

November 19, 2021

The Board of Administration  
California Public Employees' Retirement System  
400 Q Street  
Sacramento, CA 95811

Ladies and Gentlemen:

In planning and performing our audit of the financial statements of California Public Employees' Retirement System (CalPERS or the System) as of and for the year ended June 30, 2021, 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*, we considered the System's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the System's financial statements will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the second paragraph of this letter and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. We have identified certain deficiencies in internal control that we consider to be significant deficiencies as described in Appendix I.

This communication is intended solely for the information and use of management, the Board of Administration, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

We appreciate the outstanding cooperation from your staff that our personnel received during the audit of the System's basic financial statements.

Very truly yours,

(Signed BDO USA, LLP)

## Appendix I

### ***Current Year Internal Control - Significant Deficiencies***

We consider the following deficiencies to be significant deficiencies in internal control:

#### **Segregation of Duties Related to Oversight of Dormant Accounts**

Dormant accounts are those which have not had activity in over six months and the retiree has not been identified as deceased. We observed a lack of segregation of duties related to the oversight of the dormant accounts. Specifically, payments issued from dormant accounts can be requested and approved by the same individual. Additionally, the Warrant Administration team, who is responsible for processing distribution payments, can also make updates to the direct deposit information in retiree accounts during the payment reissuance process causing a segregation of duties conflict.

We recommend payments issued from dormant accounts be requested and approved by two different individuals. Furthermore, the team responsible for processing distribution payments should not also be responsible for making changes to direct deposit information in retiree accounts.

#### ***Management's Response***

Starting in April 2021, all dormant account reissues require an extra level of review by having reissued payments approved by the Retirement Benefit Services Division Assistant Division Chief or Division Chief. Changes will be made to myCalPERS to prevent a user requesting to reissue a payment from approving the payment as well. myCalPERS has been coded for this change, testing is in progress and is expected to be deployed in December 2021.

In addition, starting in July 2021, the process was changed so that the Warrant Administration team stopped making direct deposit account updates in myCalPERS. The Forms Administration Unit, who does not have access to reissue payments, enters direct deposit updates into myCalPERS when needed during the payment reissuance process. Further assessment is in progress to formally update the security roles in myCalPERS.

#### **Death Benefit Overpayment Receivables**

Death benefit overpayment receivables represent amounts owed to CalPERS due to payments made to members or beneficiaries who have since deceased. During the September 14, 2021 Risk and Audit Committee meeting, the CalPERS Office of Audit Services presented its findings over the effectiveness of controls over the death benefit overpayment receivables. The report included as Agenda Item 6a Attachment 2 to the September 14, 2021 Risk and Audit Committee meeting identified the following:

- Deaths were not consistently identified to timely minimize the issuance of benefit payments and related receivables
- Death benefit overpayment receivables were not consistently recorded within 30 days after the identification of death

- Certain lump sum survivor benefits were issued without first recovering the death benefit overpayment receivables owed to CalPERS
- Adequate attempts were not made to collect death benefit overpayment receivables from survivors, or, if available, the decedent's estate
- Death benefit overpayment receivables were not reviewed for timely write-off

*Management's Response*

See Agenda Item 6a Attachment 2 (pages 19-28) to the September 14, 2021 Risk and Audit Committee meeting for management's response.

***Current Year Internal Control - Control Deficiencies***

We have communicated to management of the System certain control deficiencies and operational observations that were identified as a result of our audit that we did not consider to be material weaknesses or significant deficiencies as follows:

**Review of Access Rights to Actuarial Valuation Systems (AVS)**

BDO observed that four members of the Actuarial Office (ACTO) have security administrative access to the Actuarial Valuation System (AVS). The security administrative access role provides users with the ability to add new users, remove users and edit user access.

We observed the users with security administrative access could change their own access levels or to switch access rights levels back and forth. This results in a segregation of duties conflict because it provides the individual with the potential ability to prepare and review an actuarial valuation report. Although CalPERS has a process to audit the user access logs every 6 months, it is being performed by a member of ACTO who has security administrative access, which also results in a segregation of duties conflict. Additionally, no audit is being performed of the database user access log to check for and investigate anomalies.

We recommend management remove the security administrative access role from active AVS users and have IT take over the user access provisioning. Additionally, it is recommended that the user access logs be audited by an individual who does not have security administrative access rights to AVS.

*Management's Response*

Starting in October 2021, the Information Technology (IT) Enterprise Solutions Development Division (ESDD) - Application Engineering & Architecture (AEA) team is responsible for user access provisioning. Access to the security administrative access role was removed from active Actuarial Office AVS users. Access requests to add new users, remove users, and edit user access will be made by the Actuarial Office through the ServiceNow system, which will be updated to accommodate these requests. User access changes will be updated in AVS by the IT AEA team as they are approved and received. The ServiceNow system keeps record of the access requests. The IT AEA team will also be responsible for the semi-annual review of the user access logs. The team member assigned to perform this review will not have security administrative access rights to AVS.

## Appendix II - Prior Year Control Deficiencies

The following control deficiency was communicated to management of the System in the previous fiscal year:

### Review of Financial Statement Classifications

BDO observed that a portion of the Government issued Treasury Bills that had short term maturities were inappropriately recorded in Global Debt Securities instead of Short-Term Investments. Also, BDO observed that a non-employer contribution made was classified inappropriately as an employer contribution. Although these classification errors were not material either quantitatively or qualitatively, both reclassifications were proposed by BDO and corrected by management. The errors appear to be as a result of a lack of internal control in place to review all financial statement categories for proper classification for financial reporting purposes. These errors and the subsequent corrections had no impact on total investments or total additions but only a change within the correct financial statement line item.

In order to record correct classification of each type of financial statement category, we recommend management implement a control during year end to review all financial statement categories to assess whether reclassifications are necessary including for investments and additions to ensure each financial statement area is properly classified.

#### *Management's Response*

Management was in a transition from the current trade and allocation service, to a new service, and the default settings had not yet been adjusted to align the Treasury Bill trades to be classified as Short-term Treasuries instead of Global Debt Securities. There is no user involvement with assigning the classification for each trade and this is an automated process. Since then, management has requested the new service, DTCC CTM, to send these trades with a Short-Term Treasury flag in their instructions in order to receive the accurate classification, when sent and recorded at State Street Bank. Management continues to work with the vendors to rectify any other situations where default settings may need to be updated.

With respect to the misclassified employer contribution, management concurs with the finding and will implement a process to identify additional or out-of-the-ordinary contributions prior to creating the financial statements to ensure proper classification. The process will be to add an additional item to our checklist for year end, it will entail a discussion with our pension accounting group about contributions. We will implement by September 2021.

#### *Management's Response FY 2021 Update*

The classification errors discovered during last year's closing of our books were all corrected and had no material effect on our statements. The Investment Office worked with State Street to record assets upon receipt and subsequent position categorization in Fund Accounting. These changes were implemented prior to the end of the fiscal year. As the independent verifier of investment holdings, the Financial Office has developed a process through Bloomberg to look up classifications separately at year end.

*BDO FY 2021 Update Response:*

Based on our audit procedures performed, we concur that this control observation was effectively remediated.

DRAFT