STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

Public Safety Personnel, Corrections Officer, and Elected Officials' Retirement System

REPORT HIGHLIGHTS
PROCEDURAL REVIEW

System has taken reasonable steps to contain its excessive legal costs

Our Conclusion

The Public Safety Personnel Retirement System (PSPRS), Corrections Officer Retirement Plan (CORP), and Elected Officials' Retirement Plan (EORP), collectively referred to as the System, provide retirement, disability, and survivor benefits, and retiree health insurance premiums to members. From 2005 through 2009, the System's legal costs steadily increased. In 2009, new policies and rules were adopted to control legal costs, which resulted in costs falling over 50 percent between 2009 and 2010. From 1991 through 2010, the System's investment portfolio—characterized at times by a high concentration in equities—earned just over 7 percent in annual gains, falling short of the actuarially assumed rate of return during this period. In 2008, the System began to make significant changes to its investment policies. These policy changes have resulted in a more diversified investment portfolio and significantly reduced the effect that any one type of investment could have on investment returns.

2011

Fiscal Years 1991 through 2011

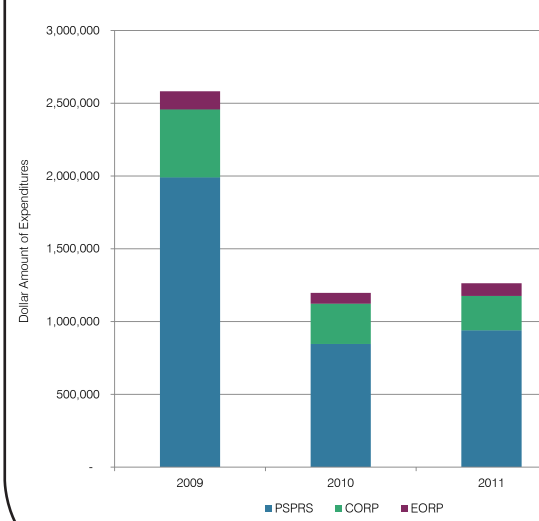
As of March 31, 2009, System's legal expenditures significantly exceeded budgeted amounts—In April 2009, the System's board of trustees (board) reviewed the status of its operating budget and determined that actual fiscal year-to-date legal expenditures of $2.3 million exceeded the budget by the end of March 2009 by over 45 percent. The fiscal year 2009 expenditures were part of a pattern of rising legal expenditures that began in fiscal year 2005.

Main cause of excessive legal fees was an inadequate review of legal invoices submitted for payment—The board's Operations and Audit Subcommittee evaluated the System's procedures for processing legal invoices and reviewed legal invoices paid to the System's outside legal counsel from July 1, 2008 through March 31, 2009. At the time of review, the System's assistant administrator was responsible for reviewing and approving legal invoices for payment. The Subcommittee determined that the procedures surrounding the use and payment of legal services were inadequate.

Board implemented new policies and procedures governing legal expenditures—In June 2009, the board approved a new Procedures and Rules for Requesting, Reviewing, Evaluating, and Approving Legal Expenditures policy. Under the new policy the System's administrator and assistant administrators must approve all requests for legal services except for 1) routine matters agreed upon in advance by the administrator and outside legal counsel, 2) requests for legal services and work product made by the board, and 3) consultations between individual board members and outside legal counsel. Legal invoices for services rendered are reviewed by both the administrator and assistant administrators.

System is taking reasonable steps to efficiently manage its need for legal services—Since the implementation of the new policy at the end of fiscal year 2009, as shown in the figure below, legal expenditures have dropped significantly. To further enhance the System's ability to manage its legal expenditures, the System has contracted with 14 law firms with specialized expertise, and plans to hire in-house legal counsel for more routine matters. Further, the System was assigned an Assistant Attorney General on a part-time basis to perform noninvestment-related legal services.

Actual Expenditures for Legal Fees
Fiscal Years 2009 through 2011



System has diversified its investment portfolio and implemented policy to better manage risk and generate more consistent returns

System's overall investment performance fell short of assumed returns—From fiscal years 1991 through 2010, the System's investment portfolio was managed by an administrator and board of trustees, with guidance provided by a variety of financial services firms. During this period, the System's total investment performance averaged just over 7 percent in annual gains. This performance was nearly 2 percent lower than the actuarially assumed return, the rate of return required for the System to meet its long-term benefit obligations. At times, the System experienced volatile rates of returns due to high concentration in domestic equities with limited constraints on the concentration in certain types of stock, particularly information technology stocks.

The System's actual rate of return exceeded the actuarially assumed rate of return in some years but dropped below it in other years. The overall result, as the figure below shows, is a cumulative rate of return of about 300 percent for fiscal years 1991 through 2010. This means that each dollar in the fund in fiscal year 1991 earned about $3.00 by fiscal year 2010 through the System's investment strategies. To match the actuarially assumed rate of return during this period, however, each dollar in the fund in fiscal year 1991 should have earned about $4.50. As the figure below shows, the System's underperformance resulted primarily from losses experienced in fiscal years 2001 through 2002 and 2008 through 2009.

System implemented new investment policy to diversify its portfolio and minimize risk—In fiscal year 2008, the System began to make significant changes to its investment portfolio, adjusting its asset allocation to lower dependence on U.S. stocks to 50 percent. At the same time, the System increased its exposure to international stocks, accounting for 16 percent of the total portfolio. During fiscal years 2009 and 2010, the System adopted a new asset allocation mix as part of its investment policy, creating a more diverse portfolio with even less reliance on stocks. The revised policy sets a target range for each type of investment and all investments are rebalanced as needed to meet their respective target range.