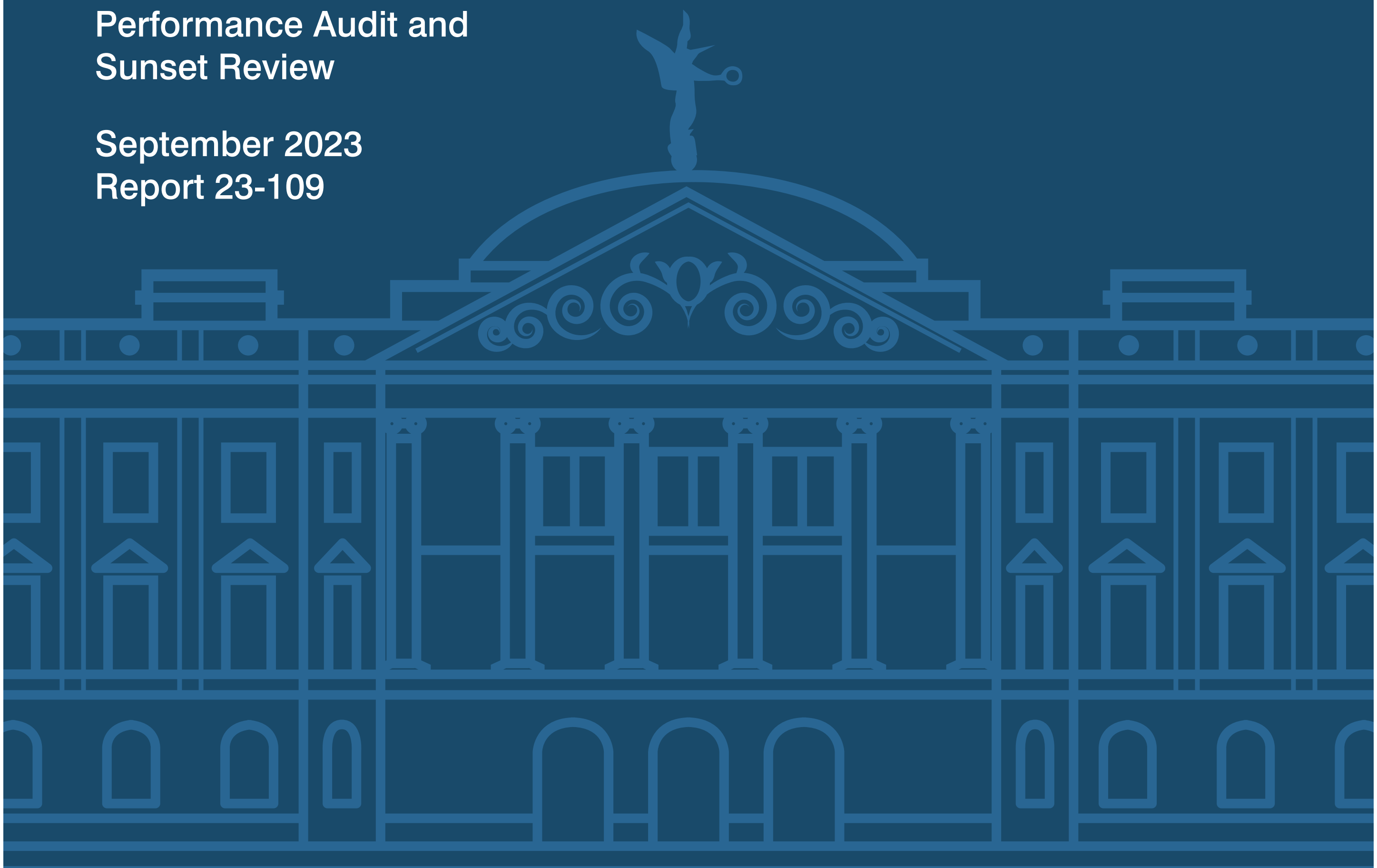
Public Safety Personnel Retirement System (System)

System and Legislature have taken various steps to improve pension plans' sustainability and ability of public safety and corrections officers' pension plans to meet retirement obligations for plan members, but despite these efforts, the elected officials' pension plan's status declined further, and System's former Administrator entered into business relationships with 2 former Board members and all 3 participated in decisions that could have been influenced by these relationships

Performance Audit and
Sunset Review

September 2023
Report 23-109



A Report to the Arizona Legislature

Lindsey A. Perry
Auditor General

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The Arizona Auditor General's mission is to provide independent and impartial information and specific recommendations to improve the operations of State and local government entities. To this end, the Office provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits and special reviews of school districts, State agencies, and the programs they administer.

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September 22, 2023

Members of the Arizona Legislature

The Honorable Katie Hobbs, Governor

Mr. Michael Townsend, Administrator
Public Safety Personnel Retirement System

Transmitted herewith is the Auditor General's report, A *Performance Audit and Sunset Review of the Public Safety Personnel Retirement System*. This report is in response to a December 17, 2020, resolution of the Joint Legislative Audit Committee. The audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within this report a copy of the Report Highlights to provide a quick summary for your convenience.

As outlined in its response, the Public Safety Personnel Retirement System agrees with all the findings and plans to implement all the recommendations. My Office will follow up with the Public Safety Personnel Retirement System in 6 months to assess its progress in implementing the recommendations. I express my appreciation to Administrator Townsend and System staff for their cooperation and assistance throughout the audit.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

Lindsey A. Perry

Lindsey A. Perry, CPA, CFE
Auditor General

Report Highlights

Arizona Auditor General
Making a positive difference

Public Safety Personnel Retirement System (System)

System and Legislature have taken various steps to improve pension plans' sustainability and ability of public safety and corrections officers' pension plans to meet retirement obligations for plan members, but despite these efforts, the elected officials' pension plan's status declined further, and System's former Administrator entered into business relationships with 2 former Board members and all 3 participated in decisions that could have been influenced by these relationships

Audit purpose

To provide information on the System's pension plans' funded status and factors affecting the funded status; efforts to improve the plans' long-term sustainability; how the funded status and investment returns compare to other plans; compliance with conflict-of-interest and open meeting laws; and to provide responses to the statutory sunset factors.

Key findings

- The System's statutory purpose is to provide a uniform, consistent, and equitable State-wide retirement program for public safety personnel and consists of 3 primary pension plans: the Public Safety Personnel Retirement Plan (PSPRS), Corrections Officer Retirement Plan (CORP), and Elected Officials' Retirement Plan (EORP).
- Our 2015 performance audit and sunset review reported steady declines in the System's 3 plans' funded statuses, which is a measure of a plan's assets compared to its liabilities. Since that time, the Legislature, voters, and System have taken several steps to improve the 3 plans' long-term sustainability, such as replacing permanent benefit increases with cost-of-living adjustments; revising eligibility, benefit, and payroll contribution requirements; and establishing an employer risk pool to help ensure that smaller PSPRS employers can pay for their members' pension benefits.
- Since 2015:
    - PSPRS' and CORP's funded statuses have improved as of June 2022, primarily due to legislative appropriations of approximately $2.2 billion, employers' additional contributions, and the System's investment income.
    - EORP's funded status has continued to decline due to various factors, including a 2016 Arizona Supreme Court ruling requiring some statutorily increased member contribution payments to be returned to affected members.
- A former System Administrator entered business relationships with 2 former Board members and all 3 failed to disclose and refrain from participating in System decisions that could have been influenced by these relationships, such as a salary increase for the former Administrator.

Key recommendation

Develop and/or revise and implement conflict-of-interest policies and procedures to ensure it complies with State requirements and follows recommended practices.

See Performance Audit and Sunset Review Report 23-109, September 2023, at www.azauditor.gov.

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INTRODUCTION

The Arizona Auditor General has completed a performance audit and sunset review of the Public Safety Personnel Retirement System (System).[1] This performance audit and sunset review provides information on the funded status of the System's defined benefit retirement plans; factors affecting the plans' funded status; changes made to help improve the plans' long-term sustainability; how the funded status compares to other plans; and the System's investments and how the investment returns for its plans compare to other plans. It also provides responses to the statutory sunset factors and assessed the System's compliance with the State's conflict-of-interest and open meeting laws.

System composition, membership, and structure

The System consists of the following 3 defined benefit plans—the Public Safety Personnel Retirement System plan (PSPRS), the Corrections Officer Retirement Plan (CORP), and the Elected Officials' Retirement Plan (EORP)—that were established for different purposes, including to serve different types of employers and members, and that vary in terms of structure (see textbox on page 2 for a description of plan types):[2]

- **PSPRS—**was established in 1968 to provide a State-wide retirement plan for public safety personnel, such as police officers, firefighters, and highway patrol officers.[3] Various employers participate in PSPRS, including State, county, city, town, community college district, Indian tribe, and fire district employers.[4] As of June 2022, PSPRS had 38,521 members and included a total of 228 employers (see Table 1 on page 4 for the number of members and Appendix A, Table 10, page a-2, for the number of employers for each employer type). The 5 largest PSPRS employers with active members are the City of Phoenix Police Department, City of Phoenix Fire Department, Arizona Department of Public Safety, City of Mesa Police Department, and City of Tucson Police Department.[5]

  PSPRS is a defined benefit, agent multiple-employer plan, which means that employers' pension assets are pooled for investment purposes, but each employer is responsible for providing lifelong pension benefits to its retired members. The System is responsible for investing and managing PSPRS' pension assets. However, A.R.S. §38-847 requires that a local board be established for each employer and that the local board perform certain administrative responsibilities, such as making eligibility determinations. Additionally, statutory changes to PSPRS created a 3-tiered structure for retirement eligibility, benefits, and employer and

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1 The System encompasses the Board of Trustees, the Administrator and staff, and the plans it oversees.

2 The plans also provide disability benefits, survivor benefits for spouses and children, and retiree health insurance subsidies to plan members. Further, the System administers the Public Safety Cancer Insurance Policy Program, a multiple-employer cancer insurance program to provide cancer insurance benefits for active and retired firefighters, peace officers, and correction officers of certain State and local governments. In addition, the System administers the Arizona Employer's Pension Prefunding Plan established by A.R.S. §38-932 to allow participating employers to prefund their unfunded and future required contributions for their defined benefit pension plans.

3 Beginning July 1, 2017, A.R.S. §38-866 established the Public Safety Personnel Defined Contribution Retirement Plan to provide an alternative to the PSPRS defined benefit plan. See page 3 for more information.

4 Fire districts are special taxing districts established pursuant to Arizona Revised Statutes, Title 48, as political subdivisions of the State and are governed by an elected board. A.R.S. 38-842(28) includes fire districts as permitted employers in PSPRS.

5 Active members are currently working for a contributing employer and are actively contributing. See Table 1 on page 4 for more information on members.

member payroll contribution rates based on members' hire dates (see Appendix B, Table 11, page b-2, for PSPRS tier information).[6]

Plan types

Defined benefit plan—Provides the member a guaranteed lifelong pension benefit after retirement. The benefit is based on factors such as the participant's salary, age, and the number of years worked for the employer. The System includes the 2 following types of defined benefit plans:

- **Agent multiple-employer plan** means that employers' pension assets are pooled for investment purposes, and the System is responsible for investing and managing the pension assets. However, each employer has a separate account and is responsible for providing pension benefits to its retired members.
- **Cost-sharing multiple-employer plan** means that the participating employers pool their assets in 1 account, the System is responsible for investing and managing the pension assets, and the employers share the costs for providing pension benefits to all members.

Defined contribution plan—Similar to a 401(k) plan, the System's defined contribution plans are retirement plans where the member and the employer contribute to the employee's individual account under the plan. The amount in the account at distribution includes the contributions and investment gains or losses, minus any investment and administrative fees. Generally, the contributions and earnings are not taxed until distribution. The value of the account will change based on contributions and the value and performance of the investments.

Source: Auditor General staff review included: Internal Revenue Service (IRS). (2023). *Definitions*. Retrieved 5/25/2023 from https://www. irs.gov/retirement-plans/plan-participant-employee/definitions; Governmental Accounting Standards Board (GASB). (n.d.). Fact sheet on the GASB's new pension standards: Governments in cost-sharing multiple-employer defined benefit pension plans. Retrieved 5/25/2023 from https://gasb.org/Page/PageContent?pageId=/staticpages/costsharing-employer.html#:~:text=A%20cost%2Dsharing%20multiple%2Demployer%20plan%20is%20one%20in%20which,retirees%20of%20any%20participating%20employer.

- **CORP—**was established in 1986 to provide retirement benefits for Arizona correctional officers and other statutorily designated employees, such as detention officers, probation officers, surveillance officers, and dispatchers.[7] Various employers participate in CORP, including the State, counties, cities, and towns. As of June 2022, CORP had 19,269 members and included 28 employers (see Table 1 on page 4 for the number of members and Appendix A, Table 10, page a-2, for the number of employers for each employer type). The 5 largest employers with active members participating in CORP are the Arizona Department of Corrections, Rehabilitation & Reentry; Arizona Administrative Office of the Courts; Maricopa County; Pima County; and Arizona Department of Juvenile Corrections.

  Like PSPRS, CORP is a defined benefit, agent multiple-employer plan.[8] A.R.S. §38-893 also requires local boards to be established to carry out similar functions as the boards for the PSPRS.[9]

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6 See Laws 2011, Ch. 357, for legislative amendments resulting in tier 2, and Laws 2016, Ch. 2, for changes resulting in tier 3. In addition, although PSPRS is largely an agent multiple-employer plan, Laws 2017, Ch. 235, established a cost-sharing, multiple-employer plan within tier 3 by creating a risk pool for smaller employers (see Questions and Answers, page 25, for additional information on the risk pool).

7 A.R.S. §38-881(13). In addition, A.R.S. §38-881.01 was amended to close CORP to all employees in designated positions, except for probation and surveillance officers employed by the judiciary, hired after July 1, 2018, and to require members to participate in the Public Safety Personnel Defined Contribution Retirement Plan (see page 3 and footnote 8 for additional information). The Arizona Supreme Court, through its Administrative Office of the Courts, administratively oversees the probation and surveillance officers employed by the judiciary and has the only CORP defined benefit plan for members hired after July 1, 2018 (see footnote 8 for additional information).

8 Although CORP is largely an agent multiple-employer plan, the Arizona Administrative Office of the Courts was established as a cost-sharing, multiple-employer plan within CORP. The Arizona Administrative Office of the Courts has a local board that decides membership and benefits eligibility for all members and each county maintains administrative responsibility over the day-to-day functions and employment of its members. As such, the System recognizes the Arizona Administrative Office of the Courts as 15 separate employers. However, because it represents 1 plan, for purposes of this audit, we considered the Arizona Administrative Office of the Courts plan to be 1 employer.

9 A.R.S. §38-893.

Additionally, statutory changes to CORP created a 3-tiered structure for retirement eligibility, benefits, and employer and member payroll contribution rates based on members' hire dates (see Appendix B, Table 12, page b-4, for CORP tier information).[10]

- **EORP—**was established in 1985 to provide retirement benefits for elected Arizona officials and certain judges, such as members of the Arizona Supreme Court, Superior Court, and Court of Appeals, and court commissioners. As of June 2022, EORP had 1,825 members and included a total of 38 employers (see Table 1 on page 4 for the number of members). EORP is a defined benefit, cost-sharing multiple-employer plan where assets are pooled and costs for pension benefits are shared among all employers. The System is responsible for EORP's administrative functions and for managing EORP's assets.[11]

  Since January 2014, EORP stopped admitting new members. Elected officials and employees elected, appointed, or hired after that date are now required to participate in the Elected Officials' Defined Contribution Retirement System (see below for more information).[12] Similar to PSPRS and CORP, statutory changes to EORP created a 2-tiered structure for retirement eligibility, benefits, and member and employee payroll contribution rates based on members' hire dates (see textbox on page 2 and Appendix B, Table 13, page b-6, for EORP tier information).[13]

The System also manages 2 defined contribution plans—the Elected Officials' Defined Contribution Retirement System (EODCRS) and the Public Safety Personnel Defined Contribution Retirement Plan (PSPDCRP):

- **EODCRS—**A.R.S. §38-832 established the EODCRS for elected officials and employees elected, appointed, or hired on or after January 1, 2014, when the EORP was closed to new members. The System reported that as of June 2023, 454 members were either enrolled or elected to enroll in the EODCRS.

- **PSPDCRP—**A.R.S. §38-866 established the PSPDCRP for public safety personnel hired on or after July 1, 2017, who must elect to participate in PSPDCRP within 90 days of their hire date or they are automatically enrolled in PSPRS. Further, all employees in statutorily designated positions hired on or after July 1, 2018, except for probation and surveillance officers employed in the judiciary, are required to participate in the PSPDCRP. The System reported that as of June 2023, 5,551 members were either enrolled or elected to enroll in the PSPDCRP.[14]

Board membership

Statute establishes the System and authorizes a Board of Trustees (Board) to administer it.[15] The Board is responsible for providing direction to and overseeing the System, including establishing investment objectives and policies, allocating assets, approving investment strategies to meet investment objectives and policies, and appointing investment managers to invest the System's assets.

[10] See Laws 2011, Ch. 357, for legislative amendments resulting in tier 2, and Laws 2017, Ch. 163, for legislative amendments resulting in tier 3.

[11] A.R.S. §38-802.

[12] Two exceptions to that requirement are: (1) returning elected officials who had inactive EORP membership are permitted by A.R.S. §38-804 to remain in EORP; and (2) new EORP members who are Arizona State Retirement System members are permitted by A.R.S. §38-727 to continue or resume membership in ASRS.

[13] See Laws 2011, Ch. 357, for legislative amendments resulting in tier 2.

[14] A.R.S. §38-881.01. In addition, the Arizona Administrative Office of the Court's members must elect to participate in the PSPDCRP within 90 days of their hire date or they are automatically enrolled in CORP (see footnote 7 on page 2 for additional information).

[15] A.R.S. §38-841 and §38-848(A)&(M). In addition, A.R.S. §38-848(C) specifies that appointed Board members who are not members of the System must be independent, qualified professionals; are responsible for the performance of fiduciary duties and other responsibilities required to preserve and protect the fund; and must have at least 10 years of substantial experience in specified positions, including portfolio manager, securities analyst, and economist.

Table 1
More than 59,000 members participate in PSPRS, CORP, and EORP defined benefit plans
As of June 2022

	PSPRS members			CORP members			EORP members	
Member type and description	Tier 1 and 2	Tier 3	Total members	Tier 1 and 2	Tier 3[1]	Total members	Tier 1 and 2	Total members
Active, including transferred—Members who work for a contributing employer and are actively contributing.	13,274	4,911	18,185	8,394	287	8,681	354	**27,220**
Retirees—Members who are retired and receive a lifetime monthly benefit.	11,336	0	11,336	5,768	0	5,768	1,043	**18,147**
Retirees-disabled—Members who are disabled and receive a lifetime monthly benefit.	1,965	5	1,970	173	0	173	15	**2,158**
Survivors of members—Deceased members' surviving beneficiaries, including spouses and children with guardians, who are receiving a lifetime monthly benefit.	1,990	3	1,993	850	0	850	245	**3,088**
Inactive—Members who are not retired and have not withdrawn their contributions, but are not currently making contributions through a participating employer.	2,152	741	2,893	3,736	61	3,797	168	**6,858**
Deferred retirement option program (DROP)—PSPRS tier 1 members with at least 20 years of credited service who opt to work for up to 5 years but divert contributions during that time toward a lump sum collected at retirement.	2,144	N/A	2,144	N/A	N/A	N/A	N/A	**2,144**
Total members	**32,861**	**5,660**	**38,521**	**18,921**	**348**	**19,269**	**1,825**	**59,615**

[1] CORP tier 3 members comprise the Arizona Administrative Office of the Courts plan members (see footnote 7 on page 2 for additional information).

Source: Auditor General staff analysis of PSPRS, CORP, and EORP actuarial valuations as of June 30, 2022.

As required by statute, the Board comprises 9 members appointed to 5-year terms, as follows:[16,17]

- 2 members representing law enforcement, 1 appointed by the Arizona Senate President and 1 by the Governor.
- 2 members representing firefighters, 1 appointed by the Speaker of the Arizona House of Representatives and 1 by the Governor.
- 3 members representing cities and towns who are not members of the System—1 appointed by the Arizona Senate President, 1 by the Speaker of the Arizona House of Representatives, and 1 by the Governor.
- 1 member appointed by the Governor who represents counties and also represents taxpayers and employers and is not a member of the System.
- 1 member appointed by the Governor from a list of 3 nominees from the Board.[18]

System staff

The Board appoints an Administrator to oversee the System's staff and operations. As of June 2023, the System reported that it had 95 Board-approved full-time equivalent (FTE) positions, 8 of which were vacant. The System is organized into the following departments:

- **Administration (12 FTE, 2 vacancies)—**Oversees the System's business operations that support its staff, members, and stakeholders. Administration also assists PSPRS and CORP employers through outreach and education. Further, Administration monitors the System's compliance with laws and develops and oversees its mission, strategic initiatives, and performance measures. In addition to the Administrator, Deputy Administrator, and General Counsel/Assistant Administrator, Administration also includes human resources, communications, building and office management, employer financial consulting, and office support.
- **Finance (9 FTE, 1 vacancy)—**Produces comprehensive annual financial reports and audits transactions and statements issued by the System's custodial bank that are used for investments.
- **Internal Legal, Audit, and Compliance (5 FTE, 0 vacancies)—**Plans and performs internal audits of the System's internal controls and ensures compliance with the System's investment policies and procedures, laws, and contract terms.
- **Investment (13 FTE, 1 vacancy)—**Manages the System's assets, including selecting and managing investments for a portfolio designed to meet Board-approved investment policy goals and objectives.
- **Investments Legal (3 FTE, 0 vacancies)—**Provides specialized legal services related to investment contracts and negotiations, and reviews opportunities for new investments.
- **Investment Operations (6 FTE, 1 vacancies)—**Manages the System's day-to-day custodial bank transactions, capital call, and due diligence responsibilities.
- **Member Services (32 FTE, 3 vacancies)—**Oversees various member-related activities, such as processing membership applications for new members, collecting and maintaining records of all active members' contributions, and processing pension payments for retired, survivor, and disabled members.

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[16] A.R.S. §38-848(A).

[17] For members appointed by the Arizona Senate President, Speaker of the Arizona House of Representatives, or Governor, appointments must be made from a list of nominations provided by State-wide associations representing law enforcement, firefighters, cities and towns, or county supervisors, as applicable.

[18] The 3 nominees the Board provides to the Governor are selected from a list of 5 nominees the System's Advisory Committee provides to the Board.

- **Systems Development and Information Technology (IT) Operations (15 FTE, 0 vacancies)—** Responsible for the IT that the System and its members use. For example, systems development staff develop websites that members use to obtain account and benefit information and local boards use to retrieve member contribution history and estimate monthly pension benefit payments for retiring members. IT operations staff manage IT networks and the computers that System staff use.

Revenues and expenditures

As illustrated in Table 2 (see pages 7 and 8), PSPRS, CORP, and EORP revenue primarily consisted of member and employer contributions and investment income. The System estimates its revenues for fiscal year 2023 to be approximately $2.2 billion for PSPRS, $511 million for CORP, and $145 million for EORP. Employer contributions to PSPRS and CORP varied between fiscal years 2021 and 2023 because of approximately $4.5 billion in legislative appropriations and additional contributions made by participating employers in fiscal years 2021 and 2022 to reduce unfunded liabilities (see Questions and Answers, page 20, for additional information). Although not separately shown in the table, included in EORP's fiscal year 2021 through 2023 revenues is a $5 million appropriation from the State General Fund each year to pay a portion of EORP's unfunded liabilities. Further, an additional $60 million was appropriated from the State General Fund in fiscal year 2023 to reduce EORP's unfunded liabilities. Aside from these additional contributions, the System's monies are not subject to legislative appropriations.

Statute allows the System to use PSPRS, CORP, and EORP contributions to pay for operational and administrative expenses, and does not establish a limit on these expenses. The System estimates its fiscal year 2023 expenses at approximately $1.1 billion for PSPRS, $240 million for CORP, and $78 million for EORP. These expenses included payments for retirement and disability benefits, health insurance subsidies, refunds to terminated members, and monies transferred to other plans. These expenses also included administrative expenses for personnel and professional and outside services. The fiscal year 2023 administrative expenses are estimated to total less than 1 percent of PSPRS' and EORP's revenues and approximately 1.3 percent of CORP's revenues. The net position restricted for benefits as of June 30, 2023, is estimated to be $14.64 billion for PSPRS, $4.13 billion for CORP, and $410 million for EORP.[19]

[19] The net position restricted for benefits reflects the resources available to pay benefits to members at the end of the fiscal year and is the difference between the System's assets and liabilities.

Table 2
PSPRS, CORP, and EORP schedules of changes in fiduciary net position
Fiscal years 2021 through 2023
(In thousands)

	2021 (Actual)	2022 (Actual)	2023 (Estimate)
PSPRS			
Revenues (additions)[1]			
Total contributions and service purchase[2]	$2,080,549	$3,207,725	$1,405,000
Net investment income (loss)	2,423,047	(532,819)	759,110
Other income		998	35
Transfers into system	201	1,310	110
Total additions	4,503,797	2,677,214	2,164,255
Expenses (deductions)[1]			
Benefits	950,851	1,031,694	1,086,200
Transfers to other plans and refunds	13,039	15,556	14,060
Administrative expenses	11,372	9,577	11,340
Total deductions	975,262	1,056,827	1,111,600
Net increase in net position	3,528,535	1,620,387	1,052,655
Net position restricted for benefits, beginning of year	8,435,358	11,963,893	13,584,280
Net position restricted for benefits, end of year	**$11,963,893**	**$13,584,280**	**$14,636,935**
CORP			
Revenues (additions)[1]			
Total contributions and service purchase[2]	$774,784	$848,388	$295,800
Net investment income (loss)	611,347	(132,626)	215,150
Transfers into system	37	38	10
Total additions	1,386,168	715,800	510,960
Expenses (deductions)[1]			
Benefits	187,603	202,219	216,150
Transfers to other plans and refunds	19,093	21,972	17,100
Administrative expenses	2,806	2,375	6,550
Total deductions	209,502	226,566	239,800
Net increase in net position	1,176,666	489,234	271,160
Net position restricted for benefits, beginning of year	2,197,614	3,374,280	3,863,514
Net position restricted for benefits, end of year	**$3,374,280**	**$3,863,514**	**$4,134,674**

Table 2 continued

	2021 (Actual)	2022 (Actual)	2023 (Estimate)
EORP			
Revenues (additions)[1]			
Total contributions and service purchase[3]	$57,972	$59,757	$123,900
Net investment income (loss)	79,155	(14,785)	20,630
Transfers into system	-	13	110
Total additions	137,127	44,985	144,640
Expenses (deductions)[1]			
Benefits	71,887	75,482	77,600
Transfers to other plans and refunds	29	71	-
Administrative expenses	352	210	520
Total deductions	72,268	75,763	78,120
Net increase in net position	64,859	(30,778)	66,520
Net position restricted for benefits, beginning of year	309,718	374,577	343,799
Net position restricted for benefits, end of year	**$374,577**	**$343,799**	**$410,319**

1 In accordance with governmental accounting standards for financial reporting for pension plans, the System's financial statements report revenues as additions and expenses as deductions.

2 Total contributions and service purchases in fiscal years 2021 and 2022 for PSPRS and CORP included large one-time contributions to reduce unfunded liabilities. Specifically, during fiscal years 2021 and 2022, approximately $4.5 billion of legislative appropriations and additional employer contributions were made by employers to PSPRS and CORP (see Questions and Answers, page 20, for additional information). Although the System also received one-time contributions in fiscal year 2023 for PSPRS and CORP, they were not as large as those received in fiscal years 2021 and 2022.

3 During fiscal year 2023, $60 million was appropriated from the State General Fund specifically to reduce EORP's unfunded liabilities.

Source: Auditor General staff analysis of PSPRS, CORP, and EORP fiscal years 2021 and 2022 annual comprehensive financial statements audited by an independent certified public accounting firm and system-prepared estimates for fiscal year 2023.

Former System Administrator entered business relationships with 2 former Board members and all 3 failed to disclose and refrain from participating in decisions that could be influenced by their relationships

Statute addresses conflicts of interest for public agency employees and public officers

Arizona law requires employees of public agencies and public officers to avoid conflicts of interest that might influence or affect their official conduct. To determine whether a conflict of interest exists, employees/public officers must first evaluate whether they or a relative has a "substantial interest" in (1) any contract, sale, purchase, or service to the public agency or (2) any decision of the public agency.

If an employee/public officer or a relative has a substantial interest, statute requires the employee/public officer to fully disclose the interest and refrain from voting upon or otherwise participating in the matter in any way as an employee/public officer.[20,21] The interest must be disclosed in the public agency's official records, either through a signed document or the agency's official minutes. To help ensure compliance with these statutory requirements, the Arizona Department of Administration's (ADOA) State Personnel System employee handbook and conflict-of-interest disclosure form require State employees to disclose if they have any business or decision-making interests, secondary employment, and relatives employed by the State at the time of initial hire and anytime there is a change.[22] The ADOA disclosure form also requires State employees to attest that they do not have any of these potential conflicts, if applicable, also known as an "affirmative no." In addition, A.R.S. §38-509 requires public agencies to maintain a special file of all documents necessary to memorialize all disclosures of

Key terms

- **Substantial interest—**Any direct or indirect monetary or ownership interest that is not hypothetical and is not defined in statute as a "remote interest."
- **Remote interest—**Any of several specific categories of interest defined in statute that are exempt from the conflict-of-interest requirements. For example, an employee or public officer who is reimbursed for actual and necessary expenses incurred while performing official duties.

Source: *Arizona agency handbook*. Phoenix, AZ. Retrieved 1/9/2023 from https://www. azag.gov/outreach/publications/agency-handbook.

[20] A.R.S. §§38-502, 38-503(A) and 38-503(B).

[21] A.R.S. §38-502(8) defines "public officer" as all elected or appointed officers of a public agency established by charter, ordinance, resolution, State constitution, or statute. According to the *Arizona Agency Handbook*, public officers include directors of State agencies and members of State boards, commissions, and committees—whether paid or unpaid.

[22] Arizona Department of Administration (ADOA). (2020). *State Personnel System: Employee handbook*. Retrieved 8/9/2023 from https://drive.google.com/file/d/19M16Yu_Bc_SEEen4WYtlS9x-Kpt1rogF/view.

substantial interest, including disclosure forms and official meeting minutes, and to make this file available for public inspection.

In response to conflict-of-interest noncompliance and violations investigated in the course of our work, such as employees/public officers failing to disclose substantial interests and participating in matters related to these interests, we have recommended several practices and actions to various school districts, State agencies, and other public entities.[23] Our recommendations are based on recommended practices for managing conflicts of interest in government and are designed to help ensure compliance with State conflict-of-interest requirements by reminding employees/public officers of the importance of complying with the State's conflict-of-interest laws.[24] Specifically, conflict-of-interest recommended practices indicate that all public agency employees and public officers complete a disclosure form annually. These recommended practices also indicate that agencies develop a formal remediation process and provide periodic training to ensure that identified conflicts are appropriately addressed and help ensure conflict-of-interest requirements are met.

Former System Administrator and 2 former Board members failed to disclose business relationships and improperly participated in System decisions that could have been influenced by these relationships

In 2018, the System's former Administrator entered into a business relationship with 2 former Board members, and all 3 individuals failed to disclose these relationships, such as in a conflict-of-interest disclosure form or at a public Board meeting. Specifically, in March 2018, the former System Administrator purchased a $550,000 home and used 1 Board member as the real estate agent and the other Board member as the loan officer for the home purchase.

Further, despite having a business relationship, all 3 individuals improperly participated in System decisions that could have been influenced by this relationship. Specifically, after the former System Administrator and 2 former Board members entered into the business relationship in March 2018:

- The 2 former Board members failed to refrain from participating in Board responsibilities for overseeing the former Administrator, including improperly participating in decisions related to the former Administrator's employment and compensation. Specifically, in February 2019, both former Board members voted in favor of a retroactive pay increase of 6 percent for the former System Administrator, setting his annual salary at $252,000.[25]

- The former Administrator failed to refrain from participating in his System responsibilities for approving travel reimbursement payments for the 2 former Board members.[26] Additionally, the former System Administrator approved travel reimbursements for these 2 Board members that were unallowable according to State requirements. Specifically, in April 2020, we conducted an annual review of per diem compensation and reimbursement payments to members of State boards, commissions, councils, and advisory committees, including the System, and found the System did not pay its Boad members in accordance

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[23] See, for example, Auditor General reports: 21-402 *Higley Unified School District—Criminal Indictment—Conspiracy, Procurement Fraud, Fraudulent Schemes, Misuse of Public Monies, False Return, and Conflict of Interest*, 19-105 *Arizona School Facilities Board—Building Renewal Grant Fund*, and 17-405 *Pine-Strawberry Water Improvement District—Theft and misuse of public monies*.

[24] Recommended practices we reviewed included: Organization for Economic Cooperation and Development (OECD). (2022). *Recommendation of the Council on OECD Guidelines for Managing Conflict of Interest in the Public Service*. Paris, France. Retrieved 8/9/2023 from https://legalinstruments.oecd.org/public/doc/130/130.en.pdf; Ethics & Compliance Initiative (ECI). (2016). *Conflicts of interest: An ECI benchmarking group resource*. Arlington, VA. Retrieved 8/9/2023 from https://www.ethics.org/wp-content/uploads/2021-ECI-WP-Conflicts-of-Interest-Defining-Preventing-Identifying-Addressing.pdf; Controller and Auditor General of New Zealand. (2020). *Managing conflicts of interest: A guide for the public sector*. Wellington, New Zealand. Retrieved 8/9/2023 from https://oag.parliament.nz/2020/conflicts/docs/conflicts-of-interest.pdf.

[25] The Board's members voted unanimously to increase the former Administrator's pay.

[26] The former System Administrator or deputy administrator was responsible for reviewing and approving all Board member travel reimbursements, including for these 2 former Board members.

with State laws and State or System policies, which put public monies at risk of misuse.[27] We found that in May 2018, the 2 former Board members attended the same conference in New York City and both stayed at the same conference hotel, but the former System Administrator approved reimbursement for 1 Board member that was $1,598 more than the other Board member. The additional reimbursement was for an unsupported additional night in New York City and an upgraded city view room. In addition, the former System Administrator approved both Board members' hotel stays without maintaining documentation supporting that any of these expenses were for a necessary public purpose, confirming the conference hotel room rate, or investigating whether there were lower-priced, convenient options available, as required by the State of Arizona Accounting Manual. In total, the former Administrator approved reimbursing 1 former Board member $2,778 for his hotel stay and reimbursing the other $1,180.[28]

System's policies and procedures did not address all State requirements and did not fully align with recommended practices

The System had not developed comprehensive conflict-of-interest policies and procedures. For example, the System did not require that Board members complete a disclosure form upon appointment or require employees and Board members to annually complete a conflict-of-interest disclosure form, consistent with recommended practices. After becoming aware of the former Board members' and Administrator's business relationships, the System took action to address some of the deficiencies in its conflict-of-interest processes. For example, in 2021, the System developed and implemented a disclosure form for Board members and modified its policies to require Board members to complete the disclosure form annually. Our review found that all 9 Board members had completed the required disclosure form in fiscal year 2023.

However, as of August 2023, the System's conflict-of-interest process and policies still did not fully align with State requirements or recommended practices. Specifically, the System:

- Reported that it did not have a special file to memorialize and track disclosures of substantial interests because none of its employees or Board members had disclosed any substantial interests for several years and reported it would establish a special file available for public inspection if/when substantial interest disclosures are made. However, the System's conflict-of-interest policies and procedures do not require the System to have or maintain the statutorily required special file to memorialize and track disclosures of substantial interest.
- Did not require System employees to annually complete a conflict-of-interest disclosure form, or at a minimum, annually remind them to update their disclosure form if/when their circumstances change.
- Had provided periodic conflict-of-interest training to Board members but had not similarly done so for its employees related to their unique programs, functions, or responsibilities. The System reported that it planned to provide employees with conflict-of-interest training in calendar year 2023.

Recommendations

The System should:

1. Develop and/or revise and implement conflict-of-interest policies and procedures to help ensure it complies with State conflict-of-interest requirements and follows recommended practices, including:
    a. Storing and tracking all substantial interest disclosures in a special file available for public inspection.
    b. Reminding employees at least annually to update their disclosure form if/when their circumstances change.

[27] See Arizona Auditor General report 20-301 *State Board member per diem compensation and expense reimbursements*.

[28] The former Administrator's employment was terminated in July 2019. The former Board members were not reappointed, and their terms expired in January 2021.

2. Develop and provide periodic training on its conflict-of-interest requirements, process, and disclosure form, including providing training to all employees on how the State's conflict-of-interest requirements relate to their unique programs, functions, or responsibilities.

System response: As outlined in its **response**, the System agrees with the finding and will implement the recommendations.

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Question 1: What were the funded statuses of PSPRS, CORP, and EORP prior to June 2014?

As discussed in our 2015 performance audit and sunset review report, the funded statuses of PSPRS, CORP, and EORP had steadily declined over several years (see textbox on page 14 for key terms and definitions).[29] Specifically, from June 2005 through June 2014, PSPRS' funded status had declined from 82.1 to 49.2 percent; CORP's had declined from 101.1 to 57.3 percent; and EORP's had declined from 95.5 to 39.4 percent. We identified 2 primary factors that contributed to these declines:

- Statutorily required permanent benefit increases to retirees' pension amounts raised the PSPRS', CORP's, and EORP's pension liabilities.
- The System had not met its expected rate of return on its investments and therefore had fewer assets than expected to pay for estimated pension liabilities, contributing to decreasing funded statuses. The rate of return on investments varied considerably between June 2005 and June 2014, ranging from a low of approximately -17.7 percent to a high of 17.4 percent, whereas the expected rate of return was between approximately 7.9 percent to 8.8 percent.

We also reported that the Legislature had amended PSPRS, CORP, and EORP in 2011 to improve their funded statuses and enhance sustainability. For example, the Legislature modified member eligibility requirements to establish a minimum age at which an individual can retire and to increase the number of years a member must work in order to be eligible for retirement. In addition, legislative changes were made to establish more stringent criteria for providing permanent benefit increases. However, the permanent benefit increase changes were challenged in court, and the Arizona Supreme Court ruled in February 2014 that some of the changes were

[29] See Arizona Auditor General report 15-111 *Public Safety Personnel Retirement System—The system's three retirement plans' funded statuses have declined and additional actions are needed to improve their long-term sustainability*.

unconstitutional.[30] Consequently, the System was required to retroactively reinstate benefit increases for EORP members who had retired on or before July 1, 2011.[31] Based on this decision, the System also took actions to retroactively reinstate benefit increases for PSPRS and CORP affected members.

Key terms and definitions

Funded status—A measure of a retirement plan's assets compared to its liabilities. A typical method for determining funded status is to divide a pension plan's assets by its liabilities, or the amount needed to pay its estimated pension liabilities for benefits that have been earned by all plan members at a particular point in time. For example:

$90 billion in assets ÷ $100 billion in estimated pension liabilities = 90 percent funded status.

Funded liabilities—The portion of a plan's estimated pension liabilities that has plan assets available to pay for the liabilities. In the example above, the pension plan has a funded liability of $90 billion.

Unfunded liabilities—The deficit between a pension plan's assets and its estimated pension liabilities. In the example above, the pension plan has an unfunded liability of $10 billion.

Employer payroll contribution rates—The rate an employer pays expressed as a percentage of a member's salary. For example, if a member earns $50,000 annually and an employer's contribution rate is 10 percent, an employer will pay contributions of $5,000 annually to the member's pension plan.

Source: Auditor General staff analysis of the PSPRS', CORP's, and EORP's actuarial valuation reports as of June 30, 2022, and Arizona Auditor General report No. 15-111, *Public Safety Personnel Retirement System—The system's three retirement plans' funded statuses have declined and additional actions are needed to improve their long-term sustainability*.

Question 2: How have PSPRS', CORP's, and EORP's funded statuses changed since June 2014?

Overall, PSPRS' and CORP's funded statuses—meaning the measure of a plan's assets compared to liabilities—have increased since June 2014; however, EORP's funded status has declined further (see textbox for key terms and definitions). As shown in Figure 1 (see page 15), although the funded statuses for PSPRS and CORP experienced some declines between June 2014 and June 2020, as of June 2022, PSPRS' funded status has increased to more than 65 percent and CORP's funded status has increased to more than 83 percent.[32,33] In comparison, as of June 2022, EORP's overall funded status has further declined to 32.6 percent. Specifically:

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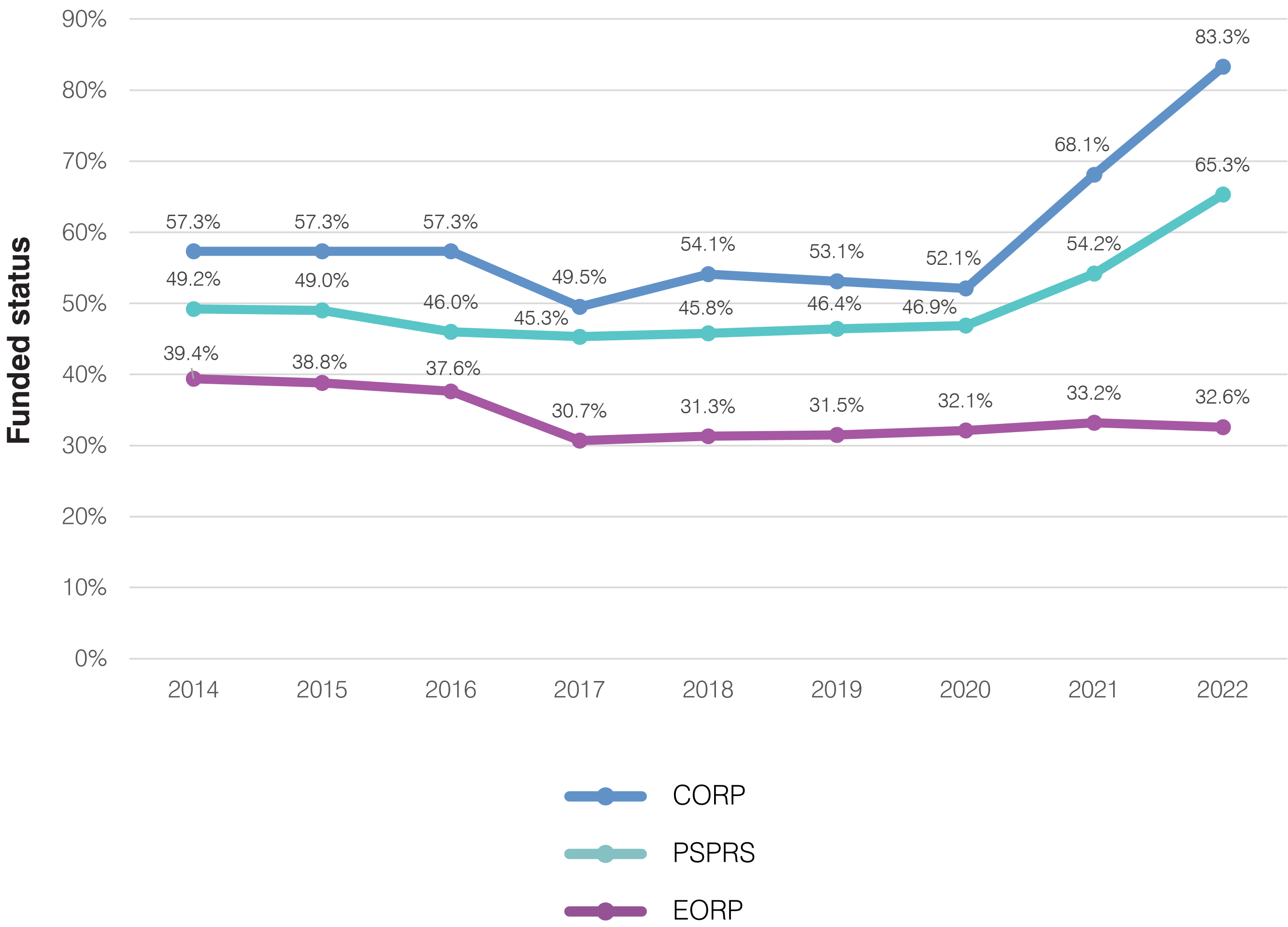
30 *Fields v. Elected Officials' Ret. Plan, 234 Ariz. 214, 222, 320 P.3d 1160, 1168 (2014)* held that a 2011 law changing the formula to calculate permanent benefit increases violated Article 29, Section 1, of the Arizona State Constitution because it diminished and impaired the benefits to which retired members are entitled.

31 The changes made in response to the February 2014 Supreme Court ruling impacted the plans' funded statuses because their previous liabilities had not included the associated liabilities related to the reinstated permanent benefit increases and the employer payroll contribution rates were calculated based on the change to a cost-of-living adjustment rather than the previous more costly permanent benefit increases.

32 As discussed in the Introduction, PSPRS and CORP are largely agent multiple-employer plans, meaning that the System aggregates the funded statuses and employer payroll contribution rates of individual participating employers' funded statuses and employer payroll contribution rates. However, the PSPRS tier 3 risk pool and CORP Arizona Administrative Office of the Courts are considered cost-sharing multiple employer plans, meaning there is 1 funded status and 1 employer payroll contribution rate for both the pool and the Arizona Administrative Office of the Court plan (see Questions and Answers, page 25, for information on the risk pool and Introduction, page 2, footnote 8, for information on the Arizona Administrative Office of the Courts). EORP is a cost-sharing multiple-employer plan, meaning there is only 1 funded status and an employer payroll contribution rate for the entire plan. See textbox on page 2 for definitions.

33 The Questions and Answers only include an analysis of the PSPRS and CORP tier 1 and tier 2 and EORP defined benefit plans (see Appendix C, footnote 75, page c-1, for additional information). In addition, as discussed in the Introduction, page 3, the System also manages 2 defined contribution plans that are not included in the Question and Answers analysis.

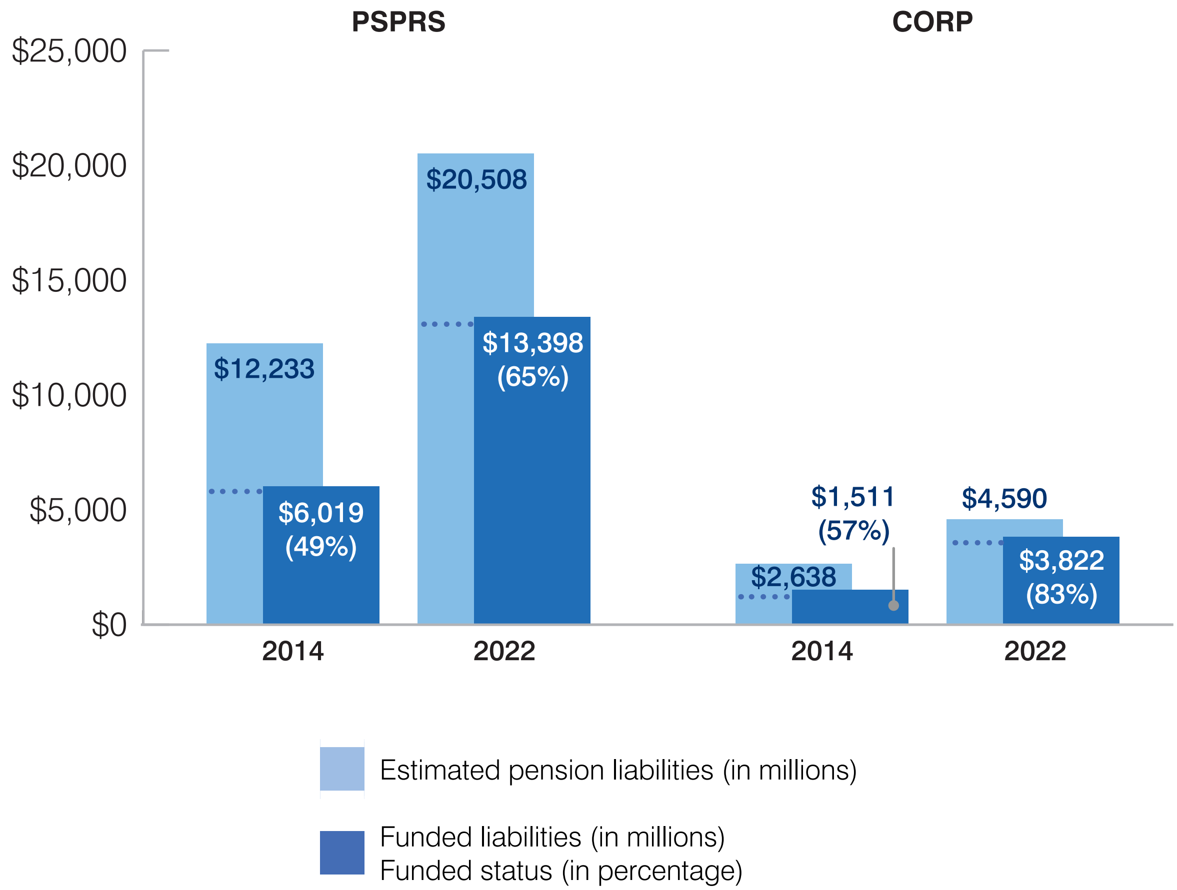
Figure 1
PSPRS' and CORP's funded statuses increased overall since June 2014; EORP's funded status declined
June 30, 2014 through June 30, 2022



Source: Auditor General staff analysis of the PSPRS, CORP, and EORP actuarial valuation reports as of June 30, 2014 through June 30, 2022.

- **PSPRS' and CORP's funded statuses have increased even with growing liabilities, and most individual plan employers have increased their respective funded statuses—**As shown in Figure 2 (see page 16), PSPRS' and CORP's funded statuses increased while pension liabilities have also increased. Specifically, PSPRS' and CORP's estimated pension liabilities have increased by nearly $8.3 billion and $2 billion, respectively, as of June 2022. Similarly, the funded status for most PSPRS and CORP employers has also increased. For example, as shown in Table 3 (see page 17), 82 of 234 PSPRS employers (or 35 percent) had funded statuses over 75 percent as of June 2014, compared to 155 of 228 employers (or 68 percent) as of June 2022. Similarly, 9 of 27 (or 33 percent) CORP employers had funded statuses over 75 percent as of June 2014, compared to 19 of the 28 employers (or 68 percent) as of June 2022. See Appendix A, Table 10, page a-2, for additional information on employer types and funded statuses.

Figure 2
PSPRS' and CORP's estimated pension liabilities and funded statuses increased[1]
As of June 30, 2014 and June 30, 2022



[1] Figure 2 includes information only for tier 1 and tier 2 members. As of June 2022, the tier 3 PSPRS estimated pension liabilities were $151.8 million and funded liabilities were $165.7 million. As a result, these estimated pension liabilities were more than 100 percent funded. Similarly, tier 3 CORP estimated pension liabilities were $4 million and funded liabilities were $4.3 million. As a result, these estimated pension liabilities were also more than 100 percent funded.

Source: Auditor General staff analysis of PSPRS and CORP actuarial valuation reports as of June 30, 2014, and June 30, 2022.

Table 3
Most PSPRS and CORP employers increased their funded statuses[1]

Funded status ranges	Number of PSPRS participating employers 2014	Number of PSPRS participating employers 2022	Number of CORP participating employers 2014	Number of CORP participating employers 2022
Status ranges below 75 percent				
Below 25 percent	7	4	-	-
25 to less than 50 percent	59	18	2	1
50 to less than 75 percent	86	51	16	8
Total below 75 percent	152	73	18	9
Status ranges equal to or above 75 percent				
75 to over 100 percent	82	155	9	19
Total	**234**	**228**	**27**	**28**

[1] The number of employers changed between fiscal years 2014 and 2022 because some employers merged their plans, and some employers did not have plans in 2014. In addition, the number of PSPRS employers in this table does not include 2 counties and 1 town in 2014 or 2 counties in 2022 because the employers did not have active members and only had assets on deposit with the PSPRS System, but no related liabilities. Further, the Arizona Administrative Office of the Courts was counted as 1 employer in this table for CORP; however, the System considers the Arizona Administrative Office of the Courts plan to have 15 employers (see Introduction, footnote 8, page 2, for additional information).

Source: Auditor General staff analysis of PSPRS and CORP actuarial valuation reports as of June 30, 2014, and June 30, 2022.

Further, as shown in Table 4 (see page 18), State agencies and universities that participate in PSPRS and CORP have increased their funded statuses while the pension liabilities have also increased. In fact, all 6 State agencies and 3 State universities that participate in PSPRS, and all 4 State agencies that participate in CORP, are nearly 100 percent funded.[34] See examples of funded status changes in textbox on page 19.

Finally, as also shown in Table 4, the overall funded statuses for non-State employers participating in PSPRS and CORP have increased while the pension liabilities have also increased.[35] For example, the funded status for non-State employers participating in PSPRS increased to 62 percent as of June 2022, compared to 51 percent in June 2014. Additionally, most individual non-State employers experienced increases. See textbox on page 18 for examples, and Question 3, pages 20 through 24, for information on factors affecting changes to the funded statuses.

[34] The 6 State agencies that participate in PSPRS are the Arizona Department of Public Safety, Arizona Game & Fish Department, Arizona Department of Emergency and Military Affairs, Arizona Attorney General's Office, Arizona Department of Liquor Licenses and Control, and Arizona State Parks Board. The 4 State agencies in CORP are the Arizona Department of Corrections, Rehabilitation & Reentry, Arizona Department of Juvenile Corrections, Arizona Department of Public Safety—Dispatchers, and Arizona Department of Public Safety—Detention.

[35] Non-State employers include cities, towns, counties, community college districts, Indian tribes, fire districts, and the Arizona Administrative Office of the Courts employers (see Appendix A, Table 10, page a-2 for the number of employers within each employer type).

Table 4
Overall funded status for both State and non-State employers participating in PSPRS and CORP increased
As of June 30, 2014 and June 30, 2022
(In millions)

	PSPRS		CORP	
	2014	2022	2014	2022
State agencies and universities				
Estimated pension liabilities	$1,240.3	$1,765.6	$1,520.1	$2,455.9
Funded liabilities	450.3	1,757.3	852.1	2,440.5
Funded status	36.3%	99.5%	56.1%	99.4%
Non-State employers				
Estimated pension liabilities	$10,992.7	$18,742.8	$1,117.4	$2,134.0
Funded liabilities	5,568.7	11,640.4	659.1	1,381.7
Funded status	50.7%	62.1%	59.0%	64.7%

Source: Auditor General staff analysis of PSPRS and CORP actuarial valuation reports as of June 30, 2014, and June 30, 2022.

However, not all non-State employers realized increases in their funded statuses. In fact, 74 of 219 PSPRS employers (or 34 percent) experienced decreases in their funded statuses since June 2014. Similarly, 7 of 24 CORP employers (or 29 percent) experienced decreases in their funded statuses between June 2014 and June 2022. See examples of funded status changes in textbox on page 19.

Examples of PSPRS and CORP employer funded status changes

	2014	2022
State employers with increased funded statuses[1]		
Arizona Department of Public Safety (PSPRS employer)	36.1%	99.5%
Arizona Department of Corrections, Rehabilitation and Reentry (CORP employer)	56.1%	99.4%
Non-State employers with increased funded statuses		
City of Tempe Police Department (PSPRS employer)	41.9%	95.5%
Pima County (CORP employer)	48.6%	94.1%
Non-State employers with decreased funded statuses		
City of Phoenix Police Department (PSPRS employer)	48.1%	42.0%
Mohave County (CORP employer)	110.3%	87.3%

1 There were no PSPRS or CORP State employers with decreased funded statuses since June 2014.

Source: Auditor General staff analysis of the PSPRS and CORP actuarial valuation reports as of June 30, 2014, and June 30, 2022.

- **EORP's funded status decreased, while estimated pension liabilities increased from June 2014**[36]**—**As shown in Table 5, EORP's estimated pension liabilities increased by nearly $200 million between June 2014 and June 2022, but in contrast to PSPRS and CORP, its funded status decreased from 39.4 percent as of June 2014 to 32.6 percent as of June 2022.

Table 5
EORP's estimated liabilities increased while its funded status decreased since June 2014
As of June 30, 2014 and June 30, 2022
(In millions)

	2014	2022
Estimated pension liabilities	$796.2	$993.0
Funded liabilities	313.4	323.9
Funded status	39.4%	32.6%

Source: Auditor General staff analysis of the EORP actuarial valuation reports as of June 30, 2014, and June 30, 2022.

36 As discussed in the Introduction, page 3, EORP is a cost-sharing multiple-employer plan with only 1 account and employers share the costs for providing pension benefits to all members equally; therefore, specific employer information is not applicable to EORP.

Question 3: What factors have affected changes to PSPRS', CORP's, and EORP's funded statuses?

The previously discussed increases in PSPRS' and CORP's funded statuses can be primarily attributed to: 1) legislative appropriations; 2) non-State participating employers' additional contributions; 3) increased State agency employer payroll contributions; and 4) an increase in net investment income, in part, due to these additional monies received from Legislative appropriations and non-State employer contributions.[37] Specifically:

- **Legislature appropriated approximately $2.2 billion to reduce unfunded liabilities for State agency employers participating in PSPRS and CORP—**The Legislature appropriated approximately $2.2 billion in State General Fund monies in fiscal years 2021 and 2022 to reduce PSPRS' and CORP's unfunded liabilities related to State agency employers. Specifically, the Legislature appropriated more than $1 billion to both PSPRS and CORP. See textbox, page 21, for examples of the State agencies for which these appropriations apply.

  In addition, according to the System, the State appropriations for the unfunded liabilities were a collaborative effort between the System, lawmakers, the State budget offices, policy staff, and others. The System reported that the goal of these efforts was to fully fund the estimated pension liabilities to lower future contributions, provide future budget savings, and facilitate ongoing management of State pension liabilities.

- **Non-State employers participating in PSPRS and CORP contributed more than $2.3 billion to reduce unfunded liabilities—**Non-State employers participating in PSPRS and CORP also paid more than $2.3 billion toward their unfunded liabilities in fiscal years 2021 and 2022. See textbox, page 21, for examples of individual non-State employer payments.

  The System's education and outreach efforts helped inform and encourage these additional non-State employer contributions. Specifically, beginning in fiscal year 2020, the System began an outreach and educational campaign that focused on educating employers about the status of their plans' unfunded liabilities, the consequences of not fully funding their plans, and the long-term positive impact of additional contributions.

  Additionally, System stakeholders that we spoke with reported that one of the impactful changes implemented by the System was the development and introduction of a modeling tool. Specifically, in January 2020, the System introduced a modeling tool that helps employers understand and assess the impact that their decisions and performance have on their plan—such as increasing contributions or realizing improved investment returns. For example, an employer could use the modeling tool to assess what amount of additional employer contributions would be required to reach a 100 percent funded status within the current unfunded liability amortization period which, according to the System, is 15 years for most plans. These stakeholders also reported that the System's education and communication efforts contributed to employers' understanding and willingness to make additional contributions that reduced their unfunded liabilities.

- **Increased employer payroll contributions have helped to reduce unfunded liabilities—**As shown in Figure 3 (see page 22), the average employer payroll contribution rates increased since fiscal year 2014 for both PSPRS and CORP. These increased employer payroll contribution rates helped to pay for employers' unfunded liabilities. Specifically, in fiscal year 2022, the average PSPRS employer payroll contribution rate increased to approximately 56 percent and CORP's increased to approximately 31 percent to further improve the funded statuses for PSPRS and CORP. For example, as shown in Table 6 (see page 22), employer payroll contributions paid by PSPRS participating State agencies increased from nearly $43 million in fiscal year 2014 to over $113 million in fiscal year 2022. Similarly, CORP State agency employer payroll contributions increased from over $47 million in fiscal year 2014 to nearly $100 million in fiscal year 2022.

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[37] See Question 4, pages 24 through 26, for additional factors that may also impact the long-term sustainability of PSPRS, CORP, and EORP.

Examples of PSPRS and CORP employers with increased funded statuses since June 2014

State employers:

Arizona Department of Public Safety (PSPRS employer)—The Legislature appropriated approximately $921 million in fiscal years 2021 and 2022 in State General Fund appropriations on behalf of the department to reduce the department's unfunded liabilities.

Arizona Department of Corrections, Rehabilitation & Reentry (CORP employer)—The Legislature appropriated approximately $975 million in fiscal years 2021 and 2022 in State General Fund appropriations on behalf of the department to reduce the department's unfunded liabilities.

Non-State employers:

City of Tempe (PSPRS employer)—Contributed approximately $346 million in fiscal year 2022 for its police and fire departments from the proceeds of debt incurred specifically to reduce its unfunded liabilities.[1]

Pima County (CORP employer)—Contributed approximately $72 million in fiscal years 2021 and 2022 for its detention officers from the proceeds of debt incurred specifically to reduce its unfunded liabilities.[1]

City of Prescott (PSPRS employer)—Contributed approximately $31 million in fiscal years 2021 and 2022 for its police and fire departments from a dedicated tax passed by the city's voters to reduce its unfunded liabilities.

[1] The City of Tempe and Pima County issued debt, the proceeds of which they used to pay for their unfunded liabilities. According to the System, some cities and counties decided to take advantage of historically low interest rates that existed at the time of issuance so that the proceeds could be used to improve their funded statuses, thereby lowering past unfunded liabilities and future payroll contribution rates by depositing the proceeds to be invested by PSPRS to generate long-term investment income. The City of Tempe and Pima County will be required to pay back the debt through principal and interest payments over time.

Source: Auditor General staff analysis of Laws 2021, Ch. 408, Laws 2022, Ch. 313, and the System's, City of Tempe's, Pima County's, and City of Prescott's annual comprehensive financial reports for fiscal years 2021 and 2022.

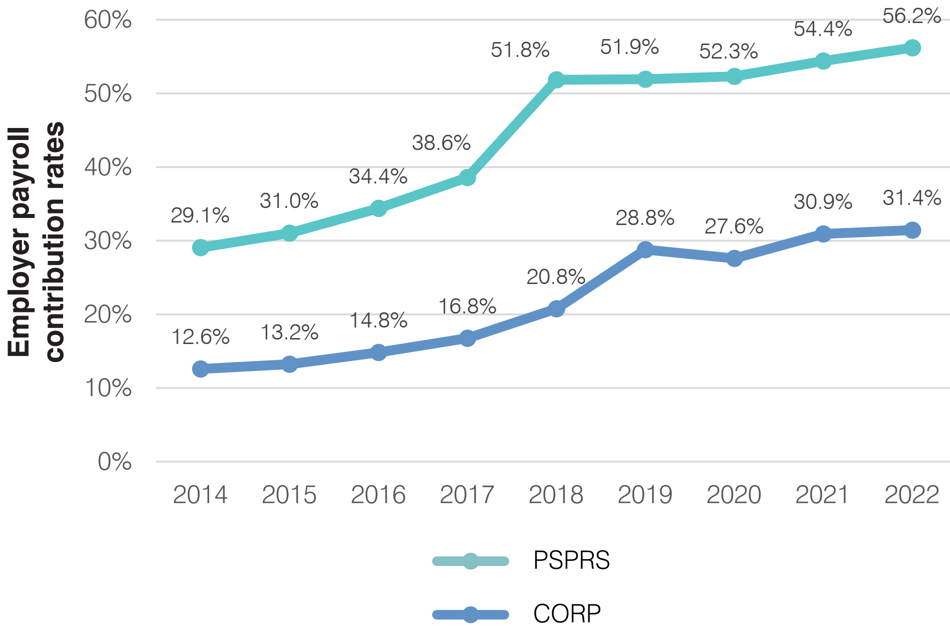
- **System generated net investment income of approximately $2.4 billion in fiscal years 2021 and 2022 that helped fund liabilities—**As shown in Figure 6, page 31, the System had a rate of return of nearly 28 percent on its investments in fiscal year 2021. This rate of return combined with additional monies received from Legislative appropriations and non-State employer contributions previously discussed (see page 20), helped generate net investment income of approximately $2.4 billion in fiscal years 2021 and 2022, thereby increasing the amount of assets available to fund liabilities.[38]

- **Despite improvements to PSPRS' and CORP's overall funded statuses, various factors contributed to declines in funded status for individual employers—**Various factors contributed to decreases for individual employers within PSPRS and CORP. For example, a 2016 Arizona Supreme Court ruling determined that legislative amendments that had increased members' contributions were unconstitutional.[39] Because of the ruling, excess member contributions had to be returned to affected members. In addition, the actuarially determined employer payroll contribution rates were based on receiving increased contributions from these members in future years: therefore, the actuarial assumptions for the calculations were not met. See textbox on page 23 for additional examples impacting specific employers' decreased funded statuses.

[38] The System reported that an additional nearly $1 billion of investment income was received in fiscal year 2023.

[39] *Hall v. Elected Officials' Ret. Plan, 241 Ariz. 33, 39, 383 P.3d 1107, 1113 (2016)* and *Parker v. Pub. Safety Pers. Ret. Sys., CV2012-000456 (Maricopa County. Super. Ct. Jan. 12, 2012)*. In November 2016, the Arizona Supreme Court ruled in *Hall* that the increased member contributions were unconstitutional. Consequently, the PSPRS Board directed PSPRS and EORP employers to return applicable contribution amounts back to these members.

Figure 3
Employer payroll contribution rates increased[1]
June 30, 2014 through June 30, 2022



1 Aggregated employer payroll contribution rates decreased in fiscal years 2023 and 2024. For example, the fiscal year 2024 employer payroll contribution rates are 46.2 percent and 17.9 percent for PSPRS and CORP, respectively. According to the System, the rates decreased for many employers because of employers' increased funded statuses and corresponding decreases in unfunded liabilities.

Source: Auditor General staff analysis of PSPRS and CORP actuarial valuation reports as of June 30, 2012 through June 30, 2020, which present contribution rates for fiscal years 2014 through 2022.

Table 6
PSPRS and CORP State agency employer payroll contributions have generally increased June 30, 2014 through June 30, 2022
(In thousands)

Fiscal year	PSPRS	CORP
2014	$42,599.8	$47,185.0
2015	49,331.3	50,967.2
2016	63,778.2	65,541.1
2017	70,647.3	64,468.5
2018	78,587.1	71,501.2
2019	80,684.0	91,780.3
2020	93,044.5	92,175.4
2021	100,587.1	106,645.2
2022	113,081.6	99,499.6

Source: Auditor General staff analysis of the *Arizona Financial Transparency Portal* for fiscal years 2014 through 2022.

Examples of PSPRS and CORP non-State employers with decreased funded statuses

City of Phoenix Police Department (PSPRS employer)—The City of Phoenix Police Department's funded status decreased since 2014. According to the System, one factor that contributed to this decrease was higher than expected vacancies in the city's police department, resulting in fewer payroll contributions.[1]

Mohave County (CORP employer)—Mohave County's funded status decreased since 2014. According to the System, one factor that contributed to this decrease was salary increases provided to detention officers in fiscal years 2020 through 2022 that were not reflected in the calculation of its contribution rates.[2]

1 The City of Phoenix made additional contributions of approximately $47 million to reduce its PSPRS unfunded liabilities in fiscal years 2021 and 2022 for its police department plan; however, these additional contributions were not sufficient to overcome the decline in its funded status. In addition, according to the System, the City of Phoenix made additional contributions in fiscal year 2023 for its police department of approximately $47.8 million and the System continues to work with the City of Phoenix to improve its funded status.

2 According to the System, Mohave County made additional CORP contributions in fiscal year 2023 of approximately $186,000, and the System continues to work with the County to improve its funded status.

Source: Auditor General staff analysis of PSPRS and CORP actuarial valuation reports as of June 30, 2014, and June 30, 2022, and System-provided information.

- **Various factors contributed to EORP's declining funded status—**According to actuarial valuation reports from June 2014 through June 2022, EORP's declining funded status can be attributed to various factors such as the following 2 factors:[40]
    - First, as mentioned previously, a 2016 Arizona Supreme Court ruling determined that some statutorily increased member contributions were unconstitutional and were required to be returned to affected members. In addition, the actuarially determined employer payroll contribution rates were based on the expectation of receiving increased contributions from the members in future years; therefore, the actuarial assumptions for the calculations were not met.
    - Second, EORP's employer payroll contribution rates were established by statute at a rate that was lower than the actuarially determined contribution rates from fiscal years 2014 through 2018 (see Figure 4, page 24).[41] The actuary included in its calculated employer contribution rates an amount to pay for the unfunded liabilities; therefore, as shown in Figure 4, those rates were substantially higher than the statutory rate. Consequently, there was a shortfall of employer contributions accumulated through fiscal year 2018 that were needed to reduce EORP's unfunded liabilities, thereby further increasing these liabilities. However, beginning in fiscal year 2019, the Legislature enacted a requirement that the employer payroll contribution rate must be based on an actuarially determined rate.[42] This allowed the employer payroll contribution rates to be established more in line with the plan's needs and helped to reduce further declines in EORP's funded status. For example, for fiscal year 2022, the actuarially and statutorily determined employer payroll contribution rates were both 61 percent.

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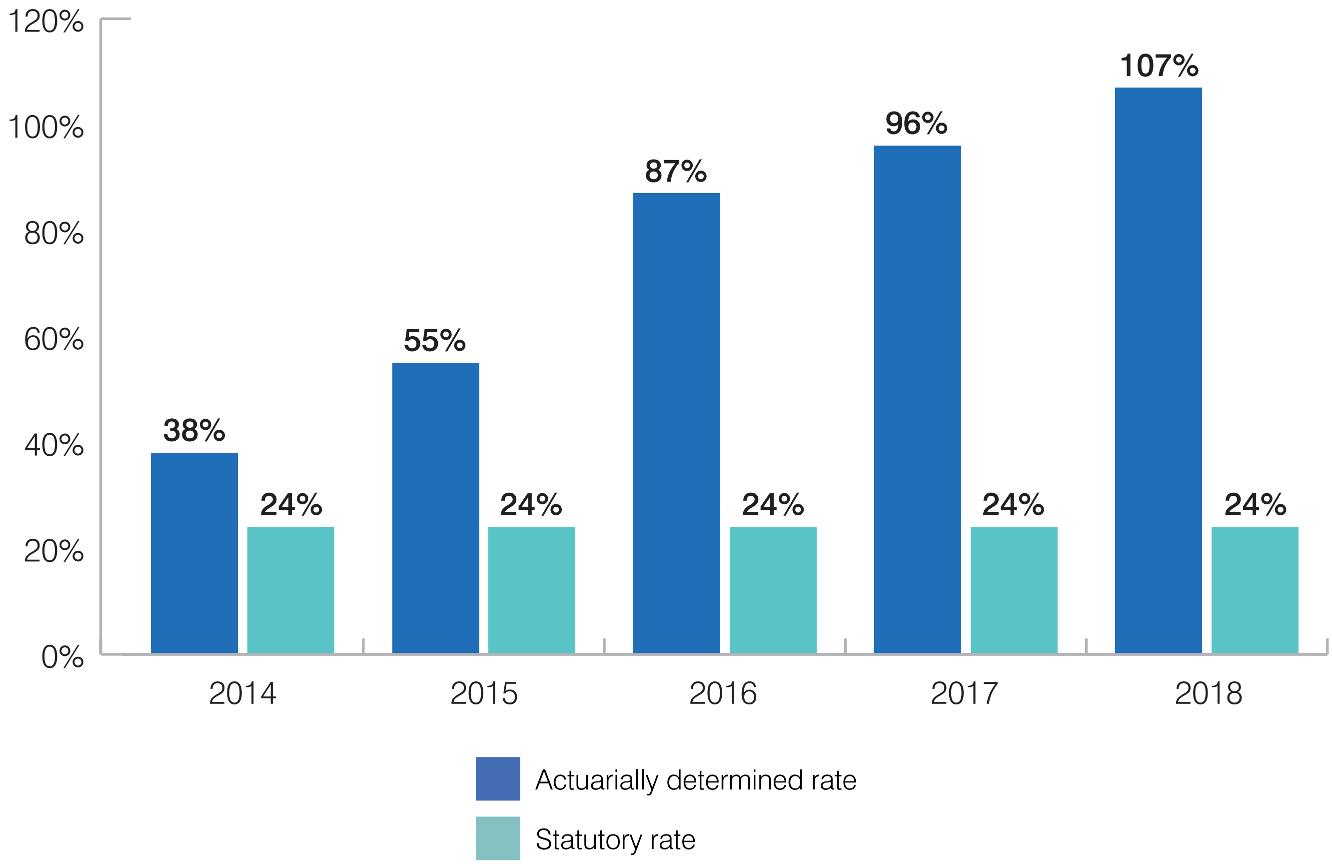
40 According to information provided in the EORP's 2016 actuary valuation report and the System's fiscal year 2018 annual comprehensive financial report, fiscal year 2018 actual member and employer contributions were approximately $22.2 million less than the actuary's estimated contributions. According to the System, $18.6 million of this difference was attributable to the *Hall v. Elected Officials' Ret. Plan* Supreme Court ruling (see page 21, footnote 39), and the remaining difference was attributable to various factors but greatly impacted by the difference between the statutory rate and actuarial calculated rates as shown in Figure 4, page 24.

41 An actuarially determined rate is the rate of contributions needed in combination with investment earnings that would provide sufficient resources to pay for promised benefits in full over the long term, including paying for unfunded liabilities.

42 Laws 2018, Ch. 343, §1.

Figure 4
EORP's employer payroll contribution rates required by statute were lower than the actuarially determined employer rates from fiscal years 2014 through 2018[1]



[1] Laws 2013, Ch. 217, §6, established a statutory rate of approximately 24 percent beginning January 1, 2014.

Source: Auditor General staff analysis of the EORP actuarial valuation reports as of June 30, 2012, through 2016.

Question 4: What additional steps have been taken to help improve PSPRS', CORP's, and EORP's long-term sustainability?

In addition to the factors discussed in Question 3 that affected the plans' funded statuses, the Legislature, voters, and System have made several changes that may also help improve PSPRS', CORP's, and EORP's long-term sustainability. Specifically:

- **Permanent benefit increases were replaced by cost-of-living adjustments to help reduce future pension benefit liabilities—**As recommended in our 2015 performance audit and sunset review of the System and discussed in our 36-month followup report in 2018, the Legislature enacted and voters approved various statutory and constitutional changes to replace costly permanent benefit increases for PSPRS, CORP, and EORP with less expensive cost-of-living adjustments.[43] In addition, the Legislature enacted changes to provide cost-of living increases only when PSPRS' and CORP's funded status is at least 70 percent for its members hired on or after July 1, 2017, or July 1, 2018, respectively (see Tables 11, 12, and 13, pages b-2 to b-7, for comparison of benefits for the various tiers).[44] Further, the Legislature

[43] Laws 2016, Ch. 2, §14, Laws 2017, Ch. 163, §21, Laws 2018, Ch. 140, §21, Proposition 124 (May 2016), and Proposition 125 (November 2018)

[44] Laws 2016, Ch. 2, §14, and Laws 2017, Ch. 163, §21.

placed limitations on the maximum salary that benefits could be based on for PSPRS and CORP members hired on or after July 1, 2017, and July 1, 2018, respectively (see Appendix B, page b-3, footnote 6, and page b-5, footnote 5, for more information).

- **Revised PSPRS and CORP eligibility, benefit, and payroll contribution requirements—**The Legislature enacted changes to various eligibility, benefit, and payroll contribution requirements (see Appendix B, Tables 11 and 12, pages b-2 to b-5, for comparison of eligibility and benefits for the PSPRS and CORP tiers).[45] For example, in 2016 and 2017, the Legislature revised statute to require PSPRS and CORP employers to contribute a percentage of their payroll, including defined contribution and tier 3 defined benefit members' payroll, to help pay for tier 1 and tier 2 unfunded liabilities.[46]

- **Revised EORP employer contributions to help address unfunded liabilities—**In addition to ensuring EORP employer payroll contributions are consistent with actuarially determined contribution rates (see Question 3, page 23), A.R.S §38-810 requires that EORP employer payroll contribution rates include a portion to pay unfunded liabilities. Further, as noted in Table 2, pages 7 and 8 (see page 8, footnote 3), the Legislature appropriated $60 million from the State General Fund in fiscal year 2023 for unfunded liabilities, which not only helped improve the funded status, but will also provide additional monies to invest and generate investment income to help ensure long-term sustainability.[47]

- **Established an employer "risk pool" that may help strengthen smaller employers' ability to pay for their plans—**Laws 2017, Ch. 235, established the Public Safety Employer Risk Pool with tier 3 members from all but the 17 largest employers participating.[48] The risk pool is intended to reduce the financial impact from unexpected events for a single employer, such as members living longer than expected or a large percentage of members becoming disabled who then become eligible for benefits before retiring. The risk pool spreads the risk across all participating employers, thereby potentially strengthening an individual employer's ability to pay for their members' pension benefits.

- **Established a new defined contribution plan, thereby limiting new liabilities—**As explained in the Introduction, page 3, A.R.S. §38-866 established the PSPDCRP for public safety personnel hired on or after July 1, 2017, in addition to the EODCRS for elected officials and employees elected, appointed, or hired on or after January 1, 2014.[49] Defined contribution plans do not create long-term liabilities for an employer because accounts are held by members rather than employers, who are responsible for managing and investing their own monies. The System reported that as of June 2023, 5,551 and 454 members were either enrolled or elected to enroll in the PSPDCRP or EODCRS, respectively. By eliminating future liabilities through a defined contribution plan alternative, it is expected that PSPRS', CORP's, and EORP's long-term sustainability will be improved.

- **Changed the System's pension funding policy and certain actuary assumptions to help ensure employers continue to progress toward achieving 100 percent funded statuses—**The System made changes to its pension funding policy and some actuary assumptions to impact employer payroll contribution rates. For example, in August 2020, the System established a "layered" approach for addressing employers' unfunded liabilities. Specifically, any change to an employer's unfunded liabilities

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[45] Laws 2016, Ch. 2, and Laws 2018, Ch. 163. These changes apply to individuals who become PSPRS members on or after July 1, 2017, and July 1, 2018, for CORP members.

[46] Laws 2016, Ch. 2, §5, and Laws 2017, Ch. 163, §18. Although employers are required to contribute a portion of defined contribution and tier 3 members' payroll toward tier 1 and tier 2 unfunded liabilities, tier 3 and defined contribution members are not required to contribute to these liabilities.

[47] Laws 2022, Ch. 323, §2.

[48] Laws 2017, Ch. 275, only allowed employers who had fewer than 250 active tier 1 and tier 2 members as of May 1, 2017, to participate in the risk pool. Liability risk pooling is the process of combining liabilities across employers with the goal of reducing or eliminating large fluctuations in an employer's or member's payroll contribution rates caused by unexpected events.

[49] A.R.S. §38-881.01 further mandated that corrections officers and other statutorily designated employees hired after July 1, 2018, participate in the PSPDCRP. However, Arizona Administrative Office of the Court members have the option to elect to participate in either the PSPDCRP or the defined benefit pension plan.

will be calculated annually and the resulting increase or decrease will create a "layer" that will be amortized over a 15-year period.[50] Based on any increases or decreases to an employer's unfunded liability, the employers' annually calculated payroll contribution rates will incorporate the 15-year amortization of the increase or decrease to the unfunded liability. Previously, employers had up to 30 years to amortize unfunded liabilities and "layers" were not used to help ensure the unfunded liabilities were addressed. A 15-year amortization period allows employers to address an increase in their unfunded liability more quickly and these monies become available sooner for investment.

Question 5: How does PSPRS' funded status compare to other plans?

We compared PSPRS' funded status to the funded statuses of similar plans in 5 other states and to the Arizona State Retirement System.[51] As illustrated in Table 7 (see page 27), PSPRS' funded status increased from June 2014 to June 2022, and the increase was higher than all 5 other plans and the Arizona State Retirement System. Specifically, PSPRS experienced a 16-percentage point increase, as compared to moderate increases, or even decreases, for the other state plans and the Arizona State Retirement System. However, each of the other 5 state plans and the Arizona State Retirement System had a better funded status than PSPRS in 2014, including 2 plans with a funded status of 90 percent or higher. As of June 2022, PSPRS had a funded status of approximately 65 percent, whereas all 5 other state plans and the Arizona State Retirement System were more than 71 percent funded.

Additionally, PSPRS' funded status increase between fiscal years 2020 and 2021 was greater than the average increases realized by 101 public retirement systems nation-wide. As illustrated in Table 8 (see page 28), according to a 2022 National Association of State Retirement Administrators' *Public Fund Survey*, the average funded status of 101 state and local government defined benefit plans increased by 2.3 percentage points between June 2020 and June 2021.[52] In comparison, PSPRS' funded status increased by approximately 7.3 percentage points (see Question 3, pages 20 through 24, for information explaining why the PSPRS funded status increased).

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[50] The Board approved a phase-in of the 15-year amortization period to limit the impact on employers. For example, if an employer's unfunded liabilities were amortized over 30 years as of June 2020 (layer 1), an increase or decrease to the employer's unfunded liabilities determined as of June 2021 (layer 2), would result in this increase or decrease being amortized over 29 years, matching the remaining amortization period of layer 1. Similarly, an increase or decrease to the employer's unfunded liabilities determined as of June 2023 (layer 3), would result in the increase or decrease being amortized over 28 years, matching the remaining amortization periods of layers 1 and 2. This would continue until all of the layers reached a 15-year amortization period and all future layers would be amortized over 15 years.

[51] See Appendix C, page c-2, footnote 77, for more information on how we selected the other plans for comparison.

[52] For more information, see National Association of State Retirement Administrators (NASRA). (2022). *Public Fund Survey: Summary of findings for FY 2021*. Retrieved 6/6/23 from https://www.nasra.org/publicfundsurvey.

Table 7
PSPRS' funded status increased more than peer plans from June 30, 2014 to June 30, 2022

	2014 Aggregate funded status[1]	2022 Aggregate funded status[1]	Difference between 2014 and 2022 aggregate funded status[2]
State plan			
Fire & Police Pension Association of Colorado[3]	100.9%	100.0%	-0.9%
Missouri Local Government Employees Retirement System	91.7%	96.5%	4.8%
Texas Municipal Retirement System[3]	85.8%	90.5%	4.7%
Rhode Island Municipal Employers' Retirement System	84.1%	85.9%	1.8%
Municipal Employees' Retirement System of Michigan[4]	78.0%	78.0%	Not available[4]
PSPRS	49.2%	65.2%	16.0%
Other System and State plans[5]			
Arizona State Retirement System	76.3%	71.3%	-5.0%
CORP	57.3%	83.3%	26.0%
EORP	39.4%	32.6%	-6.8%

1 Each plan's reporting period varied (see source). In addition, the funded status percentage is aggregated for the state plans except for the Fire & Police Pension Association of Colorado, Arizona State Retirement System, and EORP because they are cost-sharing multiple-employer plans.

2 The difference between the 2014 and 2022 aggregate funded status represents a percentage point change.

3 Fire & Police Pension Association of Colorado information is for the Defined Benefit System - Statewide Defined Benefit Plan; PSPRS information is for tier 1 and tier 2 members; and Texas Municipal Retirement System information is for the Pension Trust Fund.

4 Municipal Employees' Retirement System of Michigan did not report the aggregate funded status for its plan and instead reported an average funded status among participating employers of 78 percent as of December 31, 2013, and a median funded status among participating employers of 78 percent as of December 31, 2021. Because an average was used for 2014 and a median for 2022, a percentage point change could not be determined. For comparison, PSPRS had an average funded status among participating employers of 71.4 percent as of June 30, 2014, and a median funded status among participating employers of 90.3 percent as of June 30, 2022.

5 Although the Arizona State Retirement System, CORP, and EORP have some differences in membership composition as compared to PSPRS, we have included them for reference.

Source: Auditor General staff analysis of Arizona State Retirement System's actuary valuation report as of June 30, 2022; Fire & Police Pension Association of Colorado's Annual Comprehensive Financial Report for the year ended December 31, 2021; Municipal Employees' Retirement System of Michigan's actuarial valuation as of December 31, 2021; Missouri Local Government Employees Retirement System's actuarial valuation as of February 28, 2022; PSPRS', CORP's and EORP's actuarial valuations as of June 30, 2014 and 2022; Rhode Island Municipal Employees' Retirement System actuarial valuation as of June 30, 2022; and Texas Municipal Retirement System's Annual Comprehensive Financial Report as of December 31, 2021.

Table 8

PSPRS' funded status increased more than the average of 101 public retirement systems nation-wide between June 2020 and June 2021

	2020	2021	Difference between 2020 and 2021[2]
Nation's largest public retirement systems[1]	72.6%	74.9%	2.3%
PSPRS	46.9%	54.2%	7.3%

[1] The average funded status was from a survey of the 101 public retirement systems, comprising approximately 88 percent of the membership and assets for the entire state and local government defined benefit plan community.

[2] The difference between 2020 and 2021 represents a percentage point change.

Source: Auditor General staff analysis of the following source: NASRA, 2022; PSPRS actuarial valuation reports as of June 30, 2020 and 2021.

Question 6: What are the System's investments, and how do its investment returns compare to other plans?

The System's investment strategy is to select long-term investments to help ensure monies are available when needed to pay for benefits. Specifically, according to its policy, the System established a strategy to create an investment portfolio that is diversified, including traditional types of investments, such as stocks and bonds, as well as less risky investments that are not tied to the stock market. The System's investments are spread across several investment categories, known as asset classes. As shown in Table 9 (see page 29), as of June 2022, the System's investments and cash were valued at about $17.7 billion, more than double what it had in June 2014. This increase is largely attributable to the additional contributions and net investment income discussed in Question 3.

As also shown in Table 9, as of June 2014, $2.5 billion (50 percent) of the investments within the capital appreciation asset class were invested in global private equities and $1.3 billion (26 percent) in U.S. public equities. As of June 2022, global private equities investments decreased to 41 percent and U.S. public equities increased to 35 percent of the capital appreciation assets class.

As also shown in Table 9 and in Figure 5 (see page 30), the System experienced notable growth in its cash and short-term investments. The System reported that it experienced a larger than usual cash and short-term balance because additional contributions were made from employers in fiscal years 2021 and 2022 (see Question 3, page 20, for information on the additional contributions received). In addition, the June 2022 cash and short-term investments of $2.7 billion shown in Table 9 included $1 billion of contributions received from the State legislative appropriations on June 30, 2022.[53]

[53] Because the $1 billion of State contributions were received on June 30, 2022, the System reported it did not have sufficient time to invest the monies prior to the end of the fiscal year, and therefore these monies are reflected as cash. However, the System also reported that it has since invested the $1 billion according to its investment strategy, and that its cash and short-term investments were $1.3 billion, or 6.7 percent of its investment portfolio, as of June 30, 2023.

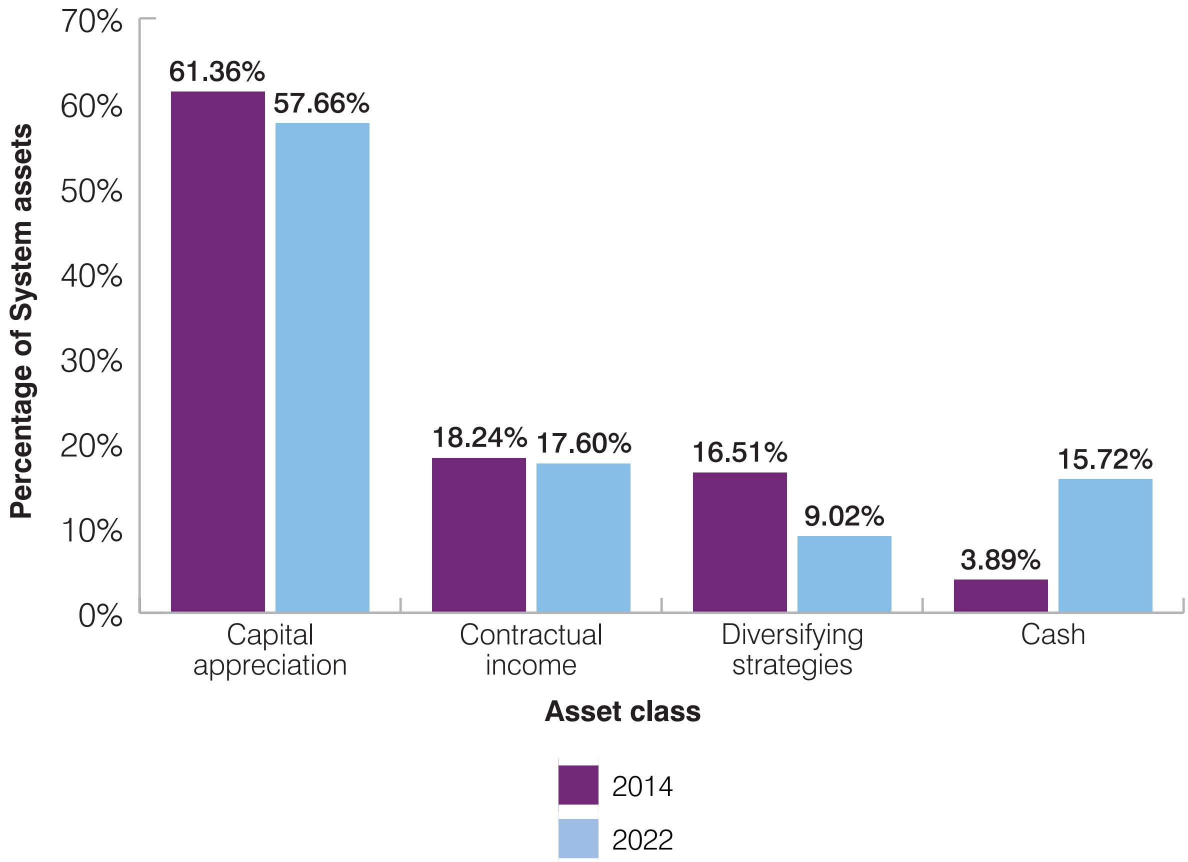
Table 9
The System's investments and cash more than doubled between June 2014 and June 2022
(In millions)

Asset Class/ Investment Type	Description	2014	2022
Capital appreciation—Investments that translate growth in the economy to growth of the system's assets such as stocks		**$4,981.4**	**$10,219.2**
Global private equites	Investments predominantly in commingled funds that are invested in privately held companies world-wide, including real estate and different types of private equity, such as venture capital and buyout funds.[1]	2,511.5	4,205.9
International public equities	Investments in commingled funds that invest in, or direct ownership of, companies that are traded on stock exchanges outside of the United States, offering exposure to global markets and diversification opportunities.	1,131.1	2,298.6
U.S. public equities	Investments in commingled funds that invest in, or direct ownership of, companies that are traded on stock exchanges in the United States, representing a stake in the company's assets and potential profits.	1,338.8	3,614.4
Other	Investments that translate growth in the economy to growth of the trust's assets.	-	100.3
Contractual income—Investments where a contractual relationship generates the return.		**1,481.4**	**3,118.6**
Private credit	Investments predominately in commingled funds that either write loans to companies or buy loans written by others. The profit is generated from the interest paid by debtholders.	714.6	2,016.2
Core bonds	Investments in commingled funds that invest in, or direct ownership of, publicly traded investment grade debt securities.	-	572.8
Other	Investments in commingled funds that pursue niche strategies like royalty payments and leasing strategies.	766.8	529.6
Diversifying strategies—Investments designed to generate positive returns over time with low correlation to traditional asset classes, such as stocks and bonds. These investments are designed to offer risk reduction and liquidity.		**1,341.6**	**1,597.6**
Cash and short-term investments—Cash and short-term investments, such as government money market funds.		**352.5**	**2,785.3**
Total investments and cash		**$8,156.9**	**$17,720.7**

[1] Venture capital is a type of private equity investment, usually one that is made in new companies that have not yet generated revenue. Buyout funds are another type of private equity investment where a partner's investment strategy is to acquire and add value to companies; however, the companies are more mature than the startups that venture capitalists typically invest in.

Source: Auditor General staff analysis of the System's annual comprehensive financial reports for fiscal years 2014 and 2022, and information provided by the System.

Figure 5
System's investments in capital appreciation and contractual income remained similar, while diversifying strategies decreased and cash increased
As of June 30, 2014 and June 30, 2022



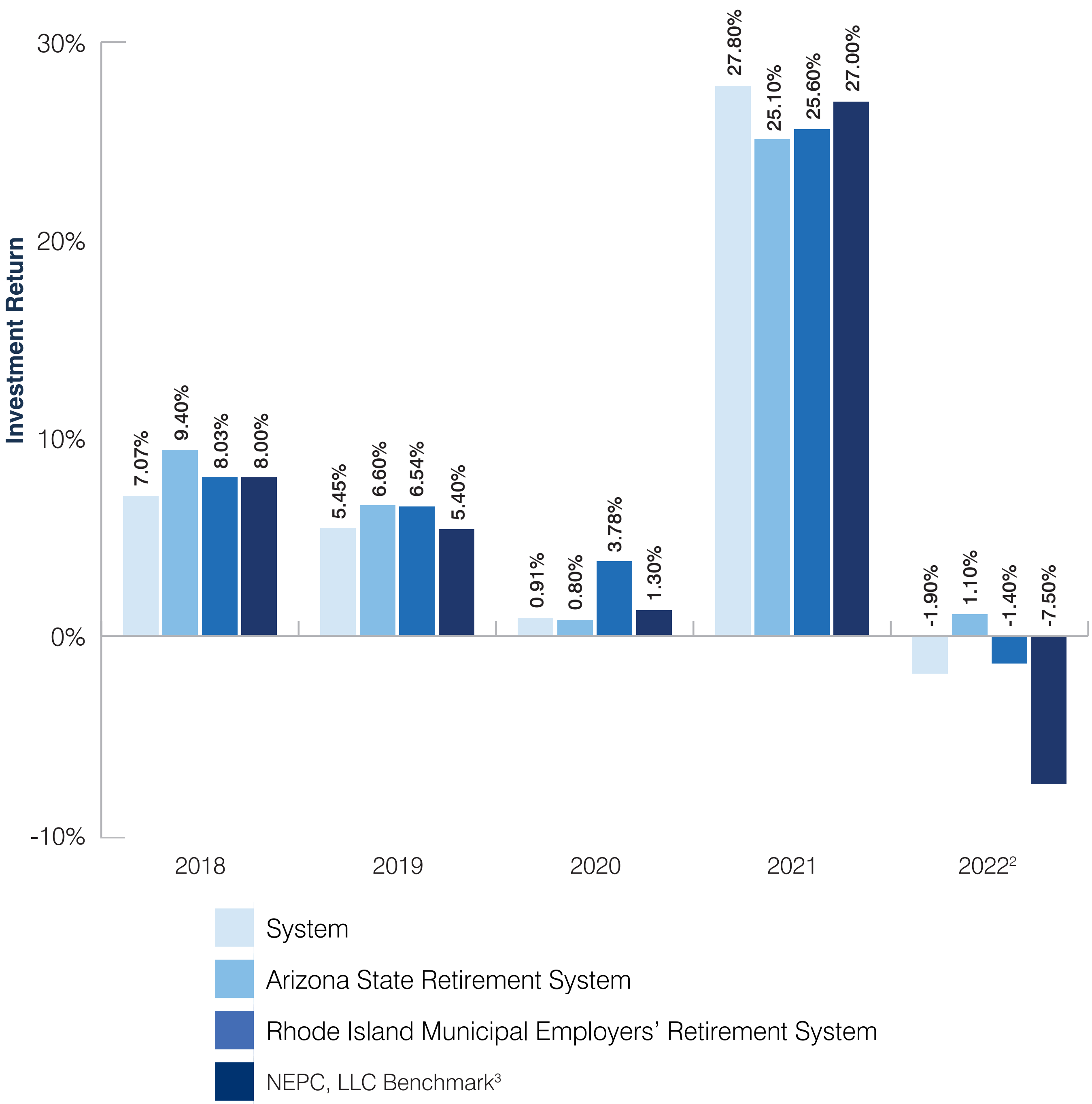
Source: Auditor General staff analysis of the System's annual comprehensive financial reports for fiscal years 2014 and 2022, and information provided by the System.

As shown in Figure 6 (see page 31), the System's annual investment returns varied from fiscal year 2018 through 2022, within a range of a 1.9 percent negative return in fiscal year 2022 and 27.8 percent positive return in fiscal year 2021. The Arizona State Retirement System, Rhode Island Municipal Employers' Retirement System, and an investment return benchmark developed by the System's independent fiduciary investment consultant (investment consultant) had a similar trend in their investment returns over this 5-year period (see Figure 6, footnote 1, for information on differences between pension systems that may affect their investment performance and Figure 6, footnote 3, for information on the investment consultant). The System's investment consultant also reported that the System's investment returns have been in the top 25 percent compared to a peer group of other defined benefit plans developed by the investment consultant over the last 3- and 5-year periods as of June 30, 2023 (see Figure 6, footnote 3, for more information on the peer group). In addition, the System's investment return was greater than the median investment return realized by the nation's largest public retirement systems. Specifically, according to a 2022 report by the National Association of State Retirement Administrators, the median investment return for plans with the same fiscal year end date as the System was 25.8 percent, compared to 27.8 percent for the System.[54]

[54] NASRA, 2022. See Table 8, footnote 1 for additional information about NASRA's report.

Figure 6

System's investment returns followed a similar trend to other plans and an investment return benchmark developed by the investment consultant for fiscal years 2018 through 2022[1]



[1] According to the System, differences between pension systems such as their investment objectives, investment portfolio composition, accounting treatment, and measurement dates may impact reported investment returns. Consequently, this presentation of 2 other plans and an investment return benchmark shows the overall investment return trend rather than a comparison of annual investment returns for fiscal years 2018 through 2022.

[2] According to the System, financial assets performed poorly in fiscal year 2022 because both stocks and bonds had negative returns.

[3] NEPC, LLC is the System's investment consultant that established an investment return benchmark consisting of other defined benefit plans it identified as peers to the System. Specifically, the NEPC, LLC benchmark illustrated in this figure includes defined benefit plans with investment portfolios of greater than $1 billion.

Source: Auditor General staff analysis of fiscal years 2018 through 2022 annual comprehensive financial reports for the System, Arizona State Retirement System, and Rhode Island Municipal Employees' Retirement System, and fiscal years 2018 through 2022 Board meeting minutes and agenda materials.

Pursuant to A.R.S. §41-2954(D), the legislative committees of reference shall consider but not be limited to the following factors in determining the need for continuation or termination of the System. The sunset factor analysis includes information not discussed earlier in the report.

Sunset factor 1: The objective and purpose in establishing the System and the extent to which the objective and purpose are met by private enterprises in other states.

The System was established in July 1968 and its statutory purpose is to provide a uniform, consistent, and equitable State-wide retirement program for public safety personnel, including for PSPRS, CORP, and EORP members.[55] According to the National Association of State Retirement Administrators, as of June 2023, all 50 states had at least 1 retirement plan for their public safety employees.[56] Although we did not identify any state retirement plans that meet their objective and purpose entirely through private enterprise, we did identify 1 state, Michigan's Municipal Employees' Retirement System, which is a nonprofit, independent retirement services company that administers the retirement plans for municipal employees in Michigan, including for some public safety personnel.

Sunset factor 2: The extent to which the System has met its statutory objective and purpose and the efficiency with which it has operated.

Our review found that the System has performed various activities consistent with its statutory responsibilities, such as obtaining annual actuarial valuations; conducting reviews of its actuarial assumptions every 5 years; annually reviewing and adopting a funding policy; and annually preparing an annual financial report.[57] For example, the System obtained fiscal years 2014 through 2022 actuarial valuations for its 3 plans that included the actuaries' recommended contribution rate, funded statuses, and other information necessary for the Board's determination of an employer contribution rate for each plan, as required by statute.

In addition, we identified an area where the System should continue its efforts to address previously identified concerns. Specifically, in a previous financial statement finding, we reported that the System and the Arizona Department of Administration did not adequately communicate and work together to ensure the accuracy of CORP's Arizona Department of Corrections Rehabilitation and Reentry member data, such as salary, hire dates, and birthdates.[58] We also found that the Arizona Department of Administration and the System did not have policies and procedures to reconcile CORP's active employee personnel data for the Arizona Department of Corrections Rehabilitation and Reentry between its payroll system and PSPRS' records. Additionally, we found during our fiscal years 2020 through 2022 State of Arizona Single Audits that a reconciliation had not been performed between the State's payroll records and the System's member data to help ensure the accuracy of the data. Inaccuracies in member data increase the risk that the estimated pension liability is inaccurate and the required contribution rate needed to cover the future benefit payments is insufficient.

To help address these issues, during fiscal year 2023, the System took steps to establish a process, including developing written procedures, to provide the Arizona Department of Administration with quarterly census data that can be reconciled to the State's payroll system for active members to help ensure the accuracy of the

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55 A.R.S. §38-841(A), (B)

56 National Association of State Retirement Administrators (NASRA). (2023). *State Info*. Retrieved 03/07/23 from https://www.nasra.org/states.

57 A.R.S. §§38-803, 38-848, 38-863.02, 38-883.

58 See finding 2019-06 in Arizona Auditor General report *State of Arizona: Single Audit Report—Year ended June 30, 2019*.

data. However, the System could not provide documentation or other evidence that it communicated with the Arizona Department of Administration to ensure that a reconciliation of the data had occurred.[59] In addition, the System's internal audits of 2 employers and local boards completed in July 2023 included testing member salary information, as this data was identified as having the greatest risk for inaccuracies. However, the internal audit did not include steps to determine if the salaries it reviewed matched the data provided to the actuaries to help ensure the accuracy of that data. According to the System, the fiscal year 2024 internal audits will include a review of salary-related member data that was provided to actuaries for the employers and local boards selected for audit.

Recommendations

The System should:

3. Continue providing quarterly census data to and working with the Arizona Department of Administration to reconcile the active member personnel data between the State's payroll records and the data provided to the System's actuaries and investigate and resolve any errors prior to providing the information to its actuaries.

4. Continue including member data in employer and local board internal audits and implement its plans to expand the audit work to include comparing member data reviewed to the data provided to the actuaries to help identify inaccuracies in the data.

System response: As outlined in its **response**, the System agrees with the finding and will implement the recommendations.

Sunset factor 3: The extent to which the System serves the entire State rather than specific interests.

The System manages pension plans on behalf of 294 participating employers of public safety personnel, correctional workers, judges, and elected officials throughout Arizona. These employers include the State, all 15 Arizona counties, and various cities, towns, Indian tribes, and fire districts throughout the State. In addition, the System serves more than 59,000 PSPRS, CORP, and EORP defined benefit plan members as of June 2022.[60] Further, the System has provided more than 200 presentations throughout the State since December 2019, such as educating employers about the funded status of their plans, the consequences of not fully funding their plans, and the long-term positive impact of additional contributions.

We also assessed whether the System serves the entire State rather than special interests by reviewing its conflict-of-interest practices. The State's conflict-of-interest requirements exist to remove or limit the possibility of personal influence from impacting a decision of a public agency employee or public officer. However, the System's former Administrator entered business relationships with 2 former Board members and all 3 failed to disclose and refrain from participating in decisions that could be influenced by their relationships. Additionally, the System's policies and procedures did not address all State requirements and did not fully align with recommended practices. We recommended that the System revise its conflict-of-interest policies and procedures and provide periodic conflict-of-interest training. See Finding 1, pages 9 through 12, for additional information and recommendations.

Sunset factor 4: The extent to which rules adopted by the System are consistent with the legislative mandate.

The System does not have statutory authority to promulgate rules and it has not adopted any rules.

[59] According to the Arizona Department of Administration, it has begun processing the first 2 quarters of the data received from the System; however, due to Department of Administration staffing shortages, it has not completed the reconciliation between the data and the State's payroll records.

[60] As discussed in the Introduction, page 3, the System also manages 2 defined contribution plans. The System reported that as of June 2023, 5,551 and 454 members were either enrolled or elected to enroll in the PSPDCRP or EODCRS, respectively.

Sunset factor 5: The extent to which the System has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.

The System does not have statutory authority to promulgate rules; therefore, it has not needed to obtain public input for this purpose. However, the System has informed the public about its actions through its Board meetings, website, and YouTube channel. For example, the System's website provides a link and instructions to members of the public who wish to join a live audio web stream of its Board meetings.

Our review also found that the System and Board complied with the provisions of the State's open meeting law we reviewed, with 1 exception.[61] Specifically, we assessed the System's compliance with various open meeting law requirements for 5 public meetings held between January 2023 through March 2023, including meetings conducted by 2 of its committees—the Board of Trustees Advisory Committee and the Board of Trustees Defined Contribution Committee.[62] Our review found that Board meeting notices and agendas were posted on the System's website at least 24 hours prior to the meetings and included statutorily required information in the meeting notices, including providing the date, time, and location of the meeting. However, the System did not always comply with 1 provision of the State's open meeting law. Specifically, the System did not make meeting minutes or recordings available within 3 working days for 2 of the 5 meetings we observed.[63,64]

Recommendation

The System should:

5. Ensure that meeting minutes, or digital recordings, are available upon request within 3 working days of public meetings, as required by statute.

System response: As outlined in its **response**, the System agrees with the finding and will implement the recommendation.

Sunset factor 6: The extent to which the System has been able to investigate and resolve complaints that are within its jurisdiction and the ability of the System to timely investigate and resolve complaints within its jurisdiction.

Although the System is not a regulatory agency, it has established policies and procedures for investigating and resolving the complaints it receives. The System reported that it began recording and tracking complaints in February 2022, and as of April 2023, the System had received a total of 25 complaints in fiscal year 2023. The complaints included a variety of allegations, such as pension fraud and depositing member pension payments into the wrong bank account. Our review of a random sample of 5 complaints from fiscal year 2023 found that the System investigated and resolved the complaints in accordance with its policies and procedures. For example, System staff met to triage complaints and conducted complaint investigations, including interviewing involved parties and documenting information gathered as part of the investigation, as required by its policies and procedures. The System also took actions to address the complaints it received, such as correcting erroneous direct-deposit payments, and providing training to System employees to prevent clerical errors. Our review also found that the System had investigated and resolved all 5 complaints in fewer than 180 days.[65]

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[61] A.R.S. §38-431.01.

[62] We reviewed the System's compliance with various open meeting law requirements for 3 Board of Trustees meetings, 1 Advisory Committee meeting, and 1 Defined Contribution Committee meeting held between January 2023 and March 2023.

[63] A.R.S. §38-431.01(D).

[64] For the 2 meetings, meeting minutes were provided within 4 and 5 days.

[65] We use a 180-day standard to assess the timeliness of complaint resolution.

Sunset factor 7: The extent to which the Attorney General or any other applicable agency of State government has the authority to prosecute actions under the enabling legislation.

According to A.R.S. §41-192(A)(1), the Attorney General serves as the System's legal advisor and provides legal services as the System requires. In addition, A.R.S §38-848(M)(3)(7) authorizes the System to contract with an independent investment counsel to advise in the investment management of the fund and assets of other plans that the System administers.

Sunset factor 8: The extent to which the System has addressed deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.

The System reported it had not identified any deficiencies in its enabling statutes that prevented it from fulfilling its statutory mandate.

Sunset factor 9: The extent to which changes are necessary in the laws of the System to adequately comply with the factors listed in this sunset law.

Our review did not identify any statutory changes necessary to comply with the factors listed in this sunset law.

Sunset factor 10: The extent to which the termination of the System would significantly affect the public health, safety, or welfare.

Terminating the System could affect public health, safety, or welfare if its responsibilities were not transferred to another entity. As of June 30, 2022, the System served more than 59,000 PSPRS, CORP, and EORP defined benefit plan members.[66] Additionally, the System provides health insurance premium subsidies to more than 13,900 PSPRS, CORP, and EORP retired members and helps pay cancer treatment expenses for some active and retired PSPRS and CORP members. Further, the Arizona State Constitution specifies that membership in a public retirement system is a contractual relationship and that members' benefits cannot be "diminished or impaired." Therefore, if the System were terminated, another entity would need to assume the System's pension and other benefit obligations. Additionally, terminating the System could negatively impact the State's ability to retain public safety and correctional employees, which in turn could jeopardize public safety services in Arizona.

Sunset factor 11: The extent to which the level of regulation exercised by the System compares to other states and is appropriate and whether less or more stringent levels of regulation would be appropriate.

This factor does not apply because the System is not a regulatory agency.

Sunset factor 12: The extent to which the System has used private contractors in the performance of its duties as compared to other states and how more effective use of private contractors could be accomplished.

The System uses private contractors for services in 6 mission-critical areas:

- **Actuarial services—**The System contracts for various actuarial services. For example, the System contracts for an annual actuarial valuation of assets of PSPRS, CORP, and EORP, as required by statute.[67] For fiscal year 2023, the System reported spending approximately $798,000 for these services.

- **Custodial banking services—**The System contracts with a custodial bank to hold assets of the System trust, value assets, and provide reports on investment performance. For fiscal year 2023, the System reported spending approximately $965,600 for these services.

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[66] As discussed in the Introduction, page 3, the System also manages 2 defined contribution plans. The System reported as of June 2023, 5,551 and 454 members were either enrolled or elected to enroll in the PSPDCRP or EODCRS, respectively.

[67] A.R.S. §§38-848 (M)(5), 38-883 (A)(3), and 38-803 (A)(2).

- **External audit services—**The System contracts for external audit services, including a review of its annual comprehensive financial report for PSPRS, CORP, and EORP. For fiscal year 2023, the System reported spending approximately $180,100 for these services.
- **IT services—**The System contracts for IT services, such as providing disaster recovery planning and maintaining its existing pension administration system. For fiscal year 2023, the System reported spending approximately $947,904 for IT services.
- **Investment management—**The System contracts with external investment management organizations to provide advice related to investing assets. For fiscal year 2023, the System reported spending approximately $5.8 million for these services.
- **Legal services—**The System contracts with private attorneys for specialized legal assistance, such as investment and tax counsel. For fiscal year 2023, the System reported spending approximately $379,800 for these services.

We reviewed financial reports for similar public safety personnel retirement plans in 5 other states—Colorado, Michigan, Missouri, Rhode Island, and Texas—to obtain information regarding their use of private contractors and found that the System uses private contractors to a similar extent as these 5 states' plans.[68,69] Specifically, similar to Arizona, these plans in 5 other states use contractors for actuarial, custodial banking, external auditing, investment management, legal, and information technology services.

We did not identify any additional areas where the Board should consider using private contractors.

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[68] We reviewed information from annual comprehensive financial reports for the Fire & Police Pension Association of Colorado (Colorado), the Municipal Employees' Retirement System of Michigan (Michigan), Missouri Local Government Employees Retirement System (Missouri), Rhode Island Municipal Employees' Retirement System (Rhode Island), and Texas Municipal Retirement System (Texas).

[69] We judgmentally selected Michigan, Missouri, and Rhode Island because the states were used in our 2015 performance audit and sunset review of the System. Additionally, we judgmentally selected Colorado and Texas based on identifiable similarities and differences after performing a review of other state public retirement plan information.

SUMMARY OF RECOMMENDATIONS

Auditor General makes 5 recommendations to the System

The System should:

1. Develop and/or revise and implement conflict-of-interest policies and procedures to help ensure it complies with State conflict-of-interest requirements and follows recommended practices, including:

    a. Storing and tracking all substantial interest disclosures in a special file available for public inspection.

    b. Reminding employees at least annually to update their disclosure form if/when their circumstances change (see Finding 1, pages 9 through 12, for more information).

2. Develop and provide periodic training on its conflict-of-interest requirements, process, and disclosure form, including providing training to all employees on how the State's conflict-of-interest requirements relate to their unique programs, functions, or responsibilities (see Finding 1, pages 9 through 12, for more information).

3. Continue providing quarterly census data to and working with the Arizona Department of Administration to reconcile the active member personnel data between the State's payroll records and the data provided to the System's actuaries and investigate and resolve any errors prior to providing the information to its actuaries (see Sunset Factor 2, pages 32 through 33, for more information).

4. Continue including member data in employer and local board internal audits and implement its plans to expand the audit work to include comparing member data reviewed to the data provided to the actuaries to help identify inaccuracies in the data (see Sunset Factor 2, pages 32 through 33, for more information).

5. Ensure that meeting minutes, or digital recordings, are available upon request within 3 working days of public meetings, as required by statute (see Sunset Factor 5, page 34, for more information).

Comparison of PSPRS and CORP participating employers' funded status

Table 10, pages a-2 through a-3, provides a comparison of the funded statuses of PSPRS and CORP employers by employer type, as of June 2014 and June 2022.[70] See Questions and Answers, Table 3, page 17, for a summary of all employers by funded status.

[70] As discussed in the Introduction (see page 3), EORP is a cost-sharing multiple-employer plan with only 1 account, and employers share the costs for providing pension benefits to all members equally; therefore, specific employer information is not applicable to EORP.

Table 10

PSPRS and CORP employers with more than a 75 percent funded status increased since June 2014

	Number of PSPRS participating employers		Number of CORP participating employers	
State agencies[1]	**2014**	**2022**	**2014**	**2022**
Below 25 percent	1			
25 to less than 50 percent	3			
50 to less than 75 percent	2		4	
75 to over 100 percent		6		4
Total state agencies	**6**	**6**	**4**	**4**
State universities				
Below 25 percent				
25 to less than 50 percent	2			
50 to less than 75 percent	1			
75 to over 100 percent		3		
Total State universities	**3**	**3**	**-**	**-**
Cities, towns, counties, community college districts, and Indian tribe governments				
Below 25 percent	6	4		
25 to less than 50 percent	52	17	2	1
50 to less than 75 percent	62	42	11	7
75 to over 100 percent	45	101	9	15
Total cities, towns, counties, community college districts, and Indian tribe governments	**165**	**164**	**22**	**23**
Fire districts				
Below 25 percent				
25 to less than 50 percent	2	1		
50 to less than 75 percent	21	9		
75 to over 100 percent	37	45		
Total fire districts	**60**	**55**	**-**	**-**
Arizona Administrative Office of the Courts[2]				
Below 25 percent				
25 to less than 50 percent				
50 to less than 75 percent				
75 to over 100 percent			1	1
Total Administrative Office of the Courts	**-**	**-**	**1**	**1**
Total all employer types[3]	**234**	**228**	**27**	**28**

[1] CORP has 3 State agency employers; however, the Arizona Department of Public Safety has 2 separate defined benefit plans, 1 for detention officers and 1 for dispatchers. Consequently, 4 participating employers are presented in the table.

Table 10 continued

[2] The Arizona Supreme Court through its Administrative Office of the Courts administratively oversees the probation and surveillance officers employed by the judiciary. As such, the System recognizes the Arizona Administrative Office of the Courts as 15 separate employers. However, because it represents 1 plan, for purposes of this audit, we considered the Arizona Administrative Office of the Courts plan to be 1 employer.

[3] The number of employers changed between fiscal years 2014 and 2022 because some PSPRS employers merged their plans, and some PSPRS and CORP employers did not have plans in 2014. In addition, the number of PSPRS employers in this table does not include 2 counties and 1 town in 2014 or 2 counties in 2022 because the employers did not have active members and only had assets on deposit with the PSPRS System but no related liabilities.

Source: Auditor General staff analysis of PSPRS and CORP actuarial valuation reports as of June 30, 2014, and June 30, 2022.

APPENDIX B

Differences within the plan tiers for certain retirement eligibility requirements, benefit calculations, and payroll contribution rates

This appendix illustrates some of the differences between each of the plans' tiers, such as those related to member and employer payroll contribution rates, retirement eligibility requirements, and benefit calculations.

Table 11
The PSPRS defined benefit plan has different retirement eligibility requirements, benefits, and payroll contribution rates across its 3 tiers[1]
As of July 2023

	Tier 1	Tier 2	Tier 3
Hire dates	Before January 1, 2012	On or after January 1, 2012, but before July 1, 2017	On or after July 1, 2017
Member payroll contribution rate[2]	7.65 percent		Rate set so members equally split costs with employers
Employer payroll contribution rate[3]	Based on individual actuarial valuation		Rate set so employers equally split costs with members, plus a portion of the tier 1 and tier 2 unfunded liabilities
Criteria for receiving full benefits[4]	20 years of credited service, or 62 years old and 15 years of credited service	25 years of credited service, or 52 1/2 years old with 15 years of credited service	55 years old and 15 years of credited service[5]
Average compensation used for benefit calculation	Average of the highest compensation for 3 consecutive years of the past 20 years.	Average of the highest compensation for 5 consecutive years of the past 20 years	Average of the highest compensation for 5 consecutive years of the past 15 years
Compensation limit[6]	$265,000 (current)		$115,868 (current)
Benefit calcuation[7]	Average monthly benefit compensation times 50 percent for 20 years of credit service	Higher of: (1) Tier 3 calculation or (2) Average monthly benefit compensation times 62.5 percent for 25 years of credited service	Average monthly benefit compensation times a multiplier based on years of credited service
Benefit increases[8] (up to 2 percent)	Cost-of-living adjustments		Cost-of-living adjustments and restricted by the funded status of the employer, payable after 7 years of retirement or 60 years of age
Criteria for receiving employer contributions upon termination[9]	A portion based on 5 to 9 years of credited service and then 100 percent at 10 years of credited service	Not available	

1 Tier 2 and tier 3 PSPRS members who do not contribute to Social Security also participate in the deferred contribution plan with both employers and members contributing 3 percent of salaries to a member's account, except employers must contribute 4 percent during fiscal year 2024 for members who were hired in 2012, and 3 percent thereafter.

2 The PSPRS tier 3 contribution rates are determined by an actuarial valuation where members contribute half of the normal cost, or cost of benefits for the current year of services, plus an amount to pay for tier 3 unfunded liabilities, if any. As discussed in the Introduction, page 1, and textbox on page 2, PSPRS is largely an agent multiple-employer plan, meaning member contribution rates are established separately for each employer, except for the tier 3 risk pool, which is a cost-sharing multiple employer plan that has 1 contribution rate for the pool. For fiscal year 2024, tier 3 members have an aggregate payroll contribution rate of 8.75 percent.

Table 11 continued

[3] As discussed in the Introduction (see page 1), and footnote 6 and textbox (see page 2), PSPRS is largely an agent multiple-employer plan, meaning that the employers have their own payroll contribution rates, except for the tier 3 risk pool, which is a cost-sharing multiple employer plan that has 1 contribution rate for the pool. Employer payroll contribution rates are determined by an actuarial valuation for each employer and the tier 3 risk pool. In addition, employers pay half of the annual costs for tier 3 (see footnote 2). Finally, all employers' payroll contribution rates include a portion to help pay for tier 1 and tier 2 unfunded liabilities, which is 32.21 percent for fiscal year 2024. See Questions and Answers, Figure 3, page 22, for the aggregate tier 1 and tier 2 employer payroll contributions for fiscal years 2014 through 2022.

[4] The information provided represents the minimum necessary for a normal retirement. Years of credited service, the time during a member's service where the member made payroll contributions to PSPRS, is used to determine eligibility for the 3 tiers.

[5] Tier 3 PSPRS members have an option for early retirement when they are 52 ½ years old and have at least 15 years of credited service. Tier 1 and 2 members do not have this option.

[6] Compensation limit is the maximum amount of a member's compensation, as defined in A.R.S. §38-842(12), that can be included in the benefit calculation. Tier 1 and tier 2 members have a compensation limit that is determined under the Internal Revenue Code, which was $265,000 for calendar year 2023. In accordance with A.R.S. §38-843.04, tier 3 members' compensation limit was established at $110,000 on or after July 1, 2017, and must be reviewed every 3 fiscal years by the Board. For fiscal year 2024, the compensation limit is $115,868.

[7] The average monthly benefit compensation is the total compensation paid to a member under the criteria for receiving full benefits and subject to the compensation limit, divided by the number of months the compensation was received. For all 3 tiers, the maximum benefit is limited to 80 percent of the member's average monthly benefit compensation. The amounts presented in the table for tier 1 and tier 2 members are the calculation used when the exact number of years presented is reached. Adjustments are made when years of credited service are less than or more than the amount presented. Specifically, the following adjustments are made:

- Tier 1—Decreased by 4 percent for each year under 20 years or increased by 2 percent for each year between 20 and 25 years of credited service, or 2.5 percent for each year over 20 years when 25 or more years of credited service is earned.
- Tier 2—Decreased by 4 percent for each year under 25 years or increased 2.5 percent for each year above 25 years; however, if the benefit is higher using the tier 3 calculation, then the member receives the benefit using the calculation.

In addition, tier 3 members receive a benefit that is calculated using a multiplier for each year of credited service, based on levels of credited service. The range is from 1.25 percent to 2.5 percent for each year of credited service.

[8] As discussed in Question 4 (see pages 24 and 25), benefit increases are based on cost-of-living adjustments. Benefit increases for tier 3 members have additional requirements that limit the increase based on the funded status of the employer and allow no benefit increases if the employer has less than a 70 percent funded status.

[9] Members are entitled to receive all the monies they contributed to PSPRS when they terminate from an employer prior to retirement. In addition, tier 1 members are also entitled to receive a portion of employer payroll contributions that vary based on years of credited service. Tier 2 and tier 3 members are not eligible to receive any employer payroll contributions; however, they are eligible to receive interest at a rate determined by the Board for the payroll contributions they made during their employment.

Source: Auditor General staff analysis of PSPRS actuarial valuation reports as of June 30, 2022, and other System-provided information.

Table 12
The CORP defined benefit plan has different retirement eligibility requirements, benefits, and payroll contribution rates across its 3 tiers
As of July 2023

	Tier 1	Tier 2	Tier 3
Hire dates	Before January 1, 2012	On or after January 1, 2012, but before July 1, 2018	On or after July 1, 2018
Member payroll contribution rate[1]	7.65 to 8.41 percent, except dispatchers contribute 7.96 percent		2/3 of the normal costs plus 1/2 of a portion of any tier 3 unfunded liabilities
Employer payroll contribution rate[2]	Based on individual actuarial valuation		1/3 of the normal costs plus 1/2 of a portion of tier 3 unfunded liabilities plus a portion of tier 1 and tier 2 unfunded liabilities
Criteria for receiving full benefits[3]	(1) 62 years old and 10 years of credited service; (2) 20 years of credited service (25 years for dispatchers) at any age, or (3) age plus years of credited service equal 80	52 1/2 years old and 25 years of credited service, or 62 years old and 10 years of credited service	55 years old and 10 years of credited service[4]
Average compensation used for benefit calculation	Average of the highest compensation for 3 consecutive years of the past 10 years	Average of the highest compensation for 5 consecutive years of the past 10 years	
Compensation limit[5]	$265,000 (current)		$72,947 (current)
Benefit calculation[6]	Average monthly benefit compensation times 50 percent for 20 years of credit service (25 years for dispatchers)	62.5 percent for 25 years of credited service	Average monthly benefit compensation times a multiplier based on years of credited service
Benefit increases[7] (up to 2 percent)	Cost-of-living adjustments		Cost-of-living adjustments and restricted by the funded status of the employer, payable after 7 years of retirement or 60 years of age
Criteria for receiving employer contributions upon termination[8]	A portion based on 5 to 9 years of credited service and then 100 percent at 10 years of credited service	Not available	

1 Member payroll contribution rates are based on an actuarial valuation that uses the employers' funded status, but fall within the ranges presented. In addition, for tier 3, members contribute 2/3 of the normal cost, or cost of benefits for the current year of services, plus half of the amount needed to help pay for tier 3 unfunded liabilities, if any. For fiscal year 2024, tier 3 members' payroll contribution rate is 8.23 percent.

Table 12 continued

[2] As discussed in the Introduction, footnote 8, and textbox (see page 2), CORP is largely an agent multiple-employer plan, meaning that the employers have their own payroll contribution rates except for the Arizona Administrative Office of the Courts plan (tier 3), which is considered a cost-sharing multiple employer plan that has 1 contribution rate for the plan. These rates are determined by an actuarial valuation for each employer for tier 1 and tier 2 members. In addition, for tier 3 members, employers are required to contribute 1/3 of the normal cost, or cost of benefits for the current year of services, plus half of the amount needed to help pay for any tier 3 unfunded liabilities. Further, all employers' payroll contribution rates also include a portion to help pay for tier 1 and tier 2 unfunded liabilities, see Questions and Answers, Figure 3, page 22, for the tier 1 and tier 2 aggregate employer payroll contributions for fiscal years 2014 through 2022. For fiscal year 2024, tier 3 employers' payroll contribution rate is 4.12 percent, plus an additional 41.22% for the unfunded tier 1 and tier 2 liabilities.

[3] The information provided represents the minimum necessary for a normal retirement. In addition, the years of credited service, the time during a member's service where the member made payroll contributions to CORP or credit was transferred from another retirement system or plan for Arizona public employees, is used to determine eligibility for the 3 tiers.

[4] Tier 3 CORP members have an option for early retirement when they are at least 52 ½ years old and have at least 10 years of credited service. Tier 1 and 2 members do not have this option.

[5] Compensation limit is the maximum amount of a member's compensation that can be included in the benefit calculation. Tier 1 and tier 2 members have a compensation limit that is determined under the Internal Revenue Code, which was $265,000 for calendar year 2023. In accordance with A.R.S. §38-895.01, tier 3 members' compensation limit was established at $70,000 on or after July 1, 2018, and must be reviewed every 3 fiscal years by the Board. For fiscal year 2024, the current compensation limit is $72,947.

[6] The average monthly benefit compensation is the total compensation paid to a member under the criteria for receiving full benefits and subject to the compensation limit, divided by the number of months the compensation was received. For all 3 tiers, the maximum benefit is limited to 80 percent of the member's average monthly benefit compensation. The amounts presented in the table for tier 1 and tier 2 members are the calculation used when the exact number of years presented is reached. Adjustments are made when years of credited service are more than the amount presented or based on a different calculation if less than 20 years. Specifically, the following adjustments are made, or different calculations are used:

- Tier 1—Increased by 2 percent for each year between 20 and 25 years of credited service, or 2.5 percent for each year over 20 years when 25 or more years of credited service is earned. If a member has less than 20 years of credited service, the benefit is calculated based on the 2.5 percent of the average monthly compensation times the years of credited service.
- Tier 2—Increased 2.5 percent for each year above 25 years. If a member has less than 25 years of credited service, the benefit is calculated based on 2.5 percent of the average monthly compensation times the years of credited service.

In addition, benefits for tier 3 members are calculated using a multiplier for each year of credited service, based on levels of credited service times the average monthly benefit compensation amount. The range is from 1.5 percent to 2.25 percent for each year of credited service.

[7] As discussed in Question 4 (see pages 24 and 25), benefit increases are based on cost-of-living adjustments. Benefit increases for tier 3 members have additional requirements that limit the increase based on the funded status of the employer and allow no benefit increases if the employer has less than a 70 percent funded status.

[8] Members are entitled to receive all the monies they contributed to CORP from an employer prior to retirement. In addition, tier 1 members are also entitled to receive a portion of employer payroll contributions that vary based on years of credited service. Tier 2 and tier 3 members are not eligible to receive any employer payroll contributions; however, they are eligible to receive interest at a rate determined by the Board for the payroll contributions they made during their employment.

Source: Auditor General staff analysis of CORP actuarial valuation reports as of June 30, 2022, and other System-provided information.

Table 13
The EORP defined benefit plan has different retirement eligibility requirements, benefits, and payroll contribution rates across its 2 tiers
As of July 2023

	Tier 1	Tier 2
Hire dates[1]	Before January 1, 2012	On or after January 1, 2012, but before December 31, 2013
Member payroll contribution rate	7 percent, except those hired after July 20, 2011 contribute 13 percent	13 percent
Employer payroll contribution rate[2]	Based on individual actuarial valuation	
Criteria for receiving full benefits[3]	(1) 62 years of age and 10 years of credited service; (2) 65 years of age and 5 years of credited service (3) 20 years of credited service at any age[4]	62 years of age and 10 years of credited service, or 65 years of age and 5 years of credited service
Average compensation used for benefit calculation	Average of the highest 3 consecutive years of the past 10 years	Average of the highest 5 consecutive years of the past 10 years
Compensation limit[5]	$265,000 (current)	
Benefit calculation[6]	4 percent of the average annual salary times the years of credited service	3 percent of the average annual salary times the years of credited service
Benefit increases[7] (up to 2 percent)	Cost-of-living adjustments	
Criteria for receiving employer contributions upon termination[8]	A portion based on 5 to 9 years of credited service and then 100 percent at 10 years of credited service	Not available

1 As discussed in the Introduction (see page 3), EORP stopped admitting new members in 2014. Elected officials and employees elected, appointed, or hired after that date are now required to participate in the Elected Officials' Defined Contribution Retirement System.

2 As discussed in Question 3 (see page 23), the employer payroll contribution rate beginning in fiscal year 2019 is based on an actuarially determined rate, including a portion to pay for the unfunded liabilities. For fiscal year 2024, the employer payroll contribution rate is 76.51 percent.

3 The information presented represents the minimum necessary for a normal retirement. Credited service does not include periods of service for which an active member is uncompensated and for which no contributions are made.

4 Tier 1 EORP members have an option for early retirement if they have at least 5 years of credited service, but at a reduced benefit amount that pays up to 30 percent of the average annual compensation. Tier 2 members do not have this option.

5 Compensation limit is the maximum amount of a member's compensation that can be used to determine pension benefits. Members have a compensation cap equal to the maximum compensation limit that is determined under the Internal Revenue Code.

6 The maximum benefit is capped at 80 percent and 75 percent of the member's average annual compensation for tier 1 and tier 2, respectively.

7 As discussed in Question 4 (see pages 24 and 25), benefit increases are based on cost-of-living adjustments.

8 Members are entitled to receive all the monies they contributed to EORP from an employer prior to retirement. In addition, tier 1 members are also entitled to receive a portion of employer payroll contributions that vary based on years of credited service. Tier 2 members are not eligible

Table 13 continued

to receive any employer payroll contributions; however, they are eligible to receive interest at a rate determined by the Board for the payroll contributions they made during their employment.

Source: Auditor General staff analysis of EORP actuarial valuation reports as of June 30, 2022, and System-provided information.

APPENDIX C

Objectives, scope, and methodology

The Arizona Auditor General has conducted a performance audit and sunset review of the System pursuant to a December 17, 2020, resolution of the Joint Legislative Audit Committee. The audit was conducted as part of the sunset review process prescribed in A.R.S. §41-2951 et seq.

We used various methods to address the audit's objectives. These methods included interviewing System staff and reviewing State statutes and session laws; voter propositions; and the System's policies, procedures, website, and other System-provided information. In addition, we used the following specific methods to meet the audit objectives:

- To evaluate the System's compliance with State conflict-of-interest requirements and alignment with recommended practices, we reviewed statute and State requirements, and recommended practices.[71,72] We also reviewed information regarding the former Administrator's and Board members' business relationships from various documents, such as publicly available and System-provided sources. We also reviewed travel reimbursement information provided by the System and from previous audit work.[73] Finally, we reviewed the disclosure forms completed by Board members in fiscal 2023.
- To obtain information for the Questions and Answers, we:
    - Reviewed our 2015 performance audit and sunset review report and November 2021, 36-month followup report.[74]
    - Reviewed PSPRS', CORP's, and EORP's actuarial valuation reports as of June 30, 2014, through June 30, 2022.[75]
    - Reviewed the System's annual comprehensive financial reports for fiscal years 2014 through 2022.
    - Reviewed various employer financial reports for fiscal years 2021 and 2022.[76]

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71 Recommended practices we reviewed included: Organization for Economic Cooperation and Development (OECD). (2021). *Recommendation of the council on OECD guidelines for managing conflict of interest in the public service*. Paris, France. Retrieved 8/9/2023 from https://legalinstruments.oecd.org/public/doc/130/130.en.pdf; Ethics & Compliance Initiative (ECI). (2016). *Conflicts of interest: An ECI benchmarking group resource*. Arlington, VA. Retrieved 8/9/2023 from https://www.ethics.org/wp-content/uploads/2021-ECI-WP-Conflicts-of-Interest-Defining-Preventing-Identifying-Addressing.pdf; and Controller and Auditor General of New Zealand (2020). *Managing conflicts of interest: A guide for the public sector*. Wellington, New Zealand. Retrieved 1/26/2023 from https://oag.parliament.nz/2020/conflicts/docs/conflicts-of-interest.pdf.

72 See, for example, Arizona Auditor General reports 21-402 *Higley Unified School District—Criminal Indictment—Conspiracy, Procurement Fraud, Fraudulent Schemes, Misuse of Public Monies, False Return, and Conflict of Interest*, 19-105 *Arizona School Facilities Board—Building Renewal Grant Fund*, and 17-405 *Pine-Strawberry Water Improvement District—Theft and misuse of public monies*.

73 See Arizona Auditor General report 20-301 *State Board member per diem compensation and expense reimbursements*.

74 See Arizona Auditor General report 15-111 *Public Safety Personnel Retirement System—The system's three retirement plans' funded statuses have declined and additional actions are needed to improve their long-term sustainability*; and Arizona Auditor General report 15-111 *36-Month follow-up report*.

75 For the purposes of this report, we analyzed the defined benefit pension plans for tier 1 and tier 2 members. Although PSPRS and CORP have 3 tiers of membership, the tier 1 and 2 members are combined in the actuary reports and represent the largest portion of each plan's liabilities for PSPRS and CORP.

76 Employer annual comprehensive financial reports included Cities of Prescott and Tempe, and Maricopa, Pima, and Pinal Counties. In addition, the fiscal year 2022 budget for the Superstition Fire & Medical District was also reviewed.

- Reviewed various documentation supporting the System's education and outreach efforts between December 2019 and April 2023, including listing of employer contacts, communication with employers and others, PowerPoint presentations given to employers and others, newsletters, Advisory Committee meeting minutes, and a modeling tool provided to employers.

- Reviewed financial information on the *Arizona Financial Transparency Portal* for fiscal years 2014 through 2022.

- Interviewed staff from the Joint Legislative Budget Committee, Arizona State Senate, League of Arizona Cities and Towns, and County Supervisors Association for Arizona.

- Compared the change in PSPRS' funded status to 5 plans in other states and the Arizona State Retirement System.[77]

- Compared the PSPRS' change in funded status as of June 30, 2020, and as of June 30, 2021, and the System's investment returns for fiscal year 2021, to 101 public retirement systems.[78]

- Presented the System's, one other state retirement plan's, Arizona State Retirement System's, and the System's investment consultant's benchmark investment return trend for fiscal years 2018 through 2022.[79,80]

- To obtain information for the Sunset Factors, we reviewed PSPRS's, CORP's, and EORP's actuarial valuation reports as of June 30, 2014, through as of June 30, 2022; the System's 2022 PSPRS, CORP, and EORP 2022 experience study performed by its actuaries; the System's June 2022 funding policy; Advisory Committee and Board of Trustees Board meeting minutes for May 2021 through December 2022; and the System's annual comprehensive financial reports for fiscal years 2014 through 2022. In addition, we reviewed the Arizona Auditor General fiscal year 2019 single audit report for the *State of Arizona*, communication between the System and the Arizona Department of Administration, and draft internal audit reports for 2 employers as of July 2023.[81] Additionally, we reviewed information from the National Association of State Retirement Administrators and reviewed annual comprehensive financial reports for retirement plans in 5 other states.[82] Further, we reviewed a random sample of 5 of 25 complaints the System received during fiscal year 2023. We also reviewed the System's compliance with various open meeting law requirements for 3 Board of Trustees meetings, 1 Advisory Committee meeting, and 1 Defined Contribution Committee meeting held between January 2023 and March 2023.

- To obtain information for the Introduction, we reviewed the System's annual comprehensive financial reports for fiscal years 2021 and 2022; PSPRS's, CORP's, and EORP's actuarial valuation reports as

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77 We judgmentally selected the Municipal Employee's Retirement System of Michigan, Missouri Local Government Employees Retirement System, and Rhode Island Municipal Employees' Retirement System because we identified these as PSPRS peer plans in our 2015 performance audit and sunset review of the System due to their similarities with PSPRS. We also judgmentally selected the Fire and Police Pension Association of Colorado and Texas Municipal Retirement System based on identifiable similarities with PSPRS after performing a review of other state public retirement plan information. In addition, we included Arizona State Retirement System because it is the largest retirement plan for State employees in Arizona.

78 National Association of State Retirement Administrators. (2022). *Public Fund Survey—Summary of findings for FY 2021*. Retrieved 6/6/2023 from https://www.nasra.org/publicfundsurvey.

79 We judgmentally selected the Rhode Island Municipal Employees' Retirement System because we identified this as a PSPRS peer plan in our 2015 performance audit and sunset review of the System due to their similarities with PSPRS and these similarities still exist. In addition, this plan had the same June 30 reporting date as the System and used the same return on investment formula. The Arizona State Retirement System was also selected because it is the largest retirement plan for State employees in Arizona and had the same June 30 reporting date and used the same return on investment formula.

80 NEPC, LLC is the System's investment consultant who established a benchmark investment return consisting of other defined benefit plans it identified as peers to the System. Specifically, the NEPC, LLC benchmark includes defined benefit plans with investment portfolios greater than $1 billion.

81 See Arizona Auditor General report *State of Arizona: Single Audit Report—Year ended June 30, 2019*.

82 National Association of State Retirement Administrators (NASRA). (2023). *State Info*. Retrieved 03/07/23 from https://www.nasra.org/states.

June 30, 2022; and System-provided information, including estimated fiscal year 2023 financial activity and information regarding staffing. Additionally, we reviewed a fact sheet on pension standards from the Governmental Accounting Standards Board.[83]

To obtain information for Appendix A and Appendix B, we reviewed PSPRS's, CORP's, and EORP's actuarial valuation reports as of June 30, 2014, through June 30, 2022; and reviewed information from the System related to the PSPRS, CORP, and EORP membership tiers.

Our work on internal controls included reviewing relevant policies and procedures for ensuring compliance with and/or adherence to State requirements, Department policies, and recommended practices, and where applicable, testing compliance with or adherence to these requirements and guidance. We reported our conclusions on internal control deficiencies in Finding 1 and in our responses to the statutory sunset factors.

We selected our audit samples to provide sufficient evidence to support our findings, conclusions, and recommendations. Unless otherwise noted, the results of our testing using these samples were not intended to be projected to the entire population.

We conducted this performance audit and sunset review of the System in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We express our appreciation to the System's Administrator, staff, and Board for their cooperation and assistance throughout the audit.

[83] Governmental Accounting Standards Board. (n.d.). *Fact sheet on the GASB's new pension standards: Governments in cost-sharing multiple-employer defined benefit pension plans*. Retrieved 5/25/2023 from https://gasb.org/Page/PageContent?pageId=/staticpages/costsharing-employer.html#:~:text=A%20cost%2Dsharing%20 multiple%2Demployer%20plan%20is%20one%20in%20which,retirees%20of%20any%20 participating%20employer.

SYSTEM RESPONSE

PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM
CORRECTIONS OFFICER RETIREMENT PLAN
ELECTED OFFICIALS' RETIREMENT PLAN
ARIZONA PSPRS TRUST

Michael Townsend *Administrator*
Michael Smarik *Deputy Administrator*
Bret Parke *Assistant Administrator, General Counsel*
Mark Steed *Chief Investment Officer*

September 21, 2023

Lindsay A. Perry
Arizona Auditor General
2910 N 44th St., Ste. 410
Phoenix, AZ 85018-7271

Dear Ms. Perry:

This cover letter is to provide the Management Response to the final report draft of the performance audit and sunset review of the Public Safety Personnel Retirement System.

Included with this letter is our response which addresses each recommendation in the revised final report draft to comply with the Joint Legislative Audit Committee's procedures. The responses incorporate one of the provided statements for each recommendation in the report and include additional comments related to sunset factor recommendations 2 and 5.

Internal planning to address the sunset factor recommendations has begun and PSPRS acknowledges it is understood the Joint Legislative Audit Committee requires that agencies provide your Office a written explanation of the status of the efforts to implement all recommendations within 6 months after the published date of the audit report.

The revised final draft report and all its parts are being managed as confidential until notice from your office is received specifying the date the report is public.

Please notify PSPRS of any further steps that need to be addressed.

Sincerely,

Michael Townsend,
PSPRS Administrator

Attachment

PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM
CORRECTIONS OFFICER RETIREMENT PLAN
ELECTED OFFICIALS' RETIREMENT PLAN
ARIZONA PSPRS TRUST

Michael Townsend Administrator
Michael Smarik Deputy Administrator
Bret Parke Assistant Administrator, General Counsel
Mark Steed Chief Investment Officer

Finding 1: Former System Administrator entered business relationships with 2 former Board members and all 3 failed to disclose and refrain from participating in decisions that could be influenced by their relationships.

Recommendation 1: The System should develop and/or revise and implement conflict-of-interest policies and procedures to help ensure it complies with State conflict-of-interest requirements and follows recommended practices, including:

Recommendation 1a: Storing and tracking all substantial interest disclosures in a special file available for public inspection.

System response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: None.

Recommendation 1b: Reminding employees at least annually to update their disclosure form if/when their circumstances change.

System response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: None.

Recommendation 2: The System should develop and provide periodic training on its conflict-of-interest requirements, process, and disclosure form, including providing training to all employees on how the State's conflict-of-interest requirements relate to their unique programs, functions, or responsibilities.

System response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: None.

Sunset Factor 2: The extent to which the System has met its statutory objective and purpose and the efficiency with which it has operated.

Recommendation 3: The System should continue providing quarterly census data to and working with the Arizona Department of Administration to reconcile the active member personnel data between the State's payroll records and the data provided

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to the System's actuaries and investigate and resolve any errors prior to providing the information to its actuaries.

System response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: PSPRS will continue to coordinate with Arizona Department of Administration – General Accounting Office and the Arizona Department of Corrections Rehabilitation and Reentry to help them appropriately provide employer data. Options for a more appropriate alternative long-term solution may be considered in connection with the implementation of the Pension Administration System.

Recommendation 4: The System should continue including member data in employer and local board internal audits and implement its plans to expand the audit work to include comparing member data reviewed to the data provided to the actuaries to help identify inaccuracies in the data.

System response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: None.

Sunset Factor 5: The extent to which the System has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.

Recommendation 5: The System should ensure that meeting minutes, or digital recordings, are available upon request within 3 working days of public meetings, as required by statute.

System response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The PSPRS procedure is to provide the information within the statutory timeframe of 3 working days. While we are generally compliant, we will review the process and make appropriate modifications to ensure compliance in all instances.

ARIZONA
Auditor General
Making a Positive Difference