CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Management Letter

Fiscal Year Ended June 30, 2014

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Management Letter

Fiscal Year Ended June 30, 2014

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

In planning and performing our audit of the financial statements of the fiduciary activities and the proprietary activities of the California Public Employees' Retirement System (the System or CalPERS) as of and for the fiscal year ended June 30, 2014, in accordance with auditing standards generally accepted in the United States of America, we considered CalPERS' 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CalPERS' internal control. Accordingly, we do not express an opinion on the effectiveness of CalPERS' internal control.

However, during our audit we became aware of deficiencies in internal control other than significant deficiencies and material weaknesses and matters that are opportunities for strengthening internal controls and operating efficiency. The current year comments and recommendations are included in the Current Year Comments and Recommendations section of this report. The status of the prior years' comments and recommendations is included in the Prior Years Comments and Recommendations section of this letter.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with appropriate CalPERS personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

CalPERS' written responses to the current and prior years' comments and recommendations have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

We would like to thank CalPERS' management and staff for the courtesy and cooperation extended to us during the course of our engagement.

This communication is intended solely for the information and use of management, the Board of Administration, and others within CalPERS and is not intended to be and should not be used by anyone other than these specified parties.

Sacramento, California

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Current Year Comments and Recommendations
Fiscal Year Ended June 30, 2014

Fiscal Year 2013/2014 Observation #1 – Investment Valuation

Investments are one of the most significant areas within CalPERS' basic financial statements, and the risk of material misstatement related to investment fair values are considered high. As part of the audit, we consider the appropriateness of the accounting methods used for measurement and disclosure, which includes understanding the process used by management in developing fair value estimates and the controls related to those estimates. During our audit of investment fair values, we noted the following accounting differences:

a. Real Estate Investments – The general partners are required to provide monthly or quarterly financial information to CalPERS, including the annual audited financial statements. In addition, the general partners are required to input monthly or quarterly financial information directly into the Automated Real Estate Information System (AREIS). CalPERS utilizes the general partners' financial information along with information posted in AREIS to record CalPERS' share of real estate investments in the general ledger. As part of the accounting and reconciliation process, Fiscal Services Division personnel verify that CalPERS' net asset values (NAV) reported in AREIS are consistent with the general partners' audited financial information. Verifying that partners' audited financial information has been properly reported in AREIS and ultimately CalPERS' general ledger is an essential part of internal control over the valuation of investments. Although timing and other differences between the partners' audited financial statements and CalPERS records are expected, our audit revealed two instances in which the general partners' audited financial statements differed from the amounts reported in AREIS and the general ledger. This was primarily due to the general partners' audited financial statements reflecting different valuation methodologies for certain properties.

b. Private Equity Investments – Effective in fiscal year 2013/2014, CalPERS changed its process to record estimated fair values for alternative investments (i.e. private equity and real assets). Under the new policy, the estimated fair values at June 30th are based on the general partners' March 31st financial information adjusted for cash flow activities through June 30th. In prior years, the estimated fair values reported in CalPERS' audited financial statements were based on the general partners' June 30th financial information. Our audit revealed that the unaudited estimated fair values for private equity investments reflected the general partners' March 31st financial information and were not adjusted for the cash flow activities through June 30th. As a result, an audit adjustment of approximately $864 million was recorded in CalPERS' audited financial statements, which decreased private equity investments and the related investment income as of and for the fiscal year ended June 30, 2014.

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Fiscal Year 2013/2014 Observation #1 – Investment Valuation (Continued)

c. Securities Not Priced by the Custodian Bank – CalPERS relies on the custodian bank to value publicly traded securities; however, there are certain securities for which the custodian bank could not determine fair value primarily due to the securities no longer being traded in an active market. On a monthly basis, the custodian bank provides the Investment Office (INVO) a listing of securities that have stale pricing, and INVO is responsible for updating the pricing using external pricing sources. As part of the audit, we requested a listing of securities that were not priced by the custodian bank. We examined supporting documentation to substantiate the June 30th values on a sample basis. Our testing revealed two investments that were understated by approximately $60 million; however, this error was not corrected in CalPERS' audited financial statements as the amount was deemed immaterial. In addition, we ascertained that the improperly valued investments were structured in a limited partnership, and the original Note 14 to the basic financial statements excluded the disclosures of total and unfunded commitments for this partnership. The audited financial statements were subsequently revised to reflect these disclosures.

Recommendation:

Given the significance and sensitivity related to investment fair values, CalPERS should enhance the following processes:

a. The partners' audited financial statements are among the highest quality evidence to support management's estimate of the fair values of investments that are not publicly traded. CalPERS should identify all investments for which audited financial information differs from CalPERS' records and enhance current procedures to review the general partners' valuation methodologies in order to ensure that the fair values reported by CalPERS are accurate.

b. CalPERS should establish internal controls to ensure proper implementation of and adherence to new accounting and financial reporting processes.

c. CalPERS should strengthen current internal control over the valuation of securities not priced by the custodian bank in order to ensure proper accounting and reporting.

Management Response:

Management concurs with the recommendations and will work to enhance our processes with the below responses. This will all be implemented by the start of the new fiscal year, July 1, 2015.

Fiscal Year 2013/2014 Observation #1 – Investment Valuation (Continued)

Management Response (Continued):

a. For Real Estate Partnerships that provide audited financial information based on historical cost methodology of accounting, CalPERS will create and enforce a process that will be compliant per the recommendations provided. CalPERS will review Partner audited financial information based on historical cost methodology. This will ensure that audited financial statements are being reviewed and are following generally accepted accounting principles (GAAP). CalPERS will also review Partner non-audited financial information based on fair value methodology to ensure GAAP is being followed. Finally, CalPERS will require Partners to provide documentation that clarifies and supports the differences in NAV between the two accounting methodologies. Furthermore, to ensure that audited financials are validated, CalPERS will have internal auditors go out to various General Partners to review their valuation methodologies. This will give CalPERS a better understanding of what is being provided by the General Partners. This will not only provide an extra sense of comfort that financials are accurate but also validate that accounting entries are being properly recorded.

b. CalPERS will review and enhance internal procedures to ensure adequate internal controls exist with respect to implementation and adherence to all new accounting and financial reporting processes. All new processes will have an additional layer of review and approval to ensure accurate implementation. CalPERS is currently in the process of implementing a new Private Equity Accounting and Reporting Solution (PEARS) which will give us additional management and oversight tools. The new solution provides comprehensive accounting, reconciliation and reporting of the Private Equity asset class at a much more detailed level and with greater reconciliation and reporting capabilities than previously available.

c. For certain securities which the custodian bank cannot determine fair value; CalPERS will implement processes that are compliant per the recommendations that were provided. On a monthly basis, the custodian bank provides the Investment Office (INVO) a listing of securities that have stale pricing. INVO will review the stale prices and update the pricing using external pricing sources. In addition, the Financial Office (FINO) will review financial statements from General Partners to ensure CalPERS financial statements correctly reflect the net asset value.

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Current Year Comments and Recommendations (Continued)
Fiscal Year Ended June 30, 2014

Fiscal Year 2013/2014 Observation #2 – Actuarial Discount Rate Determination

In fiscal year 2013/2014, the System implemented GASB Statement No. 67, *Financial Reporting for Pension Plans - An Amendment of GASB Statement No. 25* (Statement). The objective of this Statement is to improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information for defined benefit pension plans. One of the requirements of this Statement is that projected benefit payments are to be discounted to their actuarial present value using a single discount rate that reflects the long-term expected rate of return on pension plan investments that are expected to be used to finance the payment of benefits, to the extent the pension plan's fiduciary net position is projected to be sufficient to make projected benefit payments and pension plan assets are expected to be invested using a strategy to achieve that return. Paragraph 44 of the Statement states, "the long-term expected rate of return should be determined net of pension plan investment expense but without reduction for pension plan administrative expense." We noted the long-term expected rates of return used by the Actuarial Office (ACTO) for the schools (PERF B) and public agency (PERF C) pools, the Legislators Retirement Fund (LRF), and the Judges Retirement Fund II (JRF II) were determined net of administrative expenses, which does not conform to U.S. GAAP. Had the long-term expected rates of return been calculated without reduction for administrative expenses, our actuarial consultant estimated, based on information provided by CalPERS' actuaries, that the net pension liabilities for the PERF B, PERF C, LRF, and JRF II disclosed in Note 7 to the basic financial statements would be reduced by approximately $1.1 billion, $509.1 million, $2.8 million, and $15.8 million, respectively, which is not considered material to the respective plans.

Recommendation:

CalPERS should utilize a long-term expected rate of return that complies with the requirement of GASB Statement No. 67, *Financial Reporting for Pension Plans - An Amendment of GASB Statement No. 25* to project the present value of future benefit payments in determining an appropriate discount rate.

Management Response:

CalPERS agrees that the long-term expected rates of return used for the PERF B, PERF C, LRF, and JRF II were determined net of administrative expenses, which does not conform to U.S GAAP. CalPERS also agrees with the estimated impact on the net pension liability for all funds as described in the observation.

CalPERS is scheduled to review all actuarial assumptions as part of its regular Asset Liability Management (ALM) review cycle that is scheduled to be completed in February 2018. Any changes to the discount rate will require Board action and proper stakeholder outreach. For these reasons, CalPERS expects to continue using a discount rate net of administrative expenses for GASB 67 and 68 calculations through at least the 2017-18 fiscal year.

CalPERS checked the materiality threshold for the difference in calculation and did not find it to be a material difference. CalPERS will continue to check the materiality of the difference in calculation until such time as we have changed our methodology.

Fiscal Year 2013/2014 Observation #3 – Member Census Data

In accordance with GASB Statement No. 67, *Financial Reporting for Pension Plans - An Amendment of GASB Statement No. 25* (Statement), the actuarial information for single-employer and multiple-employer cost-sharing defined benefit pension plans is disclosed in the notes to CalPERS' basic financial statements. In light of the new GASB pension standard, the American Institute of Certified Public Accountants issued guidance related to the testing of single and cost-sharing employer census data, including active member census data maintained by employers, which is critical in the determination of the required actuarial information disclosures. During the fiscal year 2013/2014, we examined census data for the following reporting funds with the assistance of the Office of Audit Services:

- PERF B (Schools Cost-Sharing Plan)
- PERF C (Public Agency Cost-Sharing Plan)
- Legislators Retirement Fund or LRF (Single-Employer Plan)
- Judges Retirement Fund I or JRF I (Single-Employer Plan)
- Judges Retirement Fund II or JRF II (Single-Employer Plan)

We performed a risk assessment over the cost-sharing plans to determine which employers would be selected for census data testing. For the selected employers, we examined census data for retired, inactive, and active members on a sample basis.

As part of preparing the annual actuarial valuation reports for the employers, ACTO transfers census data from my|CalPERS to the Actuarial Valuation System (AVS) and completes a process of data review and clean-up prior to running the valuation reports. Our testing of census data for retired and inactive members includes testing the accuracy of significant data elements between my|CalPERS and AVS. For active members' census data, our testing includes procedures to verify the significant data elements from AVS to the participating employers' payroll records to determine that the census data used in the actuarial valuations is complete and accurate. Significant census data elements include: date of birth; date of hire or years of service; marital status; eligible compensation; benefit amount, member account balance, class of employee; gender; date of termination or retirement; spouse date of birth; and employment status (active, inactive, retired).

For the Schools and Public Agencies Cost-Sharing Plans, we examined a total of 630 active members from the 21 selected school districts and a total of 400 active members from the 16 selected public agencies, respectively. Our procedures revealed numerous discrepancies in census data between AVS, my|CalPERS, and the employers' records. The discrepancies we identified involved annual compensation, special compensation, hire date, employment status, birthdate, gender, name, and total active member counts. We provided a listing of discrepancies to CalPERS' management to review and address. In addition, we engaged an actuarial consultant to determine the impact of the census data discrepancies to the actuarial disclosure information, including the net pension liability. The determination of the impact was based on the demography of the cost-sharing pools under consideration, taking into account sensitivities of estimated net results to changes in methodology and demographic data. Based on high-level estimates and extrapolating the nature of the discrepancies noted, our actuarial consultant projected the impact to each cost-sharing plan to be less than .5% of the net pension liabilities for the related plans as of June 30, 2014.

Fiscal Year 2013/2014 Observation #3 – Member Census Data (Continued)

Recommendation:

Since the actuarial information disclosed in the notes to the basic financial statements is dependent on census data, CalPERS should update my|CalPERS to correct the known errors resulting from the audit, as appropriate. In addition, management should consider enhancing the current processes and controls to improve the completeness and accuracy of census data as it is a critical component in determining the actuarial information that is reported in CalPERS' audited financial statements and provided to the participating employers.

Management Response:

CalPERS concurs with the finding and the recommendations. The Actuarial Office recently established a procedure that details our methods for correcting errors in the source data in my|CalPERS and will continue to utilize this process.

There are instances where data elements in AVS purposely do not match those in my|CalPERS due to the system limitations and design of each system. For example, date of hire or annual benefit compensation is changed in AVS to reflect purchase of additional service credit. This will result in future discrepancies that won't be corrected.

CalPERS' Customer Services and Support Branch will continue to work through employers correcting census data discrepancies as they are identified through staff's ongoing work processing and by proactively verifying member information within my|CalPERS through CalPERS employer reviews.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Year Material Weakness
Fiscal Year Ended June 30, 2014

2013-1: Completeness and Accuracy of Investment Related Disclosures

Our audit procedures detected numerous errors 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. As a result, internal controls over financial reporting did not ensure the proper reporting of investment related disclosures. The following errors, along with the errors described in prior year item 2012-1, are the result of a material weakness in internal control. Though individually certain errors were not material to the System's overall financial statements, the errors in the aggregate were deemed material to the financial statements.

1. Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) mortgage pass-through securities were originally disclosed as having Moody's credit quality ratings of Aaa when in fact, certain issues of these securities are not rated by Moody's or other nationally recognized statistical rating organizations (NRSROs). The original Aaa rating was provided by the custodian bank due to the perceived implicit guarantee of the U.S. government for these securities. The accounting standards require the rating disclosure of the debt investment rather than the issuer. For instances in which the debt investment is unrated but the issuer is rated, governments should indicate that the debt investment is unrated. The disclosure was subsequently revised to properly reflect the GASB Statement No. 40 credit risk disclosure requirements for the FNMA and FHLMC mortgage pass-through securities as not rated by NRSROs.

2. Commercial paper and U.S. Treasury bill investments held in the System's unitized pool, which are classified as debt securities in the financial statements, were originally excluded from the GASB Statement No. 40 credit risk and interest rate risk disclosures. Commercial paper is an unsecured promissory note issued primarily by corporations for a specific amount and maturing on a specific day. U.S. Treasury bills are short-term government securities issued for a specific amount and maturing on a specific day. GASB Statement No. 40 specifically requires that interest rate risk and/or credit risk disclosures be presented for investments such as U.S. Treasury bills, corporate bonds, and commercial paper. The accounting standard specifically exempts obligations of the U.S. government from the credit risk disclosure requirements; however, it is the System's practice to present obligations of the U.S. government as "N/A" in the credit risk disclosure table, which represents securities not subject to GASB Statement No. 40 disclosure requirements. The disclosures were subsequently revised to properly present commercial paper and U.S. Treasury bills.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Year Material Weakness (Continued)
Fiscal Year Ended June 30, 2014

2013-1: Completeness and Accuracy of Investment Related Disclosures (Continued)

3. Investments in State Street Global Advisors' commingled funds were originally disclosed as having no effective duration in the interest rate risk disclosures, although weighted average maturity information was available. GASB Statement No. 40 requires governments that report debt investment pools (such as bond mutual funds and external bond investment pools) to use one of the following methods: segmented time distribution, specific identification, weighted average maturity, duration, or simulation model. The GASB Comprehensive Implementation Guide states "Bond funds generally own many debt investments with differing maturities, so a bond fund reports duration or average maturity - the average of all the debt investment maturities in a fund's portfolio, weighted by the par value of each investment". The disclosure was subsequently revised to properly reflect the GASB Statement No. 40 interest rate risk requirements using the weighted average maturity method for bond funds.

4. CalPERS' investments include collateralized mortgage obligations and mortgage pass-through securities, which are highly sensitive to interest rate changes in that they are subject to early payment in a period of declining interest rates. The resulting reduction in expected total cash flows affects the fair value of these securities. GASB Statement No. 40 specifically requires disclosure of investments that are highly sensitive to changes in interest rates. However, the collateralized mortgage obligations and mortgage pass-through securities were not originally identified as such in note disclosures. The disclosure was subsequently revised to properly reflect GASB Statement No. 40 risk disclosures for investments that are highly sensitive to interest rate changes.

5. U.S. Treasury bill investments were originally included in the money market funds line item in the GASB Statement No. 40 interest rate risk disclosure for securities lending collateral. The accounting standard specifically requires investment disclosures to be organized by investment type, such as U.S. Treasuries, corporate bonds, or commercial paper. Dissimilar investments should not be aggregated into a single investment type. The disclosure was subsequently revised to properly present U.S. Treasury bill investments separate from money market funds.

6. U.S. Treasury bill investments were originally disclosed as having Moody's credit quality ratings of P-1 in the GASB Statement No. 40 credit rate risk disclosure for securities lending collateral. The accounting standard specifically exempts obligations of the U.S. government from the credit risk disclosure requirements. The disclosure was subsequently revised to reflect U.S. Treasury bills as "N/A" in the credit risk disclosure table, which indicates those investments are not subject to GASB Statement No. 40 credit risk disclosure requirements.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Year Material Weakness (Continued)
Fiscal Year Ended June 30, 2014

2013-1: Completeness and Accuracy of Investment Related Disclosures (Continued)

7. The Fiscal Services Division prepares an excel spreadsheet to reconcile the fair value of debt investments in the GASB Statement No. 40 disclosures to the global debt securities amount in the financial statements. The GASB Statement No. 40 disclosures should include all debt investments at fair value regardless of the classification within the financial statements. The global debt securities line item in the statement of fiduciary net position and the statement of proprietary net position present the fair value of non-unitized investments and the net asset values for investments in the unitized pools, which include accruals in the related unitized portfolios. In addition, certain debt securities are classified as inflation assets in the statement of fiduciary net position and the statement of proprietary net position. The original reconciliation spreadsheet did not properly reconcile the GASB Statement No. 40 disclosures and financial statement amounts. The spreadsheet was subsequently revised to properly reconcile the fair value of debt securities between the disclosures and the financial statements.

We noted the following error during the fiscal year ended 2012/2013 audit of the GASB Statement No. 53 derivative disclosures:

1. In three instances, the original disclosures improperly reflected fair values for derivative instruments that had no fair values at year-end. The original underlying detail data provided by the custodian bank reflected zero fair values. These errors were subsequently revised in the GASB Statement No. 53 derivative disclosures.

Recommendation:

The System's financial reporting process should include internal controls to ensure the completeness and accuracy of investment related data. Given the complexity of the accounting standards and the System's investment transactions, we continue to recommend that the investment risk disclosures be prepared and reviewed by personnel who possess proper technical knowledge of the accounting standards and the System's investment structure to ensure the conformity of the investment disclosures to the financial reporting requirements.

Management 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.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Year Material Weakness (Continued)
Fiscal Year Ended June 30, 2014

2013-1: Completeness and Accuracy of Investment Related Disclosures (Continued)

Management Response (Continued):

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.

Fiscal Year 2013/2014 Status:

During the fiscal year 2013/2014 audit, we did not identify any errors related to the GASB Statement No. 40 and GASB Statement No. 53 investment risk disclosures. As such, we consider this material weakness to be resolved.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Years Significant Deficiencies
Fiscal Year Ended June 30, 2014

2013-2: Internal Control Over Accounting and Financial Reporting

Our audit procedures detected several errors 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. The following accounting and financial reporting errors were noted during the audit:

Public Employees' Retirement Fund:

1. Administrative expenses payable were reported as Retirement and Other Benefits Payable rather than Other Program Liabilities in the financial statements. This classification error was not considered material to the overall financial statements and was not corrected in the audited financial statements.

IRC 457 Deferred Compensation Fund:

2. The Placer County 401(k) plan activities were improperly reported in the IRC 457 Deferred Compensation Fund. The Placer County 401(k) plan activities were subsequently reversed from the IRC 457 Fund financial statements but were not properly presented in an agency fund; this error was communicated in the Report to the Risk and Audit Committee in Schedule I, Summary of Uncorrected Financial Statement Misstatements.

3. The original member contribution receivable was recorded twice as the Fiscal Services Division did not adjust its year-end accrual process in light of system reporting enhancements associated with the implementation of my|CalPERS. This error was subsequently corrected in the IRC 457 Deferred Compensation Fund financial statements.

Contingency Reserve Fund (CRF)

4. Premiums received by the CRF agency fund from the State in advance of the due date were originally reported as Due to Health Carriers. A portion of the advance premiums related to Health Care Fund (HCF) activities and should have been reported in the HCF as interfund receivables (Due from Other Funds) and Unearned Premiums payable. This error was corrected in the CRF agency and HCF financial statements. In addition, approximately $16 million of advance premiums received from public agencies was properly reported as Due to Health Carriers in the CRF agency fund; however, due to current system constraints, the Fiscal Services Division was unable to identify the portion of the $16 million of advance premiums that should have been reported in the HCF.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Years Significant Deficiencies (Continued)
Fiscal Year Ended June 30, 2014

2013-2: Internal Control Over Accounting and Financial Reporting (Continued)

Health Care Fund:

5. Insurance Premiums & Claims Payable and Unearned Premiums Payable were originally reported as Other Program Liabilities. These errors were corrected in the financial statements.

6. Effective January 1, 2013, CalPERS partnered with its Pharmacy Benefit Manager to provide a custom Medicare Part D prescription drug plan, the Employer Group Waiver Plan (EGWP). Under the EGWP, CalPERS received premium subsidies, rebates and coverage gap discounts from the Federal government. EGWP subsidies were originally reported as Premium Revenues; this error was subsequently corrected and reported as Federal Government Subsidies in the audited financial statements.

7. Loan Receivables were originally reported as Other Receivables, the current and long-term balances were not properly reported, and the loans receivable was not disclosed in the notes to the basic financial statements. There errors were subsequently corrected in the financial statements.

Long-Term Care Fund:

8. Unearned Premiums were originally reported as Other Program Liabilities. This error was subsequently corrected in the financial statements.

Lastly, we noted the following error, which impacted multiple reporting funds:

9. Unapplied general ledger accounts were originally reported as Other Program Liabilities rather than being reported to the respective Receivable accounts. These errors were subsequently corrected in the financial statements.

Recommendation:

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 Response:

Management concurs and has already and will continue to implement 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.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
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Status of Prior Years Significant Deficiencies (Continued)
Fiscal Year Ended June 30, 2014

2013-2: Internal Control Over Accounting and Financial Reporting (Continued)

Management Response (Continued):

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 being responsible for 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 additional, 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 financial 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.

Fiscal Year 2013/2014 Status:

During the fiscal year 2013/2014 audit, we did not identify any errors related to these financial reporting areas. As such, we consider this significant deficiency to be resolved.

2012-3: Implementation of my|CalPERS

The Pension System Resumption (PSR) Project has been a very large endeavor for the past few years. In fiscal year 2011/2012, the PSR project culminated with the implementation of the my|CalPERS system. The my|CalPERS system creates a "one-shop stop" for more than 50 legacy systems, and is used for Retirement Services, Benefit Services, Health Services, and Employer Payroll/Contribution Services. The implementation of my|CalPERS encompassed several go live dates for the different business areas and plans. As part of our audit, we reviewed the general and application controls of the my|CalPERS system, and, as appropriate, we performed tests of significant controls related to the major transaction streams. Our testing revealed the following:

a. Manual Overrides – All elements are editable in the system. Manual overrides are performed in the areas of benefit calculations, payroll adjustments, sick leave conversions, educational leave, and community property to name a few. In some instances, personnel do not rely on the new system calculations but rather utilize the legacy systems and manual spreadsheets to perform calculations and manually override the benefit amounts in the my|CalPERS system.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Years Significant Deficiencies (Continued)
Fiscal Year Ended June 30, 2014

<u>2012-3: Implementation of my|CalPERS (Continued)</u>

b. System Access – my|CalPERS application authorization roles should be periodically reviewed. IT general controls should ensure that information is properly secured, application access is granted to only authorized personnel, and user accounts are managed to enforce a proper segregation of duties. While proper user account provisioning and password controls have been implemented in the new my|CalPERS environment, and user authorization roles have been created, procedures are not yet established to periodically review user accounts and their associated roles to ensure they are up to date and enforce a proper segregation of duties.

c. my|CalPERS General Controls – IT general controls for systems acquisition, development and change management should ensure that system implementations maintain the integrity and completeness of the information as well as ensuring processing accuracy. While the vast majority of transactions are processing correctly in my|CalPERS, there are some errors in the areas of benefit payment processing in health benefit deductions, death benefits, and employer reporting. While management is confident that outstanding issues have been identified and are being addressed, the impact of the errors and effects on the financial information has not been quantified.

d. Data Query and Reporting Knowledge Transfer – The PSR project included the utilization of numerous external consultants. To date, there has not been an adequate transfer of knowledge as CalPERS personnel rely heavily on the external consultants to query data and to generate certain reports from the my|CalPERS system.

Recommendation:

CalPERS should enhance the following processes and controls:

a. Re-evaluate the data elements within my|CalPERS and reduce the reliance on manual overrides in the system, particularly the manual overrides that impact financial statement amounts. In the instances manual overrides are necessary, management should ensure that proper internal controls are in place for such manual overrides. Furthermore, personnel should discontinue the use of manual spreadsheets in calculating benefit payments and should refrain from manually overriding the benefits calculated by my|CalPERS.

b. The appropriate business unit managers, working with the application managers, should develop procedures for the periodic review and testing of my|CalPERS user accounts and their authorization roles to ensure they are up to date and enforce a proper segregation of duties. Documentation of the reviews should be maintained to substantiate the review process and corrections made. User roles and access rights should be evaluated to ensure that the access granted is critical to the performance of the employees' duties.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Years Significant Deficiencies (Continued)
Fiscal Year Ended June 30, 2014

2012-3: Implementation of my|CalPERS (Continued)

Recommendation (Continued):

c. CalPERS Office of Audit Services should consider conducting a review to determine the possible quantity of transactions and dollar value of the outstanding processing issues that the my|CalPERS implementation team has identified. Based upon the dollar value of the processing issues, a determination should be made as to the resources to be dedicated to addressing the outstanding issues.

d. Develop a transition plan and conduct appropriate training to educate CalPERS personnel on the my|CalPERS system's data query and reporting functions and capabilities.

Fiscal Year 2011/2012 Management Response:

a. The Customer Services and Support (CSS) Branch concurs with the observation and recommendation. Since the new system has been implemented the total number of overrides has decreased significantly and occurs on only a small percentage of the total calculations performed. Some overrides will continue to be necessary due to employer reporting errors and data conversion gaps, to pay benefits accurately and timely. CSS will continue to evaluate the data elements within my|CalPERS in regards to performing necessary manual overrides and usage of manual spreadsheets in the calculation of benefit payments. CSS currently tracks, logs and documents each override.

Preliminary Implementation Plan:

- CSS will continue to reduce the reliance on manual overrides by implementing identified enhancements or correcting defects that lead to the use of manual overrides.
- CSS will continue to reduce the usage of manual spreadsheets in calculating benefit payments as system enhancements and the correction of defects are applied.
- CSS will continue to enhance procedures and processes on the proper use and approval process for utilizing overrides. The Customer Services and Support System continues to monitor and plans a milestone evaluation at June 30, 2013.

b. CSS Branch concurs with the observation and recommendation and has developed a plan to ensure procedures for the review and testing of my|CalPERS user accounts and their authorization roles are up to date. CSS will document the reviews to substantiate the review process. CSS will evaluate user roles and access rights to ensure that the access granted is critical to the performance of the employees' duties.

2012-3: Implementation of my|CalPERS (Continued)

Fiscal Year 2011/2012 Management Response (Continued):

Preliminary Implementation Plan:

CSS is coordinating a user access project team which includes representatives from the Enterprise Risk Management Division, Information Security Management Section and the Office of Audit Services. CSS expects to implement the already approved my|CalPERS user access project by June 30, 2013. Specifically, CSS and the project team will:

- Update and roll out Requester and Approver procedures.
- Develop and implement procedures to review, communicate, and revoke access for users who have not accessed the system in the last 90+ days.
- Identify and implement a new base group role that provides limited access to peripheral users. This will replace the current CalPERS Agent as the base role and will provide limited access to my|CalPERS data.
- Review existing group roles to determine appropriate permission sets that should be included for unit staff to perform responsibilities. This is designed to prevent the routine need for cross-divisional approvals for UARS requests (User Access Request System).
- Conduct a detailed review and analysis to identify and implement changes to group roles and permission sets at the UID (User Interface Design) level. This effort will better define the group roles and permission sets and limit access to only what is needed by the business area to perform their work. Once completed CSS will implement system changes needed to add, change or delete group roles and permission sets while updating the my|CalPERS Security Matrix.
- Develop, document and implement a process for creating, modifying and deleting roles and permission sets.

c. The Office of Audit Services (OFAS) agrees with the recommendation. In the time since the financial statement audit, management has made significant continued progress in the areas noted. OFAS has included in its audit plan, and will continue to include, areas impacted by my|CalPERS, and to the extent the issues identified by the my|CalPERS implementation team have not already been addressed, OFAS will include an assessment of the impact of unresolved errors on financial information. OFAS plans to complete such reviews in stages and address all areas noted by June 30, 2014.

2012-3: Implementation of my|CalPERS (Continued)

Fiscal Year 2011/2012 Management Response (Continued):

d. Specifically relating to the area of data reporting, as of January 31, 2013, the Information Technology Branch completed the planned knowledge transfer activities from external consultants to CalPERS staff. External consultants continue to 'work down' their queue of data requests to fulfill their contractual obligations. All new data requests are handled by CalPERS Data Reporting staff who continue to mature their workload capacity. Some new requests may be routed to external consultants, as appropriate, if they are part of their existing contractual obligations. Where applicable, additional knowledge transfer activities may be initiated when new needs arise, prior to the external consultants' departure. Information Technology Services Branch expects to complete this issue by June 30, 2014.

Fiscal Year 2012/2013 Status:

a. This recommendation is in process of being implemented. The System has compiled a report that lists the overrides and processes being investigated. The report details the benefit type, system-calculated amount, override amount, approvers and override date. As of June 30, 2013, there were 346 overrides listed in the report. While the report lists the approvers of the overrides, there is still no formal policy or documentation of the override approval process that details approver authority positions and levels of approval authority.

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b. This recommendation is in process of being implemented. The System has developed account approver and requester procedures for account provisioning. A review of account roles and authorization is still being conducted to ensure user accounts allow only authorized transactions to be performed and the System enforces a proper segregation of duties. The System's management expects the reviews and updates to be completed by the end of calendar year 2014.

c. During the fiscal year 2012/2013 audit, we noted my|CalPERS implementation errors pertaining to employer reporting have been addressed. OFAS completed a review of the Death Benefit process in fiscal year 2012/2013; the results revealed that my|CalPERS implementation issues have been resolved. An internal audit project for the health benefit area is included in OFAS' fiscal year 2013/2014 audit plan and the target completion date is June 30, 2014.

d. This recommendation has been implemented.

<u>2012-3: Implementation of my|CalPERS (Continued)</u>

Fiscal Year 2012/2013 Management Response:

a. The my|CalPERS system change request to implement a unique secondary approver on all manual overrides is pending prioritization for a future my|CalPERS release. Each unit within the Benefit Services Division developed and documented manual override procedures and will continue enhancing certain override procedures. We will prioritize the related my|CalPERS changes by December 31, 2014. In the meantime, procedures will be enhanced by March 31, 2014.

b. The user access project has completed the activities identified in the plan to address the audit observation and are working to implement the my|CalPERS system changes required to better define current user access. The following activities have been completed as part of the user access project:

   - Updated my|CalPERS security role and system access procedures.
   - Eliminated inactive my|CalPERS user accounts and provided read only access to the CalPERS agent.
   - Mapped the unit processes within each Division, determined the user access needs, security roles and streamlined the approval process.
   - Reviewed and documented the Phase 1 user access changes.

   The user access project will continue with Phase 2 to implement further user access refinements in 2014.

c. Office of Audit Services completed its review of death benefits and employer reporting and did not find continued uncorrected errors caused by my|CalPERS processing. The Office of Audit Services had included a review of health deductions within the new my|CalPERS environment in its 2012-2013 and 2013-2014 Audit Plans; but significant functionality was still being implemented during the calendar 2013 timeframe, so the audit was deferred as requested by management. In January 2014, the appropriate my|CalPERS tools were implemented to capture health deductions. We anticipate sufficient data will be available to conduct a health deductions review by late spring and Audit Services plans to address this area by June 30, 2014.

Fiscal Year 2013/2014 Status:

a. We verified that formal policy and/or documentation was established in fiscal year 2013/2014; as such, we consider this significant deficiency to be resolved.

b. A review of account roles and authorization was conducted in November 2014; as such, we consider this significant deficiency to be resolved.

c. This significant deficiency has been resolved.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Years Comments and Recommendations
Fiscal Year Ended June 30, 2014

Fiscal Year 2012/2013 Observation #1 – OPEB Liability Allocation

We noted the System's liability for other postemployment 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.

The State of California (the State), as an employer, provides retired State employees with certain OPEB benefits such as health care and dental benefits, under a single-employer defined benefit plan. As a State agency, CalPERS provides funding for the State's OPEB benefits. CalPERS' funding is based on the amount determined by the State on a pay-as-you-go basis. CalPERS records its share of the net OPEB obligation as determined by the State Controller's Office (SCO) based on the most recent State of California actuarial valuation report. Given the current allocation method, the Long-Term Care Fund does not share in the cost of OPEB and the CRF Proprietary Fund will continue to experience operating losses each year and its net position will continue to decrease.

Recommendation:

CalPERS should re-evaluate the fund allocation provided by the 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 2014/2015, 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.

Management Response:

Management concurs and has already begun discussions with the State Controller's Office (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.

Fiscal Year 2013/2014 Status:

This recommendation was implemented in fiscal year 2013/2014.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Years Comments and Recommendations (Continued)
Fiscal Year Ended June 30, 2014

<u>Fiscal Year 2012/2013 Observation #2 – Member Census Data</u>

During our audit, we noted the ACTO currently does not have a formal process to communicate to other CalPERS offices and units changes made to members' census data in the 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, the Actuarial Office (ACTO) transfers member census data generated from my|CalPERS into the Actuary Valuation System (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 the ACTO making certain changes to the members' census data in the 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.

Recommendation:

We recommend that management establishes a formal process to ensure changes to members' census data are properly communicated to affected offices and units. The process should include a subsequent review by ACTO personnel to ensure appropriate changes are also reflected in my|CalPERS.

Management 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.

Fiscal Year 2013/2014 Status:

This recommendation will be implemented in fiscal year 2014/2015.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Years Comments and Recommendations (Continued)
Fiscal Year Ended June 30, 2014

<u>Fiscal Year 2011/2012 Observation #2 – Investment Commitment Disclosures</u>

The Fiscal Services Division utilizes the investment commitment summary worksheet provided by the Investment Office to prepare the investment commitment disclosures in the financial statements. During our audit, we noted the following errors related to the disclosures of investment commitments:

- Corporate governance securities are invested in the form of a partnership structure and are reported as equity securities in the financial statements. We noted one instance in which the original commitment amount was decreased during the fiscal year; however, the adjustment was not reflected in the investment commitment summary worksheet and the draft commitment disclosure was incorrect, which was subsequently revised. In addition, the original corporate governance investment commitment summary worksheet reflected certain commitment amounts in Euros, which should have been converted to U.S. dollars for financial reporting purposes. The amount was subsequently corrected to reflect U.S. dollars for disclosure purposes.

- The System entered into year-to-year contracts with certain real estate partners, in which any commitments not funded during the year must be re-evaluated and approved by appropriate CalPERS personnel in order for capital calls to be funded in future years. Due to the nature of these contracts, there are no unfunded commitments for these partners at year-end. The original disclosure of unfunded real estate commitments included expired commitments to partners with year-to-year contracts. The disclosure was subsequently revised to properly exclude these partners.

Recommendation:

We recommend the following processes be performed to ensure proper reporting of investment commitment disclosures:

- The Fiscal Services Division and Investment Office should establish a process to ensure that changes in investment commitment amounts are properly captured and disclosed in the financial statements.

- The Fiscal Services Division should establish a process to identify each investment partner that domiciles in a foreign country and verify that the amount is properly reported in U.S. dollars. The process should include inquiries of Investment Office personnel and a comparison of reported amounts to the partners' records.

- The Fiscal Services Division should review the commitment summary worksheets for reasonableness by comparing the changes in total commitment and unfunded commitment amounts for the current and prior years. Unexpected or unusual changes should be investigated and resolved through inquiries of Investment Office personnel and review of the partners' records.

Fiscal Year 2011/2012 Observation #2 – Investment Commitment Disclosures (Continued)

Recommendation (Continued):

- The Fiscal Services Division should obtain an understanding of the nature and structure of investment contracts to ensure that unfunded commitment disclosures reflect only those commitments for which CalPERS is obligated to fund the remaining commitment amounts.

Fiscal Year 2011/2012 Management Response:

Fiscal Services Division concurs with the recommendation to ensure proper reporting of investment commitment disclosures. Fiscal Services Division and the Investment Office will work together to implement the suggested recommendations for the next year-end close activities beginning July 1, 2013. The Investment Office will enhance processes by implementing the following steps:

- Gather the necessary data for unfunded liability and capital commitment amounts from Private Equity, Real Assets and Corporate Governance
- Ensure that changes in investment commitment amounts are properly captured and accurately recorded on the commitment summary worksheets
- Ensure all amounts are properly reported in U.S. dollars
- Perform high level reasonableness calculations of amounts compared to prior year numbers
- Prepare an aggregated level schedule that shows the changes from prior period
- Validate the final numbers with the appropriate asset classes and provide appropriate documentation as determined by Fiscal Services Division staff

Fiscal Services Division supports the Investment Office's proposed steps to strengthen and improve the investment commitment disclosures. This also provides Fiscal Services Division the oversight to ensure proper reporting of investment commitment disclosures. Fiscal Services Division will enhance their processes by implementing the following steps:

- Review details of the commitment summary worksheets received from the Investment Office and perform a variance analysis
- Follow up with the Investment Office staff on any unusual or unexpected changes and perform analysis and review

We anticipate the new processes to be implemented and in place for the upcoming fiscal year-end close activities, which will conclude in October 2013.

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Years Comments and Recommendations (Continued)
Fiscal Year Ended June 30, 2014**

Fiscal Year 2011/2012 Observation #2 – Investment Commitment Disclosures (Continued)

Fiscal Year 2012/2013 Status:

With the implementation of the Automated Real Estate Information System (AREIS), investment partners are required to input financial information directly into AREIS. The Investment office is responsible for the input of commitment amounts into AREIS using the financial information generated from AREIS, and to provide real estate investment data to the Fiscal Services Division for financial reporting and note disclosure purposes. During the fiscal year 2012/2013 audit, we noted the following errors related to the disclosures of investment commitments:

- One real estate partner incorrectly reported the return of capital of approximately $177 million as an increase in the unfunded commitment balance in AREIS. CalPERS does not have an obligation to fund the return of capital amount in the future, and, as such, this return of capital balance was subsequently excluded from the disclosures in the System's financial statements.

- Two infrastructure partners incorrectly reported discretionary commitment amounts in the unfunded commitment balances. CalPERS is not required to fund the discretionary commitment amounts. As such, these amounts were subsequently excluded from the disclosures in the System's financial statements.

Fiscal Year 2012/2013 Management Response:

The Investment Office concurs with the recommendation to ensure proper reporting of investment commitment disclosures and will work to implement new control functions for the next year-end close activities beginning July 1, 2014. The Investment Office will enhance processes by implementing the following steps:

- Implement a new enhancement in AREIS to reduce the possibility of a partner incorrectly recording non-recallable distributions that impact the unfunded commitment in AREIS as noted above.

- Investment office staff will adjust the commitment amounts in AREIS to remove any discretionary infrastructure commitments and track outside of the ARIES unfunded commitment reporting.

We anticipate the new control processes to be implemented and in place for the upcoming fiscal year-end close activities, which will conclude in October 2014.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Management Letter
Status of Prior Years Comments and Recommendations (Continued)
Fiscal Year Ended June 30, 2014

Fiscal Year 2011/2012 Observation #2 – Investment Commitment Disclosures (Continued)

Fiscal Year 2013/2014 Status:

During the fiscal year 2013/2014 audit, we noted the following errors related to investment commitment disclosures in Note 14 to the basic financial statements:

- The original financial statement disclosures of total and unfunded commitments for corporate governance strategy investments within the global equity investment portfolio included commitments that CalPERS has no intention of funding. CalPERS' financial statements were subsequently revised to properly exclude the total and unfunded commitment balances from the disclosures.

- The original financial statements included disclosures of total commitments for real asset investments that CalPERS is no longer obligated to fund due to a change in the investment partnership and the commitment structure. CalPERS' financial statements were subsequently revised to properly exclude these commitments from the disclosures.

- There were two instances of private equity partnerships that had gone public and for which commitment disclosures were included in Note 14, but were no longer applicable. CalPERS' audited financial statements were revised to exclude the total original commitment amount for one of the partnerships. For the other partnership, no revision was made as the original commitment amount was deemed immaterial to the overall financial statements.

Fiscal Year 2013/2014 Management Response:

The Investment Office concurs with the recommendation to ensure proper reporting of investment commitment disclosures and will work to implement new control functions for the next year-end close activities beginning July 1, 2015. The Investment Office will enhance these processes by implementing the following steps:

- Implement new steps within the review process that requires the Private Equity, Real Asset, Corporate Governance and Global Fixed Income management to disclose any changes in investment structure (e.g. private investments going public) that impact their reported total commitment and unfunded amounts.

- In addition, the review process will also require the program area management to represent that any commitment or unfunded amounts that they have no legal obligation to fund are not included the summary reporting.

We anticipate the new control processes to be implemented and in place for the upcoming fiscal year-end close activities, which will conclude in October 2015.

Fiscal Year 2011/2012 Observation #4 – Self-Funded Healthcare Enrollment Reconciliation

We previously reported as observation #8 in fiscal year 2006/2007 that the reconciliation of enrollment records between the third-party administrator and CalPERS' records for the Healthcare Fund (HCF) was not performed timely. Blue Cross is the third-party administrator of the self-funded PERS Care, PERS Choice, and PERS Select health plans. Blue Cross reconciles, on a monthly basis, enrollment records and the related premiums received from the State of California (State). During our testing of premium revenues for the HCF, we noted the monthly enrollment reconciliations were not completed in a timely manner. As of October 2012, the most recent reconciliation was for the month of October 2011.

We recommend that management establish procedures to ensure Blue Cross enrollment records are reconciled to CalPERS records in a timely manner, and that any discrepancies are investigated and resolved prior to the next billing cycle or within a reasonable timeframe.

Fiscal Year 2011/2012 Management Response:

As a result of CalPERS Enterprise-wide systems automation project implemented in September 2011 (my|CalPERS), existing Premiums Reconciliation file formats and file transfer protocols changed. As a result, Anthem Blue Cross could not generate the Premiums Reconciliation report for more than one year. CalPERS and Anthem Blue Cross agreed to halt the my|CalPERS Premiums Reconciliation file transfer format and resume using the my|CalPERS enrollment file. CalPERS and Anthem Blue Cross have agreed the most prudent approach to corrective action is to perform an on-going reconciliation with the enrollment file, rather than use the Premiums Reconciliation file until the my|CalPERS Premiums Reconciliation interface is functional. Anthem Blue Cross will utilize a complete enrollment file and will provide CalPERS an enrollment discrepancy report. CalPERS and Anthem Blue Cross will then jointly work to address the enrollment discrepancies. CalPERS will meet with Anthem Blue Cross to work through the details of the reconciliation process. In addition, regular touch-point meetings with Anthem Blue Cross will continue to ensure this process continues to move forward. CalPERS has also assigned an individual to document this procedure.

It's important to note that the functionality in my|CalPERS has been designed to minimize enrollment discrepancies. For example, the functionality in my|CalPERS supports the cancellation for non-payment (i.e. no health deduction taken from pay warrant) for active employees. This reduces the likelihood of an individual obtaining services and not paying a premium.

Customer Services and Support Division concurs with the recommendation and will work closely with Anthem Blue Cross to develop the procedures by April 30, 2013 and will implement the reconciliation process by July 31, 2013.

Fiscal Year 2011/2012 Observation #4 – Self-Funded Healthcare Enrollment Reconciliation (Continued)

Fiscal Year 2012/2013 Status:

During fiscal year 2012/2013, enrollment reconciliation procedures were established; however, we noted the procedures did not specify the required timeframe to complete the monthly enrollment reconciliation. We recommend that the timeline to complete the monthly reconciliation be incorporated in the procedures.

Fiscal Year 2012/2013 Management Response:

Customer Account Services Division (CASD) and Anthem Blue Cross (Anthem) have implemented a full-file reconciliation process that takes place on a monthly basis. CASD and Anthem will continue reconciliation processing on the monthly timeline, and procedures will be updated to reflect the changes to the business process. The timelines of the enrollment reconciliation process will be implemented March 2014.

Fiscal Year 2013/2014 Status:

This recommendation is considered to be implemented. However, in fiscal year 2013/2014, CalPERS implemented the Flex-Funded Health Maintenance Organization Plans and the enrollment reconciliation process is being performed internally by CalPERS personnel. The reconciliation process is currently being formalized, and which will be re-evaluated during the fiscal year 2014/2015 financial statement audit.