TOWN OF QUEEN CREEK, ARIZONA
PENSION FUNDING POLICY
Updated JUNE 1, 2022

INTRODUCTION

The purpose of this Policy is to establish the pension funding objectives for the Town's pension plans. The Town has three pension plans: 1. the Queen Creek Fire Department Defined Benefit Pension Plan in the Public Safety Personnel Retirement System (PSPRS); 2. the Queen Creek Police Department Defined Benefit Pension Plan in the Public Safety Personnel Retirement System (PSPRS); and 3. the Arizona State Retirement System (ASRS). The Town Council establishes this Funding Policy to help ensure the financial sustainability of the Town's plans.

In 2018, the Arizona Legislature passed HB 2097 which requires all governing boards of PSPRS member entities to adopt a pension funding policy. This requirement, along with the reporting requirements of the Governmental Accounting Standards Board (GASB) discussed below, necessitate the creation of this funding policy.

The Government Finance Officers Association (GFOA) recommends the adoption of a pension funding policy and has numerous recommendations regarding the funding of pension plans. Those recommendations are incorporated into this policy. Furthermore, the League of Arizona Cities and Towns Pension Task Force recommends adoption of a policy as well.

This policy shall be reviewed by the Town Council annually.

FUNDING OBJECTIVES

1. Fully funded pension plans. Maintain adequate assets so that current plan assets plus future contributions and investment earnings are sufficient to fund all benefits expected to be paid to members and their beneficiaries.

   The target funded ratio goal is 100% (full funding). Taxpayer and member equity is best achieved at full funding. At full funding, both the member and taxpayer have paid the appropriate costs incurred to date.

2. Maintain intergenerational equity. Pension costs are paid by the generation of taxpayers who receive the services.

   Fully funded pension plans are the best way to achieve taxpayer and member intergenerational equity.

   Pensions that are less than fully funded place the cost of service provided in earlier periods on the current and future taxpayers. If the plan is underfunded (less than 100%), future members and taxpayer are responsible for an unfair portion of plan costs.

3. Maintain stability of the Town's contribution amounts.

4. Maintain public policy goals of accountability and transparency. Each policy element is clear in intent and effect, and each should allow an assessment of whether, how and when the funding requirements of the plan will be met.

OVERVIEW OF PENSION REPORTING TERMS AND REPORTS

The following terms are used throughout this policy:

Unfunded Actuarial Accrued Liability (UAAL) – the difference between assets and the estimated future cost of pensions earned by employees. This UAAL results from actual results (interest earnings, member mortality, disability rates, etc.) being different from the assumptions used in previous actuarial valuations. This amount is reported in the annual Actuarial Valuation that is used to set contribution rates.

Annual Required Contribution (ARC) – the annual amount required to pay into the pension funds, as determined through the annual Actuarial Valuation. It is comprised of two primary components: normal pension cost – which is the estimated cost of pension benefits earned by employees in the current year; and, amortization of the UAAL – which is the cost needed to cover the unfunded portion of pensions earned by employees in previous years. The UAAL is collected over a period of time referred to as the amortization period. The ARC is a percentage of the current payroll.

Funded Ratio – a ratio of fund assets to actuarial accrued liability. The higher the ratio, the better funded the pension is, with 100% being fully funded.

Intergenerational Equity – ensures that no generation is burdened by substantially more or less pension costs than past or future generations.

Net Pension Liability (NPL) – similar to the UAAL, the difference between assets and estimated future costs of pensions earned by employees, as calculated using asset values and assumptions required by GASB Statement 68. This amount is reported in the annual GASB 68 Employer Reporting Accounting Schedules provided by the pension plan administrator.

The Annual Required Contribution (ARC) rate is calculated and reported in the Town's annual Actuarial Valuation report. For many years, the ARC was used as a basis for both funding decisions and financial reporting requirements.

In 2012, the Governmental Accounting Standards Board (GASB) approved two financial standards: GASB Statement No. 67 (*Financial Reporting for Pension Plans*) and GASB Statement No. 68 (*Accounting and Financial Reporting for Pensions*).

As a result of GASB Statement 68, the Town receives a second annual report that measures the Town's Net Pension Liability using a specific set of assumptions and asset valuation methods required by the GASB. The main difference between the Actuarial Valuation and the GASB 68 report is how the Town's pension assets are valued and reported.

GASB 68 requires the use of the market value assets at June 30th, including all investment gains and losses during the year. A point-in-time market value measurement can be very volatile. In contrast, the Actuarial Valuation follows a generally accepted actuarial method to "smooth" the value of assets by recognizing investment gains and losses over a long-term period (PSPRS uses a seven-year smoothing period, and ASRS uses a ten-year smoothing period). This smoothing method helps maintain reasonably stable contribution rates.

The result is that the Town has two different numbers that attempt to report the Town's pension liability on the same date. The Actuarial Valuation number is generally used to make *funding* decisions (i.e., set the contribution rates), while the GASB 68 number is used for *reporting* in the Town's financial statements.

The Town will use the higher of the two numbers in any given year to meet the funding objectives of this policy.

SPECIFIC FUNDING PRACTICES

The Town Council will fully fund the pension liabilities for the three pension systems by directing resources created from revenues in excess of expenses at the end of every fiscal year. The three pension liabilities will be fully funded in the following priority order: first, the fire unfunded pension liability; second, the police unfunded pension liability; and third, the ASRS unfunded pension liability.

1. Fire Plan in PSPRS

PSPRS is administered as an agent multiple-employer pension plan. This system has two main functions: 1) to co-mingle assets of all plans under its administration, thus achieving economy of scale for more cost-efficient investments, and invest those assets for the benefit of all members under its administration and 2) serve as the statewide uniform administrator for the distribution of benefits.

Under an agent multiple-employer plan, each agency participating in the plan has an individual trust fund reflecting that agency's assets and liabilities. Under this plan all contributions are deposited to and distributions are made from that fund's assets, each fund has its own funded ratio and contribution rate, and each fund has a unique annual actuarial valuation.

Prior to June 30th annually, the Town will remit a one-time payment to PSPRS. The amount remitted will be the greater of the Net Pension Liability reported in the Queen Creek Fire Department's most recent GASB 68 Employer Reporting Accounting Schedules, or the Unfunded Actuarial Accrued Liability reported in the Queen Creek Fire Department's most recent Actuarial Valuation. The amount will be based on Tier 1 and 2 employees only.

Without this policy, the Town's Fire Unfunded Actuarial Accrued Liability will not be paid off until the year 2036. The PSPRS Board makes the determination regarding the amortization period of the Unfunded Actuarial Accrued Liability which is a closed, 30-year period.

2. [REPEALED JUNE 1, 2022] Maricopa County Sheriff's Office (MCSO) Contract

The Maricopa County Sheriff's Office has a plan in PSPRS. MCSO's annual pension costs are included in the Town's service contract. This cost includes MCSO's contribution toward paying down its Unfunded Actuarial Accrued Liability.

As such, the Town is unable to directly make payments to the MCSO plan to reduce the Unfunded Actuarial Accrued Liability as the Town does with its Fire Plan. Therefore, an alternative approach has been developed to achieve the objectives identified in this Policy.

Effective June 2018, an MCSO Unfunded Pension Liability Reserve account is created in the General Fund. The amount recorded in this reserve represents the Town's share of the greater of the Net Pension Liability as reported in the MCSO's most recent GASB 68 Employer Reporting Accounting Schedules, or the Unfunded Actuarial Accrued Liability as reported in the MSCO's most recent Actuarial Valuation. The Town's share is determined based on the Town's number of sworn contract employees as a percentage of the total active sworn employees in the MCSO PSPRS plan.

Without this policy, the Town's MCSO Unfunded Actuarial Accrued Liability will not be paid off until the year 2036. The PSPRS Board makes the determination regarding the amortization period of the Unfunded Actuarial Accrued Liability which is a closed, 30-year period.

3. Police Plan in PSPRS.

A Police Unfunded Pension Liability Reserve account is created in the General Fund. The amount recorded in this reserve represents the Town's share of the greater of the Net Pension Liability as reported in the Queen Creek Police Department's most recent GASB 68 Employer Reporting Accounting Schedules, or the Unfunded Actuarial Accrued Liability as reported in the Queen Creek Police Department's most recent Actuarial Valuation. Additionally, the amount held in the Town's former MCSO Unfunded Pension Liability Reserve account will be transferred to the Police Unfunded Pension

Liability Reserve account at the end of fiscal year 2021/22 and will remain in the Police Reserve account to provide resources for funding future pension liabilities. Over time, as the actuarial valuations of the PSPRS Plan mature, the monies in the Town's reserve account will be transferred to the PSPRS Plan.

4. Arizona State Retirement System (ASRS)

ASRS is administered as a cost-sharing, multiple-employer pension plan. This system has two main functions: 1) to comingle assets and liabilities of all member entities under its administration, thus achieving economy of scale for more cost efficient investments, and 2) serve as the statewide uniform administrator for the distribution of benefits.

Under this system, each agency participating in the plan is allocated its individual share of assets and liabilities. As such, the Town does not have its own separate plan as it does with Fire and Police under PSPRS. All of the Town's employees (excluding those in the Fire and Police PSPRS) are included in this system.

As a result, an alternative approach has been developed to achieve the objectives identified in this Policy.

Effective June 2018, ASRS Unfunded Pension Liability Reserve accounts are created in the General Fund and each Enterprise Fund. The amounts recorded in these reserves represent the Town's share of the ASRS Net Pension Liability as reported in the ASRS's most recent GASB 68 Employer Reporting Accounting Schedules. The ASRS Actuarial Valuation does not have sufficient information to allocate or estimate the Town's portion of the ASRS UAAL, therefore only the GASB 68 reports will be used for this policy.

Without this policy, the Town's ASRS Net Pension Liability will not be paid off until the year 2047. The ASRS Board makes the determination regarding the amortization period of the Unfunded Actuarial Accrued Liability which is a closed, 30-year period.

Allocation of Resources to Fund Reserve Accounts

Annually, all available resources in the Operating Budget in excess of the Town's Operating Budget 25% Unassigned Fund Balance Reserve will be directed in the following priority order until both reserves are fully funded: first, to the Police Unfunded Pension Liability Reserve and second, to the ASRS Unfunded Pension Liability Reserve in the General Fund.

Annually, unrestricted net position in each Enterprise Fund will be directed to the ASRS Unfunded Pension Liability Reserve in the respective Enterprise Fund until the reserves are fully funded. Each Enterprise Fund's share of the ASRS Net Pension Liability will be based on that fund's covered payroll relative to total covered payroll for all of the Town's ASRS-eligible employees.