

Macias Gini & O'Connell
Summary of Financial Statement Audit Management Letter Comments
Current Year Report
As Of June 30, 2013

Audit (Report Issue Date): Report to Management for the Year Ended 06/30/12 (2/12/13)

Significant Deficiency 2012-1: Completeness and Accuracy of Investment Related Disclosures

Division responsible: Fiscal Services Division

Observation: The issue was reported as Observation #1 in 2011 and now has been elevated as a significant deficiency. The auditors found the GASB 40 disclosures failed to report securities subject to investment risk disclosures. They also found the GASB 53 derivative disclosures errors included: the incorrect fair value of derivative instruments, notional dollars reported as notional units, and notional units reported as notional dollars. The GASB 40 and GASB 53 disclosures should be validated for completeness and accuracy, and reviewed by personnel with knowledge of complex accounting standards and comprehension of the System's investment structure and transactions.

Management's Original Response: Fiscal Services will provide staff with training from the custodian bank, implement a secondary review of investment disclosures and strengthen procedures. Fiscal Services will also work both with the custodian bank to document the custodian's roles and responsibilities, and with the Investment Office to obtain investment expertise and validate disclosure data. Fiscal Services plans to implement the procedures and secondary level of review July 1, 2013 and conclude the process October 2013.

Fiscal Services Current Update: OPEN. Fiscal Services has updated procedures and will be submitting for approval. Fiscal Services met with the custodian bank to document the custodian's roles and responsibilities. Fiscal Services will meet with the Investment Office during year-end to obtain investment expertise and validate disclosure data and will implement a secondary review of investment disclosures. Fiscal Services plans to implement the procedures and secondary level of review starting July 1, 2013 and conclude the process October 2013.

Significant Deficiency 2012-2: Account Analysis and Financial Reporting

Division responsible: Fiscal Services Division

Observation: Fiscal Services provided comparative trial balances and the analysis of unusual changes in account balances for all funds, but the auditors found several general ledger items were not properly analyzed and contained improper posting of transactions, and the Management's Discussion & Analysis described the dollar amount and percentage changes between current year and prior year but did not provide the reason for the change.

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Management's Original Response: Fiscal Services will meet with key managers to discuss changes within System program areas and review best practices used in other Comprehensive Annual Financial Reports. Fiscal Services expects to provide changes from program areas as of June 30, 2013 and final account analysis as of November 2013.

Fiscal Services Current Update: OPEN. Fiscal Services established a working team consisting of key program area managers to discuss program changes and review best practices used in other Comprehensive Annual Financial Reports (CAFR). Fiscal Services also enhanced their internal analytical review processes and expects that both these actions will improve the quality of the Fiscal Year 2012-13 CAFR as of November 2013.

Significant Deficiency 2012-3: Implementation of my|CalPERS

Division responsible: Customer Services and Support
Information Technology Services Branch
Office of Audit Services

Customer Services and Support

Observations:

- 1) Manual overrides are performed in all elements of the system. Staff relies on the legacy systems and manual spreadsheets to perform calculations and override benefit amounts.
- 2) System access procedures should be developed to review user accounts and their associated roles to ensure they are current and enforce proper segregation of duties.

Management's Original Response:

- 1) Management will identify and correct defects to reduce staff reliance on manual spreadsheets and overrides. Management will enhance procedures and processes and will ensure staff document, track and log manual overrides. Customer Services and Support will address manual overrides by June 30, 2013.
- 2) Management is the team lead on a user access project with three other Divisions intended to update procedures, review and revoke inactive users, prevent the routine need for cross-divisional approvals, review and identify group roles and permission sets. Customer Services and Support will implement the user access project by June 30, 2013.

Customer Services and Support Current Update:

- 1) RESOLVED. Pending final verification by Macias, Gini & O'Connell.
- 2) OPEN. The user access project is being implemented as the project team is working with program divisions to map access needs, review and identify group roles and permissions sets to ensure the proper and necessary access is granted to each individual user. In an effort to better define system access across the organization the project team will continue to analyze the data collected in June. Target completion date is January 31, 2014.

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Information Technology Services Branch

Observation: The data query and reporting knowledge has not been adequately transferred from consultants to CalPERS staff to query data and reports from the my|CalPERS system.

Management's Original Response: Information Technology Services has overseen the transfer knowledge activities from external consultants to CalPERS staff, completion of consultant's contractual obligations, and transfer of additional knowledge as needed. Information Technology Services management expects to complete knowledge transfer by in this area by June 30, 2014.

Information Technology Services Current Update: RESOLVED. Pending final verification by Macias, Gini & O'Connell. Information Technology Services completed knowledge transfer activities from external consultants to CalPERS staff and assumed 100% of the workload as of June 30, 2013.

Office of Audit Services

Observation: The my|CalPERS general controls have some errors in benefit payment processing of health benefit deductions, death benefits and employer reporting, but the errors have not been quantified.

Management's Original Response: Audit Services will include in the audit plan areas identified and impacted by the my|CalPERS system and assess the impact of the unresolved errors as needed. Audit Services will address all areas by June 30, 2014.

Office of Audit Services Current Update: OPEN. Audit Services completed its review of death benefits and did not find continued uncorrected errors caused by my|CalPERS processing. Audit Services initiated a review of employer reporting in the fourth quarter of fiscal year 2012-13, and included a review of health deductions in the 2013-14 audit plan. Audit Services will address these two areas by June 30, 2014

Observation 1:	Investment Classifications
Division responsible:	Fiscal Services Division

Observation: Fiscal Services was inconsistent in reporting the unitized investments and underlying securities between the PERF and affiliate funds.

Management's Original Response: Management will initiate a secondary level review of investment transactions and ensure staff coordinates the reporting of unitized portfolios and the underlying securities to be consistent and accurate across program areas. Fiscal Services states investment classification will begin July 2013 and conclude October 2013.

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Fiscal Services Current Update: OPEN. Management will initiate a secondary level review of investment transactions and ensure staff coordinates the reporting of unitized portfolios and the underlying securities to be consistent and accurate across program areas. Fiscal Services states investment classification will begin July 2013 and conclude October 2013.

Observation 2: Investment Commitment Disclosures
Division responsible: Fiscal Services Division

Observation: Fiscal Services had errors in the investment commitment disclosures: an original corporate governance commitment amount was reduced during the year but was not reflected in the worksheet; certain foreign investment commitments were not converted from Euros to dollar amounts; and one year real estate contracts that end on June 30 had the unfunded commitment added to the investment disclosure worksheet.

Management's Original Response: Fiscal Services will develop a process to identify investments in a foreign country, perform a variance analysis on the investment commitment worksheets, and document the reason for the changes with the Investment Office. Fiscal Services will implement the process by October 2013.

Fiscal Services Current Update: OPEN. Fiscal Services will develop a process to identify investments in a foreign country, perform a variance analysis on the investment commitment worksheets, and document the reason for the changes with the Investment Office. Fiscal Services is in the process of updating procedures and has met with Investment Office on documentation required for the commitment summary worksheets they will provide by September 30th. Fiscal Services will perform variance analysis on the worksheets provided and complete disclosures in October 2013.

Observation 3: Internal Controls Over Benefit Processing
Division responsible: Customer Services and Support

Observation: The auditors found errors in retirement benefit amounts primarily from the implementation of my|CalPERS, and a need to re-evaluate policies and procedures.

Management's Original Response: Customer Services and Support will enhance policies and procedures on system testing and validation of data by June 30, 2013.

Customer Services and Support Current Update: RESOLVED. Pending final verification by Macias, Gini & O'Connell.

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Observation 4: Self-Funded Healthcare Enrollment Reconciliation
Division responsible: Customer Services and Support

Observation: The Anthem Blue Cross monthly enrollment reconciliations were not completed timely. As a result, discrepancies were not investigated and resolved prior to the next billing cycle.

Management's Original Response: CalPERS will resume reconciliation of the Anthem Blue Cross enrollment file, rather than use the Premiums Reconciliation file, until the my|CalPERS premium reconciliation is functional. Customer Services and Support will develop procedures by April 30, 2013 and implement the reconciliation process by July 31, 2013.

Customer Services and Support Current Update: OPEN. Customer Services and Support have implemented new policies and procedures and have developed an enrollment reconciliation process and flowchart. Subsequent to June 30, 2013, the enrollment reconciliation process was completed as of July 31, 2013 and is pending Macias, Gini & O'Connell review. Customer Services and Support will develop a new premium funding process and have not yet provided a target completion date.

Observation 5: Access to Programs and Data
Division responsible: Information Security Office

Observation: Information Security Office did not test or develop periodic tests of the Guardium SQL device to ensure it properly monitors database activity.

Management's Original Response: Information Security will have periodic independent testing of the Guardium SQL device performed to supplement our internal testing. This independent testing will provide additional assurance that the Guardium device is detecting and reporting all suspicious database layer activity. Information Security will retain documentation of the results of the testing. A test plan has been prepared and resources are being identified for its execution. Information Security expects to complete this item by August 31, 2013.

Information Security Office Current Update: RESOLVED. Subsequent to June 30, 2013, a limited Guardium SQL device test was completed as of August 31, 2013 and is complete pending Macias, Gini & O'Connell review.