 | -$10,115,733 | $15,494,699 |
| 2012 | $22,787,653 | $13,298,585 | -$10,260,713 | $25,825,525 |
| 2013 | $19,581,656 | $13,465,983 | -$3,199,340 | $29,848,299 |
| 2014 | $17,703,883 | $12,408,956 | $1,394,383 | $31,507,222 |
| **Totals:** | **$73,026,576** | **$51,830,572** | **-$22,181,403** | **$102,675,745** |

## Options Considered

In general, the following options exist with respect to how the RRA balances could be utilized. Each option is followed by a brief description and benefit of the option and includes the key concerns.

1. *Add Additional Health Insurance **Benefits***

   *Description & Benefit:* Adding additional coverage benefits would reduce the costs experienced by retirees when obtaining certain health services that are currently not covered.

   *Concerns:* Adding additional coverage benefits would result in additional long-term costs that could not be defrayed when or if the RRA account balance is reduced or eliminated.

2. *Reduce Health Insurance **Co-payments***

   *Description & Benefit:* Reducing health insurance co-payments would reduce out-of-pocket expenses for retirees, especially those who are high frequency users of services.

   *Concerns:* Adding additional coverage benefits would result in additional long-term costs that could not be defrayed when or if the RRA account balance is reduced or eliminated.

3. *Introduce **Wellness** Initiatives*

   *Description & Benefit:* Adding additional wellness initiatives may reduce the aggregate future costs of coverage by inducing healthier lifestyles among members.

   *Concerns:* The ASRS and UHC have already incorporated wellness initiatives (such as SilverSneakers, the 24-hour Nurse line, the Caregivers Program, the Health Risk Assessment tool, and several targeted reminders about eye screenings, wellness visits, and controlling cholesterol) and the marginal benefit of further enhancements is unclear.

4. *Establish a **Self-Funded** Program (Self-Insurance)*

   *Description & Benefit:* A self-funded program would most likely require the procurement/leasing of a medical provider network from a large medical insurance provider. In addition, a precise cash flow funding equilibrium between aggregate revenues and aggregate costs would need to be developed.

   A well implemented self-funding program could result in enhanced provider network flexibility and lower premiums.

*Concerns:* Self-funding would transfer the risk (of aggregate revenues being below aggregate costs) from the external vendor to the ASRS.

Self-funding would require significantly more internal staff management and staff (FTE) resources.

Self-funding would require significant internal (or externally purchased) actuarial underwriting and analysis that is currently provided by the program vendor.

5. *Upgrade Information **Technology** Systems*

   *Description & Benefit:* Upgrades to information technology systems could include developing analytical tools, online web applications, segmented survey capabilities, expanding data element gathering, and targeted communications capabilities.

   *Concerns:* Upgrades to the systems used to administer health insurance are already being prioritized as part of the 'Oracle Modernization' effort within the current technology development plan. The benefits of further upgrades to information technology systems are not clear and may not outweigh the costs.

   The ASRS already has a clear budgetary approval process that it follows for technology upgrades. Funding for technology upgrades should continue to follow the current process.

6. *Reduce Health Insurance **Premiums for all Plans: Monthly Basis***

   *Description & Benefit:* All monthly health insurance premiums could be reduced by various amounts and over various future periods until the RRA account balance is eliminated, therefore benefiting all groups of enrolled retirees. The premium reduction benefit will be spread out monthly throughout each year. Reductions would apply only to members enrolled in an eligible plan for the entire calendar year for which the distribution is being made, and distribution amounts would be determined by the calendar year enrollment and the member would need to be enrolled in an eligible plan during each month of the distribution.

   *Concerns:* Member groups that did not contribute to the funding of the RRA account balance would benefit at the expense of those groups that did contribute.

   Members could migrate from plans contributing to the RRA account balance to plans no contributing to the RRA account balance to arbitrage premiums. This possibility and expected benefit would likely be de minimis.

   Members who may change from among the various programs for non-arbitrage (standard health-care and age 65 CMS coverage) reasons may randomly, or based upon aging, receive or not-receive the premium reductions. This possibility and expected costs/benefit would likely be de minimis.

7. *Reduce Health Insurance **Premiums for all Plans: Annual Basis***

   *Description & Benefit:* A portion of all eligible enrolled members' annual medical plan premiums would be returned to members until the RRA account balance is eliminated, thereby benefiting all groups of enrolled retirees. The refund benefit will occur once a year.

Alternatively, all health insurance premiums could be reduced by various single annual amounts and over various future periods until the RRA account balance is eliminated, therefore benefiting all groups of enrolled retirees. The premium reduction benefit would occur once a year.

Reductions or refunds would apply only to members enrolled in an eligible plan for the entire calendar year for which the distribution is being made, and distribution amounts will be determined by the calendar year enrollment and the member would need to be enrolled in an eligible plan during the month of the distribution.

*Concerns:* Member groups that did not contribute to the funding of the RRA account balance would benefit at the expense of those groups that did contribute.

Members could migrate from plans contributing to the RRA account balance to plans not contributing to the RRA account balance to arbitrage premiums. This possibility and expected benefit would likely be de minimis.

Members who may change from among the various programs for non-arbitrage (standard healthcare and age 65 CMS coverage) reasons may randomly, or based upon aging, receive or not receive the premium reductions. This possibility and expected costs/benefit would likely be de minimis.

***8.*** *Reduce Health Insurance* ***Premiums Only for Plans that Contributed to the RRA Account Balance: Monthly Basis***

*Description & Benefit:* Only those health insurance plans that contributed to the RRA account balance ("contributing plans") would benefit from the RRA account balance. Premiums for contributing plans would be reduced by various monthly amounts and over various future periods until the RRA account balance is eliminated, therefore benefiting only those groups of enrolled retirees who contributed to the RRA account balance. The premium reduction benefit would be spread out monthly throughout each year.

Reductions would apply only to members enrolled in an eligible plan that contributed funds to the RRA account balance for the entire calendar year for which the distribution is being made, and distribution amounts would be determined by the calendar year enrollment and the member would need to be enrolled in an eligible plan during each month of the distribution.

*Concerns:* Members could migrate from plans not contributing to the RRA account balance to plans contributing to the RRA account balance to arbitrage premiums. This possibility and expected benefit would likely be de minimis.

Members who may change from among the various programs for non-arbitrage (standard health-care and age 65 CMS coverage) reasons may randomly, or based upon aging, receive or not-receive the premium reductions. This possibility and expected costs/benefit would likely be de minimis.

***9.*** *Reduce Health Insurance* ***Premiums Only for Plans that Contributed to the RRA Account Balance: Annual Basis***

*Description & Benefit:* Only those health insurance plans that contributed to the RRA account balance ("contributing plans") would benefit from the RRA account balance. Members enrolled in such contributing plans would receive a refund of a portion of their annual medical plan premiums until the RRA account balance is eliminated, thereby benefiting only those groups of enrolled retirees who contributed to the RRA account balance. The premium refund benefit would occur once a year.

Alternatively, premiums for contributing plans could be reduced by single annual amounts and over various future periods until the RRA account balance is eliminated. The premium reduction benefit would occur once a year.

Reductions or refunds would apply only to members enrolled in an eligible plan that contributed funds to the RRA account balance for the entire calendar year for which the distribution is being made, and distribution amounts would be determined by the calendar year enrollment and the member would need to be enrolled in an eligible plan during the month of the distribution.

*Concerns:* Members could migrate from plans not contributing to the RRA account balance to plans contributing to the RRA account balance to arbitrage premiums. This possibility and expected benefit would likely be de minimis.

Members who may change from among the various plans for non-arbitrage (standard health-care) reasons may randomly receive or not receive the premium reduction. This possibility and expected costs/benefit would likely be de minimis.

10. *Implement **Premium Holidays only for Members** that Contributed to the RRA Account Balance*

    *Description & Benefit:* Only those members who were enrolled in a health insurance plan that contributed to the RRA account balance (“contributing members”) would benefit from the RRA account balance. Premiums for contributing members would be reduced by single annual amounts and over various future periods until the RRA account balance is eliminated, therefore benefiting only those retirees that contributed to the RRA account balance. The premium reduction benefit would occur once a year.

    *Concerns:* This option would require complex IT upgrades as such an option would interfere with the pension payroll health benefit supplement and health insurance premium deduction programs. Contributing member identification would be difficult, contributing members may have participated in multiple plans which would result in excess funds in the cases where contributing members have deceased or moved to different plans. Not likely feasible.

**Option for Initial Consideration**

***Option 9: Reduce Health Insurance Premiums Only for Plans that Contributed to the RRA Account Balance: Annual Basis***

The following factors were utilized in determining the initial option for consideration:

- *Benefit Focus:*
  - *Ensuring that incremental benefits are clearly directed to enrolled retirees.*
- *Cost/Benefit Equity*
  - *Ensuring that members who fund the RRA account balance also receive the benefit of the account balance, where reasonably feasible, given that all members enrolled in an*

*eligible plan shared the pricing risk by participating in the plan that generated the RRA funds.*

- *Cost Sustainability:*
    - *Ensuring that possible benefit enhancements do not further increase program costs.*
- *Long Term Premium Level Consistency*
    - *Ensuring the ability to continue with the recommendation without significant premium jumps or benefit changes irrespective of the existence of future RRA account balances.*
- *Adverse Impact*
    - *Ensuring that mitigation of the differences between actual plan cost and premiums paid by members does not significantly increase utilization of the more costly plans, given that the absolute and relative premium levels may affect the selection of plans by members.*

**Concept**

The RRA Fund will be managed as a going concern with the expectation the Fund will have a perpetual life. The RRA requirement is expected to be included in future procurements.

A wind-down process will also be in place should future contributions to the RRA Fund not occur, or if the market-place is not responsive to RRA terms in the future. Specifically, the RRA Fund will be targeted to be fully distributed over an approximately four-year period if future RRA funds are no longer generated. The wind-down distribution rate will be approximately 25% per year of the beginning corpus such that the final balance at the end of the fourth distribution will be approximately zero.

The RRA Fund will target a relatively 'constant payout level,' a characteristic similar to that of an endowment, except the RRA Fund:

- Will have a declining absolute distribution level and final termination period if funds are not being constantly generated.
- The payout rate will be significantly higher in order to ensure that the members who contribute to the RRA fund will be the predominant beneficiaries of the RRA Fund.

Future contributions to the corpus are primarily a function of percentages of growing nominal dollars, and therefore future payouts are reasonably expected to hold value in real terms, although this is not a requirement of the payout structure. On the other hand, the longer RRA arrangements exist, the more accurate the premium estimates and negotiations may become, which would reasonably result in reduced RRA receipts in the future until a vendor / client risk equilibrium is met.

*Payout Methodology:*

1. Twenty-Five percent (25%) of the corpus of the Fund will be paid out each year unless no new RRA, funds were generated, or only de minimis funds were generated, in which case the aggregate payout will be approximately equal to the previous year distribution, up to the total balance of the Fund.
2. The funds will only be paid to members who elect to enroll in an ASRS 'Eligible Medical Plan.'

3. An ASRS 'Eligible Medical Plan' is a plan that provides medical benefits at a level and to a membership generally consistent with a plan that has contributed to the RRA account balance. (There are currently three plans with four different rate structures as follows: Non-Medicare In-State Choice, Non-Medicare Out-of-State Choice Plus, Medicare Advantage HMO, Medicare Senior Supplement.)
4. Each member in each plan who elects to enroll in the Single Option will receive the same distribution amount. Each member in each plan who elected to enroll in the Family Option will receive a distribution proportionate to the ratio of the Family Option premium and Single Option premium.
5. A member must be enrolled in an Eligible Medical Plan for the entire plan year for which a distribution is being made, to receive a distribution.
6. Distributions will be in dollar amounts.
7. Each distribution would be one-time and not perpetual.
8. Calculation Periods will be based upon calendar years (CYs)
9. Distribution Periods will be based upon calendar years (CYs)
10. The Distribution month will be determined by ASRS staff based upon the availability of data and logistics.

*Perpetual Fund Logic:*

A perpetual fund concept will allow for a more even distribution and may mitigate premium volatility.

*High Payout Rate Logic:*

A higher payout rate (25%) will allow quicker payments to the groups that generally have paid for the RRA Funds, and that generally have a shorter life expectancy as compared to most endowments.
*See appendix A (attached) for the pro-forma example.*

**Fund Investment Management**

The RRA Fund will be managed in a relatively conservative nature for the following reasons:

1. Relatively Short Duration of the *Liabilities*

   The average age of a retiree is approximately 70, with consequent average expected liability duration of approximately 17 years, and a limited ability to support financial market volatility.

2. Unknown Future Cash *Inflows*

   The size of future RRA contributions and the likelihood that the RRA requirement will be accepted in future contracts is unknown due to shifting cost trend lines and the shifting health insurance marketplace.

3. Unknown Recipient *Population*

   The implementation of the Affordable Care Act (ACA) as well as the advent of private exchanges may cause a change to the population of retirees who enroll in an ASRS health insurance plan and are therefore eligible for the RRA distribution.

As such, the ordered Investment Goals for the RRA Fund are as follows:

A. Low Volatility of Capital

   Some volatility of capital may occur, but should be limited.

B. High Liquidity

   Relatively high liquidity should exist in terms of potential lock-ups, gates, and bid / ask spreads.

C. Returns

   Interest rate risk in terms of duration and curve changes, as well as modest credit risk, can be accepted when warranted.

Investment Benchmark: U.S. Gov/Credit Float Adjusted: 1-5 Years.

**<u>Fund Management and Accounting</u>**

The RRA funds may be managed internally or externally and may be commingled with other assets consistent with statutory requirements. The RRA funds will be accounted for as a separate fund.

**<u>Authorizations</u>**

*Interpretations:* The Director will be responsible for interpreting and implementing a policy that will be developed to reflect the Board's decision.

*Amendments & Modifications:* Amendments and modifications of the policy will require Board approval.

# Appendix A

# Option #9 – Pro Forma Analysis

## RRA Refund Amounts by Plan and Year

| Calendar Year | RRA Amount Generated Medicare Advantage HMO | % of RRA Refund | Dollars applied to Plan Refund Pool | RRA Amount Generated Senior Supplement | % of RRA Refund | Dollars applied to Plan Refund Pool | RRA Amount Generated Non-Medicare | % of RRA Refund | Dollars applied to Plan Refund Pool | Total RRA Refund Pool |
|---|---|---|---|---|---|---|---|---|---|---|
| 2011 | $12,953,384 | 50.58% | $7,837,218.75 | $12,657,048 | 49.42% | $7,657,480.25 | -$10,115,733 | 0.00% | $0.00 | $15,494,699 |
| 2012 | $22,787,653 | 63.15% | $16,308,819.04 | $13,298,585 | 36.85% | $9,516,705.96 | -$10,260,713 | 0.00% | $0.00 | $25,825,525 |
| 2013 | $19,581,656 | 59.25% | $17,685,117.16 | $13,465,983 | 40.75% | $12,163,181.84 | -$3,199,340 | 0.00% | $0.00 | $29,848,299 |
| 2014 | $17,703,883 | 56.19% | $17,703,883.00 | $12,408,956 | 39.38% | $12,408,956.00 | $1,394,383 | 4.43% | $1,394,383.00 | $31,507,222 |
| 2015 | $1,871,940 | 16.32% | $1,380,101.29 | $9,600,919 | 83.68% | $7,076,401.71 | -$3,016,356 | 0.00% | $0.00 | $8,456,503 |
| Total by Plan: | $74,898,516 | | $60,915,139.24 | $61,431,491 | | $48,822,725.76 | -$25,197,759.00 | | $1,394,383.00 | |
| | | | | | | | | | **Corpus of RRA:** | **$111,132,248** |

## Calendar Year 2015 Enrollments

| | | |
|---|---|---|
| Medicare Advantage - Single : 15,675 | Senior Supplement - Single: 10,268 | Choice - Single: 5,672 |
| Medicare Advantage - Dual: 3,412 | Senior Supplement - Dual: 1,341 | Choice - Family: 767 |
| Medicare Advantage - Triple: 7 | Senior Supplement - Triple: 4 | Choice Plus - Single: 115 |
| | | Choice Plus - Family: 13 |

**Equal payment to all members in each plans, where family coverage payment is proportionate to the ratio of the family premium and single premium (i.e. if family coverage is two times single rate then family payment is single payment times two or if family coverage is single rate times number of individuals covered then payment is single payment times number of individuals covered).**

### Medicare Advantage Calculation

$$\frac{\text{Medicare Advantage HMO Corpus * 25\%}}{\text{MedAdvSingle Coverage + (MedAdvFamily Individuals Covered Count)}} = \text{Single Coverage Payment}$$

$$\frac{\$60{,}915{,}139.24 * 25\%}{15{,}675 + (3{,}412 * 2 + 7 * 3)} = \$676.23$$

### Senior Supplement Calculation

$$\frac{\text{Senior Supplement Corpus * 25\%}}{\text{SrSuppSingle Coverage + (Senior SuppFamily Individuals Covered Count)}} = \text{Single Coverage Payment}$$

$$\frac{\$48{,}822{,}725.76 * 25\%}{10{,}268 + (1{,}341 * 2 + 4 * 3)} = \$941.65$$

### Non-Medicare Calculation

$$\frac{\text{Non-Medicare Corpus * 25\%}}{\text{NonMedSingle Coverage + (NonMedFamily Coverage * NonMedFamily Premium/NonMedSingle Premium)}} = \text{Single Coverage Payment}$$

$$\frac{\$1{,}394{,}383.00 * 25\%}{5{,}672 + 115 + (767 * \$1{,}480/\$740) + (13 * \$2{,}070/\$1{,}035)} = \$47.52$$

| Calendar Year 2015 Annual Refund Amounts (to be paid in Calendar Year 2016): | | |
|---|---|---|
| Medicare Advantage - Single = $676.23 | Senior Supplement - Single = $941.65 | Choice - Single = $47.52 |
| Medicare Advantage - Dual = $1,352.46 | Senior Supplement - Dual = $1,883.30 | Choice - Family = $95.04 |
| Medicare Advantage - Triple = $2,028.69 | Senior Supplement - Triple = $2,824.95 | Choice Plus - Single = $47.52 |
| | | Choice Plus - Family = $95.04 |

**Total Distribution: $27,783,496.34**

# Background Materials

# Goal 2

Provide health, disability, and supplemental defined contribution programs that are accessible, affordable, reliable, and efficiently run.

## Health Insurance Program Development and Administration

Objectives:

1. Conduct an annual review of the affordability, competitiveness and accessibility of ASRS plans through comparative analysis with other plans. Present results to Executive Management and the Operations and Audit Committee.
2. Maintain access to a choice of healthcare plans (EPO/HMO and PPO/Indemnity) for all Medicare eligible ASRS retirees within Arizona.
3. Distribute open enrollment materials to retirees no later than 15 days prior to the start of the open enrollment period each year.
4. Increase the number of members receiving open enrollment materials electronically in lieu of paper each year, with an overall objective of 98 percent or more of new retirees and 50 percent or more of all retirees receiving materials electronically by the end of the strategic planning period.
5. Review medical vendor performance reports within 60 days of the quarter's end and collect penalties within 120 days of the quarter's end.

## Medical Carrier Customer Service

Objectives:

1. Receive an overall satisfaction rating of 90 percent or higher for overall administration of the medical insurance plan on the annual survey of member satisfaction.
2. Receive an overall satisfaction rating of 90 percent or higher for call center services on the annual survey of member satisfaction.
3. Answer 80 percent or higher of calls within 30 seconds.
4. Maintain a call abandonment rate of 5 percent or less.
5. Resolve 90 percent or more of member questions during the first contact.
6. Process 98 percent or higher of enrollment applications within 7 days of receipt.
7. Achieve an accuracy rating of 95 percent or higher for claims processed.
8. Distribute 99 percent of new identification cards within 10 business days after final member eligibility data is received and passes quality assurance checks.

## Dental Carrier Customer Service

Objectives:

1. Answer calls in an average of 30 seconds or less.
2. Maintain a call abandonment rate of 4 percent or less.
3. Less than 5 percent of member calls will receive a busy signal.
4. Process 90 percent of clean claims within 10 days and 80 percent of all claims within 15 days.
5. Claims processing accuracy ratings will be 97.5 percent or greater.
6. Respond to 100 percent of disputed Indemnity claim requests within 30 days.

## On-site Vendor (medical, dental, and disability) Customer Service

Objectives:

1. Respond to member phone inquiries and staff research requests within 2 business days.
2. Respond to 90 percent or higher of written member correspondence within 5 business days.
3. Respond to 80 percent or higher of walk-ins within 30 minutes.
4. Process 90 percent of medical and dental enrollments, coverage changes and adjustments on or before the coverage effective date.

## Health Benefit Supplement Payments to Employers

Objectives:

1. Process all Authorization and Change/Delete forms received from employers within 5 business days of receipt in good order, with an accuracy rate of 98 percent or higher.
2. Process all Employer Rate Surveys within 10 business days of receipt in good order, with 100 percent accuracy.
3. Process 6 month health benefit supplement reimbursement forms within 15 business days of receipt in good order, with an accuracy rate of 98 percent.

## Long Term Disability Program Administration

Objectives:

1. Conduct a periodic review of the affordability, adequacy and competitiveness of the long term disability program. Present results to Executive Management and the Operations and Audit Committee.
2. Process all payments to the third party administrator within 5 business days of invoice receipt.
3. Review the disability payment exception report to ensure any variances that have occurred are reasonable.
4. Conduct a monthly audit of members who are no longer receiving disability benefits to ensure ASRS insurance coverage has been discontinued.
5. Review disability vendor performance reports within 90 days of the quarter’s end and collect penalties as required at the end of each contract year.

## Long Term Disability Claim Administrator Customer Service

Objectives:

1. Answer incoming calls in an average of 30 seconds or less.
2. Maintain a call abandonment rate of 5 percent or less.
3. Achieve accuracy ratings of 97 percent or higher for payments (net dollar amounts) being disbursed.
4. Process 90 percent or more of all claims (decision approved or denied) within 90 days of receipt of the claim (or date of disability if claim filed earlier).
5. Deliver 97 percent or more of standard reports within 5 business days of their due date.
6. Achieve an overall satisfaction rating of 90 percent or more each quarter for the initial application process.
7. Achieve an overall satisfaction rating of 90 percent or more each quarter for open claims.

## Supplemental Defined Contribution Program Administration

Objectives:

1. Conduct a periodic review of the competitiveness and accessibility of ASRS supplemental defined contribution programs. Present results to Executive Management and the Operations and Audit Committee.
2. Conduct a quarterly review of the performance for each of the defined contribution programs.

## Risk Mitigation

Objectives:

1. In conjunction with the agency risk management program, take appropriate steps and provide reasonable assurance to Executive Management and the Board that health, disability, and supplemental defined contribution programs are accessible, affordable, reliable, and efficiently run.

COMPLIANCE communications

# What is Medical Loss Ratio (MLR)?

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The Medical Loss Ratio, or MLR, is the percentage of premium dollars received by a health insurance carrier that is spent on medical claims and quality improvement. The Affordable Care Act (ACA) requires health insurance carriers to submit data to the U.S. Department of Health & Human Services (HHS) each year detailing premiums received and how those premium dollars are spent. The ACA requires carriers to maintain at least an 80% MLR for small group (1-100 employees on average in prior calendar year and at least two employees on first day of plan year, though some states can use < 50 employees) or 85% MLR for large group. If a carrier maintains a lower MLR, it must issue a premium rebate to policyholders by no later than September 30 each year (delayed to October 30 in 2015).

If HHS notifies a carrier that its MLR is too low, the carrier must issue an MLR rebate to whomever holds the insurance policy. In most cases, the employer sponsor of a group health plan is the policyholder, so this compliance communication will focus on employer plan sponsors and the strict ACA rules regarding what they can do with an MLR rebate.

## What does MLR mean for Plan Sponsors?

Plan sponsors first must determine how much, if any, of the rebate amount is considered "plan assets" under the Employee Retirement Income Security Act of 1974 (ERISA). Typically, how much of an MLR rebate is plan assets depends on how much of the group premiums employees paid. Thus, for example, if an employer pays 100% of premium cost, none of the rebate is plan assets, and the employer may retain the full amount. If participants pay all of the premium cost, all of the rebate is plan assets and must be used for the benefits of the participants. If, for example, an employer pays 70% of premiums and employees contribute 30%, 30% of the MLR rebate is plan assets.

## What does ERISA require?

Determining how much of a rebate is plan assets is important because ERISA requires plan sponsors to use any MLR rebate amount found to be plan assets for the exclusive benefit of plan participants and beneficiaries within three months of receiving an MLR rebate. Plan sponsors must decide whether they will use these plan assets for the benefit of current participants or current as well as prior year participants (i.e., participants who actually contributed premiums for coverage subject to the MLR rebate but who are no longer employed). U.S. Department of Labor (DOL) Technical Release 2011-04 permits plan sponsors to choose to provide rebated plan assets solely to current participants if the costs of paying former participants is equal to or greater than the rebate amount due to them.

## What does the DOL require of MLR rebates?

The DOL states that plan sponsors must use a reasonable and objective method to allocate any MLR rebate amounts they distribute in cash to all affected individuals and provides these three safe harbors:

- Evenly to all covered participants;
- Based on each participant's actual contributions; or
- In a way that reasonably reflects each participant's contributions.

Plan sponsors have options aside from making cash payments directly to current and former participants. Plan sponsors may weigh all facts and circumstances, including:

- Cost of distributing payments;
- Size of the rebate amounts due (i.e., de minimis amounts); and/or
- Negative tax consequences (e.g., amounts are taxable to fully insured plan participants who paid premiums contributions on a pre-tax basis).

If, based on the foregoing factors, an employer decides it will not make cash payments to current or former participants, an employer may use the assets to reduce future premium contributions for current participants, or to provide general benefit enhancements for current plan participants.

## How is de minimis determined?

One of the permissible reasons for an employer not to make cash distributions to current and former participants is if the amounts due to each such participant is de minimis. Plan sponsors have leeway to determine whether rebate payments would be de minimis and should consider how much each participant would get after taxes, the costs of producing rebate checks and the costs of mailing rebates. There are no hard and fast rules on what amounts are de minimis, but a fair, objective and reasonable analysis will consider the foregoing factors when making this determination. Additionally, plan sponsors should document any decisions relating to determining de minimis amounts and should be sure to apply these amounts either to offset future premium payments or to add enhanced benefits to the plan.

## Conclusion

Prudence suggests that plan sponsors should determine their general strategy for handling MLR rebates and draft it into their group health plan documents and summary plan documents (SPD). The overall strategy should address how plan assets will be calculated, how rebates will be distributed, whether any rebates will go to cover administrative expenses and how the sponsor will determine de minimis amounts and what will be done with those amounts.
For assistance with your MLR questions, please contact your advisor.

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