CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Report to the Risk and Audit Committee

For the Fiscal Year Ended June 30, 2013

______, 2013

To the Risk and Audit Committee
California Public Employees' Retirement System
Sacramento, California

We have audited the financial statements of the fiduciary activities and the proprietary activities of the California Public Employees' Retirement System (the System) for the fiscal year ended June 30, 2013. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated April 12, 2013. Professional standards also require that we communicate to you the following information related to our audit.

<u>Significant Audit Findings</u>

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the System are described in Note 1 to the basic financial statements. As described in Note 1 to the basic financial statements, effective July 1, 2012, the System adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements and GASB Statement No. 63, Financial Reporting of Deferred Outflow of Resources, Deferred Inflow of Resources, and Net Position*. We noted no transactions entered into by the System during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the fiduciary and proprietary activities' financial statements were:

- Actuarial valuations of pension and other postemployment benefit assets, liabilities and required contributions
- Fair value of real assets and private equity investments and related income
- Estimated insurance claims due in the Health Care Fund
- Estimated liability for future policy benefits in the Long-Term Care Fund

The actuarial pension data contained in Note 9 to the basic financial statements and required supplementary information is based on actuarial calculations performed in accordance with the parameters set forth in GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*. The actuarial data for other postemployment benefits contained in Note 9 to the basic financial statements and required supplementary information is based on actuarial calculations and measurements performed in accordance with GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans* and the System's OPEB Assumption Model.

Real assets consist of real estate, forestland and infrastructure investments. Directly held and joint venture real estate investment fair values are based on recent estimates provided by the System's contract real estate advisors or independent appraisers. Commingled fund real estate investment fair values are based on the related partnership's June 30, 2013 financial statements. Forestland, infrastructure, and private equity investment fair values were determined by management, in consultation with the general partner and investment advisors, based on the related partnership's June 30, 2013 financial statements or the most recent financial information adjusted for cash flow activities through June 30, 2013.

The estimated insurance claims due in the Health Care Fund are based on incurred but not reported (IBNR) claims, disability extension claims and administrative expenses associated with those claims, as determined by the System's third-party administrator. The estimated liability for future policy benefits in the Long-Term Care Fund is based on the present value of future benefits and expenses less the present value of future premiums, as determined by the System's actuaries.

We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the basic financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were the schedules of funded status for the Public Employees' Retirement Fund (PERF) and the California Employers' Retirement Benefit Trust based on the most recent actuarial valuations and measurements as of June 30, 2012, and the estimated liability for future policy benefits of the Long-Term Care Fund. As described in Note 9 to the basic financial statements, actuarial valuations involve estimates of the value and probability assumptions of events far into the future, and those amounts and assumptions are subject to continual revision as actual results are compared to past expectations. As described in Note 8 to the basic financial statements, the estimated liability for future policy benefits is very sensitive to the underlying actuarial assumptions, including a discount rate of 5.75 percent, morbidity, and voluntary termination.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. The attached Schedule I summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial to the financial statements taken as a whole.

In addition, the attached Schedule II summarizes misstatements detected as a result of audit procedures, which were corrected by management.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated _______, 2013.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the System's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves. With respect to other information accompanying the financial statements in the Comprehensive Annual Financial Report such as the Introductory, Investment, Actuarial, and Statistical sections, we will read the other information to determine whether there are any material inconsistencies with the audited financial statements.

This information is intended solely for the use of the Risk and Audit Committee, Board of Administration and the management of the System and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

Macias Gini & O'Connell LLP

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Report to the Risk and Audit Committee
Schedule I - Summary of Uncorrected Financial Statement Misstatements
June 30, 2013

	Increase / (Decrease)				
Financial Statement Account Description	**Assets**	**Liabilities**	**Net Position**	**Additions**	**Deductions**
Members, Public Agencies, State & Schools Receivable	$ 385,158				
Short-Term Investments	3,116,758				
Global Equity Securities	15,700,029				
Global Debt Securities	4,383,750				
Inflation Assets	1,739,375				
Real Assets	289,498				
Due to Members, Public Agencies, State & Schools		$ 25,614,568			

To report in an agency fund at June 30, 2013, the Placer County 401(k) plan investments and related balances that are held and managed by the System in accordance with participant directives.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Report to the Risk and Audit Committee
Schedule II - Summary of Corrected Financial Statement Misstatements
June 30, 2013

		Increase / (Decrease)				
Financial Statement Account Description	**Fund Name**	**Assets**	**Liabilities**	**Additions / Revenues**	**Deductions / Expenses**	**Net Position**
Members Contributions	IRC 457			$ (1,038,702)		
Members, Public Agencies, State & Schools Receivables		$ (1,038,702)				
To adjust the year-end member contribution accrual, which was originally recorded twice.						
Other Program Receivables	IRC 457	(385,158)				
Short-Term Investments		(3,116,758)				
Global Equity Securities		(15,700,029)				
Global Debt Securities		(4,383,750)				
Inflation Assets		(1,739,375)				
Real Assets		(289,498)				
Net Position						$ (23,202,733)
Members Contributions				(2,282,672)		
Participant Withdrawals					$ (2,318,162)	
Net Appreciation in Fair Value of Investments				(2,435,614)		
Interest				(12,590)		
Other Investment Expense				(879)		
To remove from the IRC 457 Fund amounts relating to the Placer County 401(K) plan for which the System held and managed investments at June 30, 2013, but did not serve in a trustee capacity. The investments and related balances should be reported in an agency fund as reflected in Schedule I - Summary of Uncorrected Financial Statement Misstatements.						
Due to Health Carriers	CRF - Agency Fund		$ (8,827,746)			
Due To Other Funds			8,827,746			
To reclassify payables to the Health Care Fund for premiums received for the self-funded health plans.						
Due From Other Funds	HCF	8,827,746				
Unearned Premiums			8,827,746			
To record receivables from the Contingency Reserve Fund - Agency Fund for self-funded health plan premiums received in advance of coverage.						
Other Liabilities	HCF		(41,230,149)			
Insurance Premiums and Claims Payable			41,230,149			
To reclassify healthcare-related payables at year-end.						
Other Liabilities	HCF		(46,528,721)			
Unearned Premiums			46,528,721			
To reclassify premiums received for July 2013 coverage.						
Loan Receivable - Current	HCF	9,750,000				
Long-Term Loan Receivable		22,500,000				
Other Programs Receivable		(32,250,000)				
To reclassify the current and long-term portion of an outstanding loan receivable.						
Self-Insurance Premiums	HCF			(21,868,029)		
Federal Government Subsidies				21,868,029		
To reclassify federal government subsidies received under the Employer Group Waiver Program (EGWP).						

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June 30, 2013

		Increase / (Decrease)				
Financial Statement Account Description	**Fund Name**	**Assets**	**Liabilities**	**Additions / Revenues**	**Deductions / Expenses**	**Net Position**
Members, Public Agencies, State & Schools Receivables	HCF	3,635,777				
Federal Government Subsidies				507,458		
Claims Expense					(3,128,319)	
To accrue EGWP subsidies and rebates that were earned, but not received at year-end.						
Other Liabilities	LTCF		(11,774,968)			
Unearned Premiums			11,774,968			
To reclassify premiums received for July 2013 coverage.						