

Report to the Risk & Audit Committee

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Audit Plan
Year Ending June 30, 2020

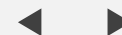


Contents

QUICK ACCESS TO THE FULL REPORT

<u>CLIENT SERVICE TEAM</u>	3
<u>SCOPE OF SERVICES, RESPONSIBILITIES, AND INDEPENDENCE</u>	5
<u>AUDIT TIMELINE</u>	10
<u>AUDIT STRATEGY</u>	12
<u>AUDIT AREAS OF FOCUS</u>	16
<u>PREPARING FOR AND RESPONDING TO COVID-19</u>	18
<u>RECENT DEVELOPMENTS IN ACCOUNTING AND FINANCIAL REPORTING</u>	22

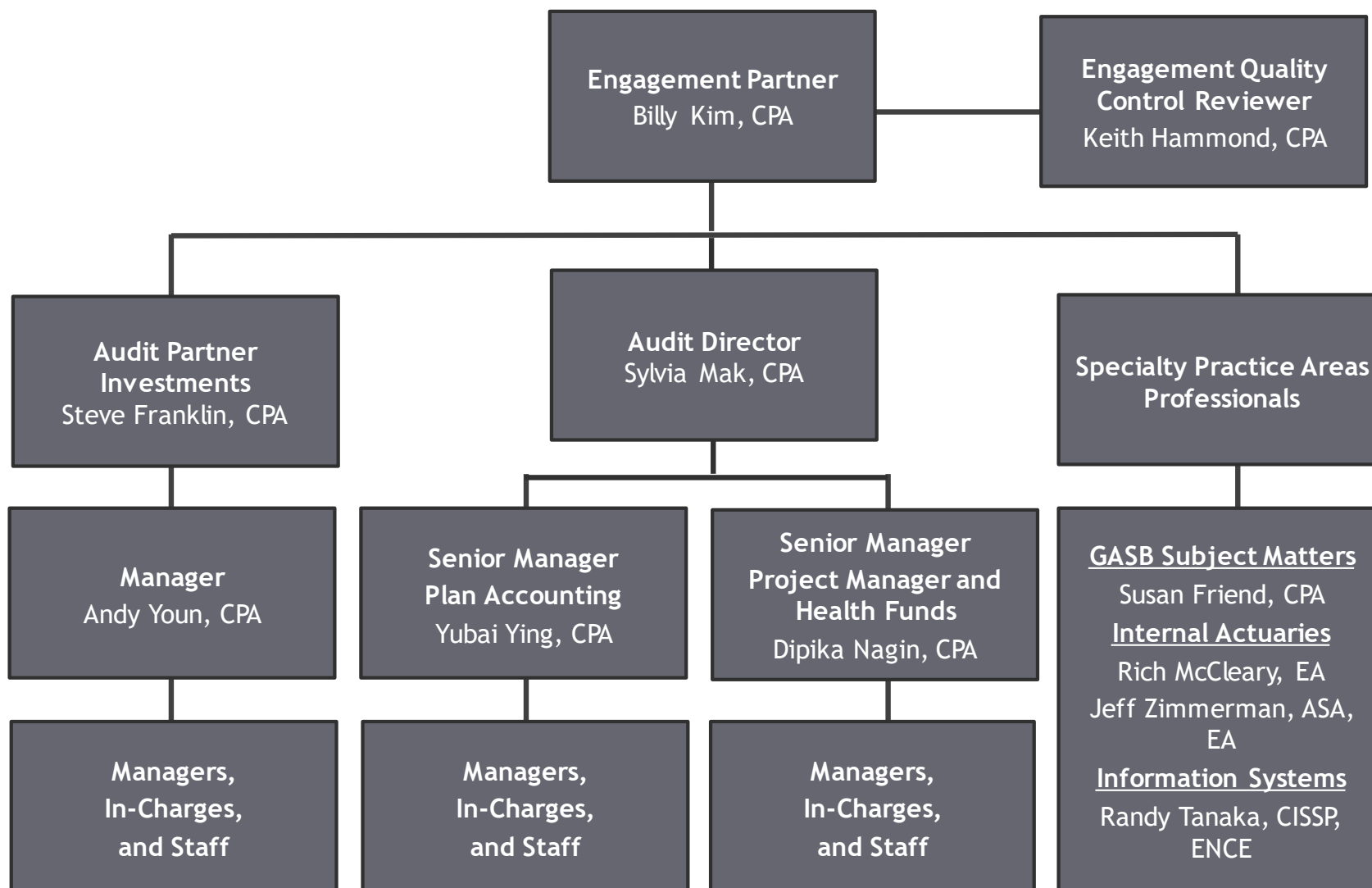
The following communication was prepared as part of our audit, has consequential limitations, and is intended solely for the information and use by those charged with governance, the Board of Administration and the Risk & Audit Committee, and, if appropriate, management of the System and is not intended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



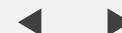
Client Service Team

Client Service Team

We have developed a client service team with professionals that can address the complexities of the system, ensuring the appropriate individuals are assigned to the engagement based on particular experience, expertise and engagement needs.



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Scope of Services, Responsibilities, and Independence

Scope of Services

SCOPE OF SERVICES

- ▶ Audit of the basic financial statements of the fiduciary and proprietary activities of the California Public Employees' Retirement System ("System") as of and for the year ending June 30, 2020.
- ▶ Audit of specified elements within the CalPERS GASB 68 pension and GASB 75 other post-employment benefit schedules.

DELIVERABLES

- ▶ Independent Auditor's Report on the basic financial statements for inclusion in the CAFR
- ▶ Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*
- ▶ Reports over the GASB 68 and 75 Schedules ("Schedules").
- ▶ Required Communications to the Risk & Audit Committee
- ▶ Management comments and recommendation letter

Responsibilities

MANAGEMENT'S RESPONSIBILITIES

- ▶ For the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America.
- ▶ For the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to error or fraud.
- ▶ To provide us with:
 - Access to all information of which you are aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters.
 - Written representations at the conclusion of the engagement.
 - Full cooperation of and unrestricted access to personnel at participating employers as we deem necessary.

RESPONSIBILITIES OF THE RISK AND AUDIT COMMITTEE

- ▶ Oversight of the financial reporting process and internal controls over financial reporting.
- ▶ Oversight of the establishment and maintenance by management of programs and controls designed to prevent, deter, and detect fraud.

RESPONSIBILITIES OF MANAGEMENT AND THE RISK AND AUDIT COMMITTEE

- ▶ Setting the proper tone and creating and maintaining a culture of honesty and high ethical standards.
- ▶ Ensuring that the System's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in the System's financial statements.

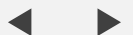
Responsibilities

RESPONSIBILITIES OF BDO

- ▶ 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.
- ▶ Performing an audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting.
- ▶ The engagement letter, a copy of which has been provided to you, includes specific details and full list of responsibilities regarding the auditor's and management's responsibilities.

Independence

Our engagement letter to you dated February 20, 2020 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.

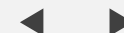


Audit Timeline

Overall Audit Timeline

The following represents our anticipated schedule with regard to our audit of the basic financial statements of the System and the Schedules:

	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Periodic Meetings and Discussions With Management	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Walkthrough and Interim Testing	✓	✓	✓							
Develop Audit Strategy, and Determine Nature and Scope of Testing	✓	✓	✓	✓	✓					
Substantive Testing (confirmation procedures, etc.)					✓	✓	✓			
Review Draft Financial Statements / CAFR							✓	✓		
Final Communications with Risk & Audit Committee								✓		
GASB 68 & 75 Schedules - Incremental Testing and Reports					✓	✓	✓	✓	✓	



Audit Strategy

Audit Strategy

Our establishment and understanding of the terms of the audit engagement have been documented in our engagement letter and include the objectives of the audit along with the responsibilities of both the auditor and of management for your reference.

Key components of our audit objectives and strategy are highlighted and explained on the following pages.

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 audit, we will obtain a sufficient understanding of the System's internal control to plan the audit 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 will continue to update the resulting assessment throughout the audit.



Audit Strategy Considerations

Overall, our audit strategy is to focus on elevated risk areas for the potential of material misstatement (whether due to error or fraud) and other areas of concern for management and the Risk and Audit Committee.

Our audit strategy includes consideration of:

- ▶ Prior year audit results together with the current year preliminary analytical review, including discussions with management and those charged with governance regarding the System's operations.
- ▶ Inherent risk within the System (i.e., the susceptibility of the financial statements to material error or fraud) before recognizing the effectiveness of the control systems.
- ▶ A continual assessment of materiality thresholds based upon qualitative and quantitative factors affecting the System.
- ▶ Recent developments within the industry, regulatory environment, and general economic conditions.
- ▶ Recently issued and effective accounting and financial reporting guidance.
- ▶ The System's significant and critical accounting policies and procedures, including those requiring significant management judgments and estimates and those related to significant unusual transactions.
- ▶ 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.
- ▶ Information about systems and the computer environment in which financial records and 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.
- ▶ Results of the work of the System's internal audit function and discussion with those personnel.
- ▶ Extent to which we plan to use others, outside the core engagement team, to perform certain planned audit procedures or evaluate audit results related to significant risks that may require specialized skills or knowledge.

Updates to the Audit Strategy

Audit planning is a collaborative and continuous process and our audit strategy, as reflected, will be reviewed and updated as our audit progresses.

We will communicate to the Risk and Audit Committee, in a timely manner, any significant changes to the planned audit strategy or the significant risks initially identified that may occur during the audit to the results of audit procedures or in response to external factors, such as changes in the economic environment.

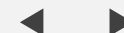
Changes to the audit risks identified, their classification, or the planned audit approach from prior year have been highlighted within the following Audit Areas of Focus.

Audit Areas of Focus

Audit Areas of Focus

Based upon our initial assessment, our audit will entail a combination of review of controls, and substantive testing. The primary areas of focus in our overall audit strategy and select example procedures, include the following:

Areas of Focus	Discussion
Fraud Risk, including Management Override of Internal Control Over Financial Reporting	Review of internal control procedures, inquiry of System personnel including those outside accounting, sending external confirmations, review of tip-line activity, and testing of journal entries.
Investments and Related Income and Disclosures	Confirmation of holdings with custodians and investment managers, obtaining audited statements and retrospective review compared to interim financial reports, performing rollforward testing procedures on lag reporting period, testing valuation models, testing a sample investment proceeds, and assessing adequacy of disclosures consistent with GASB 40 and 72.
Long Term Care Liability for Future Policy Benefits	Review of actuarial valuation report including assumptions, testing rollforward activity for the year, and testing samples of underlying census data for completeness and accuracy that support the valuations.
Health Care Estimated Insurance Claims Due	Testing a sample of claims for accuracy, retrospective review of the prior year Incurred but not reported (IBNR) reserve, recalculation of the liability amounts, etc.
Pension and Other Postemployment Benefit Liabilities and Related Disclosures	Testing samples of underlying census data for completeness and accuracy, using in-house actuarial professionals to evaluate reasonableness of assumptions based on published data and most recent experience study, performing certain recalculations including modeling long term rate of return and sufficiency of net position calculations, etc.
Plan Contributions	Testing a sample of recorded contributions for a given period based on recalculations of required contribution Rates, and using analytical procedures to identify contribution anomalies for investigation.
Plan Benefit Payments	Testing a sample of benefit payments for consistency with plan provisions, and using analytical procedures to identify benefit payment trend anomalies for investigation.
Premium Revenues	Testing a sample of premium revenues for existence, completeness and accuracy and performing procedures to test for revenue cut off.
Information Systems	Identifying all systems relevant to the financial reporting process, reviewing the design and implementation of logical access and change management controls, and reviewing user control considerations for interacting with key service providers' information systems.



Preparing for and Responding to COVID-19

Preparing for and Responding to COVID-19

GENERAL CONSIDERATIONS TO ENTITIES PREPARING FOR THE IMPACTS OF COVID-19

THE COVID-19 OUTBREAK COULD HAVE A DIRECT AND LASTING IMPACT ON ORGANIZATIONS OF ALL SIZES.

As the number of novel coronavirus (COVID-19) cases continue to climb both in the U.S. and across the globe, individuals and companies alike are taking steps to navigate this public health emergency.

What does a pandemic mean for your organization, and for you? While it's still difficult to predict the full extent of the impact of COVID-19, BDO is closely monitoring this rapidly evolving situation, offering guidance to help you through this time of uncertainty.

BDO will continue to curate and develop resources to educate and assist clients and friends of the firm during this uncertain time. Please visit our [COVID-19 resource center](#) for details.

GENERAL RECOMMENDATIONS TO ENTITIES RESPONDING TO COVID-19: CONTINGENCY PLANNING TOPICS

- ▶ Plans to ensure the wellbeing of their professionals and stakeholders
- ▶ Crisis management roles and responsibilities between the board and management team
- ▶ Risk assessment and response to disruptions in all phases of product procurement, development and delivery
- ▶ Financial management, liquidity and sustainability impacts
- ▶ Adequacy of financial reporting and disclosures to convey risk
- ▶ Increased cybersecurity and data privacy considerations as more individuals telework
- ▶ Considerations to modify pay plans as short-term responsive measures
- ▶ Ability to provide timely financial information
- ▶ Industry-specific risk mitigation plans (e.g.; contracts, supply chain, technology)

Preparing for and Responding to COVID-19

GENERAL RECOMMENDATIONS TO ENTITIES RESPONDING TO COVID-19: BOARD RISK ASSESSMENT, PREPAREDNESS AND PRACTICAL CONSIDERATIONS

- ▶ Assess organization exposure and potential financial, operational and strategic impacts
- ▶ Define crisis-response roles and responsibilities for the board and management
- ▶ Ensure effective management reporting to the board during times of crisis
- ▶ Evaluate management's internal communications strategy
- ▶ Address the challenges of providing external stakeholders with accurate information as the crisis is evolving
- ▶ Plan to hold board and stakeholder meetings remotely
- ▶ Be active in oversight but resist urge to "manage"
- ▶ Plan for resiliency and build trust via commitment to organization's purpose and stakeholders
- ▶ Continually communicate

Preparing for and Responding to COVID-19

COVID-19: FINANCIAL STATEMENT IMPACT

JANUARY 31, 2020 YEAR END AND LATER FINANCIAL STATEMENTS

Treat COVID-19 as a “recognized” event, and incorporate the effects in the financial statements, including recognition, measurement, and disclosure.

- ▶ If the effects on the are material, and significant to users’ understanding of the financial statements, auditors will likely consider adding an emphasis of matter (EOM) paragraph to the opinion on the financial statements.

Additional Questions for Audit Committees to consider:

- ▶ Have changes in alternative work methods caused by COVID-19 negatively impacted controls over financial reporting, impacted ability to obtain information or access to audit evidence?
- ▶ Has COVID-19 resulted in any changes to the audit strategy, risk assessment or controls to assess such?
- ▶ Has COVID-19 required any consequential changes in level of effort by management and the internal and external auditors?
- ▶ What impact does the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act have on the organization?

Recent Developments In Accounting and Financial Reporting

GASB Exposure Draft Issued to Postpone Effective Dates of Certain Pronouncements

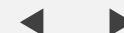
In light of the COVID-19 Pandemic, the GASB issued the Exposure Draft, [Postponement of the Effective Dates of Certain Authoritative Guidance](#), to provide relief to governments. This proposal would postpone the effective dates of the provisions in the following pronouncements by one year:

- Statement No. 83, Certain Asset Retirement Obligations
- Statement No. 84, Fiduciary Activities
- Statement No. 87, Leases
- Statement No. 88, Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements
- Statement No. 89, Accounting for Interest Cost Incurred before the End of a Construction Period
- Statement No. 90, Majority Equity Interests
- Statement No. 91, Conduit Debt Obligations
- Statement No. 92, Omnibus 2020, paragraphs 6-10 and 12
- Statement No. 93, Replacement of interbank Offered Rates, paragraphs 13 and 14

The provision in the following implementation guides has also been postponed by one year:

- Implementation Guide No. 2017-3, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (and Certain Issues Related to OPEB Plan Reporting), Questions 4.85, 4.103, 4.108, 4.109, 4.225, 4.239, 4.244, 4.245, 4.484, 4.491, and 5.1-5.4
- Implementation Guide No. 2018-1, Implementation Guidance Update—2018
- Implementation Guide No. 2019-1, Implementation Guidance Update—2019
- Implementation Guide No. 2019-2, Fiduciary Activities
- Implementation Guide No. 2019-3, Leases

The GASB is expediting their schedule to issue this guidance as quickly as possible and anticipates issuance in early May 2020. The requirements of this Statement are effective immediately upon issuance. Earlier application is encouraged and is permitted to the extent specified in each pronouncement as originally issued.



GASB Pronouncements

GASB STATEMENT NO. 87, LEASES - EFFECTIVE FOR REPORTING PERIODS BEGINNING AFTER DECEMBER 15, 2019 AND IF POSTPONED, IT WILL BE FOR ONE YEAR

- ▶ This standard will require recognition of certain lease assets and liabilities for leases that are currently classified as operating leases.
- ▶ New definition of a lease - a contract that conveys the right to use another entity's nonfinancial asset for a period in an exchange or exchange-like transaction.
- ▶ Eliminates the distinction between operating and capital leases.
- ▶ Excludes short-term leases.
- ▶ Excludes leases that transfer ownership and service concession arrangements that are covered by GASB Statement No. 60.
- ▶ Lessees would recognize a lease liability and an intangible right-to-use lease asset which would be amortized in a systematic and reasonable manner over the shorter of the lease term or the useful life of the underlying asset.
- ▶ Lessors would recognize lease receivable and deferred inflow of resources which would be recognized as revenue in a systematic and rational manner over the term of the lease.

GASB STATEMENT NO. 92, OMNIBUS 2020, EFFECTIVE AS NOTED BELOW

This Statement addresses and clarifies a variety of topics and as an example includes the following:

The effective date for interim financial reporting of Statement No. 87, Leases, and Implementation Guide No. 2019-3, Leases, is for fiscal years beginning after December 15, 2019 (if postponed, it will be for one year).

GASB Pronouncements

GASB STATEMENT NO. 93, *REPLACEMENT OF INTERBANK OFFERED RATES*, EFFECTIVE AS NOTED BELOW

Effective for Reporting Periods Beginning After June 15, 2020 (if postponed, it will be for one year):

- ▶ Provides exceptions for certain hedging derivative instruments to the hedge accounting termination provisions when an IBOR is replaced as the reference rate of the hedging derivative instrument's variable payment.
- ▶ Clarifies the hedge accounting termination provisions when a hedged item is amended to replace the reference rate.
- ▶ Clarifies that the uncertainty related to the continued availability of interbank offered rates (IBORs) does not, by itself, affect the assessment of whether the occurrence of a hedged expected transaction is probable.
- ▶ Identifies a Secured Overnight Financing Rate and the Effective Federal Funds Rate as appropriate benchmark interest rates for the qualitative evaluation of the effectiveness of an interest rate swap.
- ▶ Clarifies the definition of reference rate, as it is used in Statement 53, as amended.
- ▶ Provides an exception to the lease modifications guidance in Statement 87, as amended, for certain lease contracts that are amended solely to replace an IBOR as the rate upon which variable payments depend.

Effective for Reporting Periods Ending After December 31, 2021 (if postponed, it will be for one year):

- ▶ Removes LIBOR as an appropriate benchmark interest rate for the qualitative evaluation of the effectiveness of an interest rate swap.

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