

# AUDIT PLANNING

June 30, 2019

The following communication was prepared as part of our audit, has consequential limitations, and is intended solely for the information and use of those charged with governance (e.g., Board of Administration and the Risk and Audit Committee) and, if appropriate, management of the System and is not intended and should not be used by anyone other than these specified parties.

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June 10, 2019

Members of the Risk and Audit Committee  
California Public Employees' Retirement System

Professional standards require us to communicate with you regarding matters related to the financial statement audit that are, in our professional judgment, significant and relevant to your responsibilities in overseeing the financial reporting process. This document provides an overview of our plan for the audit of the basic financial statements of California Public Employees' Retirement System (the System) as of and for the year ending June 30, 2019 and related audits of the GASB 68 and 75 Schedules (collectively, the Schedules), including a summary of the nature, scope, and timing of the planned audit work.

### **Responsibilities**

BDO USA, LLP, as your auditor, is responsible for forming and expressing an opinion about whether the financial statements and Schedules that have been prepared by management, with your oversight, are prepared, in all material respects, in conformity with accounting principles generally accepted in the United States of America. In addition, our audit will be conducted in accordance with standards for financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States. The audit of the financial statements or Schedules does not relieve you of your responsibilities and does not relieve management of their responsibilities. The engagement letter, a copy of which has been made available to you, includes specific details regarding the auditor's and management's responsibilities.

### **Overall Audit Strategy and Planned Scope**

Overall, our audit strategy is to assess the risks of material misstatement of the financial statements and Schedules, whether due to fraud or error, and design further audit procedures responsive to assessed risks. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements and Schedules. In connection with our audits, we will obtain a sufficient understanding of the System's internal control to plan the audits of the financial statements and Schedules. However, such understanding is required for the purposes of determining our audit procedures and not to provide any assurance concerning such internal control. In addition, *Government Auditing Standards* also require that we consider compliance with provisions of laws, regulations, contracts, or grant agreements that could have a material effect on the financial statements or Schedules.

We focus on areas with higher risk of material misstatement (whether due to error or fraud). Our audit strategy includes consideration of:

- a) Prior year audit results together with current year preliminary analytical review, including discussions with management and those charged with governance regarding the System's operations.
- b) Inherent risk within the System, (i.e., the susceptibility of the financial statements or Schedules to material error or fraud before recognizing the effectiveness of the control systems.)
- c) Recent developments within global capital markets, regulatory environment and general economic conditions.
- d) Recently issued and effective accounting and financial reporting guidance,
- e) The System's significant accounting policies and procedures, including those requiring significant management judgments and estimates and those related to significant unusual transactions.
- f) The control environment, risk management and monitoring processes, and the possibility that the control systems and procedures may fail to prevent or detect a material error or fraud. We



- intend to place reliance on internal controls, where applicable, in determining the degree of detailed substantive testing required.
- g) Information about systems and the computer environment in which the related systems operate, including those operations at the System's key service providers such as third-party administrators and custodial banks as reported in their service auditor reports.
  - h) A continual assessment of materiality thresholds based upon qualitative and quantitative factors affecting the System.
  - i) Review of predecessor auditor work papers for prior year audit results along with interim results, including discussions with management and the Risk and Audit Committee regarding the System's operations and risks.
  - j) Results of the work of the System's internal audit function and discussion with those personnel.

Based upon our initial assessment, our audit will entail a combination of reviewing controls and testing internal controls for reliance and substantive testing. The primary areas of focus in our overall audit strategy include the following risks and select example procedures to address risks in those areas:

Fraud Risk, including Management Override of Internal Control Over Financial Reporting - review internal control procedures, inquire of System personnel including those outside accounting, send external confirmations, review tip-line activity, test journal entries, etc.

Information Systems - identify all systems relevant to the financial reporting process, review the design and implementation of logical access and change management controls, review user control considerations for interacting with key service providers' information systems, etc.

Investments and Related Income and Disclosures - (specifically for Level 3 and NAV investments) confirm holdings with investment managers, obtain audited statements and retrospectively review compared to interim financial reports, perform rollforward procedures on lag reporting period, test valuation models, test a sample investment proceeds, assess adequacy of disclosures consistent with GASB 40 and 72, etc.

Pension and Other Postemployment Benefits Liabilities and Related Disclosures - Test samples of underlying census data for completeness and accuracy, use in-house actuarial professionals to evaluate reasonableness of assumptions based on published data and most recent experience study, perform certain recalculations including modeling long term rate of return and sufficiency of net position calculations, etc.

Plan Contributions and Premiums - Send confirmations for select employer and member contributions, test sample of recorded contributions for a given period based on recalculations of required contribution rates, test sample of recorded premiums for existence and accuracy, use data analytics software to identify contribution anomalies for investigation, etc.

Plan Benefit Payments and Claims - Test a sample of benefit payments for consistency with plan provisions, test sample of claims for completeness and accuracy, use data analytics software to identify benefit payment trend anomalies for investigation, etc.

Our audit strategy involves extensive partner and manager involvement in all aspects of the planning and execution of the audit. Our goals include focusing resources on high risk areas and other areas of concern for management and the Risk and Audit Committee.

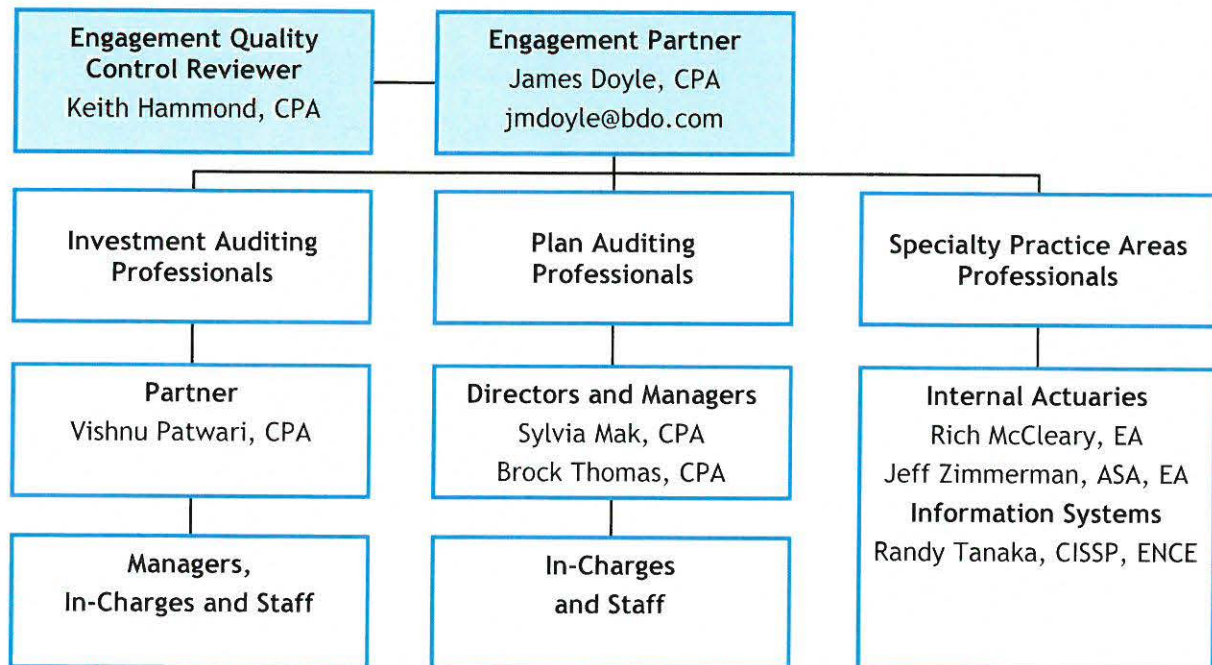


## Overall Audit Timeline

Key Task	Proposed Timing
Periodic Meetings and Discussions with Management and Risk and Audit Committee	June 2019 through January 2020
Review Predecessor Auditor Working Papers	June 2019
Develop Audit Strategy, and Determine Nature and Scope of Testing	June through August 2019
Substantive Testing - Financial Statements	July through October 2019
Review Draft Financial Statements / CAFR	October and November 2019
Final Communications with Risk and Audit Committee	November 2019
GASB 68 & 75 Schedules - Incremental Testing and Reports	August 2019 through January 2020

## Client Service Team

We have developed a client service team that with professionals that can address the complexities of the System, ensuring the appropriate individuals to be assigned to the engagement based on particular experience, expertise, and engagement needs. Also included is the contact information for the engagement partner responsible





### Independence Communication

Our engagement letter to you dated June 7, 2019 describes our responsibilities in accordance with professional standards and certain regulatory authorities with regard to independence and the performance of our services. This letter also stipulates the responsibilities of the System with respect to independence as agreed to by the System. Please refer to that letter for further information.

### Significant Accounting and Reporting Matters

Throughout the course of our contract, we'll communicate with management and the Risk and Audit Committee about significant accounting matters, including new accounting standards applicable to the System. During audit wrap up, we will discuss GASB Statement No. 87, Leases and the applicability to the System's leases (field office space, etc.).

We are pleased to be of service to the System and look forward to answering questions you may have regarding our audit plan as well as other matters that may be of interest to you when we meet in person on June 18, 2019.

Respectfully,

*BDO USA, LLP*