

Summary of Financial Statement Audit Management Letter Comments
Current Year Report
As of March 31, 2019

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. The Financial Reporting and Accounting Services (FRAS) team has been working to create or update all non-GAAP policies and procedures. Currently, we have completed over 90 percent of needed documentation and are on track to finish by the June 30, 2019 date.

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. The Health Plan Administration Division (HPAD) team completed and implemented LTCF procedure and process changes for detailed claims reconciliation, effective January 2019 monthly financial activities. The HPAD team, in coordination with the SCO, will be documenting, implementing and testing the HCF 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. This will be effective 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 is 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 Actuarial Office (ACTO) and HPAD teams are in the process of creating formal documentation that summarizes and certifies year-end IBNR estimates. This is on track for completion by the end of 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. Work teams analyzed governance, and updated existing APSs as needed. APSs are under management review, and on track for June 30, 2019 completion. Currently there is no impact identified or change required to the CAFR presentation.

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 actives members of the PERFs to census test work that included comparing such information to the census file used by CalPERS. The results of test work 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. ACTO is in the midst of valuation season. As errors are found in my|CalPERS, we are tracking them in our new Actuarial Valuation System. In the coming months we will compile the identified issues and ask the appropriate program area to assist. These errors typically go to Employer Account Management Division, benefits, payroll, and others. Also, the payroll unit is currently working on correcting payroll errors that were previously identified.