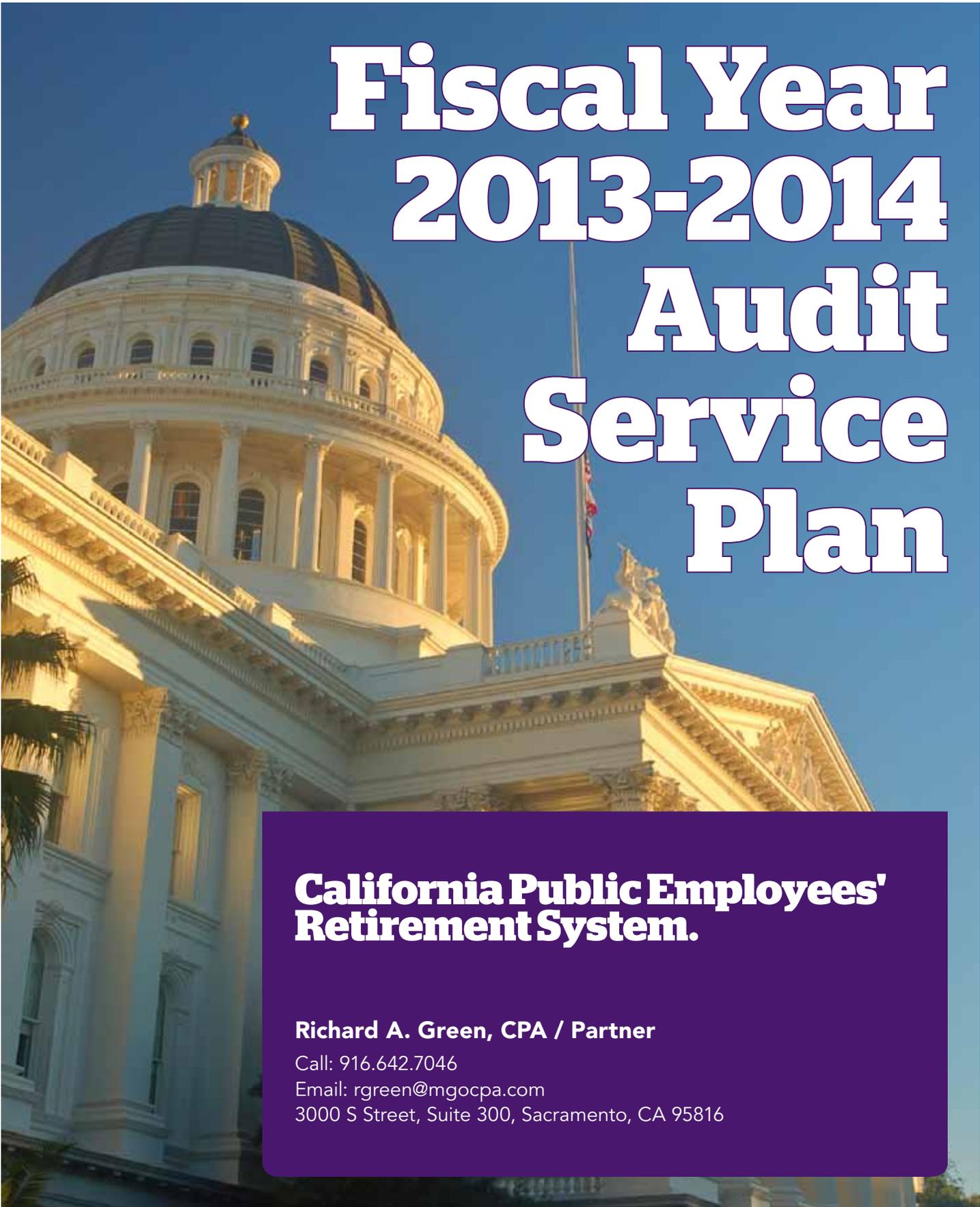


MGO

Certified Public Accountants.

The background of the page is a photograph of the California State Capitol building in Sacramento, California. The building is a grand, white, neoclassical structure with a prominent central dome. The dome is dark and has a smaller, ornate cupola on top. The building is surrounded by a colonnade of tall, white columns. The sky is a clear, bright blue. The text is overlaid on the right side of the image.

Fiscal Year 2013-2014 Audit Service Plan

**California Public Employees'
Retirement System.**

Richard A. Green, CPA / Partner

Call: 916.642.7046

Email: rgreen@mgocpa.com

3000 S Street, Suite 300, Sacramento, CA 95816



Proud To Be Boring Accountants.®

The Boring Story.

Our tagline isn't just some made-up marketing jargon; it's the result of our entire team digging deep to crystallize what drives them, what makes us different, and why clients should care about us.

Proud To Be Boring Accountants® of course plays off the old stereotype of accountants. We felt it was time we stood up and claimed our craft. It's who we are, and it's what we love doing. In a world where CPAs seem to be Jacks of all trades, we are masters of one, and proud of it.

We take our profession seriously, not ourselves. When you get to know us, you find out we're not really that boring, and our approach to problem-solving is thoughtful and looks at issues from all angles. Being boring accountants means we understand how to help clients stand clear of fads and quick fixes while staying focused on strategies that will help them succeed over the long-term.

That's enough explanation. We wouldn't want to bore you, now would we?

A handwritten signature in black ink that reads 'Kevin J. O'Connell'.

Kevin J. O'Connell, CPA
CEO & Managing Partner

Proud to be a Boring Accountant.



Introduction.

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Recent Developments in Accounting and Financial Reporting

Our approach, like our plan that follows, is all about clear communication, innovation, a willingness to always go the extra mile, and full transparency – because that’s what it takes to deliver the highest level of assurance.

On behalf of Macias Gini & O’Connell LLP (MGO) we are pleased to present our fiscal year 2013-2014 Audit Service Plan (Plan) for the California Public Employees’ Retirement System (the System). In preparing our Plan we have drawn on our experience in serving the System in the prior years and numerous retirement systems within California and Oregon. This Plan presents our engagement service team; timeline for deliverables; highlights our audit approach, scope and objectives and summarizes audit responsibilities under *auditing standards generally accepted in the United States of America*. Also included in this document is a summary of recent technical developments in governmental accounting and financial reporting that may impact the System.

We are committed to serving the System so that retirees, current employees, elected officials, and management continue to have the utmost confidence in the System financial statements, internal control systems, and compliance with laws and regulations. We dedicate the resources of our team and provide ongoing access to our very best resources to exceed the Risk and Audit Committee and management’s expectations.

We appreciate the opportunity to be of service and look forward to discussing the highlights of our Plan with the Risk and Audit Committee and management.



Richard A. Green, CPA

MGO Partner

Section 1

Overview of MGO audit services.

EXECUTIVE SUMMARY

Our goal is to continuously exceed the expectations of management and the Risk and Audit Committee in providing efficient, cost-effective and high-quality services to the System.

MGO Objectives

Our mission is to be the professional service firm that consistently exceeds the expectations of our clients and our people. Our objective is to deliver seamless, high quality, timely service to the System in all areas in which we provide professional services. These include accounting and auditing, consulting, tax and other specialized services. We will meet our objectives by identifying opportunities to provide value added services to the System. In order to accomplish this, we will:

- Identify and resolve reporting, accounting and audit issues timely and effectively;
- Regularly communicate with the System;
- Complete our audit on a timely basis;
- Provide seamless service across the organization;
- Understand your organization, culture, programs and services;
- Dedicate our most experienced professionals;
- Utilize specialists where unique skill sets are required;
- Apply our technical knowledge to identify solutions to organizational and financial issues;
- Respond to critical issues with a sense of urgency;
- Act as another set of "eyes and ears";
- Meet all deadlines; and
- Communicate key findings to top management and the Risk and Audit Committee.

Our focus is on the System's Critical Audit Areas and Financial Reporting Matters

Through planned face-to-face meetings with the Risk and Audit Committee, executive personnel, and key management personnel throughout the year, we will directly ascertain the System's expectations of us and we will communicate our responsibilities to the System under professional standards. We will listen to what members of management and the Risk and Audit Committee expect from us. We will also ask them to tell us what service attributes are most important to them. We will use this information to develop a comprehensive audit approach to respond to identified issues and service needs for fiscal year 2013-2014.

Audit Services

Our audit services emphasize comprehensive planning and risk assessment to fulfill our professional responsibilities and enable us to be responsive to the needs of the System's management and the Risk and Audit Committee.

Our Service Team

An important part of successfully implementing our plan is identifying and utilizing the appropriate resources. We have selected an engagement team that is committed to carrying out our service plan. Richard A. Green, Engagement Partner, leads our service team as outlined in the organization chart in Section 2 of this Plan.

Quality and Responsive Service

We provide service, which stresses responsive attention year-round. Close communication with our clients is one of our top service qualities. We will work with you as business advisors, and we will place special emphasis on being actively involved in understanding all significant financial and reporting matters. Accordingly, we will meet with you regularly to stay abreast of your service needs and special concerns. You can call upon us as a resource at any time.

Audit Approach

Our audit approach carefully considers the identification of key risk areas and assignment of appropriate resources. Professionals with more than ten years of governmental auditing and accounting experience lead all phases of our audit. With our experienced leaders in the field, our efficiency and effectiveness increase when dealing with complex accounting and auditing issues.

Our audit procedures include analytical reviews, verification of significant balances and transactions based on independent supporting documentation using statistical and judgmental sampling techniques, confirmation of significant balances, and the analysis of assumptions supporting significant estimates made by management.

This document further presents discussions on our approach to the services we will provide to the System, details our framework for planning and performing the audit, and sets forth our audit scope and timing.

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Section 2

Your

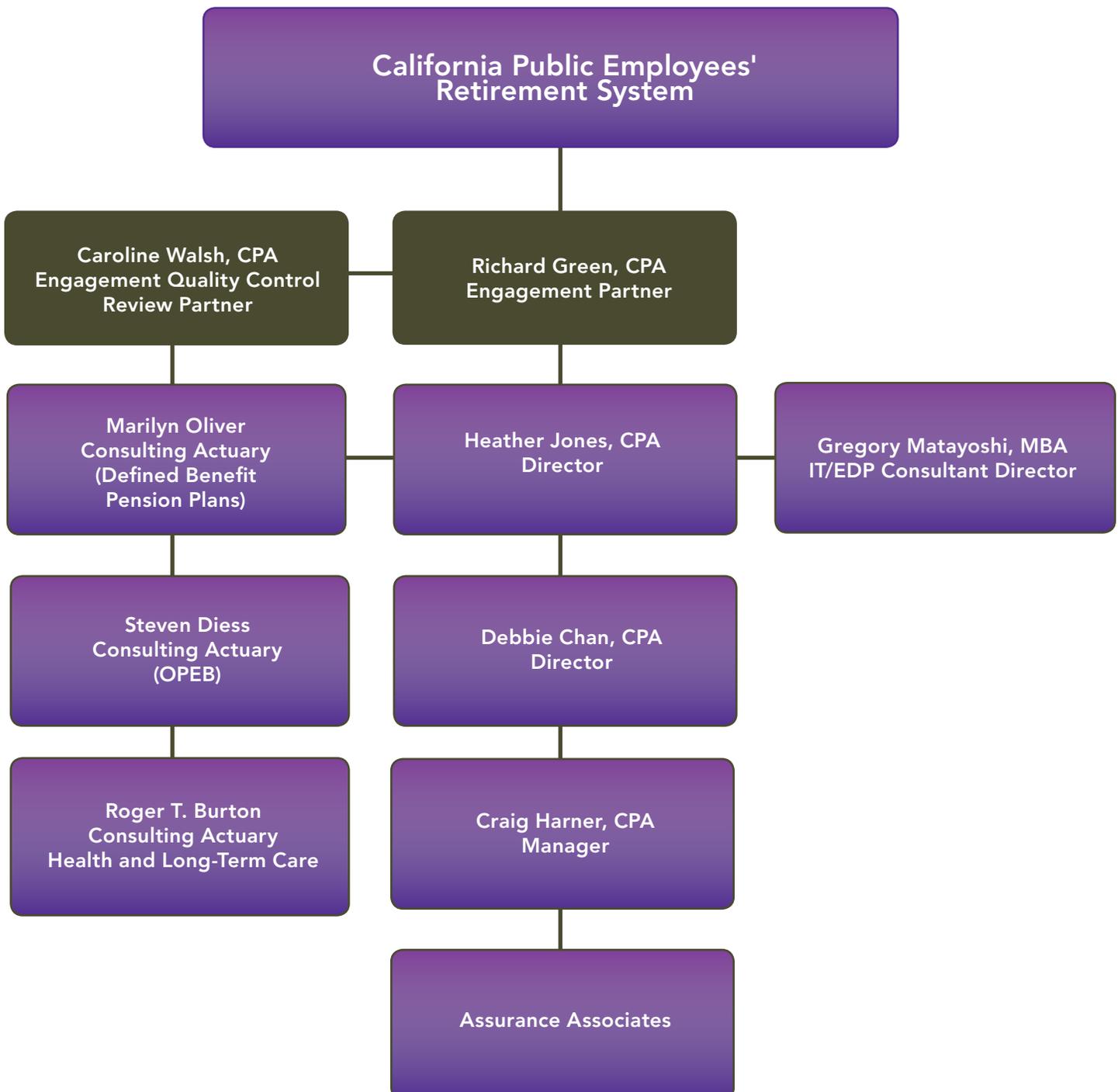
Engagement

Professionals.

ENGAGEMENT TEAM

The engagement team selected to serve the System represents a strong, balanced blend of talent, professional skills, and industry experience that is most critical to working effectively with clients of your size and complexity. Each of our key engagement team members possesses broad public employee retirement systems (PERS) and public sector experience with a detailed understanding of the significant audit and financial reporting issues facing PERS.

The MGO engagement team is integrated to allow us to respond to your needs. We are committed to providing the resources necessary to meet the timeline that has been established by the System. This commitment includes providing the appropriate number and level of staffing to meet your needs.



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Section 3

The Audit

Timeline.

AUDIT TIMING

We recognize the importance of timely completion of audit tasks and deliverables. The timing of our audit procedures will be coordinated with the System to minimize disruption of the System's operations and ensure timely delivery of all reports by your deadlines.

Our philosophy for a successful engagement is based on organization, communication, and coordination between the two parties responsible for the completion of the audit – the accounting firm and the client. We take coordination seriously and regard it as an integral factor to the relationship. We welcome the System's involvement in the planning process and believe that monitoring progress will result in timely financial reporting.

We are committed to delivering the System's reports according to the following proposed timeline:

Planning	DATES
Interim Prepared-By-Client Schedule	April 2014
Year-End Prepared-By-Client Schedule	June 2014
Present Audit Plan to the Risk and Audit Committee	June 2014
Execution	
Interim Fieldwork	May 19, 2014 - July 3, 2014
Year-End Fieldwork	August 18, 2014 - October 31, 2014
Report Issuance	
Independent Auditor's Report	October 31, 2014
Communications with Those Charged with Governance	October 31, 2014
Management Comments and Recommendations Letter	February 2015
Risk and Audit Committee Presentation	
Independent Auditor's Report	November 2014
Communications with Those Charged with Governance	November 2014
Management Comments and Recommendations Letter	March 2015

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Section 4

Understanding the Audit.

THE AUDIT

PLANNING

Timely Involvement with Risks and Issues

Planning the System's audits is a continuous process. Our ongoing attention to changes in the System's economic and operating environment enables us to react to changing circumstances and unanticipated events and enhances our understanding of the System. The objectives of the planning phase are to develop an audit plan that 1) effectively and efficiently meets our professional responsibilities and 2) meets or exceeds the expectations and needs of the management of the System.

To accomplish our planning objectives, we will:

- Document our understanding of the internal and external factors affecting the System, which enables us to identify and evaluate relevant areas of risk.
- Update our understanding of the System's control environment, accounting systems and control procedures for significant audit areas and transaction streams.
- Finalize an audit plan that identifies critical audit areas and procedures to address such risks.
- Ensure that our plan provides appropriate audit coverage.
- Coordinate our audit services with the support of the System personnel for maximum efficiency.
- Develop and execute an audit plan that provides a basis for the issuance of our opinions and is designed to deliver our services effectively and efficiently.
- Strive to add value.

Client Service Program

The System will receive the direct attention of one of our most knowledgeable and experienced professionals. The Engagement Partner and the Engagement Quality Control Review Partner will review our annual audit service plan and the reports prepared on the results of each year's work, and the assignment of personnel to the engagement. In addition, they will assure that your specialized needs receive priority access to top resources from anywhere in our organization.

Environmental Assessment

In addition, our planning process evaluates the System's financial reporting risks based on the broader financial reporting and operating environments, drawing upon our knowledge of significant changes affecting the System, including the impact of:

- The implementation of new accounting and financial reporting standards
- New operating and investing policies
- Other changes in pension plans and health and long-term care programs

EXECUTION

Performance of the Audit Plan

Our audit scope must be designed to provide sufficient audit coverage to enable us to express opinions on the System's financial statements, as well as addressing all known audit risks, which could materially impact those financial statements.

Execution of the audit plan generally includes the following steps:

- Performance of audit tests and evaluation of results
- Development of organizational insights
- Review of financial statements and subsequent events
- Obtaining management representations

During the course of the audit, we use our knowledge gained from prior years experience and during the planning phase related to your current organizational strategies, economic conditions, internal control, and the identified risks to tailor our audit procedures.

Approach to Critical Audit Areas

We have identified certain critical audit areas facing the System. During our planning phase of the audit, we expand our understanding of these critical audit areas and obtain further information as needed in order to appropriately design audit procedures to address these issues.

- Investment valuation at fair value, including private equity, real assets, derivative instruments, and securities lending transactions
- Estimated insurance claims liability, and estimated liability for future policy benefits and related claims expenses
- Employer and employee contributions, including the proper calculation of employer and employee contributions based on compensation and approved contribution rates
- Healthcare and Long-Term Care premium revenues, including proper billing based on approved rates
- Retirement, death & survivor benefits, including eligibility of retirees/beneficiaries and accurate calculation and disbursements of monthly benefits
- Reasonableness of actuarial assumptions and calculations for pension and other postemployment benefits
- Implementation of GASB Statement No. 67, and the related actuarial valuation and disclosures

Timing of Our Work

We have timed our work to coincide with key activities that are taking place in the System throughout the year. The Audit Timing section of this Plan outlines the timing of our procedures.

The Result

Our process is designed to enable us to issue the independent auditor's report within the agreed-upon timeline. The result of our work will also include the issuance of the management comments and recommendations report regarding the control environment and operations of your organization, which will be presented to the Risk and Audit Committee.

THE AUDIT

REPORTING

Reporting Responsibility under Auditing Standards Generally Accepted in the United States of America

In planning and performing our audit of the financial statements of the System in accordance with auditing standards generally accepted in the United States of America, we will consider the System's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we will not express an opinion on the effectiveness of the System's internal control.

Our consideration of internal control will be for the limited purpose described in the preceding paragraph and will not be designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore material weaknesses or significant deficiencies may exist that will not be identified.

We will report directly to management and the Risk and Audit Committee matters coming to our attention during the course of our audit that we believe are deficiencies, significant deficiencies, and/or material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

In addition to communications about our responsibilities under U.S. generally accepted auditing standards and the planned scope and timing of the audit, we will communicate to you certain other matters related to the conduct of our audit, including where appropriate the following matters:

- Qualitative Aspects of Accounting Practices
- Corrected and Uncorrected Misstatements
- Difficulties Encountered in Performing the Audit
- Disagreements with Management
- Management Representations
- Management Consultations with Other Independent Accountants
- Other Audit Findings or Issues
- Other Information in Documents Containing Audited Financial Statements

Management Comments

One of the primary service objectives is to make constructive and timely recommendations and to provide advice to management and those charged with governance on matters we believe warrant attention. We have tailored our audit approach to focus on those risks that are important to achieving control and reporting objectives. We have the benefit of being objective outsiders in considering the information we gather. The result is that we are able to add the perspective of our experience and expertise to translate our audit observations into recommendations and insights concerning existing or potential issues. We will keep management and those charged with governance apprised of any matters that we believe warrant consideration whenever they come to our attention.

Assessment

Client Service Satisfaction

We conclude the client service cycle by obtaining direct feedback as to whether we have met the System's expectations through service quality assessment meetings with management – the same individuals with whom we established expectations during our planning process. In addition to communicating with management regarding the effectiveness of our services, we use the assessment results to identify the most effective way to deliver our services as well as those areas where we need to focus and improve during the upcoming year. Our assessment process requests feedback from management on the following attributes:

- Does MGO meet commitments?
- Is MGO flexible and responsive?
- Is MGO easy to work with?
- Does MGO communicate effectively?
- Is MGO technically competent and able to translate this knowledge into practical applications?
- Is MGO forthright in dealing with difficult situations?
- Does MGO understand your organization and your activities?
- Does MGO proactively identify opportunities and bring you creative ideas?
- Does the MGO team perform as a well functioning and cohesive team?
- Do you believe you receive value for your money?

Once we receive the response to this feedback, we identify opportunities to add value; to identify the most experienced people within our organization to best respond to the System's needs and to monitor the delivery of such services to ensure we exceed your service expectation.

In addition, we will hold recurring meetings with management to discuss emerging issues. The key objective of these meetings is to consolidate our combined knowledge of the System's organizational changes and new programs or initiatives. Such meetings will result in a better understanding of the challenges facing the System and will enable us to proactively identify opportunities and bring creative ideas to the attention of management of the System.

Section 5 Our Role and Your Responsibilities.

ENGAGEMENT COMMUNICATIONS

We are pleased to confirm our understanding of the services we are to provide the California Public Employees' Retirement System (the System) for the fiscal year ended June 30, 2014 pursuant to the System Agreement No. 2011-6211 (the Agreement). One purpose of this engagement letter is to describe more fully the work we will perform under generally accepted auditing standards, as included in Attachment A of the Agreement. We will audit the financial statements of the fiduciary activities and proprietary activities, including the related notes to the financial statements, which collectively comprise the basic financial statements of the System as of and for the year ended June 30, 2014. Accounting standards generally accepted in the United States of America provide for certain required supplementary information (RSI), such as management's discussion and analysis (MD&A), to supplement the System's basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. As part of our engagement, we will apply certain limited procedures to the System's RSI in accordance with auditing standards generally accepted in the United States of America. These limited procedures will consist of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We will not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance. The following RSI is required by generally accepted accounting principles and will be subjected to certain limited procedures, but will not be audited:

1. Management's Discussion and Analysis
2. Schedule of Changes in Net Pension Liability – Single Employer and Cost-sharing Pension Plans
3. Schedule of Fiduciary Net Position as a Percentage of Total Pension Liability – Single Employer and Cost-sharing Pension Plans
4. Schedule of Net Pension Liability as a Percentage of Covered Member Payroll – Single Employer and Cost-sharing Pension Plans
5. Schedule of Actual and Actuarially Determined Contributions – Single Employer and Cost-sharing Pension Plans
6. Schedule of Annual Money-Weighted Rate of Return on Investments – Single Employer and Cost-sharing Pension Plans
7. Schedule of Funding Progress – OPEB Trust Funds
8. Schedule of Employer Contributions – OPEB Trust Funds
9. Schedule of Claims Development Information

We have also been engaged to report on supplementary information other than RSI that accompanies the System's financial statements. We will subject the following supplementary information to the auditing procedures applied in our audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America and will provide an opinion on it in relation to the financial statements as a whole:

1. Schedule of Administrative Expenses – All Funds
2. Schedule of Investment Expenses
3. Schedule of Consultant and Professional Services Expenses
4. Statement of Changes in Assets and Liabilities – Agency Funds

The following other information accompanying the financial statements will not be subjected to the auditing procedures applied in our audit of the financial statements, and our auditor's report will not provide an opinion or any assurance on that other information.

1. Introductory Section
2. Investment Section
3. Actuarial Section
4. Statistical Section
5. Compliance Section

Audit Objective

The objective of our audit is the expression of opinions as to whether the System's basic financial statements are fairly presented, in all material respects, in conformity with generally accepted accounting principles and to report on the fairness of the supplementary information referred to in the second paragraph when considered in relation to the financial statements as a whole. Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America and will include tests of the accounting records and other procedures we consider necessary to enable us to express such opinions. Circumstances may arise in which it is necessary for us to modify our opinions or add emphasis-of-matter or other-matter paragraphs. If our opinions on the financial statements are other than unqualified, we will discuss the reasons with you in advance. If circumstances occur related to the condition of your records, the availability of sufficient, appropriate audit evidence, or the existence of a significant risk of material misstatement of the financial statements caused by error, fraudulent financial reporting, or misappropriation of assets, which in our professional judgment prevent us from completing the audit or forming an opinion on the financial statements, we retain the right to take any course of action permitted by professional standards, including declining to express an opinion or issue a report, or withdrawing from the engagement; however prior to any course of action, we will provide advance written notice and allow management an opportunity to correct the condition.

Management Responsibilities

Management is responsible for the basic financial statements and all accompanying information as well as all representations contained therein. Management is also responsible for making all management decisions and performing all management functions. Management is responsible for establishing and maintaining effective internal controls, including monitoring ongoing activities; for the selection and application of accounting principles; and for the fair presentation in the financial statements in conformity with U.S. generally accepted accounting principles. Management is also responsible for making all financial records and related information available to us and for the accuracy and completeness of that information. Management is also responsible for providing us with (1) access to all information of which you are aware that is relevant to the preparation and fair presentation of the financial statements, (2) additional information that we may request for the purpose of the audit, and (3) unrestricted access to persons within the organization from whom we determine it necessary to obtain audit evidence.

Management's responsibilities include adjusting the financial statements to correct material misstatements and confirming to us in the representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Management is responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud or illegal acts affecting the System involving (1) management, (2) employees who have significant roles in internal control, and (3) others where the fraud or illegal acts could have a material effect on the financial statements.

Management's responsibilities include informing us of your knowledge of any allegations of fraud or suspected fraud affecting the System received in communications from employees, former employees, regulators, or others. In addition, management is responsible for identifying and ensuring that the System complies with applicable laws and regulations.

Management is responsible for the preparation of the supplementary information in conformity with U.S. generally accepted accounting principles (GAAP). Management agrees to include our report on the supplementary information in any document that contains and indicates that we have reported on the supplementary information. Management also agrees to include the audited financial statements with any presentation of the supplementary information that includes our report thereon. Management's responsibilities include acknowledging to us in the representation letter that (1) management is responsible for presentation of the supplementary information in accordance with GAAP; (2) that management believes the supplementary information, including its form and content, is fairly presented in accordance with GAAP; (3) that the methods of measurement or presentation have not changed from those used in the prior period (or, if they have changed, the reasons for such changes); and (4) management has disclosed to us any significant assumptions or interpretations underlying the measurement or presentation of the supplementary information. With regard to using the auditor's report, you understand that you must obtain our prior written consent to reproduce or use our report in bond offering official statements or other documents. With regard to the electronic dissemination of audited financial statements, including financial statements published electronically on your website, you understand that electronic sites are a means to distribute information and, therefore, we are not required to read the information contained in these sites

or to consider the consistency of other information in the electronic site with the original document.

Audit Procedures—General

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We will plan and perform the audit to obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the System or to acts by management or employees acting on behalf of the System.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, and because we will not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us, even though the audit is properly planned and performed in accordance with U.S. generally accepted auditing standards. In addition, an audit is not designed to detect immaterial misstatements, or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements. However, we will inform the appropriate level of management of any material errors or any fraudulent financial reporting or misappropriation of assets that come to our attention. We will also inform the appropriate level of management of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential. Our responsibility as

ENGAGEMENT COMMUNICATIONS

auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, and may include direct confirmation of investments and certain other assets and liabilities by correspondence with selected financial institutions. We will request written representations from your attorneys as part of the engagement, and they may bill you for responding to this inquiry. At the conclusion of our audit, we will require certain written representations from you about the financial statements and related matters.

Audit Procedures—Internal Controls

Our audit will include obtaining an understanding of the System and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. An audit is not designed to provide assurance on internal control or to identify deficiencies in internal control. However, during the audit, we will communicate to management and those charged with governance internal control related matters that are required to be communicated under AICPA professional standards.

Audit Procedures—Compliance

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of the System's compliance with the provisions of applicable laws and regulations and the provisions of contracts and agreements. However, the objective of our audit will not be to provide an opinion on overall compliance and we will not express such an opinion.

Engagement Administration and Other

Per the System Agreement No. 2011-6211, we will use third-party service providers in serving your account. We may share confidential information about you with these service providers, but remain committed to maintaining the confidentiality and security of your information. Accordingly, we maintain internal policies, procedures, and safeguards to protect the confidentiality of your personal information. In addition, we will secure confidentiality agreements with all service providers to maintain the confidentiality of your information and we will take reasonable precautions to determine that they have appropriate procedures in place to prevent the unauthorized release of your confidential information to others. In the event that we are unable to secure an appropriate confidentiality agreement, you will be asked to provide your consent prior to the sharing of your confidential information with the third-party service provider. Furthermore, we will remain responsible for the work provided by any such third-party service providers. We understand that your employees will prepare all confirmations we request and will locate any documents selected by us for testing.

We expect to begin our audit on approximately May 1, 2014 and to issue our reports in accordance with prescribed timeline per the System Agreement No. 2011-6211; the prescribed timeline will be revised accordingly if unexpected delays are encountered. Richard A. Green is the engagement partner and is responsible for supervising the engagement and signing the reports or authorizing another individual to sign them. Our invoices for these fees will be rendered each month as work progresses and are payable on presentation. Our fee is based on the terms prescribed in the System Agreement No. 2011-6211 and anticipated cooperation from your personnel and the assumption

that unexpected circumstances will not be encountered during the audit. If significant additional time is necessary, we will discuss it with you in advance and arrive at a new fee estimate in writing before we incur the additional costs. Effective fiscal year ending June 30, 2014, the System is required to implement Governmental Accounting Standards Board (GASB) Statement No. 67, *Financial Reporting for Pension Plans – An Amendment of GASB Statement No. 25*. We will provide a separate fee letter for the additional audit efforts related to the implementation of the new standard.

Professional and certain regulatory standards require us to be independent, in both fact and appearance, with respect to the System in the performance of our services. Any discussion that you have with personnel of our firm regarding employment could pose a threat to our independence. Therefore, you agree to inform us prior to any such discussions so we can implement appropriate safeguards to maintain our independence.

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Section 6 Changes in the World of Governmental Accounting.

RECENT DEVELOPMENTS IN ACCOUNTING AND FINANCIAL REPORTING

The following is a summary of the more recent and relevant accounting and reporting developments, which may have an impact on the System's financial statements. We will have ongoing discussions with management about these as well as other developments in an effort to be prepared in advance for their implementation.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) PRONOUNCEMENTS

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*

This statement is effective for the periods beginning after December 15, 2012.

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which is intended to clarify the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting.

GASB Concepts Statement No. 4, *Elements of Financial Statements*, specifies that recognition of deferred outflows and deferred inflows should be limited to those instances specifically identified in authoritative GASB pronouncements. Consequently, guidance was needed to determine which balances being reported as assets and liabilities should actually be reported as deferred outflows of resources or deferred inflows of resources, according to the definitions in Concepts Statement 4. Based on those definitions, Statement 65 reclassifies certain items currently being reported as assets and liabilities as deferred outflows of resources and deferred inflows of resources. In addition, this Statement recognizes certain items currently being reported as assets and liabilities as outflows of resources and inflows of resources.

GASB Statement No. 66, *Technical Corrections—2012*

This statement is effective for the periods beginning after December 15, 2012.

In March 2012, GASB issued Statement No. 66, *Technical Corrections—2012*, to resolve conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting.

This Statement amends Statement No. 10, *Codification of Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of a state and local government's risk financing activities to the general fund and the internal service fund type. As a result, governments would base their decisions about governmental fund type usage for risk financing activities on the definitions in Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This Statement also amends Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes would eliminate any uncertainty regarding the application of Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively.

GASB Statement No. 67, *Financial Reporting for Pension Plans and GASB Statement No. 68, Accounting and Financial Reporting for Pension*

On June 25, 2012, GASB approved Statement No. 67, *Financial Reporting for Pension Plans*, and Statement No. 68, *Accounting and Financial Reporting for Pensions*. Statement No. 67 addresses reporting by pension plans that administer benefits for governments, **and is effective for financial statements for fiscal years beginning after June 15, 2013.** Statement No. 68, which primarily relates to reporting by governments that provide pensions to their employees, **is effective for fiscal years beginning after June 15, 2014.** These standards were subsequently published in August 2012.

Key changes include:

- Incorporating ad hoc cost-of-living adjustments and other ad hoc postemployment benefit changes into projections of benefit payments, if an employer's past practice and future expectations of granting them indicate they are essentially automatic.
- Using a discount rate that applies (a) the expected long-term rate of return on pension plan investments to projected benefit payments for which plan assets are expected to be available to make projected benefit payments, and (b) the interest rate on a tax-exempt 20-year AA/Aa-or higher rated municipal bond index to projected benefit payments for which plan assets are not expected to be available for longterm investment in a qualified trust.
- Requiring more extensive note disclosures and required supplementary information.

RECENT DEVELOPMENTS IN ACCOUNTING AND FINANCIAL REPORTING

The System will be subject to the provisions of GASB Statement No. 67 beginning with the fiscal year ending June 30, 2014. GASB Statement No. 67 replaces the requirements of GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and GASB Statement No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria. GASB Statement No. 67 builds upon the existing framework for financial reports of defined benefit pension plans and enhances note disclosures and required supplementary information for both defined benefit and defined contribution pension plans. In addition, it requires the presentation of new information about the annual moneyweighted rates of return on pension plan investments in the notes to the financial statements and in 10-year required supplementary information schedules.

Employers will be subject to the provisions of GASB Statement No. 68, which requires governments that participate in defined benefit pension plans to report in their statement of net position a net pension liability, if applicable. The net pension liability is the difference between the total pension liability (the present value of projected benefit payments to employees based on their past service) and the assets (mostly investments reported at fair value) set aside in a trust and restricted to paying benefits to current employees, retirees, and their beneficiaries. The majority of the pension information required to be reported by employers will be derived from data maintained by the Plan.

Statement No. 68 also calls for immediate recognition of more pension expense than is currently required. This includes immediate recognition of annual service cost and interest on the pension liability and immediate recognition of the effect on the net pension liability of changes in benefit terms. Other components of pension expense will be recognized over a closed period that is determined by the average remaining service period of the plan members (both current and former employees, including retirees). These other components include the effects on the net pension liability of (a) changes in economic and demographic assumptions used to project benefits and (b) differences between those assumptions and actual experience. Lastly, the effects on the net pension liability of differences between expected and actual investment returns will be recognized in pension expense over a closed five-year period.

Statement No. 68 also requires employers to present more extensive note disclosures and RSI, including disclosing descriptive information about the types of benefits provided, how contributions to the pension plan are determined, and assumptions and methods used to calculate the pension liability.

These changes, however, relate only to accounting and financial reporting, not to how governments approach the funding of their pension plans. Pension funding is a policy decision made by government officials.

Please call us if you need anything.

California is our home.
We have offices up and down the State.
Come and see us.

Sacramento HQ

3000 S Street
Suite 300
Sacramento
California 95816
T: 916.928.4600
F: 916.928.2755

Walnut Creek

2121 N. California Blvd.
Suite 750
Walnut Creek
California 94596
T: 925.274.0190
F: 925.274.3819

Oakland

505 14th Street
5th Floor
Oakland
California 94612
T: 510.273.8974

Seattle, WA

701 Fifth Avenue
42nd Floor
Seattle
Washington 98104
T: 206.262.7850

Los Angeles

777 S. Figueroa Street
Suite 2500
Los Angeles
California 90067
T: 213.277.3373
F: 213.995.6970

Newport Beach

4675 MacArthur Court
Suite 600
Newport Beach
California 92660
T: 949.221.0025
F: 949.221.0035

San Diego

225 Broadway
Suite 1750
San Diego
California 92101
T: 619.573.1112
F: 619.238.7008

info@mgocpa.com

mgocpa.com