



ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

August 12, 2015

Ms. Debbie Davenport, Auditor General
Office of the Auditor General
2910 N. 44th St., Ste. 410
Phoenix, AZ 85018

Dear Ms. Davenport:

The Arizona State Retirement System (ASRS) appreciates the opportunity to respond to the Office of the Auditor General recommendations issued in the performance audit and sunset review report. The ASRS would like to commend the Office of the Auditor General staff on their professionalism and responsiveness during the course of this audit. They ensured the audit process proceeded smoothly with a minimum of disruption to daily operations. It was a pleasure to work with them.

Finding 1: ASRS plan is not fully funded, but steps have been taken to improve its long-term sustainability.

1.1 Recommendation: The ASRS should continue with its plans to formally adopt its funding policy and make it publicly available by posting the policy on its Web site.

ASRS Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. This item is scheduled to be discussed at the August 2015 Board of Trustees meeting.

Finding 2: Additional actions can enhance ASRS plan's financial condition and long-term sustainability.

2.1 Recommendation: The ASRS and its Board should work with its actuary to develop a method for ensuring the cost of future benefit increases do not impact the ASRS plan's sustainability. In developing this method, the ASRS should ensure that it aligns with its funding policy's goals and objectives.

ASRS Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The ASRS will incorporate this responsibility into its Funding Policy.

2.2 Recommendation: The ASRS and its Board should develop and implement a policy and procedure for periodically reviewing its actuarial cost method to determine which generally accepted actuarial cost method is appropriate for determining contributions and

helping to meet its Funding Policy's objectives. In developing this procedure, the ASRS should ensure that its adopted policy and procedures:

- a) Establish a time frame to review the appropriateness of the actuarial cost method periodically, such as every 5 years when it conducts its actuarial experience studies

ASRS Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The ASRS will incorporate this responsibility into its Funding Policy.

- b) Do not allow the Board and/or the actuary to change actuarial methods for the sole purpose of achieving a more favorable funding status, or fiscal result

ASRS Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The ASRS will incorporate this responsibility into its Funding Policy.

2.3 Recommendation: The ASRS should enhance its procedures for identifying employer termination incentive programs and assessing the cost of any resulting unfunded liability to an employer. Further, depending on the final resolution of outstanding litigation, the ASRS may also need to adopt administrative rules in order to legally enforce A.R.S. §38-749. Specifically the ARS should:

- a) Determine a methodology for calculating when a 30 percent or greater increase in a member's compensation not attributable to a promotion has occurred

ASRS Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The ASRS is currently involved in litigation related to this topic and will determine how to address the Auditor General's findings at the conclusion of these legal proceedings.

- b) Develop and implement written policy and procedures executing the methodology to determine when a 30 percent or greater non-promotion salary increase has occurred, and train staff on the policy and procedures

ASRS Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The ASRS is currently involved in litigation related to this topic and will determine how to address the Auditor General's findings at the conclusion of these legal proceedings.

- c) Assess the feasibility of implementing this procedure for all members who have retired since September 30, 2009. Accordingly, the ASRS should identify and investigate potential instances of employer termination programs, including those involving non-promotion salary increases of 30 percent or more. Further, when

an instance is identified, the ASRS should assess the cost of any resulting unfunded liabilities to the employer

ASRS Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The ASRS is currently involved in litigation related to this topic and will determine how to address the Auditor General's findings at the conclusion of these legal proceedings.

- d) Include information in its retirement benefit processing procedures on how to identify and what ASRS staff should do when they identify salary increases that appear to be a result of an employer termination incentive program or an inappropriate pre-retirement salary increase, as well as which staff are responsible for conducting further investigations on such cases and for assessing the cost of the unfunded liability to the employer

ASRS Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The ASRS is currently involved in litigation related to this topic and will determine how to address the Auditor General's findings at the conclusion of these legal proceedings.

- e) Develop and implement a policy and procedures for regularly querying the ASRS contribution accounting system for increases in compensation that could indicate employer termination incentive programs. The adopted policy and procedures should also state which ASRS staff are responsible for conducting further investigations on potential cases identified through its queries, and which staff are responsible for assessing the cost of any unfunded liability to the employer

ASRS Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The ASRS is currently involved in litigation related to this topic and will determine how to address the Auditor General's findings at the conclusion of these legal proceedings.

Sunset Factors Finding: The ASRS should enhance some of its information technology (IT) practices.

1. Recommendation: As part of its continuing efforts to enhance its IT practices, the ASRS should:
- a) Develop a process for documenting the review and approval of IT system coding changes prior to implementing changes

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

- b) Periodically update its disaster recovery plan to ensure that all information pertaining to devices, personnel, software, and processes are as up to date as possible

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

- c) Continue enhancing its data access process to ensure that access is limited to appropriate personnel

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

- d) Develop a process to review logs for key activities on its networks and systems

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

- e) Continue evaluating the recommendations it received from a 2014 limited security assessment and implement them as appropriate

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

Sincerely,

Paul Matson
Director