ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

AGENDA

NOTICE OF A PUBLIC MEETING AND POSSIBLE EXECUTIVE SESSION(S) OF THE ARIZONA STATE RETIREMENT SYSTEM OPERATIONS AND AUDIT COMMITTEE

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

August 12, 2014
10:30 a.m. Arizona Time

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 12, 2014, 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.

This meeting will be teleconferenced to the ASRS Tucson office conference room at 7660 E. Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

The Agenda for the meeting is as follows:

1. Call to Order; Roll Call; Opening Remarks.....Mr. Jeff Tyne
   Operations and Audit Committee Chair

2. Approval of the Public Session and Executive Session Minutes of the April 30, 2014 OAC Meeting .....Mr. Jeff Tyne

Regarding the following agenda item, pursuant to A.R.S. § 38-431.03(A)(2), the ASRS Committee may vote to go into executive session, which will not be open to the public, for the purpose of considering or discussing records exempt by law from public inspection.

3. Presentation, Discussion and Appropriate Action Regarding the 2015 ASRS Retiree Medical Benefits Program Request for Proposal (RFP) ..... Mr. Paul Matson
   Director
   ..... Mr. Anthony Guarino
   Deputy Director and Chief Operations Officer
   ..... Mr. Patrick M. Klein
   Assistant Director, External Affairs Division
   .....Ms. Shireen Boone
   Chief Procurement Officer

Regarding the following agenda item, pursuant to A.R.S. § 38-431.03(A)(2), the ASRS Committee may vote to go into executive session, which will not be open to the public, for the purpose of considering or discussing records exempt by law from public inspection.

4. Presentation, Discussion and Appropriate Action Regarding an ASRS Risk Assessment of Agency Technology Development, Security, and Continuity of Operations .....
   ..... Mr. Anthony Guarino
   .....Mr. Kent Smith
   Assistant Director, Technology Services Division
   .....Ms. Molly Mahai
   Manager, Network Information Systems
   ..... Mr. Gary Hummel
   Information Security Officer
   .....Mr. Srinivas Mukkamala
   Chief Technology Officer, CAaNES

5. Presentation, Discussion and Appropriate Action Regarding the ASRS Budget Related Topics Including:
   A. Presentation of the ASRS Appropriated Budget and the Estimated Administrative and Investment Spending Plan for Fiscal Year (FY) 2015
   B. Presentation of the ASRS Appropriated Budget Request and Estimated ASRS Administrative and Investment Spending Plans for FY 2016 and FY 2017
   ..... Mr. Anthony Guarino
   ..... Ms. Martha Rozen
   Chief of Administrative Services
   .....Mr. Russ Levine
   Procurement and Budget Manager

Regarding the following agenda item, pursuant to A.R.S. § 38-431.03(A)(3), the ASRS Committee may vote to go into executive session, which will not be open to the public for discussion or consultation for legal advice.

6. Presentation, Discussion and Appropriate Action Regarding Approaches and Legal Implications of Service and Account Balance Reinstatement for Members Who May be Defrauded
   ..... Mr. Paul Matson
   ..... Mr. Anthony Guarino
   ..... Ms. Jothi Beljan
   Assistant Attorney General
   ..... Ms. Nancy Bennett
   Chief Financial Officer

7. Presentation, Discussion and Appropriate Action Regarding the Audit Update for Year One of the Audit Plan.....Mr. Bernard Glick
   Chief Internal Auditor

8. Presentation, Discussion and Appropriate Action Regarding Elimination of One Audit From Year Two Audit Plan in Order to Test Census Data for the External Auditor of the ASRS.....
   .....Mr. Bernard Glick

9. Review of Recently Conducted Audits
    - Graham County Employer Audit
    - ASRS Investment Management Division's Order Management System
    - Long Term Disability Program

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

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 7660 East Broadway Boulevard, Suite 108, 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 1, 2014

ARIZONA STATE RETIREMENT SYSTEM

Gayle Williams Date	Anthony Guarino Date
Committee Administrator	Deputy Director and Chief Operations Officer

Agenda Item #2

ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

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

HELD ON
Wednesday, April 30, 2014
10:30 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 10:34 a.m.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Jeff Tyne, Chair
Mr. Mike Smarik, Vice-chair
Dr. Richard Jacob
Mr. Brian McNeil

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

2. Approval of the February 11, 2014 Minutes of the Operations and Audit Committee (OAC) Meeting

Motion: Dr. Richard Jacob moved the Committee accept the minutes of the February 11, 2014 OAC meeting. Mr. Michael Smarik seconded the motion.

By a vote of 4 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

3. Call to the Public

The Call to the Public was moved from the end of the meeting to the beginning due to the Information Technology Security agenda item.

No members of the public addressed the Committee.

4. Review of Recently Conducted Audits

- Prescott Valley Charter School

Mr. Bernard Glick, Chief Internal Auditor, introduced Ms. Rosie Tomforde, Audit Officer. Ms. Tomforde presented the Committee with an audit of the Prescott Valley Charter School (school). There were four findings listed on the audit report. First, the school did not remit contributions on all eligible compensation for two employees. Second, the school remitted contributions for one ineligible individual. Next, the school did not refund to some employees the excess contributions that were retroactively reversed. Finally, the school did not pay the alternative contribution rate for its retirees who have returned to work.

DRAFT

Ms. Rosie Tomforde explained that while Prescott Valley Charter School is an ASRS employer, their employees are now leased, not Full Time Equivalent (FTE) employees, and therefore, the school is paying the Alternative Contribution Rate (ACR) for the leased employees. Ms. Tomforde also confirmed the non-compliant findings for the Prescott Valley Charter School have been appropriately addressed.

5. Presentation, Discussion and Appropriate Action Regarding the Internal Audit Quarterly Update

Mr. Glick presented a spreadsheet containing the summary of internal audits through the period ending March 2014. The spreadsheet listed the audits, the hours budgeted, and estimates of how many hours were used to perform the audits.

Mr. Glick explained the Foreign Annuitant Confirmation Audit by stating that every three (3) years a confirmation audit is run confirming notarized signatures for those members living outside of the United States.

6. Presentation, Discussion and Appropriate Action Regarding the ASRS Return to Work Program

Mr. Anthony Guarino, Deputy Director and Chief Operations Officer, explained that changes being made to the Return to Work (RTW) program are to improve the overall experience for members and employers; he then introduced the presenters who would be discussing plans to simplify the return to work process.

Ms. Sarah Korish, Program Manager Member Services Division, presented a summary of recent RTW trends demonstrating the increase in phone calls and emails regarding RTW. Ms. Korish explained the purpose of the changes is to eliminate confusion for both the member and the employer.

Ms. Erica Dunphy, Benefits Accounting Supervisor, explained the existing RTW program is a reactive process which starts with the member completing a hard-copy RTW form. Ms. Dunphy explained the improved program replaces the paper form with an online “Smart Form” which evaluates the member’s RTW eligibility as the member enters information.

Mr. Patrick Klein, External Affairs Assistant Director, clarified and answered questions raised regarding the Alternative Contribution Rate (ACR). Mr. Klein explained the ACR is an employers’ expense and the employer is meant to remit the ACR for retirees who have returned to work.

Mr. Klein also clarified the ACR for substitute school teachers is remitted based on the RTW retiree filling an employee position of the employer and not the contributing eligibility of the RTW retiree. Trustees asked numerous questions and requested clarifying detail which was provided during the meeting.

7. Presentation, Discussion and Appropriate Action Regarding ASRS Information Technology Security

Motion: Dr. Richard Jacob moved to go into Executive Session for a presentation regarding the ASRS information technology security. Mr. Michael Smarik seconded the motion.

DRAFT

By a vote of 4 in favor, 0 opposed, abstentions and 0 excused, the motion was approved.

The Committee convened to Executive Session at 11:38 a.m.

The Committee reconvened to Public Session at 12:44 p.m.

8. Future Agenda Items

No items were requested by Committee members.

9. Adjournment of the OAC

Mr. Tyne adjourned the meeting at 12:45 p.m.

Respectfully Submitted,

ARIZONA STATE RETIREMENT SYSTEM

Courtney Micheau Date	Anthony Guarino Date
Committee Administrator	Deputy Director and Chief Operations Officer

DRAFT

Confidential meeting materials were in this agenda item

Agenda Item #3

ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

MEMORANDUM

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

FROM: Mr. Anthony Guarino, Deputy Director and Chief Operations Officer
Mr. Patrick M. Klein, Assistant Director, External Affairs
Mr. Edward Rapoport, ASRS Benefits Administrator

DATE: August 5, 2014

RE: **Agenda Item #3**: Presentation, Discussion and Appropriate Action Regarding the 2015 ASRS Retiree Medical Benefits Program Request for Proposal

Purpose
To review and accept the recommendation of the Request for Proposal (RFP) Evaluation Committee for a retiree medical benefits program effective January 1, 2015, for the ASRS.

Recommendation
Accept the Evaluation Committee's recommendation and forward it to the ASRS Board of Trustees for approval.

Background
The ASRS issued an RFP in early January 2014, for an ASRS retiree medical benefits program. The ASRS will conclude a five-year contract with UnitedHealthcare at the end of 2014. Arizona statutes require the ASRS to bid the program every five years. A new contract will be effective January 1, 2015.

Responses were due in early February. An evaluation committee was assembled and was comprised of Dr. Richard Jacob, ASRS Board Trustee; Paul Matson, ASRS Director; Anthony Guarino, Deputy Director and Chief Operations Officer; Pat Klein, Assistant Director External Affiairs; Ed Rapoport, ASRS Benefits Administrator; and with technical assistance from Shireen Boone, Chief Procurement Officer. Benefits consultants from Mercer Consulting also assisted in the process and guided many of the committee's discussions.

Two proposals were submitted by the due date; one from UnitedHealthcare and one from Transamerica Affinity, a broker for Medicare plans only. There was also an electronic submission from an individual person but without an actual offer; i.e., no documentation was provided upon which an evaluation could have been performed.

The evaluation committee met periodically from mid-March to mid-July analyzing and comparing responses from vendors based on the evaluation criteria set forth in the solicitation requirements. Some of these criteria included : Quality and Value of Benefit Plan; Pricing (premiums); Performance Guarantees; and, an acceptable Retrospective Rate Adjustment Agreement.

Best and Final Offers were provided on June 13. The committee then asked for specific clarifications regarding vendor responses with those clarifications provided on July 21. The committee convened on July 24 and formalized its recommendation.

The committee's recommendation may be found on the attached confidential exhibit.

Confidential meeting materials were in this agenda item

Agenda Item #4

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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 5, 2014

RE: **Agenda Item #4:** Presentation, Discussion and Appropriate Action Regarding an ASRS Risk Assessment of Agency Technology Development, Security, and Continuity of Operations

Purpose

Staff will provide the OAC with a risk assessment focusing on the agency technology and the strategic goal of providing members and business users with technology that is high-performing, secure, and able to support evolving business needs.

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 technology (comprised of three functional areas: (1) Business Applications Development,

Maintenance, and Upgrades, (2) Continuity of Operations, and (3) Network Applications, Hardware, and Upgrades).

Attached you will find:

Part One. Risk Assessment

- Section One. Highlights
- Section Two. Criteria, Control Structures and Heat Charts
- Appendix A. Risk Management Process

Part Two. IT Security Strategy, Assessments and Remediation

- Section One. IT Security Strategies
- Section Two. Assessments and Remediation
    a. CAaNES report executive summary
    b. Remediation priorities and status
    c. ASET review, following employee complaint
    d. ASRS response to ASET Recommendations
    e. ASRS review of employee complaint
    f. CAaNES supplemental findings – ASRS internal systems

Enterprise Risk Management

OAC Presentation

Focus on Agency Technology Development, Security, and Continuity of Operations

August 2014

Section One

Executive Summary: Highlighted Risks and Control Strategies

ASRS Strategic Goal #10:

Provide members and business users with technology that is high performing, secure, and able to support evolving business needs

Business functions included in Goal #10:

- Business Applications Development, Maintenance, and Upgrades
- Continuity of Operations (COOP)
- Maintain Network Applications, Hardware, and Upgrades

Highlighted Risks and Strategies

Business Applications (Section Two, page 14)

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies
1. Fail to utilize effective project management for new development, maintenance and upgrades	Moderate	Low	Strong	Not Likely	Accept the anticipated risk levels.

Specific control strategies as of April 2014: State and PMP certified project managers are on staff. Oversight is provided by the Senior Management Team, Change Control Board, Executive Management Team, Operations and Audit Committee, Enterprise Risk Management Committee and ASET. Project managers utilize the PMBOK principles and guidelines. For new development and upgrades, project managers are assigned to coordinate activities. TSD utilizes the SCRUM application development methodology. Development staff has been trained in the SCRUM methodology which includes retrospective reviews every two to three weeks for lessons learned. TSD utilizes project management and development tools to manage scope, schedule, cost and resources. Changes are presented to SMT for approval. SCRUM process enables requirements to be prioritized with business requirement ranking from high to low.

Future Controls/Gaps:. None identified

2. Fail to achieve planned measureable outcomes	Moderate	Low	Strong	Some Likelihood	Evaluate the anticipated risk levels.

Specific control strategies as of April 2014: SMT defines the successful completion criteria for each project. TSD utilizes the SCRUM application development methodology. SCRUM methodology includes retrospective reviews every two to three weeks for lessons learned. SCRUM methodology utilizes business users as product owners who communicate and coordinate with business stakeholders to gather and prioritize requirements, review development artifacts (documentation, SOPs, applications/programs, etc.) Business is involved in user acceptance testing and must approve prior to moving into production.

Future Controls/Gaps:. TSD will begin reporting back to SMT once per year whether successful completion criteria were met.

Highlighted Risks and Strategies

Business Applications (Section Two, pages 14 and 15)

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies
3. Insufficient number of technical staff to meet agency needs	Moderate	Low	Some Vulnerability	Some Likelihood	Accept the anticipated risk levels.

Specific control strategies as of April 2014: SMT assesses the technology application development needs annually to develop a budget and plan for the year. A gap analysis is performed between current staff available and staffing requirements to accomplish tasks. Work is prioritized according to available resources. As budget allows, outside consultants are utilized as needed. Recruitments are ongoing. Management conducts frequent reviews for salary increases because technical skills are highly valued and in demand. Job postings have been revised to attract additional candidates. Additional revisions are performed if sufficient candidates do not apply.

Future Controls/Gaps:. None identified

7. Development environments are too complex to manage	Moderate	Medium	Some Vulnerability	Some Likelihood	Evaluate the anticipated risk levels.

Specific control strategies as of April 2014: The complexity of the tool and ease of management is considered in the tool selection process. Tools selected include adequate vendor support. Some products are now aligned under a single vendor product stack to provide a single point of contact. Staff is trained and SOPs are in place. A System Architect and a team of technical leads meet weekly and a communication channel is in place to disseminate the information to all developers. Technical online forums are consulted as needed. Some deployment steps have been automated.

Future Controls/Gaps: Additional deployment steps will be automated reducing the chance for human error. Management should consider replacement of some technologies that have expensive licensing costs (FileNet, COGNOS, etc.) which prohibit setting up development environments to match production.

10. Lack of accurate project estimates disrupt project schedules and budgets	Minor	Medium	Some Vulnerability	Some Likelihood	Evaluate the anticipated risk levels

Specific control strategies as of April 2014: SMT chooses from a range of project estimates early in the requirement definition process. TSD uses a software estimation tool to determine the ranges. CCB actively manages and reviews budget and schedules throughout the project.

Future Controls/Gaps: Management should consider refining and documenting methods to estimate hours .

CONCLUSION: Manageable

Highlighted Risks and Strategies

Network Applications (Section Two, page 22)

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies
1. Information systems are not secure from external threats or electronic intrusions, including illegal, unethical, or fraudulent data manipulation, financial disbursements, and identity theft	Major	Low	Some Vulnerability	Some Likelihood	Reduce the anticipated risk levels.

Specific control strategies as of April 2014: Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. The Enterprise Risk Management Committee is in place. Measures to secure externally facing systems include: Firewalls, web filtering, network investigation tool , application and device control for PC, third party patch management, data loss prevention software for email, end point protection on PC and servers, log event managing system, administrative controls, independent network monitoring, undergo internal and external security audits and perform remediation, full disk encryption for laptops and thumb drives, policies and procedures in place, schedules are in place to replace hardware/software, inventory controls in place, and some whitelisting (stops unauthorized installation/execution) in place.

Future Controls/Gaps: Achieve targeted Gartner Security Maturity levels. Researching web application firewall and data loss prevention tools for entire network. Evaluate expanding the whitelisting scope. Need to more fully configure log event management system tool. Management should evaluate current resource allocation for security tool management. ERMC will communicate more broadly their function as the IT Security Steering Committee to staff.

2. Information systems are not secure from internal threats or physical intrusions, including illegal, unethical, or fraudulent data manipulation, financial disbursements, and identity theft	Major	Low	Some Vulnerability	Some Likelihood	Reduce the anticipated risk levels.

Specific control strategies as of April 2014: Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. The Enterprise Risk Management Committee is in place. Web filtering blocks malicious websites from staff. Every employee signs a security agreement annually. Telecommuting employees are made aware of the risks and consequences and sign an agreement. Agency follows the recommended Remediation Roadmap from the Information Security Assessment Report (January 2014) and conducts annual or bi-annual external compliance assessments. Security documentation has been standardized on the NIST framework. Code reviews are performed. The ERMC action plan is monitored. Software is used to discover new network risks. Risk mitigation strategies include: See response to #1, badging system, policy and procedures, and restrictions to ASRS floors, secure file transfer, physical access restrictions and monitoring (i.e. cameras, panic buttons, updated access reporting), and key control program.

Future Controls/Gaps: Achieve targeted Gartner Security Maturity levels. Researching network employee behavior monitoring tool. Management should evaluate current resource allocation for security tool management. Management is working on resuming background checks on ASRS staff. ERMC will communicate more broadly their function as the IT Security Steering Committee to staff.

Highlighted Risks and Strategies

Network Applications (Section Two, pages 22 and 24)

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies
22. A system breach goes undetected	Major	Low	Some Vulnerability	Some Likelihood	Reduce the anticipated risk levels.

Specific control strategies as of April 2014: Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. Notifications of vulnerabilities are received from external and internal entities. Resources are redirected to address threats. Industry standard devices and practices are utilized within ASRS IT environment. Processes and procedures are in place to remediate threats. Automatic updating of threat definitions on various security appliances.

Future Controls/Gaps: Achieve targeted Gartner Security Maturity levels. Management should consider hiring additional certified security resources to effectively monitor security appliances and purchasing additional security appliances.

7. Not enough technical resources to meet strategic objectives, state standards, and targeted Gartner maturity levels	Major	Low	Some Vulnerability	Some Likelihood	Reduce the anticipated risk levels.

Specific control strategies as of April 2014: Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. Focused subgroups (Security, Tier I HelpDesk and Tier II Networking) have been established to manage the individual tasks. Cross-training has been increased for all networking activities. Formalized remediation of scan results and an enhanced patch management strategy have been implemented. Security training provided for development and testing. Schedules are coordinated with resource availability.

Future Controls/Gaps: Achieve targeted Gartner Security Maturity levels. Management will request required permission and approvals to add resources needed.

Highlighted Risks and Strategies

Network Applications (Section Two, page 24)

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies
20. Technical resources are not fully trained in all areas of responsibility	Moderate	Medium	Some Vulnerability	Some Likelihood	Reduce the anticipated risk levels.

Specific control strategies as of April 2014: Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. New hires are generally hired for their technical skills but additional on the job training is required for tools, technologies and processes before they can be fully productive (3 to 9 months). Cross-training has been increased for all networking activities. Other TSD resources are used to fill gaps in knowledge.

Future Controls/Gaps: Achieve targeted Gartner Security Maturity levels. Management should consider having more advanced training in various technical areas (i.e. virtualization, multiple operating systems, and project management methodologies) contingent on management's success in attaining more resources.

CONCLUSION: Additional Funding Requested to Mitigate Risks

Highlighted Risks and Strategies

Continuation of Operations (COOP) (Section Two, page 19)

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies
1. Business continuity plans are not established, tested, reviewed or sufficient to support business operations in the event of a disaster	Major	Low	Strong	Not Likely	Accept the anticipated risk levels.

Specific control strategies as of April 2014: Periodic comprehensive tests are performed to evaluate the ability to recover core business systems in Tucson should a short duration incident occur. IMD's COOP is integrated into overall agency COOP. The Business Impact Assessment (BIA) is periodically reviewed and updated to verify threats, recovery time objectives, and disaster recovery (DR) staffing requirements. Internal Audit monitors COOP tests and consults as necessary.

Future Controls/Gaps: None identified.

2. Current COOP infrastructure in the alternate site is inadequate to support business needs in the event of a short-term emergency	Minor	Medium	Some Vulnerability	Some Likelihood	Evaluate the anticipated risk levels.

Specific control strategies as of April 2014: The after-action reports are considered when evaluating equipment purchases for the alternate site. COOP exercise results are utilized to enhance system performance. The current process is to limit the number of persons utilizing the systems and the order in which work is performed to bring up infrastructure. Regular reviews are performed to determine the business impact of each system to prioritize adequacy. Each division has identified critical systems that must be operational within designated timeframes in a disaster situation and management is aware of current infrastructure limitations. Each division has assigned appropriate personnel to their role in a disaster. A procedure is in place to work with Procurement to acquire any essential equipment during a disaster.

Future Controls/Gaps: A review process is underway to evaluate modernizing equipment used in the alternate site. Management should consider reviewing the cost vs. capability decisions that have been made regarding the COOP infrastructure. Management should consider defining acceptable system responsiveness at the alternate site.

CONCLUSION: Manageable

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Section Two

Ranking Criteria, Control Structures and Strategies, and Heat Charts for Goal #10 Technology Risks

Rankings: IMPACT

Measures the impact should the risk occur

Minor

Indicates a risk occurrence would create no noticeable:

Disruption to normal operations

- Disruption to existing systems:
  - Phones, network, POL, PERIS, FileNet down for up to 4 hours
  - Website down for up to 24 hours
  - MUNIS down for up to 1 week
- System security successfully defended
- System performance slower than normal but does not disrupt normal operations

Disruption to strategic technology development

- Project and production support delays have a 10 – 20% negative impact to annual project plan
- <10% negative variance to outcome user satisfaction

Financial impact

- Current budget year can absorb the equipment, resource, software and licensing costs

Reputation/public image damage

- No inquiries from media/government agencies
- No loss of stakeholder trust in ASRS

Moderate

Indicates a risk occurrence could create a modest:

Disruption to normal operations

- Disruption to existing systems:
  - Phones, network, POL, PERIS, FileNet down for 4 – 8 hours
  - Website down for 25 - 48 hours
  - MUNIS down for 8 – 31 days
- System security partially compromised but no loss occurs
- System performance impedes non-critical objectives
- COOP team assembled but not activated

Disruption to strategic technology development

- Project and production support delays have a 21 – 30% negative impact to annual project plan
- 11 - 20% negative variance to outcome user satisfaction

Financial impact

- Current budget year can partially absorb the equipment, resource, software and licensing costs

Reputation/public image damage

- Public statement issued
- Some loss of stakeholder trust in ASRS

Major

Indicates a risk occurrence could create a significant:

Disruption to normal operations

- Disruption to existing systems:
  - Phones, network, POL, PERIS, FileNet down for >8 hours
  - Website down for >48 hours
  - MUNIS down for >31 days
- System security significantly compromised and loss occurs
- System performance impedes critical objectives
- COOP plan is activated

Disruption to strategic technology development

- Project and production support delays have a >30% negative impact to annual project plan
- >21% negative variance to outcome user satisfaction

Financial impact

- Current budget year cannot absorb the equipment, resource, software and licensing costs

Reputation/public image damage

- Media coverage
- Results in legislation and/or lawsuits that set precedent
- Loss of stakeholder trust in ASRS

Rankings: CONTROLS

Strengthen controls to lessen risk

Strong

Indicates the controls in place are strong and will mitigate manageable risk

- Duties and responsibilities are clearly delineated between the Board and Director
- Staff engagement with the OAC ensures appropriate oversight
- Senior Management establishes priorities and schedules and CCB provides oversight
- Goals and objectives are clearly defined and supported by the organizational structure
- Staff engagement with ADOA (ASET) ensures adequate collaboration and timely approval of technology investment
- Established methodology (i.e. Agile SCRUM) to develop software
- Technology software/hardware in place is updated/upgraded to support business processes and ensure adequate security
- Performance is analyzed, measured, reported
- Staff duties are properly segregated and responsibilities defined
- SMEs in place
- Rules, policies, SOPs in place
- Communication channels established
- IA and external auditors test control adequacy and staff follows up
- Enterprise Risk Management Committee functions as IT security steering committee

Some Vulnerability

Indicates the controls in place have areas of vulnerability that may not, or may not always, mitigate manageable risk

- Missing some elements of strong controls
- External factors that create technology security risks may be evolving faster than the agency can mitigate
- Constraints on independence and autonomy may impede the agency's ability to mitigate some risks in a timely fashion
- Not all elements of proper governance are in place

Weak

Indicates the controls in place are not adequate to mitigate manageable risk

- Missing many elements of strong controls
- Subject matter expertise is substandard
- Goals and objectives are unclear
- Internal Audit does not verify the adequacy of controls
- Performance is not analyzed, measured, or reported
- External factors that create technology security risks are known to be evolving faster than the agency can mitigate
- Constraints on independence and autonomy impede the agency's ability to mitigate many risks in a timely fashion
- Proper governance not in place

Rankings: LIKELIHOOD

Probability that the risk identified would or would not occur

Not Likely	Some Likelihood	Likely
Indicates the risk will probably not occur • Risk event can usually be controlled • Strong controls/low tolerance • Not likely to occur in the next year	**Indicates there is some probability the risk will occur** • Risk event cannot always be controlled • Missing some elements of strong controls/some tolerance • Some likelihood to occur in the near term if unchecked	**Indicates it is probable the risk will occur** • Risk event cannot be controlled • Missing numerous elements of strong controls/high tolerance • Likely to happen if unchecked

Risks for Business Applications

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies	FY 14/15 Internal Audit Strategies
1. Fail to utilize effective project management for new development, maintenance, and upgrades	Moderate	Low	Strong	Not Likely	**Accept** the anticipated risk levels.	
2. Fail to achieve planned measureable outcomes	Moderate	Low	Strong	Some Likelihood	**Evaluate** the anticipated risk levels	
3. Insufficient number of technical staff to meet agency needs	Moderate	Low	Some Vulnerability	Some Likelihood	**Accept** the anticipated risk levels.	
4. Technical resources are not skilled in the technology	Moderate	Low	Strong	Some Likelihood	**Accept** the anticipated risk levels.	
5. Product owners and business stakeholders are not available for projects	Moderate	Low	Strong	Some Likelihood	**Evaluate** the anticipated risk levels	
6. Product owners are speaking for multiple business units and may not understand fully the impact of their decisions	Moderate	Low	Strong	Some Likelihood	**Accept** the anticipated risk levels.	
7. Development environments are too complex to manage	Moderate	Medium	Some Vulnerability	Some Likelihood	**Evaluate** the anticipated risk levels	

Risks for Business Applications

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies	FY 14/15 Internal Audit Strategies
8. Unanticipated legislation is approved that results in an unplanned project that negatively impacts other projects	Moderate	Medium	Strong	Some Likelihood	**Accept** the anticipated risk levels	
9. Lack of autonomy negatively impacts the ability to implement priorities	Minor	Low	Strong	Some Likelihood	**Accept** the anticipated risk levels	
10. Lack of accurate project estimates disrupt project schedules and budgets	Minor	Medium	Some Vulnerability	Some Likelihood	**Evaluate** the anticipated risk levels	
11. Lack of accurate business benefit estimates impact project prioritization	Minor	Medium	Some Vulnerability	Some Likelihood	**Evaluate** the anticipated risk levels	

General Control Structure for Business Applications

Duties and responsibilities are clearly delineated between the Board and Director Governance Handbook is in place.	Established methodology (i.e. Agile SCRUM) to develop software In place.	SMEs in place Provisions in place to ensure technical and business SME availability.
Staff engagement with the OAC ensures appropriate oversight Regular presentations to the OAC are given.	Technology software/hardware in place is updated/upgraded to support business processes In place.	Rules, policies, SOPs in place Some in place.
Senior Management establishes priorities and schedules and CCB provides oversight CCB meetings are held monthly and SMT meetings are attended as needed.	Technology software/hardware in place is updated/upgraded to ensure adequate security Not applicable.	Communication channels established In place.
Goals and objectives are clearly defined and supported by the organizational structure Strategic goals and objectives are in place. Funding is finite and may not always meet agency priorities.	Performance is analyzed, measured, reported Strategic performance is measured and reported.	IA and external auditors test control adequacy and staff follows up on issues In place.
Staff engagement with ADOA (ASET) ensures adequate collaboration and timely approval of technology investment An established relationship with ASET is in place. PIJs are created as needed and status is reported according to PIJ process.	Staff duties are properly segregated and responsibilities defined In place.	Enterprise Risk Management Committee functions as IT security steering committee In place.

Business Applications Specific Controls – by risk number

Specific Controls for Business Applications by risk number as of April 2014:

1. **(Ineffective project management)** State and PMP certified project managers are on staff. Oversight is provided by the Senior Management Team, Change Control Board, Executive Management Team, Operations and Audit Committee, Enterprise Risk Management Committee and ASET. Project managers utilize the PMBOK principles and guidelines. For new development and upgrades, TSD utilizes the SCRUM application development methodology. Development staff has been trained in the SCRUM methodology which includes retrospective reviews every two to three weeks for lessons learned. TSD utilizes project management and development tools to manage scope, schedule, cost and resources. Changes are presented to SMT for approval. SCRUM process enables requirements to be prioritized with business requirement ranking from high to low.
2. **(Outcomes not achieved)** SMT defines the successful completion criteria for each project. TSD utilizes the SCRUM application development methodology. SCRUM methodology includes retrospective reviews every two to three weeks for lessons learned. SCRUM methodology utilizes business users as product owners who communicate and coordinate with business stakeholders to gather and prioritize requirements, review development artifacts (documentation, SOPs, applications/programs, etc.) Business is involved in user acceptance testing and must approve prior to moving into production.
3. **(Insufficient staff)** SMT assesses the technology application development needs annually to develop a budget and plan for the year. A gap analysis is performed between current staff available and staffing requirements to accomplish tasks. Work is prioritized according to available resources. As budget allows, outside consultants are utilized as needed. Recruitments are ongoing. Management conducts frequent reviews for salary increases because technical skills are highly valued and in demand. Job postings have been revised to attract additional candidates. Additional revisions are performed if sufficient candidates do not apply.
4. **(Unskilled staff)** Java has been used since 2005 so necessary staff is fully trained. New hires are generally hired for their technical skills but additional on the job training is required before they can be fully productive. Selection of new technology is influenced by the maturity and perceived longevity of the technology. Any new technology is extensively tested prior to moving to production. The number of technologies in use has been reduced. Management conducts frequent reviews for salary increases because technical skills are highly valued and in demand. There is a training budget in place.
5. **(Unavailable owners/stakeholders)** SMT appoints and approves product owners and business stakeholders for projects. SCRUM start and end dates are staggered to accommodate the availability of the business. The short duration of the sprints limits the impact of product owner and stakeholder availability; however with three to five SCRUM teams running projects at a given time, there is an impact to the business.
6. **(Owners unaware of all impacts)** SCRUM methodology clearly defines the responsibility of a product owner. TSD provides training materials for new product owners. The Senior Management Team made product owner and stakeholder coordination a priority. Product owners are selected because of their understanding and knowledge of the business areas affected by the development. Stakeholders are selected to assist the product owner based on their knowledge. The short duration of the sprints provides timely feedback from the stakeholders to the product owner and teams. SCRUM master ensures the process is followed.

Business Applications Specific Controls – by risk number

Specific Controls for Business Applications by risk number as of April 2014:

7. **(Development environments complex)** The complexity of the tool and ease of management is considered in the tool selection process. Tools selected include adequate vendor support. Some products are now aligned under a single vendor product stack to provide a single point of contact. Staff is trained and SOPs are in place. A System Architect and a team of technical leads meet weekly and a communication channel is in place to disseminate the information to all developers. Technical online forums are consulted as needed. Some deployment steps have been automated.
8. **(Legislation)** Designated staff monitors legislation and updates management and the Board. The Legislature is provided with financial and administrative cost impact estimates during the legislative session. Requests for additional funds and time (future effective date) to cover system enhancements are generally submitted. Management has a process to adjust scheduled projects so FTEs with sufficient understanding of the business and process are leading the legislative projects.
9. **(Lack of autonomy)** TSD is fully engaged in the PIJ process. Strong relationships are established with ASET, OSPB and JLBC.
10. **(Inaccurate estimates disrupt project schedules)** SMT chooses from a range of project estimates early in the requirement definition process. TSD uses a software estimation tool to determine the ranges. CCB actively manages and reviews budget and schedules throughout the project.
11. **(Inaccurate estimates disrupt project prioritization)** Managers and SMEs work together to develop business need estimates that are reviewed by SMT. SMT matches business needs to the strategic plan and the budget.

Future Controls/Gaps for Business Applications by risk number as of April 2014 :

2. **(Outcomes not achieved)** TSD will begin reporting back to SMT once per year whether successful completion criteria were met.
5. **(Unavailable owners/stakeholders)** Webcasts for SCRUM demonstrations of the functionality being developed are under consideration.
7. **(Development environments complex)** Additional deployment steps will be automated reducing the chance for human error. Management should consider replacement of some technologies that have expensive licensing costs (FileNet, COGNOS, etc.) which prohibit setting up development environments to match production.
10. **(Inaccurate estimates disrupt project schedules)** Management should consider refining and documenting methods to estimate hours.
11. **(Inaccurate estimates disrupt project prioritization)** Management should consider documenting management procedures for conducting business need estimates.

Risks for COOP

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies	FY 14/15 Internal Audit Strategies
1. Business continuity plans are not established, tested, reviewed or sufficient to support business operations in the event of a disaster	Major	Low	Strong	Not Likely	**Accept** the anticipated risk levels	
2. Current COOP infrastructure in the alternate site is inadequate to support business needs in the event of a short-term emergency	Minor	Medium	Some Vulnerability	Some Likelihood	**Evaluate** the anticipated risk levels	
3. Emergency communications are not executed effectively	Moderate	Low	Strong	Some Likelihood	**Reduce** the anticipated risk levels	
4. COOP infrastructure in the alternate site is unavailable at the same time the primary site is unavailable	Major	High	Weak	Not Likely	**Accept** the anticipated risk levels	

General Control Structure for COOP

Duties and responsibilities are clearly delineated between the Board and Director Governance Handbook is in place.	Established methodology (i.e. Agile SCRUM) to develop software Not applicable.	SMEs in place In place.
Staff engagement with the OAC ensures appropriate oversight Regular presentations to the OAC are given.	Technology software/hardware in place is updated/upgraded to support business processes Some in place.	Rules, policies, SOPs in place In place.
Senior Management establishes priorities and schedules and CCB provides oversight SMT meetings are attended as needed.	Technology software/hardware in place is updated/upgraded to ensure adequate security Some in place.	Communication channels established In place.
Goals and objectives are clearly defined and supported by the organizational structure Strategic goals and objectives are in place.	Performance is analyzed, measured, reported Strategic objective performance is measured and reported.	IA and external auditors test control adequacy and staff follows up on issues In place.
Staff engagement with ADOA (ASET) ensures adequate collaboration and timely approval of technology investment An established relationship with ASET is in place. PIJs are created as needed and status is reported according to PIJ process.	Staff duties are properly segregated and responsibilities defined In place.	Enterprise Risk Management Committee functions as IT security steering committee In place.

COOP Specific Controls - by risk number

1. **(Lacking COOP plan)** Periodic comprehensive tests are performed to evaluate the ability to recover core business systems in Tucson should a short duration incident occur. IMD's COOP is integrated into overall agency COOP. The Business Impact Assessment (BIA) is periodically reviewed and updated to verify threats, recovery time objectives, and disaster recovery (DR) staffing requirements. Internal Audit monitors COOP tests and consults as necessary.
2. **(Inadequate infrastructure in DR site)** The after-action reports are considered when evaluating equipment purchases for the alternate site. COOP exercise results are utilized to enhance system performance. The current process is to limit the number of persons utilizing the systems and the order in which work is performed to bring up infrastructure. Regular reviews are performed to determine the business impact of each system to prioritize adequacy. Each division has identified critical systems that must be operational within designated timeframes in a disaster situation and management is aware of current infrastructure limitations. Each division has assigned appropriate personnel to their role in a disaster. A procedure is in place to work with Procurement to acquire any essential equipment during a disaster.
3. **(Ineffective communication)** An emergency contact phone tree is regularly updated. A conference line is in place that can be used in an emergency situation. Staff is aware of their COOP role (telecommute, drive to Tucson, administrative leave, etc.). An SOP is in place. Communication is discussed during the COOP exercises, whether live or tabletop. TSD works cooperatively with ADEM.
4. **(No third level redundancy)** The alternate site is more than 100 miles from the primary site to reduce the likelihood of risk occurrence. Upon request the disbursement bank can issue payrolls based on previous month's pension run. The public ASRS website is hosted offsite. IMD has provisions to continue operations independent of the alternate site.

Future Controls/Gaps for COOP by risk number as of April 2014 :

2. **(Inadequate infrastructure in DR site)** A review process is underway to evaluate modernizing equipment used in the alternate site. Management should consider reviewing the cost vs. capability decisions that have been made regarding the COOP infrastructure. Management should consider defining acceptable system responsiveness at the alternate site.
3. **(Ineffective communication)** Management should consider more frequent tests of the emergency phone tree and communicator system.
4. **(No third level redundancy)** Management should consider a third level of redundancy .

Risks for Network Applications

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies	FY 14/15 Internal Audit Strategies
1. Information systems are not secure from external threats or electronic intrusions, including illegal, unethical, or fraudulent data manipulation, financial disbursements, and identity theft	Major	Low	Some Vulnerability	Some Likelihood	**Reduce** the anticipated risk levels.	IA audit scheduled for FY 15
2. Information systems are not secure from internal threats or physical intrusions, including illegal, unethical, or fraudulent data manipulation, financial disbursements, and identity theft	Major	Low	Some Vulnerability	Some Likelihood	**Reduce** the anticipated risk levels.	IA audit scheduled for FY 15
3. Information systems, applications, and data are not recoverable from system outages and/or physical loss	Major	Low	Strong	Not Likely	**Accept** the anticipated risk levels.	IA audit scheduled for FY 15
4. Proper sanitation of equipment is not performed prior to disposal causing a loss of data	Moderate	Low	Strong	Not Likely	**Evaluate** the anticipated risk levels.	IA audit scheduled for FY 15
5. Non-secure email containing PII is sent	Major	Low	Some Vulnerability	Some Likelihood	**Evaluate** the anticipated risk levels.	IA audit scheduled for FY 15
6. Unauthorized information containing non-PII sensitive data is released	Major	Low	Some Vulnerability	Some Likelihood	**Evaluate** the anticipated risk levels.	IA audit scheduled for FY 15
7. Not enough technical resources to meet strategic objectives, state standards, and targeted Gartner maturity levels	Major	Low	Some Vulnerability	Some Likelihood	**Reduce** the anticipated risk levels.	IA audit scheduled for FY 15

Risks for Network Applications

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies	FY 14/15 Internal Audit Strategies
8. SOPs inadequate or not in place (seldom used processes not covered)	Minor	Medium	Some Vulnerability	Some Likelihood	**Reduce** the anticipated risk levels.	IA audit scheduled for FY 15
9. Processing speed is not meeting business needs	Minor	Medium	Some Vulnerability	Some Likelihood	**Evaluate** the anticipated risk levels.	IA audit scheduled for FY 15
10. The schedule of network hardware and software upgrades is not presented timely to Senior Managers or is not complete	Minor	Medium	Strong	Not Likely	**Accept** the anticipated risk levels.	IA audit scheduled for FY 15
11. Telephone system could experience a hardware/software failure	Minor	Low	Strong	Not Likely	**Evaluate** the anticipated risk levels.	IA audit scheduled for FY 15
12. Telephone carrier may experience an outage	Minor	Low	Strong	Not Likely	**Accept** the anticipated risk levels.	IA audit scheduled for FY 15
13. Hardware (servers, switches, etc.) failures may occur	Minor	Low	Strong	Some Likelihood	**Accept** the anticipated risk levels.	IA audit scheduled for FY 15
14. Software application failures may occur	Minor	Low	Strong	Some Likelihood	**Accept** the anticipated risk levels.	IA audit scheduled for FY 15
15. HelpDesk survey sample size does not allow for effective measurement	Minor	High	Some Vulnerability	Some Likelihood	**Evaluate** the anticipated risk levels.	IA audit scheduled for FY 15
16. Unplanned hardware/software/licensing purchases negatively impacts pre-planned purchases	Moderate	Medium	Some Vulnerability	Likely	**Evaluate** the anticipated risk levels.	IA audit scheduled for FY 15

Risks for Network Applications

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies	FY 14/15 Internal Audit Strategies
17. ASRS software licensing compliance is not adequate	Moderate	Low	Some Vulnerability	Some Likelihood	**Evaluate** the anticipated risk levels.	IA audit scheduled for FY 15
18. Vendor licensing structures are too complex to effectively manage	Moderate	Medium	Some Vulnerability	Some Likelihood	**Evaluate** the anticipated risk levels.	IA audit scheduled for FY 15
19. Lack of autonomy to make technology investments to meet business needs	Minor	High	Some Vulnerability	Some Likelihood	**Accept** the anticipated risk levels.	IA audit scheduled for FY 15
20. Technical resources are not fully trained in all areas of responsibility	Moderate	Medium	Some Vulnerability	Some Likelihood	**Reduce** the anticipated risk levels.	IA audit scheduled for FY 15
21. TSD is not involved early enough in business-led projects to properly assess technology impact	Minor	Medium	Some Vulnerability	Some Likelihood	**Reduce** the anticipated risk levels.	IA audit scheduled for FY 15
22. A system breach goes undetected	Major	Low	Some Vulnerability	Some Likelihood	**Reduce** the anticipated risk levels.	IA audit scheduled for FY 15
23. Unauthorized data gets stored in the cloud	Minor	Low	Some Vulnerability	Some Likelihood	**Evaluate** the anticipated risk levels.	IA audit scheduled for FY 15

General Control Structure for Network Applications

Duties and responsibilities are clearly delineated between the Board and Director Governance Handbook is in place.	Established methodology (i.e. Agile SCRUM) to develop software Not Applicable.	SMEs in place Some in place. Gaps have been identified in critical areas that need to be addressed.
Staff engagement with the OAC ensures appropriate oversight Regular presentations to the OAC are given.	Technology software/hardware in place is updated/upgraded to support business processes In place.	Rules, policies, SOPs in place Some in place.
Senior Management establishes priorities and schedules and CCB provides oversight CCB meetings are held monthly and SMT meetings are attended as needed. Common control #8 (ERMC) in place.	Technology software/hardware in place is updated/upgraded to ensure adequate security In place.	Communication channels established Some in place. Gaps have been identified in business-led projects.
Goals and objectives are clearly defined and supported by the organizational structure Strategic goals and objectives are in place. The State of AZ has adopted NIST standards for all state agencies. NIST standards for IT security need to be incorporated into the Strategic Plan.	Performance is analyzed, measured, reported Strategic objective performance is measured and reported.	IA and external auditors test control adequacy and staff follows up on issues In place.
Staff engagement with ADOA (ASET) ensures adequate collaboration and timely approval of technology investment An established relationship with ASET is in place. PIJs are created as needed and status is reported according to PIJ process.	Staff duties are properly segregated and responsibilities defined In place.	Enterprise Risk Management Committee functions as IT security steering committee In place.

Network Applications Specific Controls - by risk number

Specific Controls for Network Applications by risk number as of April 2014:

1. **(Not secure from external threats)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. The Enterprise Risk Management Committee is in place. Measures to secure externally facing systems include: Firewalls, web filtering, network investigation tool , application and device control for PC, third party patch management, data loss prevention software for email, end point protection on PC and servers, log event managing system, administrative controls, independent network monitoring, undergo internal and external security audits and perform remediation, full disk encryption for laptops and thumb drives, policies and procedures in place, schedules are in place to replace hardware/software, inventory controls in place, and some whitelisting (stops unauthorized installation/execution) in place.
2. **(Not secure from internal threats)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. The Enterprise Risk Management Committee is in place. Web filtering blocks malicious websites from staff. Every employee signs a security agreement annually. Telecommuting employees are made aware of the risks and consequences and sign an agreement. Agency follows the recommended Remediation Roadmap from the Information Security Assessment Report (January 2014) and conducts annual or bi-annual external compliance assessments. Security documentation has been standardized on the NIST framework. Code reviews are performed. The ERMC action plan is monitored. Software is used to discover new network risks. Risk mitigation strategies include : See response to #1, badging system, policy and procedures, and restrictions to ASRS floors, secure file transfer, physical access restrictions and monitoring (i.e. cameras, panic buttons, updated access reporting), and key control program.
3. **(Systems/data not recoverable)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. Continuity of Operations Plan ensures information systems, applications, and data are recoverable. ASRS uses a dual method of backup of its data systems disk to tape and disk to disk. Backup tapes are sent to an offsite location. Mirroring of key databases and files are being completed to our off-site facility.
4. **(Improper sanitation prior to disposal)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. All hard drives are removed from devices prior to disposal and shredded by a third party vendor. Prior to being sold as surplus, items require a TSD certification in writing of proper cleansing prior to disposal by Procurement. Updated Surplus Property SOP in place and is adhered to. Only encrypted printer drives are used and the destruction software is purchased at the same time the printer is purchased; additionally the hard drives are removed and shredded prior to disposal. Every surplus pick up is witnessed by TSD staff.
5. **(Non-secure email with PII)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. Control software (an email inspection tool and secure file transfer) in place. Role based access controls in place.
6. **(Unauthorized information release)** See response to #2 above.
7. **(Not enough resources)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. Focused subgroups (Security, Tier I HelpDesk and Tier II Networking) have been established to manage the individual tasks. Cross-training has been increased for all networking activities. Formalized remediation of scan results and an enhanced patch management strategy have been implemented. Security training provided for development and testing. Schedules are coordinated with resource availability.

Network Applications Specific Controls - by risk number

Specific Controls for Network Applications by risk number as of April 2014:

8. **(SOPs inadequate)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. Where applicable, procedures are available to map to NIST standards. Some SOPs are in place. The desk procedures are reviewed and updated as needed (when HelpDesk tickets are resolved, when infrastructure changes are made, etc.).
9. **(Processing speed inadequate)** TSD evaluates business needs when determining the adequacy of technology. Response times are now addressed in project charters and evaluated by the CCB as needed. Any degradation of speed is reported to HelpDesk.
10. **(Upgrade schedule not complete/communicated)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. Regular meetings to assess security vulnerabilities end of life support and systems compatibility are held in TSD to determine needed upgrades. A regular schedule is established to present findings/recommendations to Senior Management. Unanticipated, mid-year upgrades are presented to SMT as needed**.**
11. **(Telephone system failure)** Hardware has built-in redundancy to guard against failure. The system is mature and stable. Vendor support is reliable with established service level agreements in place.
12. **(Telephone carrier outage)** Carriers have redundancy to guard against outages. Vendor support is reliable with established service level agreements in place.
13. **(Hardware failure)** Some components have built-in redundancy to guard against failure. A stable, virtualized environment helps prevent outages and makes recovery faster. A disaster recovery site has been established and is regularly tested. Alerts will notify dedicated staff in the event of a failure.
14. **(Software failure)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. System and user acceptance tests are run prior to releasing new software. Database redundancy is established. Vendor support is in place. A stable, virtualized environment helps prevent outages and makes recovery faster. A disaster recovery site has been established and is regularly tested. Alerts will notify dedicated staff in the event of a failure. An established configuration management process is in place for software releases. Patches are tested on subgroups of servers and workstations prior to rollout.
15. **(Survey sample inadequate)** A survey is sent with every ticket that is closed.
16. **(Negative impact of unplanned purchases)** HelpDesk purchase requests are reviewed and prioritized by NIS management as they are submitted. Purchase requests must first be approved by the requestor's supervisor. SMT is involved once a dollar threshold is reached. Unplanned purchases are subject to budget availability.
17. **(Licensing compliance inadequate)** A software asset licensing tool records the licenses as they are purchased. Twice per year reconciliations of installations to purchases are performed. Some agreements involve semi-annual true-ups (at six month mark buy any additional licensing as needed). Manual checks are performed against what is installed to determine license availability at the time of request for certain software. Internal Audit conducts periodic reviews.

Network Applications Specific Controls - by risk number

Specific Controls for Network Applications by risk number as of April 2014:

18. **(Licensing structures too complex)** Detailed contract reviews are conducted by TSD and Procurement prior to purchase or upon ownership or product changes.
19. **(Lack of autonomy)** TSD is fully engaged in the PIJ process. Strong relationships are established with ASET, OSPB and JLBC.
20. **(Staff not trained)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. New hires are generally hired for their technical skills but additional on the job training is required for tools, technologies and processes before they can be fully productive (3 to 9 months). Cross-training has been increased for all networking activities. Other TSD resources are used to fill gaps in knowledge.
21. **(Timing of TSD participation in projects)** Some business-lead projects have TSD representatives on their steering committees. Only TSD purchases software. TSD performs security assessments on cloud endeavors. TSD communicates to SMT when competing priorities exist.
22. **(Undetected breach)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. Notifications of vulnerabilities are received from external and internal entities. Resources are redirected to address threats. Industry standard devices and practices are utilized within ASRS IT environment. Processes and procedures are in place to remediate threats. Automatic updating of threat definitions on various security appliances.
23. **(Unauthorized cloud data)** Operations geared toward meeting clearly defined NIST standards, overseen and supported by ERMC. A cloud policy and SOP are in place and have been communicated. SMT must approve new and modifications to existing cloud ventures. A security audit for each vendor and venture is performed according to NIST, FedRamp, and other security frameworks.

Future Network Applications Controls / Gaps - by risk number

1. **(Not secure from external threats)** Achieve targeted Gartner Security Maturity levels. Researching web application firewall and data loss prevention tools. Evaluating expanding the whitelisting scope. Need to more fully configure log event management system tool. Management should evaluate current resource allocation for security tool management. ERMC will communicate more broadly their function as the IT Security Steering Committee to staff.
2. **(Not secure from internal threats)** Achieve targeted Gartner Security Maturity levels. Researching network employee behavior monitoring tool. Management should evaluate current resource allocation for security tool management. Management is working on resuming background checks on ASRS staff. ERMC will communicate more broadly their function as the IT Security Steering Committee to staff.
3. **(Systems/data not recoverable)** Achieve targeted Gartner Security Maturity levels. Management should evaluate equipment upgrade. Management should evaluate the necessity of a third level of redundancy.
4. **(Improper sanitation prior to disposal)** Achieve targeted Gartner Security Maturity levels. Management should evaluate shredding procedures (witnessing the destruction). Evaluating degausser (magnetized hard drive cleaner) purchase.
5. **(Non-secure email with PII)** Achieve targeted Gartner Security Maturity levels. Management should evaluate whether additional controls should be implemented.
6. **(Unauthorized information release)** Achieve targeted Gartner Security Maturity levels. Management should evaluate whether additional controls should be implemented.
7. **(Not enough resources)** Achieve targeted Gartner Security Maturity levels. Management will request required permission and approvals to add resources needed.
8. **(SOPs inadequate)** Achieve targeted Gartner Security Maturity levels. Gaps in SOPs will be identified and addressed at least annually. An overall security policy detailing security controls is under development.
9. **(Processing speed inadequate)** Management will begin surveying user satisfaction.
11. **(Telephone system failure)** Replacing the telephone system is being discussed with AZNet II.
15. **(Survey sample inadequate)** TSD will review the survey questions and the survey management process.
16. **(Negative impact of unplanned purchases)** Management should consider annual budget requests.
17. **(Licensing compliance inadequate)** Management should consider enhancing the tool and/or process to ensure ASRS maintains compliance (regular discoveries, etc.).

Future Network Applications Controls / Gaps - by risk number

18. **(Licensing structures complex)** Management should consider increasing the involvement of Procurement to include assistance in the review of contract licensing structure/terms.
20. **(Staff not trained)** Achieve targeted Gartner Security Maturity levels. Management should consider having more advanced training in various technical areas (i.e. virtualization, multiple operating systems, and project management methodologies) contingent on management's success in attaining more resources.
21. **(Timing of TSD participation in projects)** Management should consider following a standard process for non-TSD led projects to ensure technology needs are considered early enough to provide adequate lead time.
22. **(Undetected breach)** Achieve targeted Gartner Security Maturity levels. Management should consider hiring additional certified security resources to effectively monitor security appliances and purchasing additional security appliances.
23. **(Unauthorized cloud data)** Achieve targeted Gartner Security Maturity levels. TSD will monitor other external entities for their participation in the cloud to determine if ASRS should modify current practices. Management should consider options to review cloud policy compliance.

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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

Risk Assessment Sample Layout

Risk/Threat	Impact	Tolerance	Controls	Likelihood	Management Strategies	FY 14/15 Internal Audit Strategies
1. Individual Risk	Minor	Low	Strong	Not Likely	Accept, Reduce, Evaluate or Avoid	Quality Reviews, Employer Audits, Fraud Hotline or Possible Audit
2. Individual Risk	Moderate	Medium	Some Vulnerability	Some Likelihood	Accept, Reduce, Evaluate or Avoid	Quality Reviews, Employer Audits, Fraud Hotline or Possible Audit
3. Individual Risk	Major	High	Weak	Likely	Accept, Reduce, Evaluate or Avoid	Quality Reviews, Employer Audits, Fraud Hotline or Possible Audit

General Control Structure:

Duties and responsibilities are clearly delineated between the Board and Director	Staff engagement with ADOA (ASET) ensures adequate collaboration and timely approval of technology investment	Performance is analyzed, measured, reported	Communication channels established
Staff engagement with the OAC ensures appropriate oversight	Established methodology (i.e. Agile SCRUM) to develop software	Staff duties are properly segregated and responsibilities defined	IA and external auditors test control adequacy
Senior Management establishes priorities and schedules and CCB provides oversight	Technology software/hardware in place is updated/upgraded to support business processes	SMEs in place	Staff follows up on audit issues
Goals and objectives are clearly defined and supported by the organizational structure	Technology software/hardware in place is updated/upgraded to ensure adequate security	Rules, policies, SOPs, after-action reports in place	

Specific control strategies per area by individual risk as of the review date:

1. Key controls associated with risk #1 in the chart listed.
2. Key controls associated with risk #2 in the chart listed.
3. Key controls associated with risk #3 in the chart listed.

Future Control Strategies per area by individual risk as of the review date:

1. Controls associated with risk #1 in the chart that are under evaluation or not yet been deployed listed.
2. Controls associated with risk #2 in the chart that are under evaluation or not yet been deployed listed.
3. Controls associated with risk #3 in the chart that are under evaluation or not yet been deployed listed.

Confidential meeting materials were in this agenda item

Agenda Item #5

ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

MEMORANDUM

TO: 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 5, 2014

RE: **Agenda Item #5A** Presentation, Discussion and Appropriate Action Regarding the ASRS Appropriated Budget and the Estimated Administrative and Investment Spending Plan for Fiscal Year (FY) 2015

Purpose

To review and discuss the ASRS Appropriated Budget and the Estimated Administrative and Investment Spending Plan for Fiscal Year FY 2015.

Recommendation

Informational only, no action required.

Background

Effective budget planning and administration are a cornerstone of the ASRS Strategic Planning model. Strategically, the ASRS aims to be a high service, low cost pension administrator. The ASRS spending plan for FY 2015 is structured to continue implementation of a service paradigm that reduces the need for manual transactions and physical contacts and is focused on moving member transactions to web-based self-service to further reduce our cost per transaction. This spending plan supports further modernizations and re-engineering of systems, the goal of which is to avoid future costs associated with more costly transactions and processes. Specifically, in FY 2015, the ASRS spending plan is designed to include the following:

- Appropriated funding for the second year of 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. The software development project has progressed ahead of schedule; therefore, the allotment of appropriations was reallocated over four years rather than the original five year timeline ($4,484,500).
- Alignment of funds between base appropriations and continuous appropriations.
  - $1,500,000 for internal investment management personnel salaries and benefits shifted from base operating appropriations to investment continuous appropriations.
  - Appropriated funding for a compensation plan focused on rewarding non-investment staff for performance in achieving established goals, adding to plan assets and/or reducing plan liabilities, reducing risk and costs, improving efficiency, productivity, customer service, and the member experience, and migrating members to self-

service options, as well as addressing salary levels that are behind the market when compared to other peer organizations ($750,000).

- Appropriated funding for the ASRS Incentive Compensation Plan (ICP) for Internal Investment Professionals. Incentives earned for FY 2014 performance will be paid during FY 2015 ($350,000 approximate amount of budget reserved).
- Appropriated funding to fill appropriated FTE software development positions approved but not funded in FY 2014 ($400,000).

- Continued appropriated funding for resources to assist with the implementation of recently passed HB 2050. This bill eliminates the requirement that members must be covered by an employer's Social Security 218 Agreement to be eligible for membership in the Arizona State Retirement System and closes the A.R.S. § 38-955 defined contribution plan, established by HB 2562 in 2013. ($72,400 shifted from special line item legislative appropriations in FY 2014 to base operating appropriations in FY 2015).
- Increased investment continuous appropriation expenditures primarily from an increase in investment management fees, which are due to anticipated growth in investable assets.
  - For public markets, the 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%.
  - For private markets, there are two fee components:
    - 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.
    - 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.

  Fees for both public and private markets are correlated to investment performance as well as net cash flows and commitments, respectively.

Attachment A: FY 2015 ASRS Total Appropriated Budget Overview and ASRS Administrative and Investment Spending Plan Schedules
Attachment B: ASRS Pension Cost and Service CEM Benchmarking Results (FY 2013)

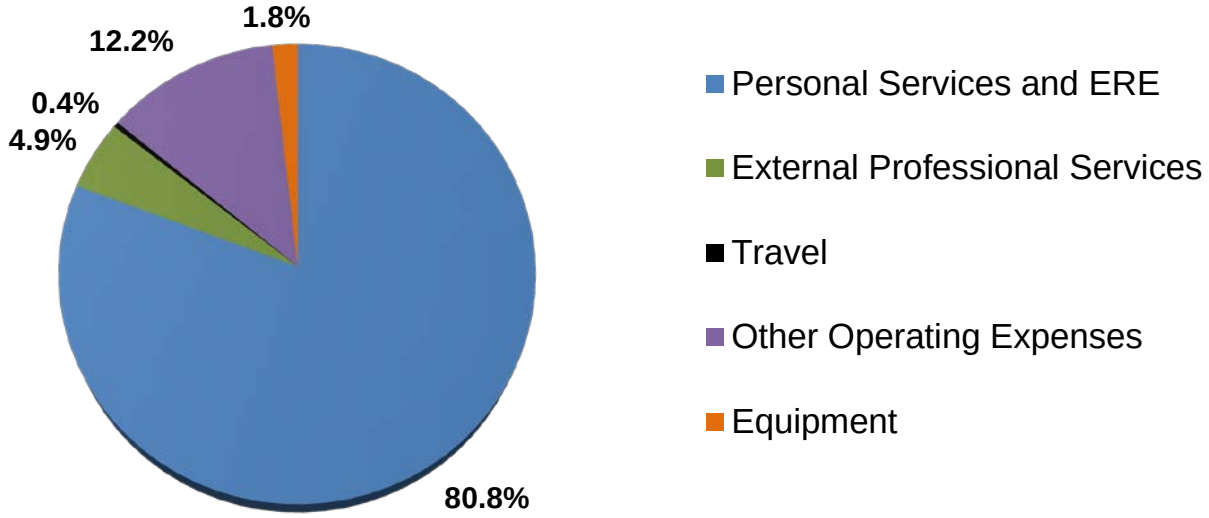
Attachment A

FY 2015 ASRS Total Appropriation Budget Overview and ASRS Administrative and Investment Spending Plan Schedules

FY 2015 ASRS Total Appropriated Budget Overview

	FY 2014 Appropriations	FY 2015 Appropriations
Personal Services & Employee Related Expenditures	17,697,900	17,778,000
External Professional Services	1,079,300	1,079,300
Travel	78,600	78,600
Other Operating Expenses	2,684,800	2,684,800
Equipment	389,500	389,500
Base Operating Budget Subtotal	**21,930,100**	**22,010,200**
Long Term Disability Program Administration (LTD)	**2,800,000**	**2,800,000**
Total Appropriated Operating Budget	**24,730,100**	**24,810,200**
Special Line Item Appropriations (Legislative Initiatives)		
PIJ: Oracle Forms and Reports Modernization (Yr. 2 of four year Software Development Project)	1,390,000	4,484,500
Initiatives from 2013 Legislative Session	853,400	
SB 1170 - Survivor Benefits Modifications		
HB 2562 - 401(a) and LTD for Ineligibles		
HB 2001 - Statewide IT and Automation Projects		
Total Appropriated Budget	**26,973,500**	**29,294,700**

FY 2015
ASRS Base Operating Budget Overview



Personal Services and Employee Related Expenditures (ERE) $ 17,778,000

***Personal services includes salaries and wages paid to agency employees. Also includes payments for employee leave taken, overtime, leave payouts and Board per diem.**

***Includes annual Variable Compensation Strategies Plan & Investment Incentive Compensation Plan (ICP).**

***Employee Related Expenditures (ERE) – Cost of an employee's benefit package. ERE includes the following: FICA, Retirement, Worker's Compensation, Health, Dental, and Life Insurance, Retiree Accumulated Sick Leave charges, Personnel Division charges.**

***Average ASRS ERE Rate is 40% (The percentage that employee related expenditures represents of the agency's personal services subtotal).**

External Professional Services $ 1,079,300

***Legal services (External legal counsel, Arizona Office of Administrative Hearings fees and staff assigned from Arizona Attorney General's office)($300,000)**
***Technology resources ($529,300), temporary staffing ($100,000) and other professional services ($150,000)**

Travel $ 78,600

***In-state travel for Member and Employer Outreach Teams, staff and Board Trustees ($53,600)**

***Out-of-state travel (investment related due diligence and educational conferences - $25,000)**

Other Operating Expenses $ 2,684,800

***Equipment repair and maintenance ($150,000) and software support and maintenance ($1,375,000)**

***Printing and mailing annual newsletter ($150,000) and agency printing and postage ($145,000)**

***Telecommunications ($340,000) and other operating expenditures ($160,400)**

***ADOA Risk Management insurance premium ($155,000)**

***Professional dues, books and subscriptions ($119,400)**

***Education, training and conferences ($75,000), employee tuition assistance ($15,000)**

Equipment $ 389,500

***Replacement equipment, furniture, and technology equipment**

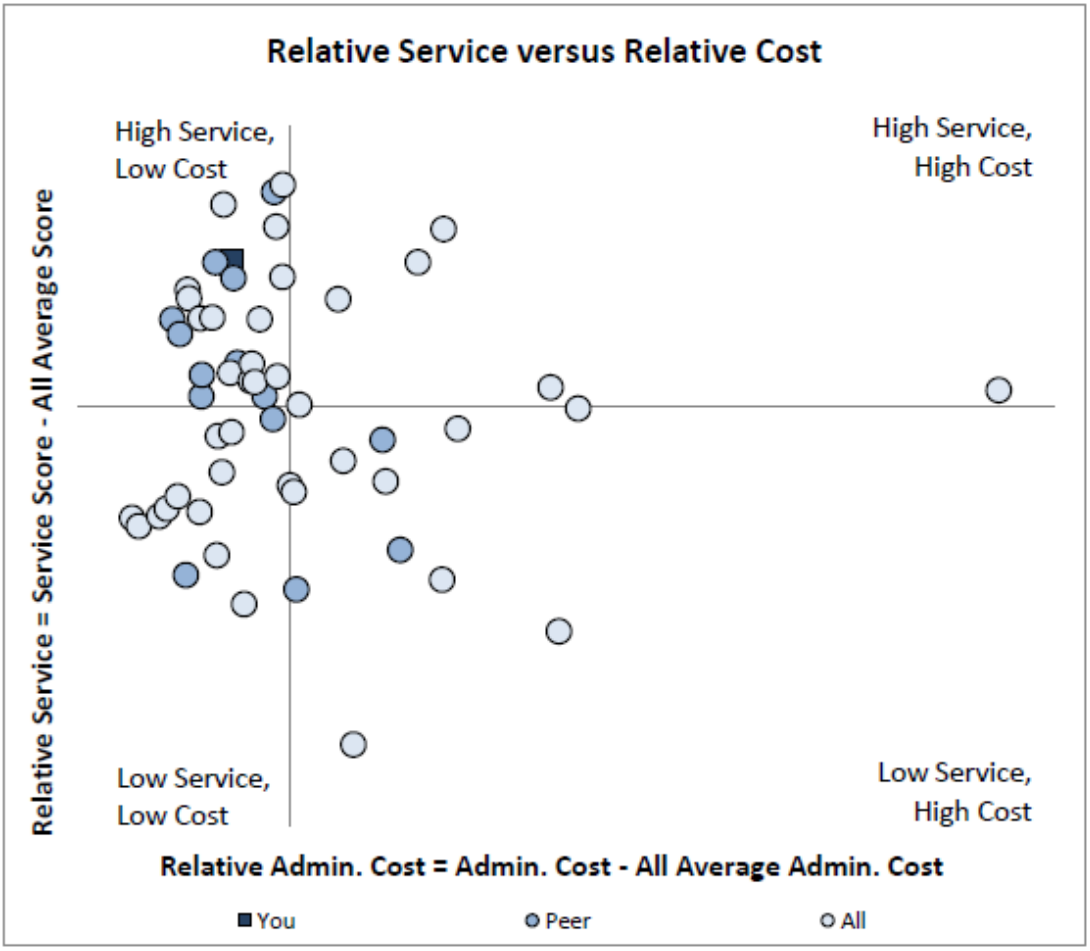
Base Operating Budget Total $ 22,010,200

ASRS Administrative and Investment Spending Plan
Fiscal Year 2015
(Dollars In Thousands)

	Base Operating Appropriations	+	Long Term Disability Appropriations	+	Oracle Modernization Special Legislative Appropriations	+	Administrative Continuous Appropriations	=	Administrative Subtotal	+	Investment Continuous Appropriations	=	Total
Personal Services (PS) and Employee Related Expenses (ERE)													
PS (Wages and Salaries)	12,225.3								12,225.3		1,183.0		13,408.3
ERE (Employer costs for Benefits, Taxes and ADOA Admin. Fees)	4,897.7								4,897.7		317.0		5,214.7
Variable Compensation Strategies (PS/ERE)	305.0								305.0				305.0
Investment Incentive Compensation Plan (PS/ERE budget reserved)	350.0								350.0				350.0
Total PS and ERE	**17,778.0**		**-**		**-**		**-**		**17,778.0**		**1,500.0**		**19,278.0**
External Professional Services													
External Investment Management Expenses											251,070.0		251,070.0
LTD Program Administration			2,800.0						2,800.0				2,800.0
Software Programming Costs	529.3				4,484.5		500.0		5,513.8				5,513.8
Actuary & Benefit Consulting							1,225.0		1,225.0				1,225.0
Consulting & Legal Fees	300.0								300.0		5,266.0		5,566.0
Pension Payroll Disbursement Services							1,543.5		1,543.5				1,543.5
Other Outside Services	250.0								250.0				250.0
Total External Professional Services	**1,079.3**		**2,800.0**		**4,484.5**		**3,268.5**		**11,632.3**		**256,336.0**		**267,968.3**
Travel, Other Operating & Equipment													
Software Licenses & Support	1,375.0								1,375.0				1,375.0
Equipment & Furniture	389.5								389.5				389.5
Telephone	340.0								340.0				340.0
Postage and Delivery	220.0						172.0		392.0				392.0
Insurance	155.0								155.0				155.0
Operating Supplies	160.4								160.4				160.4
Repair & Maintenance	150.0								150.0				150.0
Dues & Subscriptions	119.4								119.4		1,714.0		1,833.4
Education & Training	90.0								90.0				90.0
Travel	78.6								78.6				78.6
External Printing	75.0								75.0				75.0
Office Rent	-						1,505.0		1,505.0				1,505.0
Total Travel, Other Operating & Equipment	**3,152.9**		**-**		**-**		**1,677.0**		**4,829.9**		**1,714.0**		**6,543.9**
TOTAL	**22,010.2**		**2,800.0**		**4,484.5**		**4,945.5**		**34,240.2**		**259,550.0**		**293,790.2**

Attachment B
ASRS Pension Cost and Service CEM Benchmarking Results (FY 2013)

This graph compares cost effectiveness among all participating North American and Dutch pension funds. The ASRS is currently in the High Service, Low Cost sector. One of 15 peers is ranked higher.



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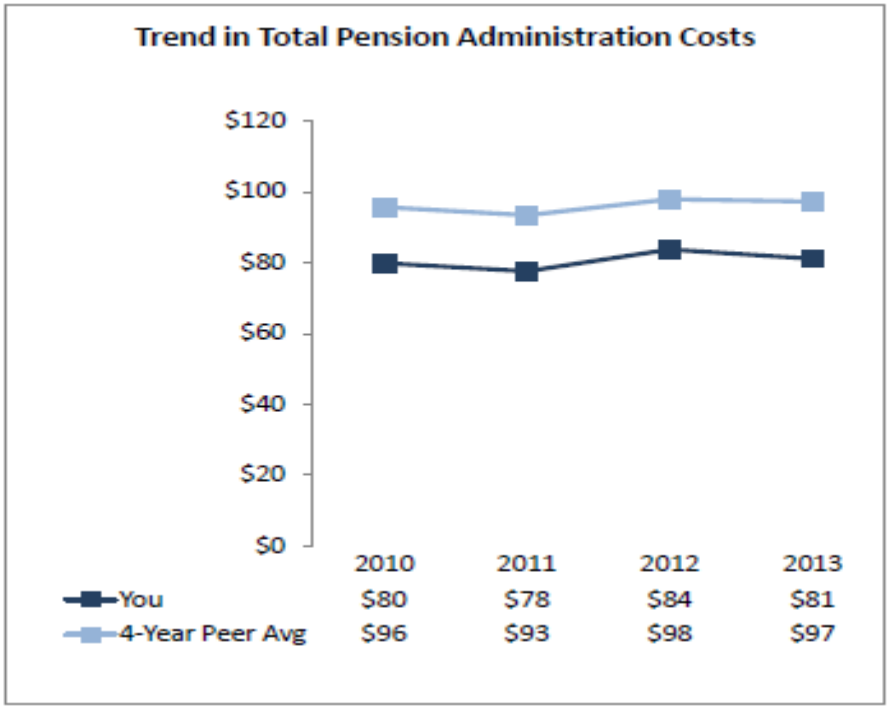
ASRS trends in service cost have tracked consistently lower than its peers over the last four years.



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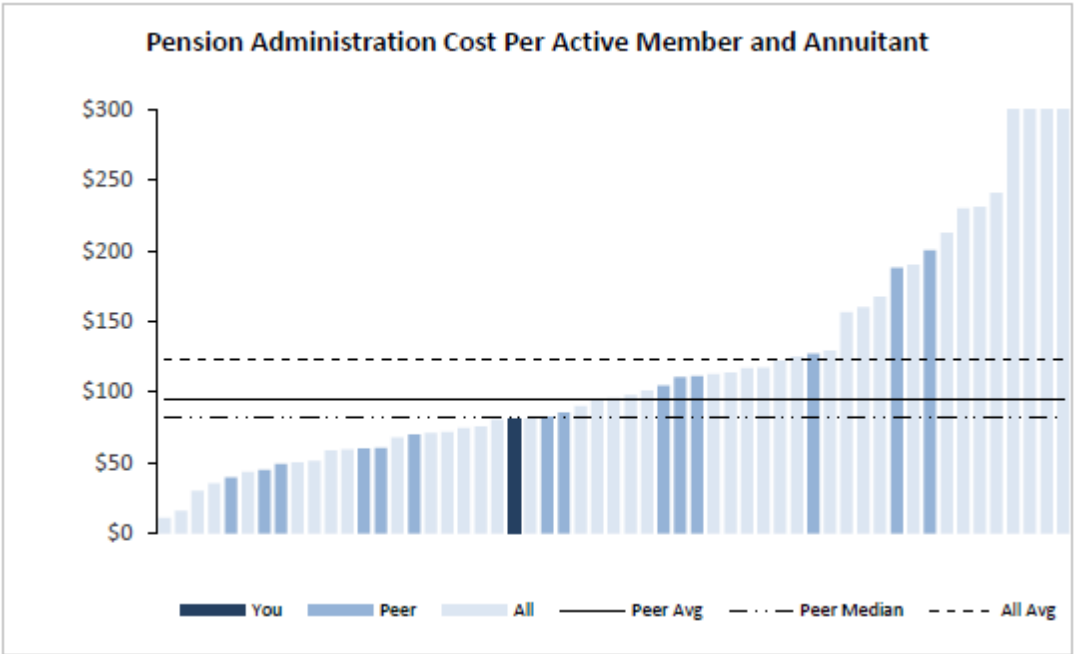
ASRS costs per active member and annuitant are slightly below the 50th percentile when compared to its peers.



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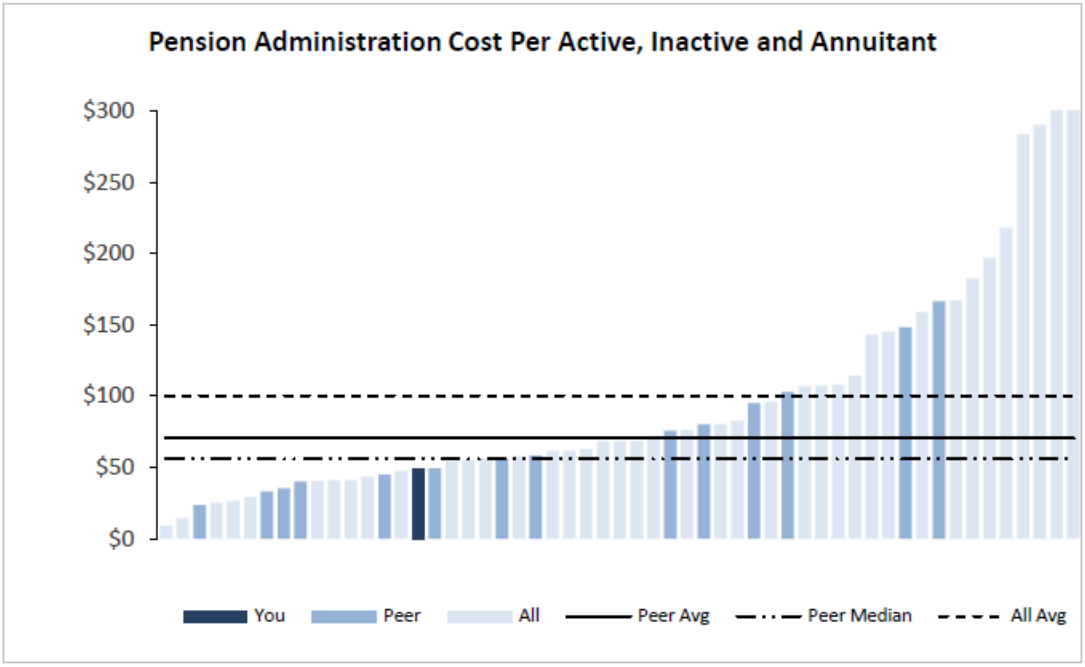
ASRS costs per active member, inactive member and annuitant are below the 50th percentile with compared to peers.



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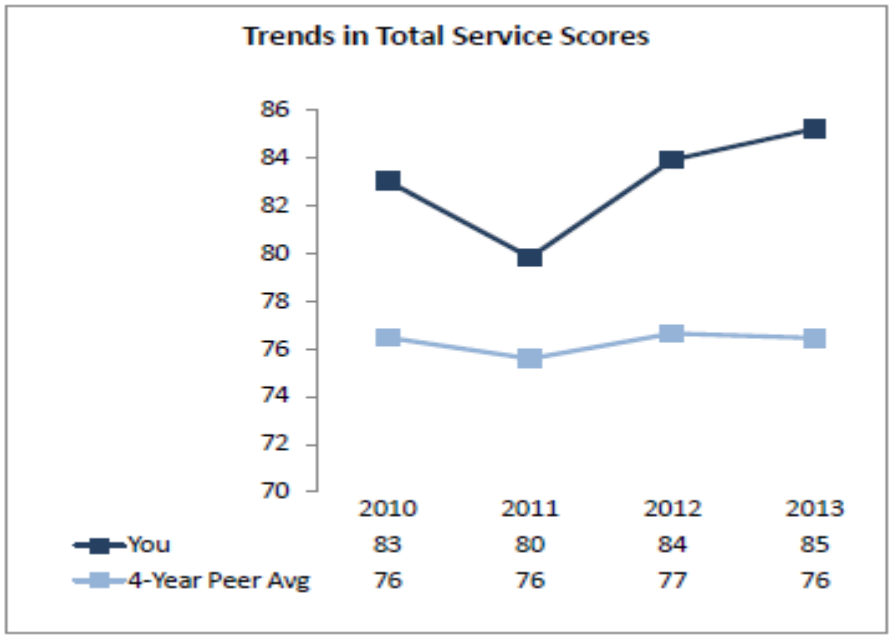
ASRS trends in service delivery have tracked consistently higher than its peer average over the last four years.



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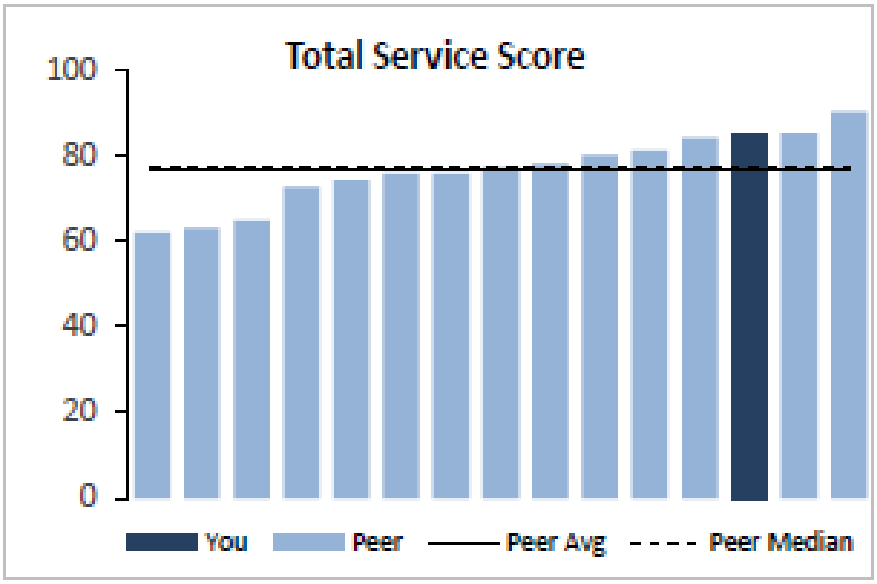
The ASRS is currently achieving its vision of being a top service performer among its pension peers.



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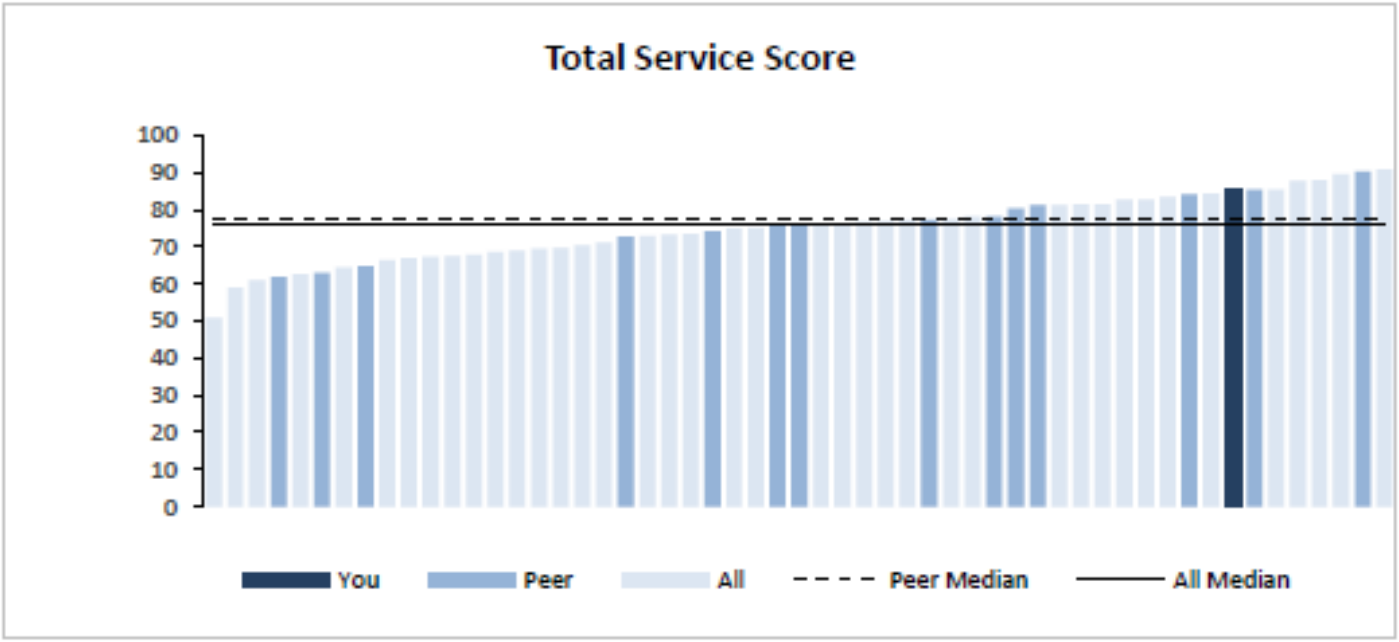
The ASRS is also a top quartile performer among all participating pension systems.



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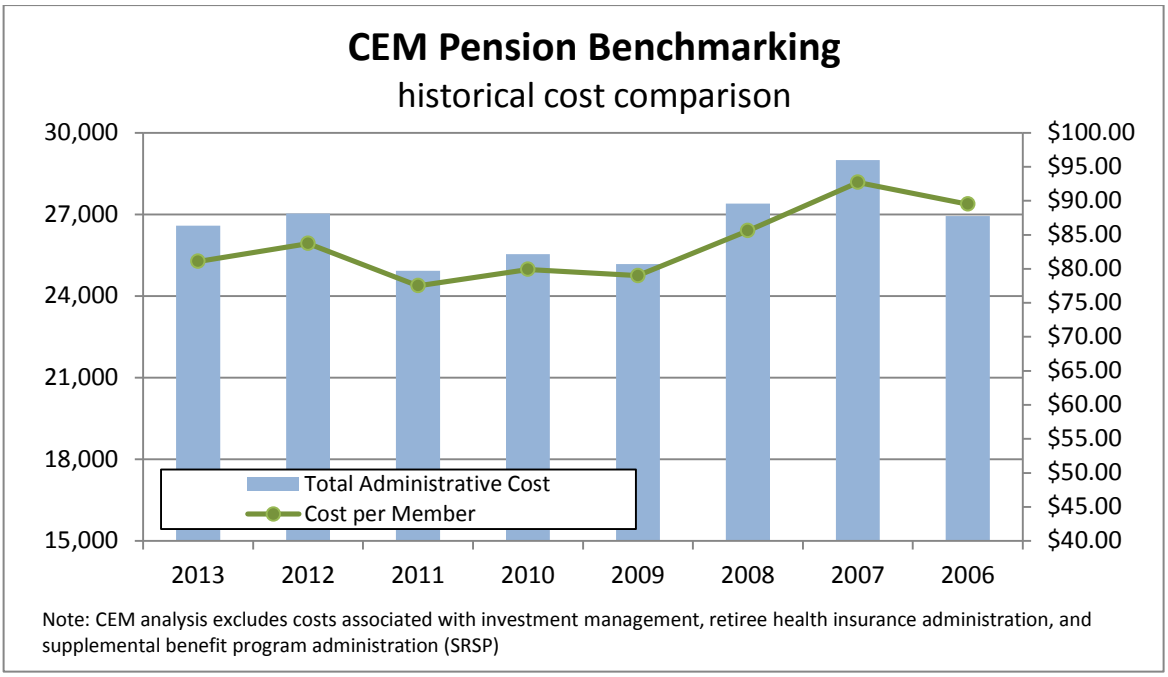
Over the previous eight budget cycles, the ASRS has maintained a relatively flat administrative budget, while reducing the cost of service per active member, inactive member and annuitant.



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Paul Matson
Director

MEMORANDUM

TO: 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 5, 2014

RE: **Agenda Item #5B** Presentation, Discussion and Appropriate Action Regarding the ASRS Appropriated Budget Request and Estimated ASRS Administrative and Investment Spending Plans for FY 2016 and FY 2017

Purpose

To review and discuss the ASRS Appropriated Budget Request and Estimated ASRS Administrative and Investment Spending Plans for FY 2016 and FY 2017.

Recommendation

Staff recommends that the OAC accept and forward to the ASRS Board an appropriated budget request for FY 2016 in the amount of $28,106,200 within a total spending plan of $315,036,200 and an appropriated budget request for FY 2017 in the amount of $27,659,200 within a total spending plan of $337,410,200.

Background

The ASRS budget requests for FY 2016 and FY 2017 have been structured to continue implementation of a service paradigm that reduces the need for manual transactions and physical contacts in favor of web-based alternatives.

Additionally, management hopes to strategically address the following initiatives during FY 2016 and FY 2017:

- Additional funds and full-time equivalent (FTE) positions to address **risk management strategies** that include enhancements to data security efforts ($923,500 in FY 2016 and $683,500 in FY 2017, equivalent to a 2.33% annual increase to the ASRS Appropriated Budget).
- An additional FTE to expand the Internal Audit team responsible for reviewing **employer compliance** with ASRS laws, rules and policies ($102,500 in FY 2016 and $95,500 in FY 2017, equivalent to a 0.33% annual increase to the ASRS Appropriated Budget).

In total, these requested items result in a modest annual increase to the ASRS Appropriated Budget of 2.66% or an approximate 0.26% increase over the FY 15 ASRS Administrative and Investment Spending Plan ASRS Spending Plan.

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 limit the need for increased funding by providing service to members in a more cost effective, productive, timely and reliable manner. This 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.

Appropriated Budget Topics

1. Technology Risk Management Strategies

Purpose: Request funding to support the addition of five full-time staff and the purchases of IT security appliances and software in FY 2016 and FY 2017.

Given the sensitive and confidential nature of member data the ASRS possesses and utilizes, it is critical that acceptable safeguards and protections are in place to secure ASRS information technology (IT) systems. The ASRS has adopted standards and controls set by the National Institute of Standards and Technology (NIST), a non-regulatory federal agency within the U.S. Department of Commerce. However, IT risk and security have been increasingly recognized as business issues – not just technical issues. Therefore, as part of overall business planning, the ASRS Enterprise Risk Management (ERM) Steering Committee, led by the Deputy Director and staffed with senior managers, is responsible for the continuous assessment, oversight and monitoring of ASRS IT security practices.

The ASRS regularly partakes in external assessments to assess the effectiveness of its IT security program and controls, risk management strategies, and current infrastructure and security maturity levels. Because each level of increased maturity can provide greater business value, ASRS management is committed to achieving an elevated security maturity level in identified, specific areas (or security zones).

Information technology provides the framework for the ASRS business model. As the threat landscape continues to change and gain sophistication, IT organization, skills, processes, and tools, particularly as they relate to security levels and risk mitigation, need to continue to progress to effectively support and align business and service requirements. The ASRS requires an expanded ASRS Technology Security team who are dedicated subject matter experts to:

- Implement and execute identified improvement initiatives
- Configure and optimize the use of new or existing security tools by reviewing, monitoring, updating, and remediating on a scheduled basis
- Stay relevant and establish new measures as IT security and risk are redefined
- Ensure compliance with regulatory requirements

Achieving overall maturity levels is a multiyear transformation – movement from one level to another is not evenly distributed in effort or time, and requires sustained commitment to avoid significant delays and increased risk.

Recommendation: Staff recommends that the OAC accept and forward to the ASRS Board a funding increase of $923,500 for FY 2016 and $683,500 for FY 2017 in the agency budget request to support enhanced technology risk management strategies (See Schedule B3 for detailed expenditure schedule).

2. Internal Audit

Purpose: Request funding for an additional internal audit officer beginning in FY 2016.

Expanded scope of audits

Two recently issued Governmental Accounting Standards Board (GASB) standards (No. 67 and No. 68) substantially change the accounting and financial reporting of public employee pension plans and the state and local governments that participate in such plans. These new standards will require the external auditors of pension plans to obtain a more thorough understanding of the processes and controls used by the plan's management to support the completeness and accuracy of member census data.

In anticipation of this requirement, the Internal Audit Division has expanded the scope of current and future employer audits to include additional testing of significant elements of census data (including date of birth, date of membership and years of service, marital status, eligible compensation, gender, date of termination or retirement). This effort will strengthen the completeness and accuracy assertions sought by the external auditors of the ASRS as well as the external auditors of ASRS employers. This expanded audit scope will require additional time for each employer audit; an additional audit officer will help maintain and potentially increase the number of employers audited each year.

Annual employer audits

With a current team of three audit officers performing employer audits, the Internal Audit Division is able to audit, on average, twelve employers per year. An additional audit officer will increase the coverage of the team and further support the fulfillment of the Internal Audit Division's strategic objective to identify and make recommendations to enhance employer compliance with ASRS laws, rules and policies. These recommendations assist the ASRS Employer Relations team engage and educate employers on common areas of non-compliance, provide information related to new processes and procedures, and encourage utilization of web services for employers.

Recommendation: Staff recommends that the OAC accept and forward to the ASRS Board a funding an increase of $102,500 for FY 2016 and $95,500 in FY 2017 in the agency budget request to support an additional resource in the ASRS Internal Audit Division (See Schedule B4 for detailed expenditure schedule).

3. Oracle Forms and Reports Modernization – Special Line Item Appropriation

Purpose: Request funding to complete the Oracle Forms and Reports Modernization software development project in FY 2016 and FY 2017.

The Oracle Forms and Reports Modernization software development project began in FY 2014. To date, the ASRS has achieved successful results and impact of the initial projects is providing greater efficiencies. Because of progress made, the overall timeline for the development effort was reduced from five to four years. Additionally, the allotment of appropriations was reallocated over the shortened project schedule.

The project is enabling the ASRS to:

- Modernize existing legacy technology (Oracle Forms and Reports) to newer open standards-based technologies (Java) while retaining ASRS business logic and data.

- Re-engineer business processes to increase productivity, reduce costs, mitigate risks, improve member satisfaction and improve service turnaround time to members.

Recommendation: Staff recommends that the OAC accept and forward to the ASRS Board funding of $2,270,000 in FY 2016 and $2,070,000 in FY 2017 for the completion of the Oracle Forms and Reports Modernization software development project. (See Schedule B5 for detailed expenditure schedule).

4. Long Term Disability Program Administration

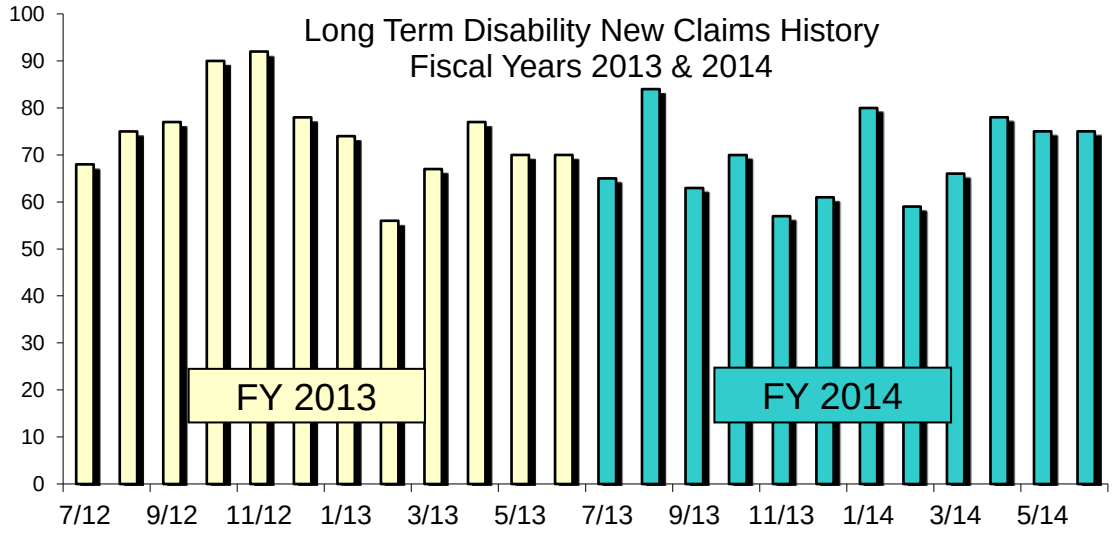
Purpose: To review and accept the Long Term Disability (LTD) Program administration budget request for FY 2016 and FY 2017.

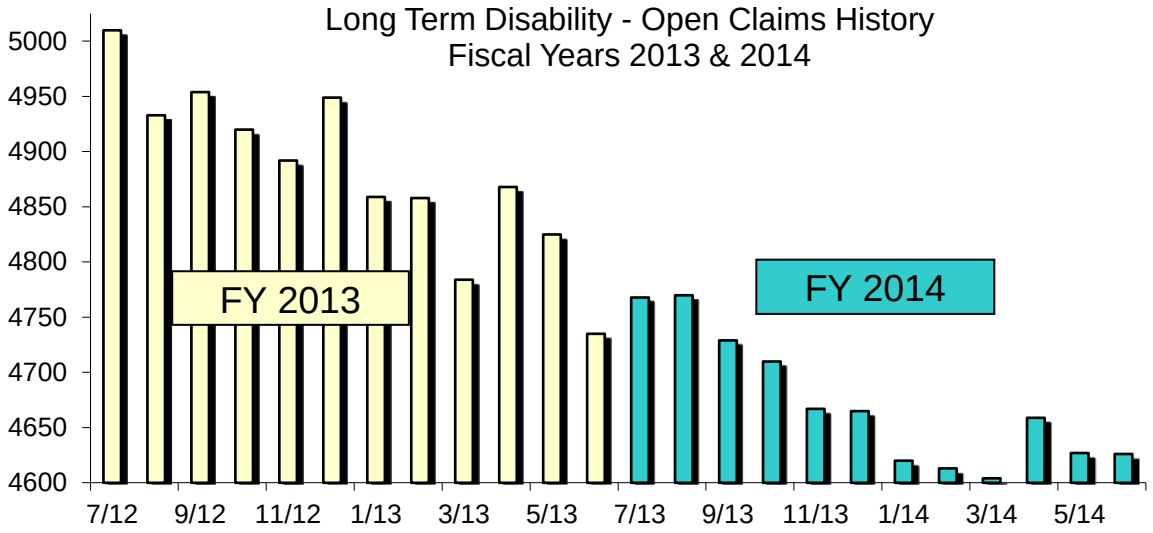
Pursuant to Arizona Revised Statutes (A.R.S.) § 38-797, the ASRS administers an LTD Program, which provides ASRS active members with a monthly benefit designed to partially replace income lost during periods of total disability resulting from a covered injury, sickness, or pregnancy. The administrative costs associated with the program are paid from the LTD Program Trust Fund, which is funded by employee and employer contributions. Currently, the ASRS contracts with a third-party vendor, Sedgwick Claim Management Services, Inc. (Sedgwick CMS) for claims administration and initial decisions regarding disability claims. FY 2014 LTD Program administrative costs consisted of:

- $13,392 per month for administrative costs (a fixed amount per contract terms).
- $29 per month for each open (active) claim.
- $425 per month for each new claim.
- $135 per month for late claims (submitted 12 months or more after the onset of disability). It is anticipated that the number of late claims will remain at an average of two to three per month.
- $30,400 per month (on average) in actual costs for plan expenses, which include medical evaluations, rehabilitation expenses, and costs for copies of medical records.

The current contract with Sedgwick CMS, if each extension is granted, will expire on June 30, 2016. A new contract will be in place for FY 2017, thus the costs associated with the administration of the LTD Program may change. Nonetheless, given the decline over the last three fiscal years in the number of ASRS members receiving LTD benefits, an appropriation of $2,800,000 for LTD Program administration appears to be sufficient. Additionally, statutes allow for the administrative costs associated with the program to be paid from the LTD Program Trust Fund on a continuously appropriated basis. In fiscal years past, when costs have exceeded the appropriations, both appropriated and continuously appropriated funding has been utilized. Dialogue with the Governor's Office of Strategic Planning and Budget, the Arizona Department of Administration General Accounting Office – State Comptroller, staff of the Joint Legislative Budget Committee, and counsel from the Arizona Attorney General's office has resulted in an awareness of the flexibility for payment allowed in statute with regard to the costs associated with the LTD Program.

Recommendation: Staff recommends the OAC accept and forward to the ASRS Board an LTD Program administration request for FY 2016 and FY 2017 equal to the same annual appropriations since FY 2008 ($2,800,000) (See Schedule B6 for detailed expenditure schedule).


Long Term Disability New Claims History
Fiscal Years 2013 & 2014
100
90
80
70
60
50
40
30
20
10
0
FY 2013
FY 2014
7/12
9/12
11/12
1/13
3/13
5/13
7/13
9/13
11/13
1/14
3/14
5/14


Long Term Disability - Open Claims History
Fiscal Years 2013 & 2014
5000
4950
4900
4850
4800
4750
4700
4650
4600
FY 2013
FY 2014
7/12
9/12
11/12
1/13
3/13
5/13
7/13
9/13
11/13
1/14
3/14
5/14

Continuously Appropriated Funding Projections

The ASRS investment and administrative costs are expended in accordance with A.R.S. § 38-721. A.R.S. § 38-721(C) provides that specific expenditures are continuously appropriated in the amount deemed necessary by the Board. These administrative expenses complement ASRS' operations and service functions.

Schedule B7 includes the estimated expenditures for FY 2014 along with the projected funding requirements for FY 2015, FY 2016 and FY 2017.

These specific expenditures, outlined in A.R.S. § 38-721(C), are described below:

- **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, electronic information (data) services and subscriptions, custodial banking administrative fees and external financial service fees.

  - Internal Investment Management – Beginning in FY 2015, the costs of the salaries and benefits for the Investment Management staff (currently 11 FTEs) will be paid from this funding source.

    In order to meet the increasing complexities of managing and overseeing new and existing asset classes and investment strategies consistent with those in the Board-approved ASRS Strategic Asset Allocation Policy, the Investment Management Division (IMD) is requesting one additional investment position beginning in FY 2016 (See Schedule B8 for detailed expenditure schedule). This position will support the Private Markets Investment team and will focus on analysis of new opportunities in the markets; timely fulfillment of required due diligence essential to the investment selection process, and management of appropriate investments deemed critical to the success of the asset class.

  - Investment Management, Transactional and Other Fees (Public Markets) – These quarterly fees are calculated as a percentage of market value of the underlying investments. Accordingly, the fees are directly correlated with both investment performance as well as net cash flows. The attached projections of investment management fees are based upon the estimated annual rate of return of 8% less estimated net cash flows of approximately 2.5%. Transactional and other fees include foreign taxes and commissions on derivatives and other incidental costs.

  - Investment Management, Performance Incentive and Other Fees (Private Markets) – These quarterly 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. 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. Performance incentive and other fees are only paid if earned or incurred, and therefore may vary each quarter.

- **Rent**

  Costs associated with rent as tenants for occupancy in the 3300 Tower in Phoenix and in the satellite office in Tucson.

- **Actuarial consulting fees**

  Costs associated with actuarial services related to plan design, administration and valuations.

- **Retiree Payroll**

  Costs associated with administering retiree pension benefits and disbursements, including third-party payroll administration fees, postage and benefit-related consulting fees.

Attachment: ASRS Budget and Spending Plan Schedules for FY 2016 and FY 2017

Attachment

ASRS Budget and Spending Plan Schedules for FY 2016 and FY 2017

Total Appropriated Budget Request FY 2016 and FY 2017

	FY 2015 Appropriations	Total Requested FY 2016 Appropriations	Total Requested FY 2017 Appropriations
Personal Services & Employee Related Expenditures	17,778,000	18,485,000	18,525,000
External Professional Services	1,079,300	1,079,300	1,039,300
Travel	78,600	80,100	80,100
Other Operating Expenses	2,684,800	2,710,300	2,755,300
Equipment	389,500	681,500	389,500
Base Operating Budget Subtotal	**22,010,200**	**23,036,200**	**22,789,200**
Long Term Disability Program Administration (LTD)	**2,800,000**	**2,800,000**	**2,800,000**
Total Appropriated Operating Budget	**24,810,200**	**25,836,200**	**25,589,200**
Special Line Item Appropriations (Legislative Initiatives)			
PIJ: Oracle Forms and Reports (4 Year IT Modernization Project)	4,484,500	2,270,000	2,070,000
Total Appropriated Budget	**29,294,700**	**28,106,200**	**27,659,200**

Policy Issues	FY 2016 Change relative to FY 2015 Total Appropriated Budget		FY 2017 Change relative to FY 2015 Total Appropriated Budget	
Policy Issue #1 : Technology Risk Management Strategies	$ 923,500	3.15%	$ 683,500	2.33%
Policy Issue #2 : Internal Audit FTE	$ 102,500	0.35%	$ 95,500	0.33%
Policy Issue #3 : Oracle Forms and Reports (4 Year IT Modernization Project)	$(2,214,500)	-7.56%	$(2,414,500)	-8.24%
Subtotals	$(1,188,500)	-4.06%	$(1,635,500)	-5.58%

Total Administrative Spending Plan FY 2016 and FY 2017

	FY 2015 Appropriations	Total Requested FY 2016 Appropriations	Total Requested FY 2017 Appropriations
Personal Services & Employee Related Expenditures	17,778,000	18,485,000	18,525,000
External Professional Services	1,079,300	1,079,300	1,039,300
Travel	78,600	80,100	80,100
Other Operating Expenses	2,684,800	2,710,300	2,755,300
Equipment	389,500	681,500	389,500
Base Operating Budget Subtotal	**22,010,200**	**23,036,200**	**22,789,200**
Long Term Disability Program Administration (LTD)	**2,800,000**	**2,800,000**	**2,800,000**
Total Appropriated Operating Budget	**24,810,200**	**25,836,200**	**25,589,200**
Special Line Item Appropriations (Legislative Initiatives)			
PIJ: Oracle Forms and Reports (4 Year IT Modernization Project)	4,484,500	2,270,000	2,070,000
Total Appropriated Budget	**29,294,700**	**28,106,200**	**27,659,200**
Administrative Continuous Appropriations	**4,945,500**	**5,031,000**	**5,120,000**
Administrative Subtotal	**34,240,200**	**33,137,200**	**32,779,200**

Policy Issues	FY 2016 Change relative to FY 2015 Total Administrative Budget		FY 2017 Change relative to FY 2015 Total Administrative Budget	
Policy Issue #1 : Technology Risk Management Strategies	$ 923,500	2.70%	$ 683,500	2.00%
Policy Issue #2 : Internal Audit FTE	$ 102,500	0.30%	$ 95,500	0.28%
Policy Issue #3 : Oracle Forms and Reports (4 Year IT Modernization Project)	$(2,214,500)	-6.47%	$(2,414,500)	-7.05%
Subtotals	$(1,188,500)	-3.47%	$(1,635,500)	-4.78%

FY 2016 and FY 2017 Appropriated Budget Request: Technology Risk Management Strategies

Objective: Request additional resources to address risk management strategies that include enhancements to data security efforts.

					Funding Requested for FY 2016	Funding Requested for FY 2017
Personal Services					**440,000**	**440,000**
Fiscal Yr.	**Quantity**		**Description**	**Salary**		
FY 16/17	1	Annual	Senior Network Administrator	100,000	100,000	100,000
FY 16/17	4	Annual	Security Engineer	85,000	340,000	340,000
Employee Related Expenditures (ERE)					**176,000**	**176,000**
Fiscal Yr.	**Rate**		**Description**			
FY 16/17	40.0%	Annual	Employee Related Expenditures (Rate expressed as a % of Personal Services)		176,000	176,000
Other Operating Expenses					**22,500**	**67,500**
Fiscal Yr.	**Quantity**	**Unit**	**Description**	**Unit Cost**		
FY 17	1	Annual	New Security Appliances and Software: Annual License and Support Renewal	45,000		45,000
FY 16/17	5	Annual	New FTE Associated Costs (Standard Operating Costs)	4,500	22,500	22,500
Equipment					**285,000**	**-**
Fiscal Yr.	**Quantity**	**Unit**	**Description**	**Unit Cost**		
FY 16	1	One-Time	PIJ- Security Appliances and Software	250,000	250,000	
FY 16	5	One-Time	New FTE Associated Costs (Equipment)	7,000	35,000	
TOTALS - FY 2016 AND FY 2017 APPROPRIATED BUDGET REQUEST					**923,500**	**683,500**

FY 2016 and FY 2017 Appropriated Budget Request: Internal Audit

Objective: Request additional resources to assess and assist employer compliance with ASRS laws, rules, and policies.

					Funding Requested for FY 2016	Funding Requested for FY 2017
Personal Services					**65,000**	**65,000**
Fiscal Yr.	**Quantity**		**Description**	**Salary**		
FY 16/17	1	Annual	FTEs, Employer Audit Officer	65,000	65,000	65,000
Employee Related Expenditures (ERE)					**26,000**	**26,000**
Fiscal Yr.	**Rate**		**Description**			
FY 16/17	40.0%	Annual	Employee Related Expenditures (Rate expressed as a % of Personal Services)		26,000	26,000
Conference, Education and Travel					**1,500**	**1,500**
Fiscal Yr.	**Quantity**	**Unit**	**Description**	**Unit Cost**		
FY 16/17	1	Annual	Annual Travel Related Expenses	1,500	1,500	1,500
Other Operating Expenses					**3,000**	**3,000**
Fiscal Yr.	**Quantity**	**Unit**	**Description**	**Unit Cost**		
FY 16/17	1	Annual	New FTE Associated Costs (Standard Operating Costs)	3,000	3,000	3,000
Equipment					**7,000**	**-**
Fiscal Yr.	**Quantity**	**Unit**	**Description**	**Unit Cost**		
FY 16/17	1	One-Time	New FTE Associated Costs (Equipment)	7,000	7,000	
TOTALS - FY 2016 AND FY 2017 APPROPRIATED BUDGET REQUEST					**102,500**	**95,500**

FY 2016 and FY 2017 Appropriated Budget Request: Oracle Forms and Reports Modernization

Special Line Item Project

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.

				Appropriation FY 2014	Appropriation FY 2015	Funding Requested for FY 2016	Funding Requested for FY 2017	Project Totals
External Professional Services				**1,330,000**	**4,484,500**	**2,270,000**	**2,070,000**	**10,154,500**
Fiscal Yr.	**Quantity**	**Unit**	**Description**					
FY 14 - FY 17	1	Project	Development Resources	1,330,000	4,484,500	2,270,000	2,070,000	
Other Operating and Equipment				**60,000**	**-**	**-**	**-**	**60,000**
Fiscal Yr.	**Quantity**	**Unit**	**Description**					
FY 14	1	One-Time	Project Equipment and Software	60,000				
TOTALS - FY 2016 AND FY 2017 SPECIAL LINE ITEM BUDGET REQUEST				**1,390,000**	**4,484,500**	**2,270,000**	**2,070,000**	**10,214,500**

FY 2016 and FY 2017 Appropriated Budget Request - Long Term Disability Program Administration

Description	Actual FY 2013	Appropriation FY 2014	Appropriation FY 2015	Funding Requested for FY 2016	Funding Requested for FY 2017
Administration costs of the LTD program (Appropriated Funding)	2,736,300	2,800,000	2,800,000	2,800,000	2,800,000
TOTALS - FY 2016 AND FY 2017 APPROPRIATED BUDGET REQUEST	**2,736,300**	**2,800,000**	**2,800,000**	**2,800,000**	**2,800,000**

ASRS Continuously Appropriated Funding Projections
(Dollars In Thousands)

	FY 2014 Estimated	FY 2015 Projection	FY 2016 Projection	FY 2017 Projection
Investment Management Expenses				
Custodial Banking, Security Lending and Master Cash STIF Fees	1,934	2,692	2,692	2,692
Internal Investment Management (Salaries and Benefits)		1,500	1,652	1,645
Public Markets				
External Investment Management Fees	69,830	77,298	81,549	86,035
Transactional and Other Fees	3,323	3,865	4,077	4,302
Private Markets				
Private Equity Management Fees	38,473	39,160	45,210	51,260
Private Equity Performance Incentive and Other Fees	38,163	33,286	38,429	43,571
Real Estate Management Fees	19,464	25,523	27,773	30,023
Real Estate Performance Incentive and Other Fees	20,415	24,246	26,384	28,521
Opportunistic Management Fees	14,106	15,000	15,750	16,500
Opportunistic Performance Incentive and Other Fees	33,697	30,000	31,500	33,000
Subtotal Investment Management Expenses	239,405	252,570	275,016	297,549
Investment Related Consulting, Legal and Information Services				
Investment Consulting Services	2,885	4,310	4,042	4,053
Investment Related Legal Services	1,265	881	881	881
Investment Electronic Information Services	1,481	1,714	1,885	2,073
External Financial Consulting Services	65	75	75	75
Subtotal Investment Related Consulting, Legal and Information Services	5,696	6,980	6,883	7,082
Subtotal Investment Continuous Appropriations	245,101	259,550	281,899	304,631
Rent	1,492	1,505	1,505	1,505
Actuarial Annual Consulting Fees	1,053	1,200	1,200	1,200
Actuarial Special Projects (5 Yr. Actuarial Audit, Benefits Consulting Services)	180	25	25	25
Retiree Payroll (Disbursement Administration)	1,586	1,716	1,801	1,890
Retiree Payroll (Technology Programming/Support)	839	500	500	500
Subtotal Administrative Continuous Appropriations	5,150	4,946	5,031	5,120
Continuously Appropriated Funding Totals	**250,251**	**264,496**	**286,930**	**309,751**

FY 2016 and FY 2017 Budget Request: Internal Investment Management

Objective: Request additional resource to support asset class extensions and to provide financial analysis within the Investment Management Division.

					Funding Requested for FY 2016	Funding Requested for FY 2017
Personal Services					**100,000**	**100,000**
Fiscal Yr.	**Quantity**		**Description**	**Avg. Salary**		
FY 16/17	1	Annual	Private Markets Portfolio Analyst	100,000	100,000	100,000
Employee Related Expenditures (ERE)					**40,000**	**40,000**
Fiscal Yr.	**Rate**		**Description**			
FY 16/17	40.0%	Annual	Employee Related Expenditures (Rate expressed as a % of Personal Services)		40,000	40,000
Travel					**2,000**	**2,000**
Fiscal Yr.	**Quantity**	**Unit**	**Description**	**Unit Cost**		
FY 16/17	1	Annual	Annual Travel Related Expenses	2,000	2,000	2,000
Other Operating Expenses					**3,000**	**3,000**
Fiscal Yr.	**Quantity**	**Unit**	**Description**	**Unit Cost**		
FY 16/17	1	Annual	New FTE Associated Costs (Standard Operating Costs)	3,000	3,000	3,000
Equipment					**7,000**	**-**
Fiscal Yr.	**Quantity**	**Unit**	**Description**	**Unit Cost**		
FY 16	1	One-Time	New FTE Associated Costs (Equipment)	7,000	7,000	
TOTALS - FY 2016 AND FY 2017 BUDGET REQUEST (INVESTMENT CONTINUOUS APPROPRIATIONS)					**152,000**	**145,000**

ASRS Administrative and Investment Spending Plan
Fiscal Year 2016
(Dollars In Thousands)

	Base Operating Appropriations	+	Long Term Disability Appropriations	+	Oracle Modernization Special Legislative Appropriations	+	Administrative Continuous Appropriations	=	Administrative Subtotal	+	Investment Continuous Appropriations	=	Total
Personal Services (PS) and Employee Related Expenses (ERE)													
PS (Wages and Salaries)	12,730.3								12,730.3		1,295.0		14,025.3
ERE (Employer costs for Benefits, Taxes and ADOA Admin. Fees)	5,099.7								5,099.7		357.0		5,456.7
Variable Compensation Strategies (PS/ERE)	305.0								305.0				305.0
Investment Incentive Compensation Plan (PS/ERE budget reserved)	350.0								350.0				350.0
Total PS and ERE	**18,485.0**		**-**		**-**		**-**		**18,485.0**		**1,652.0**		**20,137.0**
External Professional Services													
External Investment Management Expenses											273,364.0		273,364.0
LTD Program Administration			2,800.0						2,800.0				2,800.0
Software Programming Costs	529.3				2,270.0		500.0		3,299.3				3,299.3
Actuary & Benefit Consulting							1,225.0		1,225.0				1,225.0
Consulting & Legal Fees	300.0								300.0		4,998.0		5,298.0
Pension Payroll Disbursement Services							1,620.0		1,620.0				1,620.0
Other Outside Services	250.0								250.0				250.0
Total External Professional Services	**1,079.3**		**2,800.0**		**2,270.0**		**3,345.0**		**9,494.3**		**278,362.0**		**287,856.3**
Travel, Other Operating & Equipment													
Software Licenses & Support	1,375.0								1,375.0				1,375.0
Equipment & Furniture	681.5								681.5				681.5
Telephone	340.0								340.0				340.0
Postage and Delivery	220.0						181.0		401.0				401.0
Insurance	155.0								155.0				155.0
Operating Supplies	185.9								185.9				185.9
Repair & Maintenance	150.0								150.0				150.0
Dues & Subscriptions	119.4								119.4		1,885.0		2,004.4
Education & Training	90.0								90.0				90.0
Travel	80.1								80.1				80.1
External Printing	75.0								75.0				75.0
Office Rent	-						1,505.0		1,505.0				1,505.0
Total Travel, Other Operating & Equipment	**3,471.9**		**-**		**-**		**1,686.0**		**5,157.9**		**1,885.0**		**7,042.9**
TOTAL	**23,036.2**		**2,800.0**		**2,270.0**		**5,031.0**		**33,137.2**		**281,899.0**		**315,036.2**

ASRS Administrative and Investment Spending Plan
Fiscal Year 2017
(Dollars In Thousands)

	Base Operating Appropriations	+	Long Term Disability Appropriations	+	Oracle Modernization Special Legislative Appropriations	+	Administrative Continuous Appropriations	=	Administrative Subtotal	+	Investment Continuous Appropriations	=	Total
Personal Services (PS) and Employee Related Expenses (ERE)													
PS (Wages and Salaries)	12,725.3								12,725.3		1,288.0		14,013.3
ERE (Employer costs for Benefits, Taxes and ADOA Admin. Fees)	5,099.7								5,099.7		357.0		5,456.7
Variable Compensation Strategies (PS/ERE)	320.0								320.0				320.0
Investment Incentive Compensation Plan (PS/ERE budget reserved)	380.0								380.0				380.0
Total PS and ERE	**18,525.0**		**-**		**-**		**-**		**18,525.0**		**1,645.0**		**20,170.0**
External Professional Services													
External Investment Management Expenses											295,904.0		295,904.0
LTD Program Administration			2,800.0						2,800.0				2,800.0
Software Programming Costs	489.3				2,070.0		500.0		3,059.3				3,059.3
Actuary & Benefit Consulting							1,225.0		1,225.0				1,225.0
Consulting & Legal Fees	300.0								300.0		5,009.0		5,309.0
Pension Payroll Disbursement Services							1,700.0		1,700.0				1,700.0
Other Outside Services	250.0								250.0				250.0
Total External Professional Services	**1,039.3**		**2,800.0**		**2,070.0**		**3,425.0**		**9,334.3**		**300,913.0**		**310,247.3**
Travel, Other Operating & Equipment													
Software Licenses & Support	1,420.0								1,420.0				1,420.0
Equipment & Furniture	389.5								389.5				389.5
Telephone	340.0								340.0				340.0
Postage and Delivery	220.0						190.0		410.0				410.0
Insurance	155.0								155.0				155.0
Operating Supplies	185.9								185.9				185.9
Repair & Maintenance	150.0								150.0				150.0
Dues & Subscriptions	119.4								119.4		2,073.0		2,192.4
Education & Training	90.0								90.0				90.0
Travel	80.1								80.1				80.1
External Printing	75.0								75.0				75.0
Office Rent	-						1,505.0		1,505.0				1,505.0
Total Travel, Other Operating & Equipment	**3,224.9**		**-**		**-**		**1,695.0**		**4,919.9**		**2,073.0**		**6,992.9**
TOTAL	**22,789.2**		**2,800.0**		**2,070.0**		**5,120.0**		**32,779.2**		**304,631.0**		**337,410.2**

Total Administrative and Investment Full-Time Equivalent (FTE) Positions

	FY 2015	Total Requested FY 2016	Total Requested FY 2017
Base Operating	**235.9**	**241.9**	**241.9**
Investment Continuous Appropriations	**11.0**	**12.0**	**12.0**
ASRS FTE Position Total	**246.90**	**253.90**	**253.90**
Annual Change	0.0%	2.8%	0.0%

Agenda Item #6

ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

MEMORANDUM

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

FROM: Mr. Anthony Guarino, Deputy Director and Chief Operations Officer
Ms. Nancy Bennett, Chief Financial Officer
Ms. Jothi Beljan, Assistant Attorney General

DATE: August 5, 2014

RE: **Agenda Item #6**: Presentation, Discussion and Appropriate Action Regarding Approaches and Legal Implications of Service and Account Balance Reinstatement for Members Who May be Defrauded

Purpose

To discuss whether the ASRS should indemnify members when fraudulent activity takes place on their account.

Recommendation

Informational only; no action required.

Background

On March 31, 2011, the ASRS implemented an electronic forfeitures request process whereby a former ASRS member can log into their on-line account, or create an on-line account if they have yet to set one up, and request a forfeiture of their contributions. The forfeiture is sent via an electronic funds transfer (EFT) to the bank account designated by the member. Prior to this implementation, members could only request forfeitures via a paper application. Paper forfeiture applications gave former ASRS members the option of receiving their funds via check or EFT. Electronic forfeiture requests have the following advantages over paper forfeiture requests:

- more convenient for members;
- faster member service;
- improved service to members/employers (Employer Payroll Verification routing was automated);
- ability for member to check status online;
- reduced call volume for refund forms and refund status checks;
- reduced volume of rejected forms; and
- reduced stale checks.

While it is possible for fraud to occur in any disbursement types that occur at the ASRS, we believe that forfeitures are the most vulnerable to fraudulent activities. Both paper forfeiture requests and electronic forfeiture requests can be fraudulently submitted. If a check requested through a paper forfeiture application is fraudulently cashed or deposited, it is the bank that bears the financial responsibility for that transaction. An EFT transaction shifts the financial responsibility to the ASRS.

In view of a recent alleged fraudulent on-line forfeiture, the ASRS has been discussing whether it should indemnify a member if it is confirmed that a fraudulent activity did indeed take place on the member's account.

To aid in the decision making process, staff researched the action other financial institutions take in the event fraudulent activity occurs on a customer's account. A summary of that research follows:

Charles Schwab & Co.

- Schwab will cover 100% of any losses in any Schwab account due to unauthorized activity. To ensure the customer's protection under this guarantee, thecustomer must:
    - Safeguard account access information and payment devices (login ID, password, or any other info used by Schwab to authenticate customer, checks, debit cards, credit cards)
        - If customer shares this information with anyone, Schwab will consider the transaction authorized by customer
    - Report unauthorized transactions as quickly as possible
        - Different transactions have different reporting deadlines
        - More details available in account agreements, statements and trade confirmations

Nationwide

Case by case determination

- Associate escalates to Team Manager for review
- Team Manager escalates to Regulatory Manager/Fraud SME
- Regulatory Manager/Fraud SME completes Suspicious Incident Report Form (SIRF)
- SIRF sent to Office of Financial Crimes and Sanctions Compliance (OFCSC)
- OFCSC determines if law enforcement should be notified

TIAA-CREF

Case by case determination

- TIA-CREF reviews each incident individually
- A few, rare, selected cases where TIAA-CREF has reimbursed because of fraudulent activity
- Fraudulently transacted withdrawals that result in secure access breach (like providing PIN, etc.) have customarily been viewed as the responsibility of the account holder
- TIAA-CREF does employ internal and external investigators when deemed appropriate
- TIAA-CREF will also work with law enforcement agencies on behalf of victimized participants when appropriate

Bank of America

BofA will reimburse customer for fraudulent activity in customer account if the following conditions are met:

- Customer must:
    - Exercise reasonable control over personal information and account access information
    - Guard against improper access of the above by others

    - Report unauthorized activity as soon as possible – 60 days after receipt of notification is maximum reasonable amount of time
    - Cooperate in investigation and prosecution of their claim and any attempt to recover funds
    - Agree to identify and seek criminal and civil penalties against responsible person
- If customer refuses to do any of the above the bank will consider the refusal to be a ratification of the defect in their statement or unauthorized item and the bank will charge the full amount to the customer's account
- Electronic funds transfer fraud is subject to Regulation E
    - Must provisionally credits the consumer's account in the amount of the alleged error (including interest where applicable) within 10 business days of receiving the error notice.
    - ASRS not subject to Regulation E

The ASRS is also exploring whether the State's Risk Management Department will indemnify a member if it is proved that a fraudulent transaction took place in the member's account.

Options

The ASRS has several options with respect to indemnifying a member against fraudulent activity:

- Member liable unless they can demonstrate that the ASRS was negligent
- ASRS assumes liability when it can be shown that the member's account has been compromised by someone other than the member and member can demonstrate that he or she prudently guarded his/her PII
- Case by case determination at executive management level

Agenda Item #7

STATUS OF INTERNAL AUDITS
FOR THE 12 MONTHS ENDED (June 2014)

2013/14 AUDITS	HOURS BUDGETED	ACTUAL HOURS WORK YTD	PERCENT OF HOURS UTILIZED	ESTIMATED HOURS REMAINING	ESTIMATED TOTAL HOURS WHEN COMPLETE	EXPANATION OF ACTUAL HOURS THAT EXCEED BUDGET BY MORE THAN 10%
Service purchase invoices	150	131	87%	19	131	
Investment trade tickets	550	378	69%	172	378	
Fraud hotline/internal investgations	200	99	50%	101	99	
Employer audits	4,250	4,174	98%	76	4,174	
Continuous audit monitoring	250	58	23%	192	58	
Pension/survivor final audit	200	213	107%	0	213	
Refunds processing	150	119	79%	31	119	
audit follow-up	150	144	96%	6	144	
Spreadsheets review	350	122	35%	228	350	
LTD	350	395	113%	0	395	New closing conference procedures
Investment trading system	400	330	83%	70	330	
TOTALS	7,000	6,163		895	6,391	
OTHER THAN AUDITS						
Member statement testing	100	103	103%	0	103	
Director requests	150	0	0%	150	150	
Requested audits/other*	150	10	7%	140	150	
Foreign annuitant confirms	100	61	61%	39	100	
TOTALS	500	174		329	503	
GRAND TOTAL	7,500	6,337		1,224	6,894	

Agenda Item #8

ARIZONA STATE RETIREMENT SYSTEM

3300 NORTH CENTRAL AVENUE • PO BOX 33910 • PHOENIX, AZ 85067-3910 • PHONE (602) 240-2000
7660 EAST BROADWAY BOULEVARD • SUITE 108 • TUCSON, AZ 85710-3776 • PHONE (520) 239-3100
TOLL FREE OUTSIDE METRO PHOENIX AND TUCSON 1 (800) 621-3778
EMAIL ADDRESS: ASKMAC@AZASRS.GOV • WEB ADDRESS: WWW. AZASRS.GOV

Paul Matson
Director

MEMORANDUM

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

FROM: Mr. Bernard Glick, Chief Auditor

DATE: August 5, 2014

RE: **Agenda Item #8**: Presentation, Discussion and Appropriate Action Regarding Elimination of One Audit From Year Two Audit Plan in Order to Test Census Data for the External Audit of the ASRS

Purpose

To present to the OAC the suggested change to the ASRS Audit Plan for the 2015 Fiscal Year of replacing the WEB services social media audit with the ASRS Compliance with GASB 68 census audit.

Recommendation

Remove the WEB Services Social Media Audit from the ASRS FY15 Audit Plan and replace it with the ASRS Compliance with GASB 68 Census Audit and move the WEB services social media audit to the FY16/17 Biennial Audit Plan.

Background

The Governmental Accounting Standards Board (GASB) is recognized as the authoritative body for establishing and improving financial accounting and reporting standards of state governmental entities. In 2012, GASB issued “GASB 68” which addresses the role of census data for multiple-employer defined benefit plans and the external auditors’ responsibility for such census data.

ASRS accounting staff and the ASRS Chief Auditor met with the ASRS external auditors, Clifton, Larson Allen to decide when and how to test census data in 2014. The external auditors would select 27 employers to perform the necessary tests to verify the census data (age of member, date of membership, salary) and the agency would be charged $3,500 per employer in addition to the negotiated cost of the audit.

The ASRS was able to negotiate a plan whereby the field work could be performed by Internal Audit under the supervision of the external auditors. I believe this would require 300 hours of internal audit time but would save the agency a portion of the cost of doing this extra work by the external auditors.

If approved, the WEB services social media audit would be moved to the 2016-17 Biennial audit plan.

Agenda Item #9

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

ARIZONA STATE RETIREMENT SYSTEM
EMPLOYER AUDITS

GRAHAM COUNTY

JANUARY, 2014

The audit of Graham County was completed January 22, 2014, for the period July 1, 2010 through June 30, 2013.

The audit objectives are to determine whether Graham County is in compliance with Arizona State Retirement System (ASRS) statutes 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.
- Statutes governing retirees' return to work.
- Statutes governing termination incentive programs.

SUMMARY OF FINDINGS:

Based on the results of the work performed to meet the above audit objectives, the following statement summarizes the finding presented to Graham County:

1. **Graham County did not Remit ASRS contributions for thirty-eight employees who worked or were engaged to work at least twenty hours per week for at least twenty weeks in one or more fiscal years.**

BACKGROUND

Graham County joined the ASRS July 1, 1957 by executing an Application and Social Security 218 agreement. Graham County currently has approximately 155 employees contributing to the ASRS.

DESCRIPTION OF AUDIT WORK PERFORMED

The audit work completed consisted of an examination of the employer's payroll and personnel records for the time period July 1, 2010 through June 30, 2013. The auditor reviewed pertinent documentation and interviewed Graham County 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 contributions. The following audit tests were performed:

- Review of the Social Security 218 agreement to determine eligible employees.
- Review of the employer payroll records and related ASRS reports.
- Review of employees' time sheets 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.
- Review the salaries of retiring employees to determine whether there is salary spiking during the years prior to the employee retirement.
- Review for unreported retirement incentive programs.
- Other detailed testing as required to meet the audit objectives.

AUDITOR COMMENTS:

Graham County personnel were cooperative, informative and helpful in providing 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

GRAHAM COUNTY

FINDINGS AND RECOMMENDATIONS

JANUARY, 2014

FINDING 1:

Graham County did not Remit ASRS contributions for thirty-eight employees who worked or were engaged to work at least twenty hours per week for at least twenty weeks in one or more fiscal years.

A.R.S. § 38-711, paragraph 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." 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 twenty or more hours.

Thirty-eight employees of Graham County worked or were engaged to work at least twenty hours per week for twenty or more weeks during the fiscal year without paying contributions when they first became eligible.

The ASRS Financial Services Department will generate invoices for the employee's portion of the contribution due after payment is made by Graham County. Graham County will be responsible to send these invoices to each employee.

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	**$327,188**
Member Contributions	**35,609**
Employer Contributions	**35,609**
Estimated Interest Due	**6,062**
Total Estimated Due ASRS	**$77,280**

Recommendation(s):

1. ASRS contributions should be withheld from employees' earnings when an employee is engaged to work at least twenty weeks in each fiscal year and at least twenty 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 twenty or more hours.
2. The employer should have all eligible non-contributors complete online the ASRS enrollment and beneficiary forms, if applicable, so that contributions will be properly processed.
3. The employer should self-audit the eligibility of all employees for the fiscal year beginning July 1, 2013**,** and remit contributions for all eligible employees' earnings.

Employer Response:

Graham County appreciates the opportunity to work with Mr. Rennaker on the ASRS Payroll Audit. The results of the audit were one finding related to the application of the 20/20 eligibility criteria to 38 employees.

Graham County respectfully disagrees with the audit finding. We assert that the finding is a matter of interpretation. We will be pursuing an appeal through Paul Matson, ASRS Director.

Management Response:

Mr. Terry Cooper, Graham County Manager, in a March, 2014 letter to the ASRS in response to this audit finding asserts that "while [the county] admits to making errors in select cases, it was never [the county's] intent to circumvent State rules regarding eligibility and payment of member contributions to ASRS, nor [does the county] believe that [it] did violate the rules in the overwhelming majority of cases cited in the report."

Mr. Cooper further asserts that the county's interpretation of "engaged to work" from A.R.S. § 38-711 (23)(b) is being applied too narrowly by audit staff. The attached summary of the Computation of CNW Assessment Due (see Exhibit 1) prepared by audit staff assumes the county should have enrolled all 38 county staff from day one of their appointments.

Mr. Cooper offers the following rebuttals to Finding 1:

- The county did enroll and remit ASRS contributions once the employees hit the 20/20 threshold of twenty weeks of employment of twenty or more hours per week, or the employees were enrolled in CORP if they were promoted to permanent full time positions before they met the ASRS 20/20 threshold. Several were separated from service before they met the 20/20 threshold. At this point, nineteen of the 38 employees noted in the report are no longer employed by Graham County.
- An overwhelming majority of the employees in question were Reserve Detention, Reserve Control Room or Reserve Juvenile Detention Officer positions. These positions were designed to be and designated on the referrals authorizing their appointments (see Exhibit 2) as being either part time, temporary, reserve, or "not to exceed twenty hours per week." In other words, they were never "engaged" to be full time employees, nor was it anticipated on their appointment date that they would eventually exceed the 20/20 threshold.
- The main purpose of the part time reserve program is to give Graham County Jail and Juvenile Detention Center additional help, while also giving them an opportunity to determine which candidates would be most suitable to promote to full time permanent employment. Employees can only be appointed to full time permanent positions with benefits by the processing of a subsequent referral (see Exhibit 3) that authorizes their appointment to full time status.
- Since these positions are primarily involving detention, the applicable retirement system once employees are appointed to full time status is CORP, not ASRS.
- The fact that many employees did exceed the 20/20 threshold and were enrolled in ASRS was a circumstance of intermediate supervisors not complying with the part time appointment restrictions and scheduling them for extra hours due to unanticipated absences for illness, annual leave, or otherwise maintain necessary staffing levels; i.e., appropriate staff to inmate ratios.
- When the county became aware that certain employees were working varied weekly schedules, at times over 20 hours per week, the county's policy was to implement Recommendation 1 noted on page 2 of the ASRS Findings and Recommendation Report: F**or those employees who work irregularly from one week to the next,**

[ASRS] contributions should be withheld no later than the beginning of the twentieth week of working twenty or more hours.

- The county believes that mistakes were made with regard to only 6 county staff and for which the county owes contributions and not the full 38 county staff identified in the audit report.

ASRS Management finds the county's explanation reasonable and acceptable in light of established protocols to administer the hours worked for new employees, that new employees in select county positions are enrolled in CORP after a probationary period, not the ASRS, and that additional training and oversight have been provided as a result of the audit findings to mitigate the potential for future circumstances warranting a contributions not withheld (CNW) finding and directs ASRS staff to issue CNW invoices for the six identified county employees.

Employer's Response to ASRS Management Response:

Mr. Terry Cooper, Graham County Manager, concurs with the ASRS Management Response.

Attachments:

Graham County Exhibit 1
Graham County Exhibit 2
Graham County Exhibit 3

EXHIBIT 1

Employer's Name: Graham County
Employer's Address: 921 Thatcher Blvd.
Safford, Az 85546

Contact Person: Julie Rodriquez
928-792-3039

COMPUTATION OF CNW ASSESSMENT DUE - ALL EMPLOYEES

Termination Date	Employee Name	Gross Salaries	CNW Member Cost	CNW Employer Cost	CNW Employer Interest	CNW Employer Total	CNW Total Due		Comments	Retirement Enrollment	Employee Name
Contributions Not Withheld (CNW)											
6-14-13	Aguayo, Jane	11,439.72	1,274.38	1,274.38	115.08	1,389.46	2,663.84	19	Reserve Detention Officer	ASRS	Aguayo, Jane
	Arreola, Wendy	2,911.66	324.36	324.36	29.29	353.65	678.01	31	Reserve Detention Officer	CORP	Arreola, Wendy
	Bailey, Denise	9,155.91	1,019.97	1,019.97	92.10	1,112.07	2,132.04	36	Reserve Detention Officer	CORP	Bailey, Denise
2012	Bejarano, Michael	13,907.65	1,369.90	1,369.90	600.19	1,970.09	3,339.99	1	Construction Forman for jail extension		Bejarano, Michael
	Borquez, Tommy	5,535.11	616.61	616.61	55.68	672.29	1,288.90	33	Reserve Detention Officer	CORP	Borquez, Tommy
1-10-14	Chacon, Julie	14,846.51	1,653.90	1,653.90	149.35	1,803.25	3,457.15	20	Reserve Juvenile Detention Officer	ASRS/CORP	Chacon, Julie
	Counes, Nicholas	10,770.93	1,199.88	1,199.88	108.35	1,308.23	2,508.11	37	Reserve Detention Officer	CORP	Counes, Nicholas
5-11-11	Earl, Jeb	8,705.42	857.48	857.48	375.69	1,233.17	2,090.65	2	Reserve Detention Officer	ASRS	Earl, Jeb
	Edwards, Don E	15,792.43	1,759.28	1,759.28	158.87	1,918.15	3,677.43	27	Reserve Juvenile Detention Officer		Edwards, Don E
11-21-12	Edwards, Laurie	12,514.97	1,344.11	1,344.11	346.14	1,690.25	3,034.36	13	Reserve Detention Officer	ASRS	Edwards, Laurie
4-20-13	Ellison, Veronica	4,714.82	506.37	506.37	130.40	636.77	1,143.14	14	Reserve Detention Officer	CORP	Ellison, Veronica
	Esperas, Kuuipo	7,194.17	801.43	801.43	72.37	873.80	1,675.23	35	Reserve Control Room Operator	CORP	Esperas, Kuuipo
	Estrada, Christina	8,985.83	1,001.02	1,001.02	90.39	1,091.41	2,092.43	26	Reserve Detention Officer	CORP	Estrada, Christina
	Evans, Angelina	7,496.51	835.11	835.11	75.41	910.52	1,745.63	21	General Clerical	ASRS	Evans, Angelina
2-9-13	Evans, Brice	7,253.29	808.02	808.02	72.97	880.99	1,689.01	25	Reserve Detention Officer		Evans, Brice
	Feigler, Dennis	6,359.04	626.37	626.37	274.43	900.80	1,527.17	3	Laborer, Parks	ASRS	Feigler, Dennis
4-4-13	Galarza, Jose	2,700.69	300.86	300.86	27.17	328.03	628.89	32	Reserve Control Room Operator	CORP	Galarza, Jose
1-2-14	Gonzales, Francisco	5,372.53	577.01	577.01	148.59	725.60	1,302.61	9	Reserve Detention Officer	CORP	Gonzales, Francisco
	Gonzalez, Jacob	14,873.33	1,656.89	1,656.89	149.62	1,806.51	3,463.40	24	Reserve Control Room Operator		Gonzalez, Jacob
	Jones, Raymond	827.68	81.53	81.53	35.72	117.25	198.78	5	Reserve Detention Officer	ASRS	Jones, Raymond
7-8-13	Jones, Shelby	6,549.98	729.67	729.67	65.89	795.56	1,525.23	34	Reserve Control Room Operator	CORP	Jones, Shelby
11-29-13	Knight, J. William B	5,147.14	573.39	573.39	51.78	625.17	1,198.56	38	Reserve Detention Officer	ASRS	Knight, J. William B
3-9-12	Lopez, Richard	6,552.24	703.71	703.71	181.22	884.93	1,588.64	6	Reserve Control Room Operator	ASRS	Lopez, Richard
12-2-11	Martin, Berta	9,019.50	954.62	954.62	273.97	1,228.59	2,183.21	12	Reserve Detention Officer	CORP	Martin, Berta
7-13-12	Mendez, Araunah	6,265.20	675.53	675.53	161.62	837.15	1,512.68	15	Reserve Control Room Operator		Mendez, Araunah
	Mendez, Thelma	8,951.83	997.23	997.23	90.06	1,087.29	2,084.52	22	Secretary		Mendez, Thelma
	Nabor, Henry	15,962.40	1,778.21	1,778.21	160.57	1,938.78	3,716.99	17	Reserve Juvenile Detention Officer	ASRS	Nabor, Henry
10-6-10	Nevins, Cassidy	3,761.51	370.51	370.51	162.33	532.84	903.35	4	Reserve Detention Officer		Nevins, Cassidy
	Ornelas, James	20,337.29	2,253.58	2,253.58	257.39	2,510.97	4,764.55	18	Reserve Juvenile Detention Officer	ASRS/CORP	Ornelas, James
	Pennington, John	12,053.09	1,300.39	1,300.39	307.48	1,607.87	2,908.26	16	Reserve Detention Officer	CORP	Pennington, John
	Roybal, Erik	6,724.91	749.15	749.15	67.65	816.80	1,565.95	29	Reserve Juvenile Detention Officer	ASRS	Roybal, Erik
	Shelton, Jason	5,036.29	561.04	561.04	50.66	611.70	1,172.74	30	Reserve Juvenile Detention Officer	ASRS/CORP	Shelton, Jason
	Smith, Leslie	8,125.44	905.17	905.17	81.74	986.91	1,892.08	28	Reserve Control Room Operator	CORP	Smith, Leslie
1-5-12	Tomlinson, Raymond	3,924.09	421.45	421.45	108.53	529.98	951.43	11	Reserve Detention Officer		Tomlinson, Raymond
3-15-12	Upshaw, Abner	12,607.35	1,324.37	1,324.37	400.35	1,724.72	3,049.09	8	Reserve Detention Officer	ASRS	Upshaw, Abner
12-14-12	Walden, Michael	13,287.22	1,464.03	1,464.03	204.80	1,668.83	3,132.86	23	Reserve Juvenile Detention Officer		Walden, Michael
9-27-11	Wheeler, James	4,955.00	532.17	532.17	137.05	669.22	1,201.39	10	Reserve Detention Officer		Wheeler, James
	Wilkerson, William	6,569.71	700.32	700.32	190.86	891.18	1,591.50	7	Reserve Detention Officer	ASRS	Wilkerson, William
	Contribution Not Withheld Total	327,188.39	35,609.02	35,609.02	6,061.76	41,670.78	77,279.80				Contribution Not Withheld Total

U:\13-14 Accounting\Payroll Audit\Graham County Workpaper Assess - 2013 Update\Summary

#1

EXHIBIT #2

GRAHAM COUNTY
DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health (928) 428-1962 *826 West Main Street, Safford, Arizona 85546* *Fax(928) 428-8074*

REQUEST FOR RECRUITMENT AND APPOINTMENT

I. ESTABLISHING THE VACANCY

POSITION: RESERVE DETENTION OFFICER
DEPARTMENT: SHERIFF'S DEPARTMENT
PAY RATE: RANGE 12
JOB STATUS: CLASSIFIED, PART TIME – Not to exceed 20 hours per week

Due to the **promotion of Erik Roybal,** the job listed above is vacant. Upon initiating this recruitment, I understand that it is my responsibility to assure that all of the appointment processing steps are completed, including sign up for payroll, before an applicant can begin work:

APPOINTING AUTHORITY SIGNATURE: _____ DATE: 12/03/13

This position is budgeted for the current fiscal year or it has been specifically authorized by the Board of Supervisors, and the Personnel Committee may proceed with the recruitment process:

COUNTY MANAGER SIGNATURE: _____ DATE: 12-3-13

II. RECRUITMENT PROCESS

( ) RULE 206B, NON-COMPETITIVE PROMOTION
( ) RULE 201A, OPEN COMPETITIVE APPOINTMENT
(X) RULE 204B, CURRENT CERTIFICATION LIST
( ) RULE 205E, EMERGENCY APPOINTMENT, Not to exceed sixty days
( ) UNCLASSIFIED APPOINTMENT
( ) RULE 206B, NON-COMPETITIVE PROMOTION
( ) RULE 201A(2), INTRADEPARTMENTAL ANNOUNCEMENT
( ) RULE 205D, TEMPORARY APPOINTMENT

The individual recommended for appointment was selected from among the qualified applicants referred from a certification list (see attachment), or the individual was specifically recommended for approval by the Personnel Committee:

PERSONNEL COMMITTEE SIGNATURE: _____ DATE: 12/2/13

III. APPOINTMENT

APPLICANT SELECTED: **Ezra Payne** STARTING DATE: ~~01-16-2014~~ 12-16-13

APPOINTING AUTHORITY SIGNATURE: _____ DATE: 12/03/13

COUNTY MANAGER SIGNATURE: _____ DATE: 12-3-13

EXHIBIT #3

GRAHAM COUNTY
DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health (928) 428-1962 826 West Main Street, Safford, Arizona 85546 Fax(928) 428-8074

REQUEST FOR RECRUITMENT AND APPOINTMENT

I. ESTABLISHING THE VACANCY

POSITION: JUVENILE DETENTION OFFICER
DEPARTMENT: JUVENILE DETENTION CENTER
PAY RATE: RANGE 12
JOB STATUS: FULL TIME, CLASSIFIED with Benefits

Due to the **separation of Julie Chacon,** the job listed above is vacant. Upon initiating this recruitment, I understand that it is my responsibility to assure that all of the appointment processing steps are completed, including sign up for payroll, before an applicant can begin work:

JUVENILE DETENTION ADMINISTRATOR C Hatwood DATE: 12-26-13

This position is budgeted for the current fiscal year or it has been specifically authorized by the Board of Supervisors, and the Personnel Committee may proceed with the recruitment process:

COUNTY MANAGER SIGNATURE: _____ DATE: 12-26-13

II. RECRUITMENT PROCESS

( ) RULE 206B, NON-COMPETITIVE PROMOTION
(X) RULE 201A, OPEN COMPETITIVE APPOINTMENT
( ) RULE 204A, CURRENT CERTIFICATION LIST
(X) RULE 206B, COMPETITIVE PROMOTION
( ) RULE 205D, TEMPORARY APPOINTMENT
( ) RULE 205E, EMERGENCY APPOINTMENT, Not to exceed sixty days

The individual recommended for appointment was selected from among the qualified applicants referred from a certification list (see attachment), or the individual was specifically recommended for approval by the Personnel Committee:

PERSONNEL COMMITTEE SIGNATURE: N. Karnes by L Grance-Lee DATE: 12-31-13

III. APPOINTMENT

APPLICANT SELECTED: Don Edwards STARTING DATE: 12-30-13

APPOINTING AUTHORITY SIGNATURE: C Hatwood DATE: 12-31-13

COUNTY MANAGER SIGNATURE: _____ DATE: _____

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

ARIZONA STATE RETIREMENT SYSTEM
INTERNAL AUDIT

BLOOMBERG'S ASSET & INVESTMENT MANAGER (AIM)
ORDER MANAGEMENT SYSTEM

May, 2014

The Internal Audit Division completed the audit of the Investment Management Division's (IMD) Order Management System, which is Bloomberg's Asset and Investment Manager (AIM) program and related processes on May 8, 2014.

Our audit objectives were:

1) The reliability and integrity of information.
2) Compliance with policies, plans, procedures, laws, and regulations.
3) The safeguarding of assets.
4) The economical and efficient use of resources.
5) The accomplishment of established objectives and goals for operations and programs.

The scope of our audit encompassed the examination and evaluation of the internal control structure and the quality of performance in carrying out assigned responsibilities for the audited area. The tests were designed to obtain sufficient, competent, and relevant evidence to provide a reasonable basis for our conclusions.

The Arizona State Retirement System administration is responsible for establishing and maintaining the internal control structure. Because of the inherent limitations in any internal control structure, errors or irregularities may occur and not be detected.

Based on the results of work performed to meet the audit objectives, the following statements summarize the results of our testing and the internal recommendations presented to the Arizona State Retirement System administration with the Internal Recommendations Supplement.

Bloomberg's AIM Order Management System has reduced errors, expedited trade processing and compliance review, and portfolio holdings are electronically linked to market data as well as the custodial bank. However, there are potential segregation of duties (SOD) conflicts with regard to AIM system administration and equity trades being approved by equity staff rather than fixed income staff.

BACKGROUND

The ASRS has a percentage (statutorily limited to 50%) of its fund assets managed internally by our IMD. These internal portfolios cover fixed income and equity holdings and are benchmarked to specific related indexes. Returns and deviations from the indexes are closely tracked against quantitative goals.

Prior to the introduction of AIM as an order management system the transactions processes were manually generated and input. This was a time consuming process that sometimes resulted in errors from input and inadvertent short selling.

The acquisition of the Bloomberg AIM order management system has mitigated many issues associated with the efficiency and accuracy of trade processing. It also has the capability to test each trade against an established set of compliance rules before trade execution, thereby avoiding short sales and ensuring adherence to dollar limits on trades and other agency criteria.

Additionally, the system maintains a history of trades for at least two years, providing users and management with a reference of trade activity.

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*. Internal Audit (IA) reviewed the internal control structure, interviewed personnel, obtained and reviewed documentation, and performed analytic reviews when appropriate. IA performed tests of the existing systems to provide sufficient evidence that controls were in place and being monitored, or were needed.

Some of the tests performed were:

- Review of IMD SOPs, practices, and related statutes.
- Review of automated compliance rules established within the AIM system.
- Review of past rule violation reporting.
- Review of segregation of duties (SOD) for trade initiation and approval.
- Review of mitigating controls for potential inadequate SOD controls.
- Sample testing of rules with fake trades for violation alerts.
- Review content of internally managed Equity and Fixed Income portfolios.
- Interviews with IMD users of the AIM Order Management System.
- Interview IMD management

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

ARIZONA STATE RETIREMENT SYSTEM
INTERNAL AUDIT

BLOOMBERG'S ASSET & INVESTMENT MANAGER (AIM)
ORDER MANAGEMENT SYSTEM

INTERNAL RECOMMENDATION SUPPLEMENT

MAY, 2014

INTERNAL FINDINGS AND RECOMMENDATIONS:

1. **Bloomberg's AIM Order Management System has reduced errors, expedited trade processing and compliance review, and portfolio holdings are electronically linked to market data as well as the custodial bank. However, there are potential segregation of duties (SOD) conflicts with regard to AIM system administration and equity trades being approved by equity staff rather than fixed income staff.**

   Our testing and interviews revealed the following:

   1) Currently, there are only two Investment Management Division (IMD) staff members from the equity side and two from the fixed income side who have access to AIM to conduct and approve trades, and do administrative tasks and compliance rule set-up.
   2) AIM system administration is being done by a member of the IMD trading desk for equities. Ideally, this function should be separate from involvement with the trading environment.
   3) AIM compliance rule creation and maintenance is done by IMD staff for equities and fixed income, respectively. Ideally, trading staff should not be creating and maintaining their own compliance rules.
   4) Equity trades have been routinely approved by equity staff rather than fixed income staff, which is the establish norm.
   5) Agency Standard Operating Procedures (SOP) and controls at the custodial bank provide mitigation of the risk associated with these separation of duties (SOD) conflicts, but best practices dictate they should be avoided if at all possible.
   6) IMD management indicated they are in the process of expanding AIM access to other IMD staff to have more personnel available for appropriate trade approvals.
   7) IMD management indicated they will be conducting cross-training sessions to ensure all IMD staff are aware of approval responsibilities in the areas of equity and fixed income trading.

RECOMMENDATION(S):

Management should:

1) Enforce established SOD for trade approvals to the extent possible with limited staff.
2) Expedite expansion of AIM user access to appropriate IMD staff to ensure availability of approvals when needed.
3) Establish strict and verifiable oversight over AIM administrative activities and compliance rules. Given the existing SOD limitations, implement high level authority of access granting and changes to the system, with periodic monitoring to confirm compliance.

ADMINISTRATIVE RESPONSE:

Management concurs with the findings and will implement the noted recommendations by July 1, 2014.

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

ARIZONA STATE RETIREMENT SYSTEM
INTERNAL AUDIT

LONG-TERM DISABILITY (LTD) PROGRAM

FEBRUARY, 2014

The Internal Audit Division (IA) completed the audit of the ASRS Long-Term Disability (LTD) program and related processes on January 31, 2014.

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Our audit Objectives were:

1) The reliability and integrity of information.
2) Compliance with policies, plans, procedures, laws, and regulations.
3) The safeguarding of assets.
4) The economical and efficient use of resources.
5) The accomplishment of established objectives and goals for operations and programs.

The scope of our audit encompassed the examination and evaluation of the internal control structure and the quality of performance in carrying out assigned responsibilities for the audited area. The tests were designed to obtain sufficient, competent, and relevant evidence in order to provide a reasonable basis for our conclusions.

The Arizona State Retirement System administration is responsible for establishing and maintaining the internal control structure. Because of the inherent limitations in any internal control structure, errors or irregularities may occur and not be detected.

Based on the results of work performed to meet the audit objectives, the following statements summarize the results of our testing and the internal recommendations presented to the Arizona State Retirement System administration with the Internal Recommendations Supplement.

1) The automated salary estimation method used in POL to determine LTD salary is not consistently reliable for accurate salary determinations when variable contribution streams are involved.
2) An LTD over-payment (OP) collection control was circumvented when the member was able to refund in June 2013, without the OP being deducted in full from the refund amount. Also, the Turn-Around-Time (TAT) is slow for resolving potential RTW over-payment offsets provided to Sedgwick by ASRS staff.
3) Until the agency completes development of the system to identify hours worked, the ASRS should determine membership eligibility prior to approving new LTD claims.
4) A variety of data integrity, reporting errors, and information technology issues related to LTD need to be addressed by management.
5) The existing SOPs for LTD are outdated and incomplete. The Strategic Plan and Risk Assessment are missing areas that should be included or clarified.
6) A past LTD recipient provided an incorrect date of birth which resulted in an extension of time on LTD, with more LTD service years towards retirement.

BACKGROUND

The ASRS has the responsibility of providing partial monthly income to its roughly 4,300 members who are currently on long-term disability.

A third party vendor, Sedgwick CMS, Inc. (Claims Management Services), is contracted annually to administer the LTD program. Sedgwick CMS is a widely-used provider of LTD services for a broad spectrum of clients, and is well-known in the industry. Sedgwick provides a wide array of services, reporting, and expertise which is monitored throughout the year by the External Affairs Division (EAD) of the ASRS. Due to Sedgwick's dominance in the industry, RFPs for competitive bidding for LTD Third Party Administrators (TPAs) usually receive little response.

The number of ASRS members on LTD each month during the past several years reflects a steady decline from about 5,000 members down to 4,300. This decline has been attributed to economic conditions related to poor employment opportunities, resulting in members staying in their positions.

Actuarially, the LTD fund has improved as well since FY 2009, with LTD contribution rates paid by employees and employers dropping from 0.50 to 0.24 in FY 2014.

Improvements have been made to overpayment collection monitoring on members returning to work so their reported earnings are more effectively offset against their monthly benefits. This program resulted in funding reductions of $814,000 since implementation on 07/01/2011, or an average of more than $27,000 per month.

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*. IA reviewed the internal control structure, interviewed personnel, obtained and reviewed documentation, and performed analytic reviews when appropriate. IA performed tests of the existing systems to provide sufficient evidence that controls were in place and being monitored, or were needed.

Some of the tests performed were:

- Global testing of all LTD members from November 2013's funding report to determine:
    a) If the six-month waiting period prior to benefits had been adhered to based on disability and effective dates.

       Conclusion: waiting period honored.

    b) If any future maximum pay date exceeds a reasonable date based on maximum number of years allowed on LTD.

       Conclusion: none were found.

    c) If any membership dates were after the normal retirement legislative change effective date of 7-1-2011.

       Conclusion: 23 were, sample tested for MPD accuracy with no errors.

d) If birth dates and membership dates were logical and reasonable.

   Conclusion: exceptions noted in data integrity finding.

e) Global testing of POL/LTD database and Sedgwick CMS, Inc. database to identify out-of-sync conditions.

   Conclusion: many exceptions found – see data integrity finding.

f) Global testing of PERIS database and POL/LTD database to identify out-of-sync conditions.

   Conclusion: 28 terminated in POL/LTD but still active in PERIS – see data integrity finding.

g) Active LTDOP (LTD Over-Payment) account event codes in PERIS – these apparently have been obsolete since 2007.

   Conclusion: 52 found, see data integrity finding.

- Analysis of active POL/LTD service accruals.

  Conclusion: exceptions - see data integrity finding.

- Analysis of post-LTD service accrual adjustment project.

  Conclusion: exceptions - see data integrity finding.

- Statistical sample testing of calculations for LTD salary, LTD benefit, Max Pay Date (MPD), and LTD service accrual.

  Conclusion: exceptions noted in various findings.

- Testing of selected POL/LTD reports.

  Conclusion: errors exist – see data integrity finding.

- Interviewed users and administrative staff of the LTD function.
- Interviewed TSD staff on technology related issues involving LTD.
- Reviewed existing SOPs.
- Reviewed the Risk/Threat Matrix and Strategic Plan Goals for LTD area.
- Review of reports available from POL/LTD.
- Review of performance measurement reports from Sedgwick.
- Review of LTD overpayment and collection processes.
- Reviewed Sedgwick's offsetting methodology for compliance with statutes.
- Matched Sedgwick's LTD funding report amounts to ASRS' payment funding authorizations for both the regular and off-cycle funding for three of six months since July 2013.

  Conclusion: no exceptions found.

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

ARIZONA STATE RETIREMENT SYSTEM
INTERNAL AUDIT

LONG-TERM DISABILITY (LTD) PROGRAM

INTERNAL RECOMMENDATION SUPPLEMENT

FEBRUARY, 2014

INTERNAL FINDINGS AND RECOMMENDATIONS:

1. **The automated salary estimation method used in POL to determine LTD salary is not consistently reliable for accurate salary determinations when variable contribution streams are involved.**

   Our testing revealed the following:

   Of 40 randomly sampled accounts out of approximately 4,400 LTD accounts in the population, we found nine exceptions:

   1) Three, or 7.5% of these exceptions, were 2005 UNISYS migration accounts that management designated to be transferred to POL with existing data. Therefore, they were considered acceptable salary determinations at time of migration.

   2) Six, or 15.0% of the sample tested had LTD salary variances that result in LTD benefit variances of $50 over or under per month. Of these:

      a. Four, or 10%, had LTD benefit variances of + or - $100 per month.

      b. Two, or 5%, had LTD benefit variances of $50, but less than $100 per month.

      c. Minimum and maximum LTD benefit variances were ($301) and $700 per month.

      d. Of the six LTD benefit variances; three indicated overpayments and three indicated underpayments.

      e. In one example, Internal Audit (IA) compared the ASRS-calculated salary to the ASRS salary earned in the prior fiscal year and the salary reported by the employer to the LTD administrator. We identified a variance in salary estimation that resulted in the member receiving an increased LTD benefit of over $700 a month. As of December 2013, they had received 81 LTD payments with a total increased value of about $56,700. The member continues receiving LTD payments and will presumably do so until their normal retirement date in July 2014.

   3) The Max Pay Date (MPD), which is the date an LTD account is ended, usually due to the member having reached a normal retirement milestone, was off in three cases, by 2-3 months (an error rate of 7.5% in the sample). Such occurrences are mitigated by the practice of conducting manual audits for all active LTD accounts within six months of the MPD.

   4) The use of prior-year pay period counts in the salary calculation method was not consistently applied and was used to adjust salary up or down without explanation. Also, the use of this count from the year prior to disability is questionable, as it can vary for a number of reasons that have no direct relationship to income earned annually.

   5) Though the methodology was followed in testing, and matched POL/LTD figures in certain cases, evaluation of estimated salary to actual past year's salary showed significant swings in the 20-35% range (+ or -). Such swings can result in overpayment or underpayment of LTD benefits, and should not be considered without appropriate documentation or objective criteria to substantiate them.

A.R.S. § 38-797, section 11 define monthly LTD salary to be "… one-twelfth of a member's annual compensation paid and payable in the fiscal year during which a member becomes disabled." Given that it is 2/3 of this amount that determines the LTD benefit which is paid to a member each month; there is a need for LTD salary to be highly accurate and determinable in an objective and repeatable way. When the method of estimating LTD salary does not produce accurate results, then manual adjustments are made, which include explanations on what was done to arrive at the revised LTD salary amount. Not all adjustments to LTD salary receive explanatory comments.

RECOMMENDATION(S):

Management should:

1) Emphasize to LTD review staff the importance of LTD salary approximating either ASRS prior year salary or employer reported salary, so as to avoid large variances from known salary that is sometimes produced by the automated POL calculation. This should include an objective definition to guide staff on what is a reasonable variance.
2) In all cases where LTD salary undergoes adjustment from the automated method, adequate explanations should be required so that any staff accessing the account can readily identify how the indicated salary was determined.

ADMINISTRATIVE RESPONSE:

Management agrees that its methodology and controls for calculating an LTD benefit should be codified so its calculations can be easily explained and audited without confusion. The ASRS took steps to codify the LTD salary calculation in statute during the most recent legislative session, which will become effective on July 24, 2014.

Management also reviewed each of the variances identified by internal audit and found that each of the cases followed the current procedures in place or the procedures in place at the time the disability claim was submitted. Management agrees these procedures should be better documented, and will strengthen its written procedures and controls regarding LTD benefit calculations. As part of this effort, Management will review the adequacy of its procedures in cases where the standard LTD benefit calculation has a high degree of variance from the prior fiscal year's salary or employer reported salary. If deemed necessary, Management will develop additional controls for cases that fall outside the tolerance range deemed acceptable.

Management also agrees to prospectively begin documenting any variance from the standard POL calculation in the member's record (see basic procedures below).

To determine an employee's salary for the purposes of calculating a monthly disability benefit, the ASRS uses the following procedure:

1. POL takes the six pay periods closest to the disability date (this is typically the salary closest to the member's pay at the onset of disability).
2. POL then excludes the highest and the lowest pay period and calculates the median value of the remaining four pay periods.

3. This value is multiplied by the number of pay periods that the employee had in the prior fiscal year to derive an annual salary.
    - This amount is compared to the annual salary reported by the employer and the annual salary in POL. If circumstances warrant, the number of pay periods is changed to more closely reflect the member's salary as reported by the employer. (See explanation below.)
    - All adjustments deemed necessary are reviewed by a second person in Member Services, who must agree the change is reasonable.
4. The annual salary is then divided by 12 to derive a monthly salary.
5. The monthly salary is then multiplied by 66⅔ percent to calculate the gross benefit.
6. Once complete, the member is notified of the salary calculated by the ASRS and of their rights to appeal the calculation.

In the normal course of business, circumstances often require users to customize some elements of the salary calculation to more closely approximate the member's current salary as reported by the employer. For example:

- Some members, usually teachers, do not always have the same number of pay periods from year to year as a result of balance of contract payments, proposition 301 payments, or other payments that occur after the end of the school year. As a result, it may appear that one year, a member was paid 24 payrolls, and the next year 26. In a few instances, it may even appear as though the member was paid 28 times, even though more than one payment occurred with the same pay period ending date. This variance can cause the salary to appear higher or lower than the salary reported by the employer. When these circumstances occur, the current procedure is to adjust the number of pay periods being used in the calculation to more closely reflect the member's annual salary.
- POL will use the closest six pay periods in the most recent fiscal year. If the disability date occurs near the start of the fiscal year the system will not have six pay periods to use in the calculation. Similarly, some members do not have six pay periods of data to use. This variance can cause the salary to appear overly high or low. When these instances occur, the user reviews the salary to see if it is close to what the employer is reporting. If it is not, then the user takes the prior fiscal year's earnings and divides it by 12 to obtain a monthly salary.

Each time a calculation is customized, a second staff person is required to review and approve the new calculation.

2. An LTD overpayment (OP) collection control was circumvented when the member was able to refund in June 2013, without the OP being deducted in full from the refund amount. Also, the Turn-Around-Time (TAT) is slow for resolving potential RTW overpayment offsets provided to Sedgwick by ASRS staff.

Our testing revealed the following:

1) A past LTD member who had been overpaid LTD benefits of almost $10,000 as of November 2011, was able to obtain a refund of their account in June 2013, including the employer portion and interest. The account had been turned over to the Attorney

General's office two years ago and was being monitored on the AG's Accounts Receivables (A/R) list by ASRS staff in FSD.

Though good controls are in place and work most of the time, in this case, when the member applied for a refund, an e-mail requesting an overpayment status update should have been sent to FSD Accounts Receivable, per policy. Accounts Receivable then notifies the refund function of the outstanding amount owed, which is deducted from the refund to the extent possible. In this case, the entire overpayment amount owed to the ASRS could have been recovered. No e-mail was sent and the refund was then processed and fully paid in early June, 2013, in the amount of approximately $32,000 after taxes.

2) ASRS staff report monthly to Sedgwick on contributions made for members on LTD, which specify RTW wages have been earned in specific pay periods. Sedgwick verifies what is reported, and, if not reported and handled already, applies the proper offset against the LTD benefit where appropriate. They then notify ASRS staff who track the offset amounts. This process sometimes takes several months to complete, which slows credits for LTD offsets and creates tracking problems.

   The ASRS reporting of RTW wages to Sedgwick only covers employers that are reporting to the ASRS. If an LTD recipient were to work for an employer other than an ASRS employer, there is no way for the ASRS to know of such an arrangement. In those cases, the ASRS and Sedgwick rely on LTD recipients to voluntarily provide income and pay period data for purposes of offsets. This situation can be problematic, in that RTW employees on LTD may be motivated to not report such earnings in order to improve their financial position by avoiding any offsets against their LTD benefit.

The system the ASRS uses to collect amounts owed from past LTD members should be reliable and ensure that no refund, retirement, or survivor benefit is paid out without first offsetting it for outstanding over-payments to the extent possible.

The offsetting of ASRS reported RTW income against corresponding LTD benefits should be timely, so that credits are available as soon as possible after reported wages are known for a month.

RECOMMENDATION(S):

Management should:

1) Improve existing controls to minimize the risk that any future ASRS benefit payable can be obtained without first being offset for amounts owed to the ASRS by the member. Such an improvement might include the use of the account event code "LGHLD" (legal hold), which we understand locks the account to processing until some action is taken.

2) Establish an effective method of tracking and aging the RTW income data submitted to Sedgwick for offset research and application. In this way, LTD administration can determine how timely the vendor is in processing the information that is provided to them by ASRS staff and what issues remain to be handled.

3) Implement a "Right of Reimbursement" form with the initial claim application packet, and require the member's signature acknowledging that they will be responsible to reimburse the disability plan if they receive earned income from any other sources that are not properly reported for offset consideration.

ADMINISTRATIVE RESPONSE:

1) Management has procedures to place LTD members requesting a refund in the 'complex' refund processing queue, which ensures a staff member reviews the file to ensure no overpayment is due. In this instance, the procedure was not followed. As part of the risk assessment process, Management will discuss the viability of using the legal hold account event to further strengthen its controls, and follow up with IA as part of its scheduled follow-up audit. In the interim, Management will send a reminder to staff regarding current procedures for overpayments.
2) Management agrees the tracking and aging of return to work income could be improved. Sedgwick set up a tracking mechanism to respond within two weeks of notification by the ASRS. After 31 days, if a response has not been received, the claim will be sent for recalculation, and be treated as a 100% offset.
3) Management agrees and has developed a Right of Reimbursement form that will be signed by future LTD applicants.

3. Until the agency completes development of the system to identify hours worked, the ASRS should determine membership eligibility prior to approving new LTD claims.

Our testing revealed the following:

1) A current LTD recipient did not work in eligible employment (20/20) either during the fiscal year when they became disabled or the prior fiscal year. The apparent ineligibility as a member of the ASRS prior to the LTD event calls into question the legitimacy of the LTD claim with the employer.

   The LTD benefits paid from May, 2012 through January, 2014 for this individual totals over $8,300. If the benefit continues to be paid until the normal retirement date in January 2025, the total expended in LTD payments will be approximately $60,600.

   Additionally, the individual's past contribution stream going back to fiscal year 2004 is questionable as to whether adequate hours were worked in eligible employment, with the possible exception of FY 2009. If this is the case, then roughly 7.44 years of ineligible service is reflected on the person's PERIS account.

   This example is one in a statistical sample of 40 randomly selected LTD accounts. Based on the results of testing the sample, there is a potential for other similar occurrences in the population.

RECOMMENDATION(S):

Management should:

1) Follow A.R.S. § 38-797.08, on errors in benefit computations and end the LTD account for the ineligible employee and attempt to collect the LTD overpayments. Also, research prior year's ASRS eligibility status, and, if warranted, return contributions and adjust the accrued years of service for this individual.
2) Establish a means by which new LTD accounts can be verified for ASRS membership eligibility prior to an LTD claim being approved and paid.
3) Conduct testing on all existing LTD recipients to check for possible additional instances of ineligible ASRS membership prior to disability. One method might be to establish a threshold salary indicative of eligibility and research in detail exceptions below that threshold.
4) Accelerate management's project for identifying ineligible employees to minimize the risk of similar events occurring in the future.
5) Contact this LTD recipient's employer to review the 20/20 eligibility criteria and determine if the employer is in need of additional training on the proper reporting of contributions.

ADMINISTRATIVE RESPONSE:

1) Management has done a preliminary review of this member, and found that this member may not have met the criteria for membership. Management will meet to further discuss this case and determine the appropriate course of action, and follow up with IA as part of its scheduled follow-up audit.
2) Management does not believe the single case identified by IA is demonstrable enough to warrant a change in the current control structure at this time. Management will discuss this issue further as part of its risk assessment to determine if additional controls are warranted and will follow up with IA as part of its scheduled follow-up audit.
3) Management does not believe the single case identified by IA is demonstrable enough to warrant a change in the current control structure at this time. Management will discuss this issue further as part of its risk assessment to determine if additional controls are warranted and will follow up with IA as part of its scheduled follow up audit.
4) In fiscal year 2013, Management approved a technology project to expand the payroll reporting format to include additional data elements such as hours worked. This effort was identified as a way to assist the ASRS (and also employers) in identifying potential cases where an ineligible member may be contributing through the regular contribution reporting structure, rather than requiring an employer audit. The technology phase of this effort was completed in the fall of 2013, and the Financial Services Division (FSD) and the External Affairs Division have begun to roll the new format out to employers.

   Staff anticipates the rollout effort could take as long as two years, due to the number of staff available to work on the rollout, the effort that may be required from

employers to submit the new data, and the number of employer payroll reporting units (over 500).

5) Management agrees and will work with the employer to identify whether further training is needed.

4. **A variety of data integrity, reporting errors, and information technology issues related to LTD need to be addressed by management.**

Our testing revealed the following:

1) LTD database inconsistencies between POL and PERIS. When an LTD account is terminated in POL, there is a trigger that is supposed to end the LTD account event code in PERIS. As previously reported, that trigger doesn't always work properly, resulting in PERIS showing an active LTD event when POL indicates a terminated status. There were 28 such inconsistencies noted during the audit. Erroneously active LTD account events in PERIS cause confusion for users and can result in continuing group insurance and HBS benefits that may not be appropriate.

2) LTD database inconsistencies between Sedgwick CMS and POL. Though some of these issues appear minor, they were included to reflect the degree to which the databases are misaligned.

   a. Only about 22% of all LTD accounts in POL matched Sedgwick's database for LTD benefit amount paid in November, 2013.

   b. Of the remaining 78%, all but a handful were within the range of + or - $1. The minor variances were the result of Sedgwick consistently using four decimal points to calculate the 2/3% LTD benefit, while POL used the following conventions:

      - Whole dollar rounding during FYs 1996-2001 (211 instances, or about 5% of LTD accounts)
      - Five decimal points used by POL (about 3,200, or 72% of LTD accounts)

      These minor variances do not appear on the POL Funding Reconciliation report due to a programmed exclusion for variances of less than a dollar.

   c. Approximately ten LTD accounts have LTD benefit variances larger than $1. These were reviewed by Member Services Division (MSD) staff and verified as being incorrectly calculated, based on the salary displayed in POL. These LTD accounts are from the UNISYS migration, and staff has been told not to alter such data.

   d. The Risk/Control Strategies (#2) specifies a monthly reconciliation by the vendor's rep of active LTD recipients. The active reconciliation report in POL is intended for this purpose so as to maintain certain data from both databases in sync. This report has previously been reported as having known flaws, although about 70% of the report is usable. The Sedgwick representative reported not using section "A" of the report to correct such things as disability date and benefit effective date.

e. Testing of section "A" of the Active Reconciliation report in POL showed:

- About 33% of the exceptions reported were logic errors that should not be appearing on the report. Once a claim number doesn't match, the report should not then compare dates on a claim number that it already declared doesn't match.
- One error type did not reflect a true description of the exception reported on. This occurs when "Claim number does not match" is displayed, but no claim exists at all.
- At least one reported exception was sometimes tested as false … "Claim number does not match," when indeed it did.

3) POL for LTD posts accrued LTD service for the current month on the first day of the following month. We noted the following issues with the accrual of LTD service in POL:

a. The section heading indicating an "as of" date for the service is false. The date is actually the date the LTD module is accessed by the user.

b. March and April accruals for FY 2007 were consistently missing during testing and users indicated a processing problem existed for those months.

c. Other single month accrual omissions were noted in FY 2008.

d. One LTD account was found to have multiple LTD accrual omissions totaling 13 months.

e. LTD service is accrued at 0.083 per month in which an LTD benefit is paid. This adds up to 0.996 over 12 months and results in the need for an adjustment of 0.004 per year to reflect a full year of service on LTD.

f. ASRS staff manually audit and adjust the LTD service credit based on the issues mentioned. This is to ensure members have access to accurate overall years of service for benefit estimates. Post-LTD manual service audits are done from a list that is 34 months old, with about 12 completed per month as time permits. Unfortunately, there are about 770 accounts remaining on the list. Also, 625 new post-LTD accounts have been created during those 34 months, which is a growth rate of over 18 per month. Without assistance or automation of this process, ASRS staff is unlikely to get caught up.

4) The PERIS database has 52 obsolete LTDOP account event codes that are active (not ended). This code was used several years ago to track LTD overpayment collections, but is reportedly no longer used. The ASRS currently has FSD Accounts Receivable tracking LTD overpayment collections. Only three of these 52 codes were found to be associated with SSNs for currently active LTD collections in Accounts Receivable. Allowing outdated codes to remain in active status can be confusing to users and impairs data integrity.

5) Post-LTD Health Benefit Supplement (HBS) monitoring is done to ensure HBS payments are not continued after an LTD event has ended. A COGNOS report was created as a monitoring tool for this purpose. This report has been found to include LTD accounts that are still active, which creates false positives, unnecessary

research, and wasted time. This happens when more than one LTD account event is associated with an SSN and one of them remains active while an ended LTD code triggers appearance on the report.

6) Post-LTD insurance monitoring for the 12-month rule and RTW, whichever occurs first, ensures that group health insurance benefits will continue for only the statutorily allowed period of time. The member pays the premiums for such insurance, but receives no HBS allowance. A COGNOS report was created as a monitoring tool for this purpose. This report has been found to include LTD accounts that are still active, which creates false positives, unnecessary research, and wasted time. This happens when more than one LTD account event is associated with an SSN and one of them remains active while an ended LTD code triggers their appearance on the report.

7) There is an additional event that is related to the above two reporting tools, and the database inconsistency problem mentioned under item #1 above. This event is a refund of a members account balance. This action is supposed to end all membership rights in the ASRS. Instead, when coupled with an LTD code erroneously left active in PERIS, a refunding situation can result in both insurance and HBS continuing while not appearing on either report above, since the reports look for ended LTD events. This situation was discovered and reported in a previous audit. This audit found one instance covering dental insurance and HBS over a 61-month period, after the member refunded. The issue was reviewed with the dental vendor and FSD staff. The coverage was terminated and a credit for HBS was posted for over $1,300.

8) The Sedgwick funding report is downloaded to a PERIS database table monthly. Since July 2013, one of the fields, “Post Tax Overpayment Deductions,” has had the cents truncated from the amount in the field during download. This created an out-of-balance condition for the monthly downloaded files that apparently went unnoticed for six months. The impact of the missing cents appears to be insignificant, except for the overall data integrity factor involved.

9) There were approximately 175 POL/LTD accounts that had no LTD salary with which to test the LTD benefit. The same accounts usually had no ASRS salary as well. All the accounts had LTD benefit effective dates prior to FY 2002 and so were UNISYS migration accounts in FY 2005. The absence of this data hinders the ability to readily verify an LTD benefit calculation.

10) POL performance issues;

    a. The LTD module is sporadic, with LTD account queries executing in a range of 5 to 26 seconds, depending on the day and time accessed.

    b. LTD account printing does not work properly. Data displayed on screen is skewed and missing when printed. (This could be a POL problem in general.)

11) PERIS data integrity that could impact the LTD area. As of 07/01/2011, membership date has become relevant in determining normal retirements and, therefore, Max Pay Dates. Testing of this field found:

    a. A membership date of 8/20/0980, which is over 1,000 years ago.

b. A membership date of 1/01/1950, which was more than four years before the member was born.

c. A membership date of 7/11/1960, which was the same as the member's birthdate.

Best practices dictate that database integrity be maintained in order to promote timely and accurate processing and instill trust in a system. Databases that are expected to be in sync should be periodically tested to ensure they are, and reconciled for all exceptions found. This testing and reconciling process can indicate programming glitches that have gone undetected and assist management in making corrections and improvements. Data that is faulty or not logical can lead to bad decisions, no decisions, confusion and frustration on the part of users.

RECOMMENDATION(S):

Management should:

1) Create a process that effectively compares the active LTD members in POL and PERIS periodically (suggest monthly at the outset). This process should produce a report that provides sufficient detail on the exceptions so that the differences can be reconciled and corrected, from the prospective of both databases. Since this issue wasn't expected to occur, special attention should be given to potential causative factors, with a view to determining why the triggering feature between the two databases doesn't work in some cases. In this regard, the Technology Services Division's (TSD) expertise may be needed.

2) Decide on how firmly in sync the POL/LTD and Sedgwick databases should be. If the agency wants them in sync, then:

   a. 22% are already in sync.

   b. Recalculate all LTD Benefit amounts with variances from Sedgwick of less than $1 using the same four decimal % that Sedgwick uses (i.e. 0.6667). Replace the existing amounts in POL/LTD with these corrected amounts. If this is done, approximately 99% of POL/LTD will match to Sedgwick payment amounts to within a cent.

   c. For the 10 or so LTD accounts with benefit variances of over $1, either correct the benefit amount so that it's accurately calculated or reverse calculate a corresponding salary so that a consistent application of salary x .6667 is maintained. In these few cases, a comment in the POL record could explain the reason for the salary adjustment.

   d. Regardless of its current partial flaws, ensure the useful portions of the Active Reconciliation report are acted on and verified by ASRS staff as being completed. During this process, flaws in the report that have been identified could be expanded and clarified by users so that any eventual fix further improves the product. Finally, expedite the long-overdue corrections to this report, taking into account all known issues.

3) Decide on whether to enhance automation of the LTD service accrual process to improve accuracy and reliability, and also avoid the slow and costly process of

having to manually adjust LTD service well into the future. Also, until manual adjustments are made, benefit estimates will be off slightly.

a. Remove the "as of" date in the section heading. Leave only the simple section heading, or replace with a meaningful description of contents … such as "LTD service accrued as of the 1st day of the following month."

4) If the LTDOP account event code is indeed obsolete, then end all existing active ones immediately. If, on the other hand, LTDOP or LGHLD could be used effectively to ensure that member overpayments are collected without the possibility of collection being inadvertently circumvented, as was reported in finding #2, then, such an avenue should be researched for possible adoption.

5) Have TSD fine-tune the post-LTD HBS monitoring report to exclude those instances where more than one LTD account event is associated with an SSN and at least one of them remains active.

6) Have TSD fine-tune the post-LTD insurance monitoring report to exclude those instances where more than one LTD account event is associated with an SSN and at least one of them remains active.

7) Have TSD create a COGNOS report that is similar in nature to the post-LTD HBS and insurance monitoring reports, except that it could be called the post-REFUND(FORFTR) monitoring report. It would include all instances of HBS payments and active INSMED and INSDEN insurance account event codes in PERIS where a FORFTR status is present, but exclude RETIRE status members. The object of the report would be to identify PERIS accounts for members that have no membership rights because they have refunded, but they are still receiving HBS allowances and/or group health insurance benefits. This unusual occurrence is associated with post-LTD events where the member refunds.

8) Determine how and why the download process for Sedgwick's funding file somehow changed in July, 2013, which resulted in truncation of cents from an amount column that had previously downloaded accurately. Have TSD verify that adequate protections exists to ensure such downloads are not altered from their original content.

9) To avoid active POL/LTD fields that are missing data from the UNISYS migration, the LTD salary for the 175 or so accounts can be reverse calculated from the benefit, to a corresponding salary and then input. In these cases, a comment in the POL record could state "to maintain data integrity" as a reason for the salary being filled in.

10) POL Performance:

a. Have TSD research whether LTD account record return time can be shortened to lessen the time ASRS staff must wait for retrieval when an inquiry is made. This applies to LTD staff, Call Center staff, or anyone accessing LTD records.

b. Have TSD research why LTD account printing does not work properly and fix, if possible.

ADMINISTRATIVE RESPONSE:

1) Management agrees and has submitted a service request that will help the FSD complete this reconciliation (JIRA# CGN-229). This JIRA is expected to be completed prior to the end of the fiscal year.

2) Management does not believe additional technology development is warranted, and that variances under $1 fit within an acceptable range and should require no further action. Although it would be ideal to have each system match exactly, the cost to update the rounding rule used at either the ASRS or Sedgwick is likely to outweigh the benefit of such a change.

   The cases that have been identified by IA as having a variance of $1 or more have been all reviewed, and staff was able to reasonably explain all but one instance, including the accounts that have been identified as being in error as a result of the migration from UNISYS to POL. The one error that Management identified had already been fixed by Sedgwick as of March 2014.

   Management agrees the Active Reconciliation Report could be improved and has submitted a service request to modify the report (JIRA# POL-8301).

3) Management is aware of these issues and does not believe the impact of these events is great enough to warrant additional technology development or human resources to correct them at this time. The LTD service accrual process was automated in 2006 when the LTD module was built, making the new system far more robust than the previous version. Users are aware that some types of accounts will require manual intervention for some services, and procedures have been written with this in mind.

4) Management agrees that obsolete account event codes should not be used, and will work to have them ended. As part of the risk assessment process, Management will also discuss the viability of using the legal hold account event to further strengthen its controls.

5) Management agrees and has submitted a service request to modify the report mentioned (JIRA# CGN-222). This JIRA is expected to be completed prior to the end of the fiscal year.

6) Management agrees and has submitted a service request to modify the report mentioned (JIRA# CGN-223). This JIRA is expected to be completed prior to the end of the fiscal year.

7) Management is confident this issue will be resolved with the implementation of JIRA# CGN-229, which is referenced in #1 above and is not currently planning to request additional reports regarding this issue.

8) Management agrees and has reported this incident. JIRA# POL-13167 has been created to address this issue. This JIRA is expected to be completed prior to the end of the fiscal year.

9) The reverse calculation of salaries and missing data on old, open LTD accounts occurs when the account is audited. Audits are conducted on LTD accounts when a member on LTD requests a benefit estimate, or six months prior to the member's estimated max pay date (the date the ASRS estimates the member will be eligible

for normal retirement). The ASRS estimates that all of these audits will likely be concluded within the next six months.

10) a. TSD recently implemented a new database appliance, which should improve return time for users. MSD will submit a service request in the future if it determines the processing speed of this application needs to be further improved.

b. Management agrees and has reported this as an incident (JIRA# POL-12173).

5. The existing SOPs for LTD are outdated and incomplete. The Strategic Plan and Risk Assessment are missing areas that should be included or clarified.

Our testing revealed the following:

1) The existing 77 page LTD SOP was created in 2009 and does not reflect what is currently done in the area.

2) A number of LTD related functions have no SOPs. Some of these are:

- Post-LTD (and FORFTR) HBS monitoring to ensure ending of payments for subsidies.
- Post-LTD (and FORFTR) insurance monitoring for 12-month rule and RTW, whichever occurs first (for ongoing group insurance from ASRS vendors only).
- Post-LTD (and FORFTR) insurance cleanup of account event codes for employer provided plans (non-ASRS vendors … no need to monitor).
- Monitoring of LTD recipients making contributions to ASRS and monthly reporting to Sedgwick CMS on these.
- The current over-payment collection process and monitoring.
- Any new procedures that are implemented as a result of resolutions to this audit.

3) Risk/Threat matrix item #2, regarding member eligibility for LTD, is not clear as to medical eligibility or ASRS membership eligibility. Both forms of eligibility impact risk should a member lack status for either. The ASRS does not currently check whether an employee applying for LTD is eligible to be a member of ASRS. Finding #3 covered one LTD recipient that was not eligible for ASRS membership.

4) The Risk/Threat matrix is missing post-LTD HBS payment monitoring, which is a process similar to item #4 of the matrix. The audit found over $1,500 in HBS overpayments that had avoided detection due to members refunding shortly after coming off LTD. In one case, both the dental coverage and the HBS payment for same continued for 61 months after the member refunded. FSD credited the over-payments back to the ASRS when notified of them.

5) Risk/Threat matrix item #4 is incomplete in that it only mentions the 12-month portion of the statutory limitation to group health insurance coverage. There is also a RTW element, and both are predicated on whichever occurs first.

6) The Strategic Plan - LTD program administration section item #4, mentions post-LTD discontinued insurance coverage, when, in fact, coverage can continue per statute as indicated in item #5 above.

Best practices dictate that all important functions performed by an organization be recorded in sufficient detail to allow for the training of staff, and alternative personnel to be able to perform the job in the event of staffing changes that could jeopardize the standard work processes. In this way, the agency reduces its risk exposure and protects itself from such changes and other unexpected events by maintaining a comprehensive how-to library that includes institutional knowledge.

The Risk Assessment and Strategic Plan should cover all relevant risks and agency objectives in mitigating those risks.

RECOMMENDATION(S):

Management should:

1) Arrange for the update of the existing LTD SOP from 2009. For those LTD related functions performed, but not yet covered in the larger SOP, include them or create individual SOPs that cover these as well.
2) Establish a method to periodically review SOPs to ensure they remain timely and accurate.
3) Include missing risk and control elements and clarify language where necessary on the Risk Assessment and Strategic Plan.

ADMINISTRATIVE RESPONSE:

1) Management agrees and has already taken steps to update and/or add to the relevant SOP document(s).
2) Management agrees and will ensure the SOP is reviewed every two years, or when a major change occurs to the LTD process.
3) Management agrees and will work to add or clarify language in the risk assessment and operational objectives as needed.

6. A past LTD recipient provided an incorrect date of birth which resulted in an extension of time on LTD, with more LTD service years towards retirement.

We noted:

1) Regarding the member's false birthdate:
   - In mid-November, 2013, IA learned of a situation involving a then deceased retired member who reportedly had provided a false date of birth on documents previously submitted to the ASRS (Enrollment form, Retirement Application, HI Enrollment Application).
   - The member had been on LTD from 1993 until retirement in 2000.
   - The member died on 11/02/2013, and left a surviving spouse with benefits.
   - As a result of misinforming the ASRS on the birth date, the member received more than $17,429 in overpayments for LTD and pension.

- The overpayments were actuarially offset against the survivor beneficiary's payments.
- As a result of the member submitting an illegible driver's license copy, the ASRS staff was aware of a potential age variance of five years and its overpayment impact as of 04/02/2012. Electronic notes made in PERIS indicate clearer documentation was requested and a birth certificate was eventually received and imaged on 02/13/2013, ten months later. No action was taken to correct the pension amount or collect the overpayments for nine months, though the requested document had been received. The member's death on 11/02/2013 initiated such action and a notifying letter to the survivor beneficiary was sent 12/02/2013.

2) Regarding the agency's policy on proof of age:
   - The ASRS has an overreliance on employers as a main point of control over date of birth (DOB) accuracy, via enrollment form data checks that began in May 2010. As employer audits have shown, employers can and do make mistakes and take shortcuts. Relying on employers to verify DOB with regard to initial membership does not have the same degree of credibility as an independent verification of DOB when an age-based benefit is about to be paid out by the ASRS.
   - Prior to May 2010, enrollment forms were manually filled out by employees or employers and manually keyed by ASRS staff, if and when received. This old process has resulted in identified DOB errors due to legibility, dating, and keying errors. Approximately 98% of currently active LTD recipients became members prior to the current online enrollment form and employer check now being used as a control.
   - Currently, the ASRS requires a driver's license for identification purposes when a refund of a member's account exceeds $5,000. It is noteworthy that $5,000 represents about 2-3 months of the average LTD benefit which could continue for years, yet no similar documentation is needed to justify an LTD benefit, where the length of the benefit is determined by age and can also impact years of service towards a pension benefit.
3) Regarding the delay in action on the overpayment, a process should be in place to ensure action is taken expeditiously when factors are known that involve overpayments for LTD and/or pensions, which were both impacted in this situation.

   Best practices dictate that a person's age is independently verified when it is a determining factor in the amount of benefits received and, in the case of LTD, for how long those benefits are received. At the ASRS, a member's age is an important factor for both LTD and retirement benefits. The ASRS already requires independent proof of age for joint annuitant pension options.

RECOMMENDATION(S):

Management should:

1) Arrange for all new LTD applicants to have their age independently verified prior to receiving an LTD benefit. Some suggested ways this could be accomplished are:

a. Require all LTD applications to include a legible copy of a driver's license or equivalent independent proof of age, such as a birth certificate or passport.

b. Per Sedgwick, obtain the DOB directly from the employer by adding a field to the employer notice that could be verified against the DOB on the member's claim form. Presumably, the employer would have an accurate DOB due to implementing E-Verify and other documentation requirements.

c. Use Accurint or a similar third-party vendor to verify DOBs on all new LTD applicants.

2) Use Accurint or a similar third-party vendor to verify DOBs on any existing LTD recipients, either all at once or gradually, over a period of time.

3) Create a process where potential overpayment situations that become known to staff are monitored to expedite appropriate actions. This may include suspension of benefits till required documents are received, or tracking of needed documents when they are imaged so as to trigger an action.

ADMINISTRATIVE RESPONSE:

1) Management does not believe that the single case identified by IA is demonstrable enough to warrant a change in the current control structure at this time. Management will discuss this issue further as part of its risk assessment to determine if additional controls are warranted and will follow up with IA as part of its scheduled follow up audit.

   Currently, the ASRS relies on employers to verify membership eligibility, social security numbers and birth dates at the time of enrollment. Management believes that these controls have been generally sufficient, carrying a low likelihood of a risk event occurring, beyond an acceptable risk tolerance. However, as noted above, Management will take steps to update its risk assessment.

   As a secondary control, staff also routinely reviews member data when various applications are received. In the case mentioned, staff did identify a discrepancy in the birthdate and followed through by requesting supplementary documentation from the member, which was sent, but not acted upon until after the member had passed away. Staff has applied an actuarial reduction to the remaining survivor benefit to recover the overpayment.

2) Management does not believe sufficient data is present to warrant an immediate review of all LTD benefit recipients. Management does believe that data integrity is important and will discuss this issue as part of a risk assessment discussion on data integrity.

   Management believes a better approach to independently verifying data at the time of disbursement would be for IA to include a sample review of active member census data in its employer audit objectives. With this review, potential data integrity issues could be identified far in advance of a member applying for benefits.

3) Management does not currently have a process to workflow enable and track the receipt of birth certificates or other data verification documents unless the documents are required in the normal course of conducting business, such as

processing a retirement application. Management does not believe that sufficient data is present at this time to warrant further action on this issue, but will discuss it as part of its risk assessment discussion on data integrity.