



State of California

Report on Pension Amounts
Fiscal Year Ended June 30, 2014

Report 2015-001.2

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January 22, 2016

2015-001.2

Honorable Betty T. Yee, State Controller
Office of the State Controller
300 Capitol Mall, Suite 1850
Sacramento, California 95814

Dear Controller Yee:

The State Auditor's Office presents its Independent Auditor's Report on the California State Controller's Schedule of Pensionable Compensation by Plan, Schedule of Pension Amounts by Plan, and the related notes for the State Miscellaneous and State Peace Officers and Firefighters plans administered by the California Public Employees' Retirement System, as of and for the year ended June 30, 2014. The schedules provide certain state entities and their auditors with information related to the Governmental Accounting Standards Board Statement No. 68, Accounting and Financial Reporting for Pensions. The schedules and the related notes are presented in conformity with accounting principles generally accepted in the United States of America.

Our report is intended solely for the parties included in the restriction of use paragraph contained in the Independent Auditor's Report and is not intended to be and should not be used by anyone other than these specified parties.

We conducted the audit to comply with the California Government Code, Section 8546.4.

Respectfully submitted,



JOHN F. COLLINS II, CPA
Deputy State Auditor

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Contents

Independent Auditor's Report	1
<i>Schedules by Plan</i>	3
Schedule of Pensionable Compensation by Plan	4
Schedule of Pension Amounts by Plan	5
<i>Notes to the Schedules</i>	7
Notes to the Schedules	8

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Independent Auditor's Report

THE LEGISLATURE OF THE STATE OF CALIFORNIA
AND THE CALIFORNIA STATE CONTROLLER'S OFFICE

We have audited the accompanying Schedule of Pensionable Compensation by Plan for the State Miscellaneous and State Peace Officers and Firefighters plans administered by the California Public Employees' Retirement System, for the year ended June 30, 2014. We have also audited the captions for the two plans titled net pension liability, as of June 30, 2013; net pension liability, as of June 30, 2014; total deferred outflows of resources, total deferred inflows of resources, and total pension expense included in the accompanying Schedule of Pension Amounts by Plan as of and for the year ended June 30, 2014, and the related notes to the schedules.

Management's Responsibility for the Schedules

Management is responsible for the preparation and fair presentation of these schedules in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the schedules that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on the schedules based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the schedules are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the schedules. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the schedules, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the schedules in order to design 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. Accordingly, we express no such opinion. 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 schedules.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the schedules referred to above present fairly, in all material respects, the pensionable compensation for the State Miscellaneous and State Peace Officers and Firefighters plans for the year ended June 30, 2014; net pension liability, as of June 30, 2013; net pension liability, as of June 30, 2014; total deferred outflows of resources, total deferred inflows of resources, and total pension expense for the State Miscellaneous and State Peace Officers and Firefighters plans as of and for the year ended June 30, 2014, in accordance with accounting principles generally accepted in the United States of America.

Other Matter

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America, the financial statements of the State of California as of and for the year ended June 30, 2014, and our report thereon, dated March 19, 2015, expressed an unmodified opinion on those financial statements.

Restriction on Use

Our report is intended solely for the information and use of the California State Controller's Office, the California Public Employees' Retirement System, State Miscellaneous Plan and State Peace Officers and Firefighters Plan employers and their auditors and is not intended to be and should not be used by anyone other than these specified parties.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 19, 2015 on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the fiscal year ended June 30, 2014. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State's internal control over financial reporting and compliance.

CALIFORNIA STATE AUDITOR



JOHN F. COLLINS II, CPA
Deputy State Auditor

January 19, 2016

Schedules by Plan



Schedule of Pensionable Compensation by Plan

For the Year Ended June 30, 2014

<u>Plans</u>	<u>Pensionable Compensation</u>
State Miscellaneous (Tier 1 & 2)	<u>\$ 10,019,739,286</u>
State Peace Officers and Firefighters	<u>\$ 3,030,525,435</u>

Schedule of Pension Amounts by Plan

As of and For the Year Ended June 30, 2014

(amounts in thousands)

	Plans	
	State Miscellaneous	State Peace Officers and Firefighters
Net Pension Liability, as of June 30, 2013	\$ 28,867,495	\$ 11,942,161
Net Pension Liability, as of June 30, 2014	23,808,612	10,158,286
Increase (decrease) in the Net Pension Liability	<u>\$ (5,058,883)</u>	<u>\$ (1,783,875)</u>
Deferred Outflows of Resources: ^{1,2}		
Differences between expected and actual experience	\$ —	\$ —
Changes in assumptions	—	—
Differences between projected and actual earnings on plan investments ³	—	—
Total Deferred Outflows of Resources	<u>\$ —</u>	<u>\$ —</u>
Deferred Inflows of Resources: ²		
Differences between expected and actual experience	\$ —	\$ —
Changes in assumptions	—	—
Differences between projected and actual earnings on plan investments ³	4,701,748	1,797,622
Total Deferred Inflows of Resources	<u>\$ 4,701,748</u>	<u>\$ 1,797,622</u>
Total Pension Expense	<u>\$ 1,799,177</u>	<u>\$ 973,488</u>

¹ This schedule does not include deferred outflows of resources for employer contributions made subsequent to the measurement date.

² This schedule does not include deferred outflows and inflows of resources for changes in the employers' proportionate share of pensionable compensation made subsequent to the measurement date.

³ Deferred outflows and inflows of resources related to differences between projected and actual earnings on plan investments are netted and amortized over a closed 5-year period.

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Notes to the Schedules



Notes to the Schedules

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Schedule of Pensionable Compensation by Plan and the Schedule of Pension Amounts by Plan (Schedules) present selected information for the State Miscellaneous Plan and the State Peace Officers and Firefighters Plan (Plans), administered by California Public Employees' Retirement System (CalPERS). Accordingly, the information contained in the Schedules does not purport to be a complete presentation of the Fiduciary Net Position or the changes in Fiduciary Net Position of the Plans. The Schedules are prepared using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Such preparation requires the California State Controller's Office to make a number of estimates and assumptions related to the reported amounts and disclosures. Due to the inherent nature of these estimates, actual results could differ.

The Schedule of Pension Amounts by Plan excludes amounts that are entity-specific deferred outflows of resources that may need to be recognized in accordance with Governmental Accounting Standards Board Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, specifically, those amounts that may be required in accordance with paragraph 3 of Statement No. 71.

NOTE 2: PENSIONABLE COMPENSATION

The Schedule of Pensionable Compensation by Plan is prepared to provide state entities with the total pensionable compensation amounts. These amounts were used to calculate state entities' proportionate share of pension amounts. The Schedule of Pensionable Compensation by Plan and the Schedule of Pension Amounts by Plan have the same measurement period of July 1, 2013, through June 30, 2014.

NOTE 3: NET PENSION LIABILITY

The following table shows the components of the net pension liability for the Plans as of June 30, 2014 (amounts in thousands):

Net Pension Liability Components	State Miscellaneous Plan	State Peace Officers and Firefighters Plan
Total Pension Liability	\$ 92,189,174	\$ 36,526,275
Less: Fiduciary Net Position	(68,380,562)	(26,367,989)
Net Pension Liability	\$ 23,808,612	\$ 10,158,286

NOTE 4: ACTUARIAL METHODS AND ASSUMPTIONS

For the measurement period ended June 30, 2014 (the measurement date), the total pension liability was determined by rolling forward the June 30, 2013 total pension liability. The June 30, 2013 and June 30, 2014 total pension liabilities for the Plans were based on the following actuarial methods and assumptions:

Valuation Date:	June 30, 2013
Actuarial Cost Method:	Entry Age Normal in accordance with the requirements of GASB Statement No. 68
Actuarial Assumptions	
Discount Rate:	7.65%
Inflation:	2.75%
Salary Increases:	Varies by Entry Age and Service
Investment Rate of Return:	7.65% Net of Pension Plan Investment Expense but without reduction for Administrative Expenses; includes Inflation
Mortality Rate Table:	Derived using CalPERS' Membership Data for all Funds
Post Retirement Benefit Increase:	Contract COLA up to 2.75% until Purchasing Power Protection Allowance floor on purchasing power applies

The mortality table used was developed based on CalPERS' specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on this table, please refer to the 2014 CalPERS Experience Study and Review of Actuarial Assumptions report (Experience Study).

All other actuarial assumptions used in the June 30, 2013 valuation were based on the results of an actuarial experience study for the period from 1997 to 2011, including updates to salary increase, mortality, and retirement rates. The Experience Study report can be obtained from CalPERS' website at www.CalPERS.ca.gov.

NOTE 5: DISCOUNT RATE

The discount rate used to measure the total pension liability was 7.65%. To determine whether the municipal bond rate should be used in the calculation of a discount rate for each plan, CalPERS stress tested plans that would most likely result in a discount rate that would differ from the actuarially assumed discount rate. Based on the testing, none of the tested plans exhaust assets. Therefore, the current 7.65% discount rate is adequate and the use of the municipal bond rate calculation is not necessary. The long-term expected discount rate of 7.65% is applied to both plans. The stress test results are presented in the GASB Crossover Testing Report, which may be obtained from CalPERS' website.

CalPERS is scheduled to review all actuarial assumptions as part of its regular Asset Liability Management review cycle, which is scheduled to be completed in February 2018. Any changes to the discount rate will require action on the part of CalPERS' Board of Administration and proper stakeholder outreach.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense but without reduction for administrative expenses; includes inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Such cash flows were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years. Using historical returns of all the funds’ asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

The following table reflects long-term expected real rates of return by asset class.

<u>Asset Class</u>	<u>Strategic Allocation</u>	<u>Real Return Years 1-10</u>	<u>Real Return Years 11+</u>
Global Equity	47.0 %	5.25 %	5.71
Global Fixed Income	19.0	0.99	2.43
Inflation Sensitive	6.0	0.45	3.36
Private Equity	12.0	6.83	6.95
Real Estate	11.0	4.50	5.13
Infrastructure and Forestland	3.0	4.50	5.09
Liquidity	2.0	(0.55)	(1.05)

The Real Return Years 1-10 used an expected inflation rate of 2.5% for this period. The Real Return Years 11+ used an expected inflation rate of 3.0% for this period.

NOTE 6: PENSION EXPENSE, DEFERRED OUTFLOWS OF RESOURCES AND DEFERRED INFLOWS OF RESOURCES RELATED TO PENSIONS

For the fiscal year ended June 30, 2014, for both Plans, deferred inflows of resources are recognized only for the differences between projected and actual earnings on plan investments. Deferred outflows of resources due to contributions subsequent to the measurement date are not included in the table below. No other deferred outflows of resources are recognized for the fiscal year ended June 30, 2014 (amounts in thousands):

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
State Miscellaneous Plan	\$ —	\$ 4,701,748
State Peace Officers and Firefighters Plan	\$ —	\$ 1,797,622

Amounts reported as deferred inflows of resources related to pensions will be recognized in pension expense as either a debit or a (credit) in the future as follows (amounts in thousands):

	<u>State Miscellaneous Plan</u>	<u>State Peace Officers and Firefighters Plan</u>
Year Ended June 30,		
2015	\$ (1,175,437)	\$ (449,406)
2016	(1,175,437)	(449,406)
2017	(1,175,437)	(449,405)
2018	(1,175,437)	(449,405)
2019	-	-
Thereafter	-	-
Total	<u>\$ (4,701,748)</u>	<u>\$ (1,797,622)</u>

For the fiscal year ended June 30, 2014, the amounts recognized as components of pension expense for each of the Plans were as follows (amounts in thousands):

<u>Description</u>	<u>State Miscellaneous Plan</u>	<u>State Peace Officers and Firefighters Plan</u>
Service Cost	\$ 1,477,762	\$ 816,836
Interest on the Total Pension Liability	6,670,928	2,622,406
Changes of Benefit Terms	-	-
Recognized Differences between Expected and Actual Experience	-	-
Recognized Changes of Assumptions	-	-
Employee Contributions	(766,896)	(331,956)
Projected Earnings on Pension Plan Investments	(4,493,653)	(1,717,726)
Recognized Differences between Projected and Actual Earnings on Plan Investments ..	(1,175,437)	(449,406)
Administrative Expense	86,473	33,334
Other Changes in Fiduciary Net Position	-	-
Total Pension Expense/(Income)	<u>\$ 1,799,177</u>	<u>\$ 973,488</u>

Detailed information about each of the Plans' fiduciary net position is available in the separately issued CalPERS reports.

NOTE 7: SENSITIVITY OF THE NET PENSION LIABILITY TO CHANGES IN THE DISCOUNT RATE

The following table presents the net pension liability of the Plans as of the measurement date, calculated using the discount rate of 7.65%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.65%) or 1 percentage-point higher (8.65%) than the current rate (amounts in thousands):

	Current Rate -1%	Current Rate (7.65%)	Current Rate +1%
State Miscellaneous Plan			
Net Pension Liability/(Asset)	\$ 35,024,779	\$ 23,808,612	\$ 14,184,286
State Peace Officers and Firefighters Plan			
Net Pension Liability/(Asset)	\$ 15,304,428	\$ 10,158,286	\$ 5,835,514

We conducted this audit to comply with Section 8546.4 of the California Government Code. The Independent Auditor's Report provides the opinions we expressed on the Schedule of Pensionable Compensation by Plan, Schedule of Pension Amounts by Plan, and the related notes.

Respectfully submitted,



JOHN F. COLLINS II, CPA
Deputy State Auditor

Date: January 22, 2016

Project Manager: Nicholas Kolitsos, CPA, Audit Principal

Team Lead: Lisa Ayrapetyan, CPA, CIA

Staff: Reed Adam
Laurence Ardi, CFE
Ryan Mooney
Hunter Wang

IT Audit Support: Michelle J. Baur, CISA, Audit Principal
Ben Ward, CISA, ACDA
Amanda Garvin-Adicoff

Legal Counsel: Joseph L. Porche, Staff Counsel

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at (916) 445-0255.