Macias Gini & O'Connell
Summary of Financial Statement Audit Management Letter Comments
Current Year Report
As of June 30, 2017

Audit Management Letter Comments for the Year Ended 06/30/16

Observation #1:	Accounting and Reporting for Internal Pooled Investments
Divisions responsible:	Financial Office

CalPERS implemented Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application* in fiscal year 2015/2016, which establishes general principles for measuring fair value and standards of accounting and financial reporting for assets and liabilities measures at fair value. As part of the implementation, the underlying securities held in CalPERS' internally pooled (unitized) investments are reported at fair value rather than at net asset value (NAV). We observed that unitized investments provided by the custodian bank are first recorded at NAV and then allocated to participating funds based on the respective fund's ownership percentage of the unitized portfolios. The Financial Office has to manually adjust the reported NAV in order to properly record the investment fair values and the related investment receivables and payables. The manual process is time consuming and prone to errors as the draft financial statements contained a misclassification between global debt securities and global equity securities, which was corrected in the audited financial statements. The Financial Office should work with the custodian bank to automate the accounting and recording for unitized investments.

Financial Office's Current Update: RESOLVED. Pending review by Macias Gini & O'Connell. CalPERS evaluated the cost/benefit of having State Street Bank automate this process. Based on this analysis, CalPERS has developed an enhanced internal process. Process improvements have been made to reduce the amount of manual labor, and incorporate additional controls. These additions will reduce the risk of error and make the process more efficient. The new internal process was tested during the mid-year analysis and proved to take less time, with a reduction in errors.

Observation #2:	Replacement Benefit Fund Account Reconciliation
Division responsible:	Financial Office

The Replacement Benefit Fund (RBF) was established to account for benefit payments to retirees whose retirement allowance exceeds the Internal Revenue Code (IRC) Section 415(b) limits. IRC Section 415(b) imposes a dollar limit on the annual retirement benefits an individual may receive from a qualified defined benefit pension plan. Employers are responsible for paying the excess benefit amounts for their former employees, CalPERS sends invoices to the respective employers for the portion of pension benefits exceeding the limits. Upon receiving payments from the employers, CalPERS remits the excess benefit portion to the respective retirees. The accounting and reporting for these types of transactions are custodial in nature and CalPERS reports a statement of net position for the RBF. As part of the fiscal year 2015/2016 financial statement audit, we obtained the year-end reconciliation between the general ledger and my|CalPERS for the receivable from employers and payable to members and employers accounts. We noted the balances do not reconcile and that as part of the annual reconciliation process, the data in the reconciliation generated from my|CalPERS has to be

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manually adjusted. The Financial Office should work with the appropriate CalPERS Division to ensure that data in the general ledger and my|CalPERS are consistent and the two systems properly reconcile.

Financial Office's Current Update RESOLVED. Pending review by Macias Gini & O'Connell. CalPERS continues to participate in a multi-part functional optimization process for the Replacement Benefit Fund (RBF) to improve reconciliation functionality. The Financial Office, Benefit Services, and Information Technology divisions are continuing to implement business processes and procedures to identify and document reconciling items between the RBF Detail Reconciliation report and PeopleSoft financials. CalPERS is continuing to improve the overall RBF benefit payment process.

Observation #3:	Long-Term Care Fund Annual Actuarial Valuation
Division responsible:	Actuarial Office/Benefits Programs Policy and Planning/Financial Office

On an annual basis, an actuarial valuation report is completed to determine the Estimated Liability for Future Policy Benefits for the Long-Term Care Fund. In fiscal year 2015/2016, the Actuarial Office (ACTO) prepared the annual valuation report (the report) based on member census data provided by the third-party administrator. The Financial Office utilizes the report to record the Estimated Liability for Future Policy Benefits in the Long-Term Care Fund and for financial statement disclosure purposes. The Estimated Liability for Future Policy Benefits is considered a significant estimate in the Long-Term Care Fund due to the sensitivity of the underlying actuarial assumptions and methods. The fiscal year 2015/2016 draft valuation results were available in mid-October, which created a challenge in meeting the established financial reporting and audit timeline of October 31st. In order to meet this deadline, the valuation should be completed no later than September 30th to allow sufficient time to complete the financial reporting and audit process. We understand the completion of the annual actuarial valuation report requires the third-party administrator to submit accurate member census data to ACTO in a timely manner as well as sufficient staffing resources by ACTO. We suggest that ACTO request that the third-party administrator submit the member census data in a time frame that allows ACTO sufficient time to review the data and prepare the report. If staffing constraints delay preforming the valuation in a timely manner, we suggest that ACTO evaluate staffing needs and maintain sufficient personnel in order to complete the recommended procedures.

Actuarial Office and Benefits Programs Policy and Planning's Current Update: RESOLVED. Pending review by Macias Gini & O'Connell. The Financial Office, the Actuarial Office, and Benefits Program Policy and Planning met with the long-term care vendor; moving forward it was decided that CalPERS will use the experience study for the first three quarters to update the valuation assumption, but still use the fiscal year end data to do the valuation projection. This will ensure a draft is ready by the end of August and final results before the end of September. This will meet all of the deadlines for the year end audit, and the vendor can accommodate this requirement.