

Summary of Financial Statement Audit Management Letter Comments  
Current Year Report  
As of December 31, 2018

## **Audit Management Letter Comments for the Year Ended 06/30/18**

### **Observation #1: Non-GAAP Policies**

#### **Division responsible: Financial Report and Accounting Services Division**

Entities often determine that certain generally accepted accounting principles (GAAP) are not material and therefore excluded from presentation in their audited financial statements. CalPERS has selected to also not reflect certain immaterial items from its Comprehensive Annual Financial Report (CAFR), for example certain cut-off reporting of accruals.

CalPERS should formally document all of its non GAAP policies as well as annually evaluate and determine that said policies continue to be immaterial to its CAFR.

**Financial Office's Current Update:** OPEN. Financial Reporting and Accounting Services (FRAS) is in the process of ensuring all non-GAAP policies are documented; this will be completed June 30, 2019. The annual review of existing policies and procedures, for CAFR materiality, has also been added to the financial reporting task list.

### **Observation #2: Third Party Administrations**

#### **Division responsible: Health Plan Administration Division**

CalPERS' proprietary funds include the activities of the Health Claims Funds (HCF) and the Long-Term Care Fund (LTCF) and the related oversight and monitoring of claims activity administered by third-party administrators (TPAs). During the audit, KPMG noted that CalPERS did not have access to nor routinely reviewed or reconciled the detail claims activity processed by the TPAs to what was reflected in the books and records of either the HCF or the LTCF.

CalPERS should review its oversight controls of the TPAs and update its controls as deemed necessary. At a minimum, KPMG would recommend that CalPERS should reconcile summary TPA claim activity to the detail claim activity on a regular basis.

**Financial Office's Current Update:** OPEN. For the LTCF, the HPAD team is in the process of creating a desktop procedure. The HPAD team is also planning to secure the detailed claims report to reconcile with claims summary by April 2019. For the HCF, the HPAD team in coordination with the SCO will be documenting, implementing and testing the TPA reconciliation of the claims summary to the detail claims for the new PPO Contract Period: January 1, 2020 – December 31, 2024, from April 2019 to December 2019 for effective date of January 1, 2020.

### **Observation #3: Actuarial Certifications**

#### **Division responsible: Actuarial Office/ Health Plan Administration Division**

CalPERS reports an incurred but not reported (IBNR) liability related to its HCF activity. The process for establishing the IBNR at year-end includes accumulating actuarial certifications provided by the various TPAs. While it's apparent that management monitors and reviews those

TPA provided certifications, CalPERS does not evidence that monitoring and review in a formal document or memorandum.

CalPERS should summarize the collected TPA certifications and have one its health actuaries certify the year-end IBNR accrual in a formal document in accordance with the provisions Actuarial Standards of Practice No. 41, Actuarial Communications. Such a formal communication would clarify management's responsibility for the IBNR reported at year-end.

**Financial Office's Current Update:** OPEN. The ACTO and HPAD teams are in the process of creating a formal documentation that summarizes and certifies the year-end IBNR estimates by April 2019.

#### **Observation #4: Accounting Position Statement**

##### **Division responsible: Financial Report and Accounting Services Division**

As evidence of a best practice approach to documenting key accounting decisions, CalPERS prepares accounting position statements (APSs). KPMG has reviewed several of these APSs during the initial audit this fiscal year. In an effort to improve the contents of these APSs, KPMG has recommended some be updated to reflect current CAFR treatment (e.g. APS No. 2014/15-1 related to GASB 68 recognition on the CAFR) and/or suggested supplemental language (e.g. APS No. 2013/14-1 related to GASB 67 PERF breakout as PERF A, B and C). In other situations (e.g. APS No. 2015/16-1 related to GASB 68 NPL allocations to Public Agencies), KPMG noted that certain APSs focused more on the conclusions reached than the process and laws and /or accounting literature considered in arriving at its conclusions.

CalPERS should review its past APSs and update as deemed necessary. On a go-forward basis, KPMG encourage CalPERS to include a robust analysis of the laws and or accounting literature considered in arriving at and supporting its final conclusions.

**Financial Office's Current Update:** OPEN. Management is in the process of establishing work teams to review existing APSs and update as necessary; this will be completed by June 30, 2019, and has been added to the financial reporting annual task list. The team will also analyze new governance to determine any impact to the CAFR or accounting treatment.

#### **Observation #5: Census Data**

##### **Division responsible: Actuarial Office**

CalPERS is responsible for maintaining census data for the approximately 2 million members (active and retired) who participate in CalPERS' defined benefit pension plans. Significant elements of census data include: date of birth; years of service; eligible compensation; and gender among other elements.

Effective management of the census data for active employees include procedures to verify the underlying payroll records of the participating employers to determine that the information provided is complete and accurate as this census information is utilized by CalPERS' actuaries to calculate a total pension liability for each of the various defined benefit plans, a significant accounting estimate that is part of the financial reporting process.

In accordance with audit procedures promulgated by the American Institute of Certified Public Accountants (AICPA), KPMG subjected certain Schools and Public Agencies whose employees are active members of the PERFs to census testwork that included comparing such information to the census file used by CalPERS. The results of testwork indicated approximately 100 data quality issues such as incorrect date of birth, understated eligible compensation and/or incorrect years of service. Such data quality issues are not unusual for a public employee retirement system with nearly 1.3 million active members.

KPMG understands that the CalPERS continually updates both the information technology and manual controls over its member management system, my|CalPERS.

CalPERS should conduct a root cause analysis for all its known errors and adjust its internal controls accordingly to address any common causes related to data errors. One potential common cause is the timeliness of data submitted through the my|CalPERS portal. Accordingly, KPMG is also recommending that CalPERS enhance its existing internal controls to ensure the timely and accurate reporting of census data by the participating employers.

**Financial Office's Current Update:** OPEN. The Actuarial Office is currently beginning the valuation season. This is the time of year that data and internal controls are reviewed, so this process is in the beginning stages.