

Macias Gini & O'Connell
Summary of Financial Statement Audit Management Letter Comments
Current Year Report
As of September 30, 2014

Audit (Report Issue Date): Report to Management for the Year Ended 06/30/13 (3/17/14)

Material Weakness 2013-1: Completeness and Accuracy of Investment Related Disclosures

Division responsible: Financial Reporting and Accounting Services

Observation: Numerous errors were detected in the investment risk disclosures in the draft financial statements. Deficiencies in the design and effectiveness of internal controls over financial reporting and insufficient knowledge of the accounting standards and the System's investment structure result in a reasonable possibility that a material misstatement of the System's financial statements will not be prevented, or detected and corrected, on a timely basis. The System's financial reporting process should include internal controls to ensure the completeness and accuracy of investment related data.

Management's Original Response: Management concurs and has already taken the steps to address this issue. We are performing interim reviews of GASB 40 and GASB 53 disclosure data to identify issues by evaluating this information using another source (BlackRock). We are meeting with State Street regularly to discuss the differences and determine solutions to these issues. We will continue to ensure that the data is accurate from State Street Bank and work with them to ensure quality assurance processes are implemented. We will be performing a comprehensive review of all CalPERS underlying investments. We will be working closely with the Investment Office to identify any new investment types, which are subject to GASB 40 and GASB 53 risk disclosures. We will continue to gain an understanding of the risk characteristics of different investment types.

We have also moved the GASB analysis and reporting functions from Trust Accounting I to the Financial Reporting Unit who is responsible for GASB related disclosures. We will be moving the reporting that is currently completed in Trust Accounting II to Financial Reporting to ensure consistent, accurate and complete reporting for all the Trusts related to GASB 40 and GASB 53.

By June 30, 2014 all new procedures for GASB 40 and GASB 53 will be implemented. Transition of workload to the Financial Reporting Unit will also be complete.

Financial Reporting and Accounting Services Current Update: RESOLVED. Pending final verification by Macias Gini & O'Connell. Financial Reporting and Accounting Services:

- Reviewed and analyzed March GASB 40 and GASB 53 disclosure data.
- Worked with State Street Bank on issues to improve year-end reporting.
- Reviewed the methodology for fair value and notional amount calculations.
- Reviewed State Street Global Advisors (SSgA) investments for GASB 40 applicability.

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Significant Deficiency 2013-2: Internal Control Over Accounting and Financial Reporting
Division responsible: Financial Reporting and Accounting Services

Observation: Several errors were detected in the reported amounts and classification in the draft financial statements. The System's current accounting and reporting process is insufficient to prevent, or detect and correct, financial statement misstatements in a timely manner. Although individually the errors were not deemed material to the System's overall financial statements, the errors in the aggregate were considered significant to the financial statements. Internal controls over financial reporting should include procedures to ensure that financial statement amounts are accurate and properly classified. Given the complex nature of the System, we recommend that the accounting and financial reporting transactions be processed and reviewed by personnel who possess an appropriate level of technical knowledge of the accounting standards and understanding of the System's accounting and financial reporting activities.

Management's Original Response: Management concurs and has already implemented solutions to better track accounting changes and reporting requirements. We have begun to work on monthly financial reports to analyze changes on a month to month basis in our accounting areas. We have started quarterly reporting which is a year to date report and compares to prior year information. We have also started to work with the program areas and ITSB to gather programmatic data to use when evaluating financial data. We continue to review and analyze this information to ensure the data is accurate and correct, and correlates to our financial data.

CalPERS has hired a Controller in October 2013 to oversee both the accounting areas and the financial reporting within the organization. This position is responsible for reviewing all financial reporting, both monthly and quarterly, as well as ensuring the proper treatment of new accounting standards. The Controller is responsible for bridging the gap between financial reporting and program accounting to make sure that they communicate and collaborate on any issues that arise. In addition, functional changes have been implemented within this area. The Financial Reporting Unit is accountable for the information within the financial statements while the other accounting areas are responsible for the accounting entries. The Financial Reporting Unit is analyzing any accounting changes to ensure this information is represented accurately within the financial reports. Monthly meetings will be held among these areas to ensure cross collaboration is occurring. Topics will include discussion of any new chart of accounts, accounting process changes, analysis from quarterly and monthly financials, and new reporting requirements. These changes have already begun, and we will continue to develop our reporting sections' skills and we will have a fully implemented quarterly and monthly reporting process by June 30, 2014.

Financial Reporting and Accounting Services Current Update: RESOLVED. Pending final verification by Macias Gini & O'Connell. Financial Reporting and Accounting Services:

- Ongoing analysis and staff development to strengthen monitoring and analysis.
- Shares knowledge with all accounting units.

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<ul style="list-style-type: none"> Evaluates new types of transactions to ensure the proper disclosure and accounting. 	
Observation 2012/2013 #1:	OPEB Liability Allocation
Division responsible:	Financial Reporting and Accounting Services
<p>Observation: The System’s liability for other post-employment benefits (OPEB) is not allocated to the Public Employees’ Long-Term Care Fund. We also noted that the Public Employees’ Contingency Reserve Fund (CRF Proprietary Fund) reports a material OPEB liability balance. The System’s OPEB liability should be allocated to each plan (or fund) based on a reasonable and consistently applied allocation method. CalPERS should re-evaluate the fund allocation provided by the State Controller’s Office (SCO) to ensure the allocation is appropriate for CalPERS’ accounting and financial reporting purposes. With the implementation of GASB Statement No. 68 Accounting and Financial Reporting for Pensions - An Amendment of GASB Statement No. 27 effective for fiscal year 2015, CalPERS should also determine the allocation method for pension expense and the net pension liability, which may include CalPERS as an employer. Allocations should be made to only those funds that will actually pay the benefits.</p> <p>Management’s Original Response: Management concurs and has already begun discussions with the SCO to better understand the treatment of the OPEB liability and how it is calculated. We will work with SCO to explain the concerns, determine if a solution can be reached and prepare an implementation plan. We recognize there are external dependencies in working with other state agencies in obtaining a satisfactory resolution and will examine our required reporting options. We will have our discussion with the State Controller’s Office by June 30, 2014. There cannot be timeline for implementation of a solution until we have been able to determine what that solution could entail.</p> <p>Financial Reporting and Accounting Services Current Update: RESOLVED. Pending final verification by Macias Gini & O’Connell. Financial Reporting and Accounting Services has come to an agreement with the State Controller’s Office that we will take their total OPEB liabilities and allocate to our funds per our own methodology. This will better allocate the OPEB liabilities to our funds. We are using an allocation percentage that is developed as a part of cost allocation of administrative expenses within CalPERS. This methodology distributes costs based on a methodology that has been in use at CalPERS for many years and was developed with thorough analysis of CalPERS costs and funds.</p>	
Observation 2012/2013 #2:	Member Census Data
Division responsible:	Actuarial Office
<p>Observation: The Actuarial Office (ACTO) currently does not have a formal process to communicate to other CalPERS offices and units changes made to members’ census data in the Actuarial Valuation System (AVS) or to verify that the related changes are made in my CalPERS by the other appropriate CalPERS offices and units. Effective for the fiscal year ended June 30, 2013, ACTO transfers member census data generated from my CalPERS into</p>	

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AVS to prepare the annual actuarial valuation reports for participating employers. Prior to the preparation of the actuarial valuation reports, a reconciliation is performed, which includes a comparison of member census data to the prior year. In some instances, discrepancies in members' census data exist, which can result in ACTO making certain changes to the members' census data in AVS. Certain changes were not communicated to other CalPERS offices and units, which resulted in immaterial discrepancies in members' census data between my|CalPERS and AVS.

Management's Original Response: The Actuarial Office concurs with the observation and recommendation to formalize a process to ensure necessary changes to members' census data are communicated to the appropriate areas for correction. The Actuarial Office performed the first annual valuation utilizing data from the my|CalPERS system for fiscal year-end, June 30, 2012. We utilized two processes to communicate adjustments of member census data: 1) ClearQuest to log data issues to the Data Corrections team and 2) the my|CalPERS Workflow system to direct work requests to the appropriate area. We will formalize this procedure to ensure the member's census data is properly communicated, monitored and validated by the Actuarial Office. The Actuarial Office will implement these actions by December 20, 2014.

Actuarial Office Current Update: OPEN. The Actuarial Office continues to utilize established processes to communicate adjustments of member census data: Management will formalize its procedure to ensure the member's census data is properly communicated, monitored and validated by December 20, 2014.