**CALIFORNIA PUBLIC EMPLOYEES'
RETIREMENT SYSTEM**

Report to the Risk and Audit Committee

Fiscal Year Ended June 30, 2016

___________, 2016

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

We have audited the financial statements of the fiduciary activities and the proprietary activities of the California Public Employees' Retirement System (the System) for the fiscal year ended June 30, 2016. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated April 25, 2016. Professional standards also require that we communicate to you the following information related to our audit.

<u>Significant Audit Findings</u>

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the System are described in Note 2 to the basic financial statements. As discussed in Note 2 to the basic financial statements, the System implemented the provisions of Governmental Accounting Standards Board Statement (GASBS) No. 72, *Fair Value Measurement and Application*, and GASBS No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, for the fiscal year ended June 30, 2016. We noted no transactions entered into by the System during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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

- Actuarial valuations of total pension liabilities and actuarially determined contributions for the cost-sharing multiple-employer and single-employer defined benefit pension plans
- Fair value of real assets and private equity investments and related income
- Estimated insurance claims due in the Health Care Fund/Contingency Reserve Fund
- Estimated liability for future policy benefits in the Long-Term Care Fund

The actuarial pension data contained in Note 8 to the basic financial statements and required supplementary information is based on actuarial measurements performed by the System's Actuarial Office in accordance with the parameters set forth in GASBS No. 67, *Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25*. The actuarial valuations are very sensitive to the underlying actuarial assumptions, including the discount rate.

Real assets consist of real estate, forestland and infrastructure investments, real estate investments include directly held and joint venture real estate. Private equity holdings include direct and co-investments with existing general partners, direct secondary investments, and fund of funds. The System reported these investments at net asset value based on the System's ownership interest in partners' capital to which a proportionate share of net assets is attributed. Investments at net asset value are commonly calculated by subtracting the fair value of liabilities from the fair value of assets. The System reported its net asset values based on the related partnerships' March 31, 2016 financial statements adjusted for cash flow activities through June 30, 2016.

The estimated insurance claims due in the Health Care Fund/Contingency Reserve Fund are based on actuarial estimates of incurred but not reported (IBNR) medical and pharmacy claims, disability extension claims and administrative expenses associated with those claims, as determined by the System's third-party administrator.

The estimated liability for future policy benefits in the Long-Term Care Fund is based on the present value of future benefits and expenses less the present value of future premiums, as determined by the System's Actuarial Office. As described in Note 13 to the basic financial statements, the estimated liability for future policy benefits is very sensitive to the underlying actuarial assumptions, including a discount rate of 5.75 percent, morbidity, lapse rates, voluntary termination, conversion rates to fixed term policies, mortality, plan expenses and rate increase.

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

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

- The total pension liabilities for the cost-sharing multiple-employer and single-employer defined benefit pension plans, which are based on the most recent actuarial valuations as of June 30, 2015, rolled forward to June 30, 2016.
- The estimated liability for future policy benefits in the Long-Term Care Fund, which is determined based on the present value of future benefits and expenses less the present value of future premiums, as determined by the System's Actuarial Office.

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

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. The accompanying Schedule I summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements of the fiduciary activities taken as a whole. In addition, the accompanying Schedule II summarizes material misstatements detected as a result of the audit procedures and were corrected by management. The adjustments in Schedule II related to the implementation of GASBS No. 72, *Fair Value Measurement and Application*, a complex new accounting and financial reporting standard.

Disagreements with Management

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

Management Representations

We have requested certain representations from management that are included in the management representation letter dated ________, 2016.

Management Consultations with Other Independent Accountants

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

Other Audit Findings or Issues

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

Other Matters

We applied certain limited procedures to the following required supplementary information (RSI) that supplements the basic financial statements:

1. Management's Discussion and Analysis
2. Schedules of Changes in Net Pension Liability/(Asset) and Related Ratios
3. Schedules of Plan Contributions
4. Schedule of Investment Returns
5. Schedule of Claims Development Information (Health Care Fund)

Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the following supplementary information, which accompany the financial statements but are not RSI:

1. Administrative Expense – All Funds
2. Investment Expense – Investment Management Fees
3. Investment Expense – Performance Fees
4. Investment Expense – Other Investment Expenses
5. Consultant and Professional Services Expenses – All Funds
6. Statement of Changes in Assets & Liabilities – Agency Fund

With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the Introductory, Investment, Actuarial, Statistical, and Compliance sections, which accompany the financial statements in the Comprehensive Annual Financial Report, but are not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Restriction on Use

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

Very truly yours,

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Report to the Risk and Audit Committee
Schedule I - Summary of Uncorrected Financial Statement Misstatements
June 30, 2016

Financial Statement Account Description	Fund Name	Assets	Liabilities	Increase/ (Decrease) Additions /	Deductions /	Net Position
Real Assets Investments	PERF A	$ 441,756,388				
Real Assets Investments	PERF B	113,359,325				
Real Assets Investments	PERF C	50,112,932				
Private Equity Investments	PERF A	334,191,350				
Private Equity Investments	PERF B	85,757,008				
Private Equity Investments	PERF C	37,910,733				
Net Appreciation in Fair Value of Investments	PERF A			$ 775,947,738		
Net Appreciation in Fair Value of Investments	PERF B			199,116,333		
Net Appreciation in Fair Value of Investments	PERF C			88,023,665		

To adjust the fair values of real assets and private equity investments based on the partnerships' June 30, 2016 financial information.

Financial Statement Account Description	Fund Name	Assets	Liabilities	Increase/ (Decrease) Additions /	Deductions /	Net Position
Global Equity Securities	PERF A	456,961,204				
Global Equity Securities	PERF B	117,261,041				
Global Equity Securities	PERF C	51,837,769				
Private Equity Investments	PERF A	(456,961,204)				
Private Equity Investments	PERF B	(117,261,041)				
Private Equity Investments	PERF C	(51,837,769)				

To reclassify private equity investments to global equity securities to properly reflect publicly traded private equity partnerships at June 30, 2016.

Financial Statement Account Description	Fund Name	Assets	Liabilities	Increase/ (Decrease) Additions /	Deductions /	Net Position
Beginning Net Position	CERBT					$ (54,694,161)
Employer Contributions Direct – OPEB	CERBT			54,694,161		

To restate beginning fiduciary net position related to the implementation of GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amounts recognized as receivables for contributions should include only those due pursuant to legal requirements.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Report to the Risk and Audit Committee
Schedule II - Summary of Corrected Financial Statement Misstatements
June 30, 2016

		Increase / (Decrease)				
Financial Statement Account Description	**Fund**	**Assets**	**Liabilities**	**Additions / Revenues**	**Deductions / Expenses**	**Net Position**
Global Debt Securities	PERF A	$ 6,137,425,453				
Global Debt Securities	PERF B	1,574,927,781				
Global Debt Securities	PERF C	696,230,754				
Global Equity Securities	PERF A	(6,137,425,453)				
Global Equity Securities	PERF B	(1,574,927,781)				
Global Equity Securities	PERF C	(696,230,754)				

To reclassify a portion of the System’s internally pooled (unitized) investments from global equity to global debt securities.

Investment Purchases & Other Liabilities	PERF A		$ (6,509,069,903)			
Investment Purchases & Other Liabilities	PERF B		(1,670,631,324)			
Investment Purchases & Other Liabilities	PERF C		(737,955,727)			
Investment Purchases & Other Liabilities	LRF		(502,891)			
Investment Purchases & Other Liabilities	CERBTF		(15,838,426)			
Investment Sales & Other Receivables	PERF A	$ (6,509,069,903)				
Investment Sales & Other Receivables	PERF B	(1,670,631,324)				
Investment Sales & Other Receivables	PERF C	(737,955,727)				
Investment Sales & Other Receivables	LRF	(502,891)				
Investment Sales & Other Receivables	CERBTF	(15,838,426)				

To adjust foreign currency forward contracts to be consistent with the requirements of GASBS No. 72, *Fair Value Measurement and Application*.