

Macias Gini & O'Connell
Summary of Financial Statement Audit Management Letter Comments
Current Year Report
As of December 31, 2017

Audit Management Letter Comments for the Year Ended 06/30/17

Observation #1: Service Organization Control (SOC) Reports

Division responsible: Financial Office

CalPERS engages service organizations to process and account for transactions that are significant to the administration and financial reporting of CalPERS investment, pension, health and long-term care activities. Statements on Standards for Attestation Engagements (SSAE) No. 16, Reporting on Controls at a Service Organization, and AICPA AT-C Section 320, Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting, which is effective for reports dated on or after May 1, 2017, provide guidance regarding examinations and related reports on controls at service organizations. One of the most effective ways a service organization can communicate information about the service organization and its control environment is through a Service Organization Control 1 (SOC 1) report. SOC 1 Type 2 report focuses on controls at the service organization that would be useful to user entities' internal control over financial reporting and includes an examination report on management's description of the suitability of the design and the operating effectiveness of the controls. CalPERS, as a user entity, requests SOC 1 Type 2 reports from certain third-party service organizations on an annual basis. However, CalPERS does not have processes or procedures in place related to the following:

- Identification of all third-party service providers that have a direct impact on CalPERS' accounting and financial reporting,
- Tracking of timely receipt and review of SOC 1 Type 2 reports,
- Review and evaluation of SOC 1 Type 2 reports to determine whether findings noted could have a direct impact on CalPERS' financial reporting, and
- Determination of whether CalPERS has the required complimentary user entity controls in place and whether those controls are operating effectively.

CalPERS should implement formal procedures related to the identification, receipt, and review of SOC 1 Type 2 reports for third-party service organizations that have a direct impact on CalPERS' financial statements. In addition, the Financial Office should review each SOC 1 Type 2 report along with the provisions of AT-C 320 to understand the scope and objectives of SOC 1 Type 2 engagements and to evaluate whether CalPERS' user entity controls are sufficient to compliment service organization controls.

Financial Office's Current Update: OPEN. The Financial Office has developed an implementation plan to adhere to all SSAE-18 requirements. An annual process to determine any financial reporting impacts, based on third-party service providers' SOC-1 reports, will be in place by the July 31, 2018 target date.

Observation #2: Accounting and Reporting for OPEB Contributions and Reimbursements Outside of the California Employers' Retiree Benefit Trust Fund (CERBTF)

Division responsible: Financial Office

Governmental Accounting Standards Board (GASB) Statement No. 74, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, requires an Other Postemployment Benefits (OPEB) plan to report on all activities of the OPEB plan, and not solely the activities of the trust through which the OPEB plan is administered. Further, GASB Statement No. 74 requires that contributions from employers include amounts for OPEB as the benefits come due, including amounts that will not be reimbursed to the employers using OPEB plan assets. In addition, benefit payments should include benefit amounts paid directly by employers. In this circumstance, an amount equal to the benefit payments is recognized both as an addition to and a deduction from OPEB plan fiduciary net position. The System records this type of activity as Employer Contributions Outside of Trust – OPEB and OPEB Reimbursements – Outside Trust in the CERBTF statement of changes in fiduciary net position. In order to quantify benefits paid by employers outside of the trust, CERBTF Program personnel obtain this information from participating employers as part of year-end closing procedures. Contributions and reimbursements made outside of the trust are calculated as the sum of retiree healthcare premiums and implicit rate subsidies, net of any reimbursements made directly from the trust. As part of our testing, we noted the following errors, which resulted in audit adjustments:

- For 15 employers, there were errors in the implicit rate subsidy used in the calculations.
- For 10 employers, late and/or revised information submitted by the employers was not sufficiently reviewed for accuracy prior to making changes to the employers' original calculations.
- For three employers, calculations related to reimbursement amounts contained arithmetic errors.
- For two employers, the implicit rate subsidy was accounted for twice in the calculation.
- For two employers, the implicit rate subsidy used in the calculation pertained to an incorrect period.
- For one employer, CalPERS remitted an OPEB reimbursement that exceeded the employer's retiree healthcare premiums.

CERBTF Program personnel working in conjunction with the Financial Office should strengthen the current procedures to ensure the completeness and accuracy of information submitted by employers. Since the accounting and financial reporting for contributions and OPEB reimbursements outside of the trust is dependent on the completeness and accuracy of information submitted by the participating employers, management should consider providing additional guidance and tools to employers to assist in the preparation of financial information required by CalPERS.

Financial Office's Current Update: OPEN. CERBT Management is in the process of creating training documents and planning the schedule for the Webinars to better communicate and train CERBT contracted employers regarding year-end OPEB data collection. CERBT Management and team members are also working on revisions to the year-end data summary document to improve and more efficiently capture the required data under GASB 75.

Lastly, CERBT Management and Team Members are revising our current processes for renewal valuation documentation collection and validation to include a secondary review and the tracking of the reduced number of data elements as required under GASB 74. This will improve efficiency and decrease complexity for the CERBT Contracted Employers.

The corrective actions will be implemented by June 30, 2018.

Observation #3: Accounting and Reporting for the Replacement Benefit Fund (RBF)

Division responsible: Financial Office

CalPERS elected to early adopt the provisions of GASB Statement No. 84, Fiduciary Activities, effective July 1, 2016. GASB Statement No. 84 eliminates the agency fund type and creates a new fund type called a custodial fund. As a result of the implementation, the RBF is now classified as a custodial fund and is required to present a statement of changes in fiduciary net position. During the audit, we noted the following items:

- The trial balance and reconciliations for the material RBF financial statement line items were not available for audit until mid-October.
- The original draft RBF financial statements contained misclassifications, which resulted in audit adjustments.
- Differences related to unearned replacement benefits recorded in the general ledger and my|CalPERS have not been corrected.

Although the Financial Office has improved reconciliation procedures, additional procedures are necessary to ensure RBF balances are complete and accurate.

The Financial Office should continue to work with the appropriate CalPERS Division to reconcile account balances in the RBF and to ensure accuracy and consistency between the general ledger and my|CalPERS. In addition, the information for the RBF should be made available by early September to allow sufficient time for auditing procedures.

Financial Office's Current Update: OPEN. Financial Reporting and Accounting Services has updated procedures to incorporate GASB 84 requirements and ensuring balances are complete, accounted for accurately and recorded timely. We continue to communicate and work closely with other CalPERS divisions to ensure transactions are recorded consistently between the general ledger and my|CalPERS. The RBF Reconciliation Detail Report is completed 45 days after each month end which allows for data submission by the due date of early September. CalPERS will meet the implementation due date of July 31, 2018.