



**Certified Public Accountants.**

A photograph of the California State Capitol building in Sacramento, featuring its iconic dome and classical architecture, bathed in the warm light of a low sun.

# **Fiscal Year 2014-2015 Audit Service Plan**

**California Public Employees'  
Retirement System.**

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## Introduction.

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# Section 1 Executive Summary.

EXECUTIVE SUMMARY



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Oakland

LA/Century City

Newport Beach

San Diego

Seattle

On behalf of Macias Gini & O'Connell LLP (MGO) we are pleased to present our fiscal year 2014-2015 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.

### MGO Mission

Our mission is to be the professional service firm that provides insights, quality professional services and that consistently exceed the expectations of our clients. We will fulfill our mission through our unwavering commitment to our professional standards and code of ethics in all areas in which we provide professional services. These include accounting and auditing, consulting, tax and other specialized services.

### Engagement Team

The experience and professionalism of the members of an engagement team is critical in ensuring that our clients receive the highest quality of professional services. The CalPERS engagement team members possess these traits and are committed to fulfilling their responsibilities under the professional standards and delivering the highest level of client service possible. See section 2 of this Plan for team members.

### Audit Timeline

MGO employs a disciplined approach to the execution of our professional services and delivery of our final reports. We will work with CalPERS management to establish completion dates for significant phases of the audit process, delivery of final reports and presenting the results of our work to the Risk and Audit Committee. Section 3 of the Plan details the "key" dates for the delivery of our professional services.

### Overview of Audit Process

Our assurance services emphasize comprehensive planning, risk assessment, execution and reporting in accordance with our applicable professional standards. In addition, 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 related to the scope of work and delivery of client service.

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.

A handwritten signature in cursive script that reads "Richard A. Green".

**Richard A. Green, CPA**  
MGO Partner

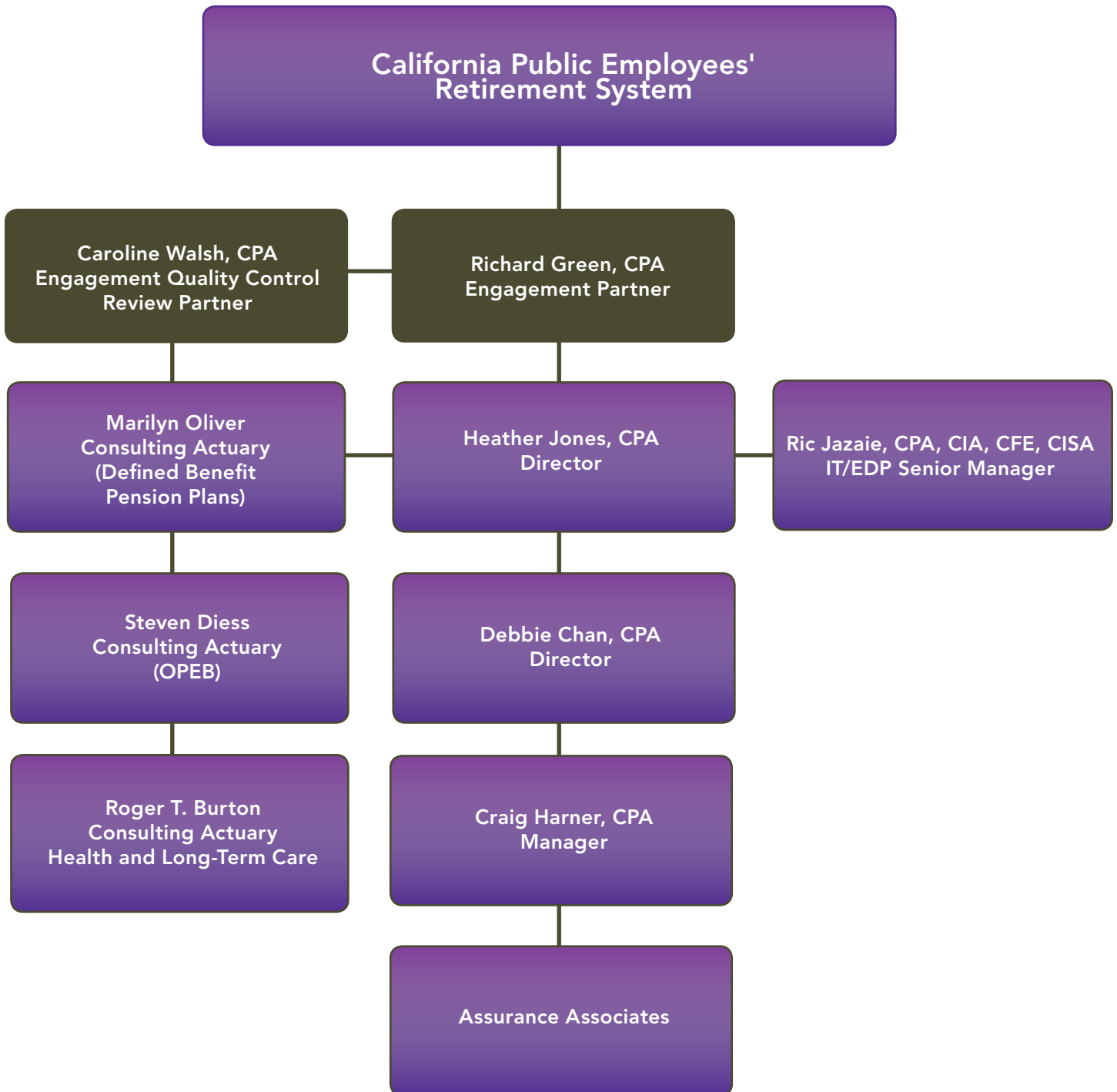
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# Section 2

# Engagement Team.

## 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 extensive public employee retirement systems (PERS) and public sector experience with an indepth understanding of the significant audit and financial reporting issues facing PERS. Your engagement team members are as follows:



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# Section 3

# Audit Timeline.

## AUDIT TIMELINE

We recognize the importance of timely completion of audit tasks and the issuance of deliverables. The timing of our audit procedures will be coordinated with the System's management to minimize disruption of the System's operations and ensure timely execution of our work and delivery of all reports by established 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 2015
Year-End Prepared-By-Client Schedule	June 2015
Present Audit Plan to the Risk and Audit Committee	June 2015
Execution	
Interim Fieldwork	May 25, 2015 - July 3, 2015
Year-End Fieldwork	August 17, 2015 - October 31, 2015
Report Issuance	
Independent Auditor's Report	October 31, 2015
Communications with Those Charged with Governance	October 31, 2015
Management Comments and Recommendations Letter	February 2016
Risk and Audit Committee Presentation	
Independent Auditor's Report	November 2015
Communications with Those Charged with Governance	November 2015
Management Comments and Recommendations Letter	March 2016

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# **Section 4**

# **Overview of Audit Process.**

## OVERVIEW OF AUDIT PROCESS

### Scope of Work

We are pleased to confirm our understanding of the services we are to provide the California Public Employees' Retirement System (CalPERS) for the year ending June 30, 2015 pursuant to CalPERS Agreement No. 2011-6211 (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 CalPERS as of and for the year ended June 30, 2015. 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 CalPERS' basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board. We have also been engaged to report on supplementary information other than RSI that accompanies CalPERS' financial statements.

### Audit Objective

The objective of our audit is the expression of opinions as to whether your 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 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. We will issue a written report upon completion of our audit of CalPERS' financial statements.

### Management Responsibilities

CalPERS Management is responsible for the following:

- Basic financial statements and all accompanying information as well as all representations contained therein.
- Establishing and maintaining effective internal controls, including monitoring ongoing activities; for the selection and application of accounting principles; and for the preparation and fair presentation of the financial statements in conformity with U.S. generally accepted accounting principles.
- Making all financial records and related information available to us and for the accuracy and completeness of that information.
- Providing us with:
  1. Access to all information of which management is 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 government from whom we determine it necessary to obtain audit evidence.
- Adjusting the financial statements to correct material misstatements and confirming to us in the management 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.
- Design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud affecting the government involving:
  1. Management;
  2. Employees who have significant roles in internal control, and;
  3. Others where the fraud could have a material effect on the financial statements.
- Informing us of their knowledge of any allegations of fraud or suspected fraud affecting the government received in communications from employees, former employees, regulators, or others.
- Identifying and ensuring that the government complies with applicable laws and regulations.

## OVERVIEW OF AUDIT PROCESS

### 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 audit risk.
- Update our understanding of the System's control environment, accounting systems and control procedures for significant audit areas and transaction streams, including any new programs/plans, systems, and/or processes.
- Finalize an audit plan that identifies significant audit risk 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
- Changes in the key personnel

### EXECUTION

#### Performance of the Audit Plan

Our audit scope must be designed to obtain sufficient and appropriate audit evidence 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, including the evaluation of fair value true-up analysis for alternative investments
- 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 by employer rate plan and proper cutoff period
- Healthcare and Long-Term Care premium revenues, including proper billing based on approved rates and reconciliation of premium revenues to subledger and external sources
- Retirement, death & survivor benefits, including eligibility of retirees/beneficiaries and accurate calculation and disbursements of monthly benefits by rate plan
- Reasonableness of actuarial assumptions and calculations for pension and other postemployment benefits (OPEB), including evaluation of the long-term discount rate for pension plans
- Actuarial census data for Single-Employer and Cost-Sharing Multiple-Employer Pension Plans, testing of census data for active employees against the participating employers' underlying payroll records
- Implementation of Actuarial Standard of Practice (ASOP) No. 6 and the related OPEB valuation and disclosures
- Accounting and reporting related to the termination of the State Peace Officers' and Firefighters' Defined Contribution Plan
- Management's preparation of the following schedules to facilitate employer reporting in accordance with GASB 68:
  - Schedule of Employer Allocations
  - Schedule of Changes in Fiduciary Net Position

## OVERVIEW OF AUDIT PROCESS

### 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.

## 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
- Difficulties Encountered in Performing the Audit
- Corrected and Uncorrected Misstatements
- Disagreements with Management
- Management Representations
- Management Consultations with Other Independent Accountants
- Other Audit Findings or Issues
- Other Matters, such as required supplementary information and other supplemental information

### 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.

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.

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# **Section 5**

# **Recent Developments in Accounting and Financial Reporting.**

## RECENT DEVELOPMENTS IN ACCOUNTING AND FINANCIAL REPORTING

The following is a summary of the most 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. 68, Accounting and Financial Reporting for Pensions, An Amendment of GASB Statement No. 27**

**This Statement was issued in June 2012.**

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria.

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2014 or effective fiscal year ending June 30, 2015.

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.

Participating employers' implementation of Statement No. 68 requires significant coordination between the employers, the System and the respective auditors.

#### **GASB Statement No. 72, Fair Value Measurement and Application**

**This Statement was issued in February 2015.**

The objective of this Statement is to improve financial reporting by clarifying the definition of fair value for financial reporting purposes, establishing general principles for measuring fair value, providing additional fair value application guidance, and enhancing disclosures about fair value measurements. These improvements are based in part on the concepts and definitions established in Concepts Statement No. 6, *Measurement of Elements of Financial Statements*, and other relevant literature.

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015 or effective fiscal year ending June 30, 2016.

RECENT DEVELOPMENTS IN ACCOUNTING AND FINANCIAL REPORTING

**FUTURE GASB PRONOUNCEMENTS**

**GASB Proposed Statement,  
*Financial Reporting for  
Postemployment Benefit Plans  
Other Than Pension Plans***

The objective of this proposed Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This proposed Statement includes requirements for defined benefit OPEB plans that would replace the requirements of Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*.

**GASB Proposed Statement,  
*Accounting and Financial Reporting  
for Postemployment Benefit Plans  
Other Than Pensions***

The primary objective of this proposed Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also would improve information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This proposed Statement would replace the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB.

# Please call us if you need anything.

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**We have offices up and down the State.**  
**Come and see us.**

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