

November 20, 2020

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, 2020, 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.

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 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:

### **1. 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 nonemployer 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.

## Appendix II - Prior Year Control Deficiencies

The following control deficiencies were communicated to management of the System in the previous fiscal year:

### 1. Review of Estimated Claim Liabilities

The System's proprietary Health Claims Fund (HCF) records estimated claim liabilities including estimates of the ultimate claim costs that have been reported but not settled, and of claims that have been "incurred but not reported" (IBNR). During our audit, we noted that the System does not have a comprehensive review process over the completeness and accuracy of such claim liabilities. Part of this matter is related to a prior year finding where it was found that the System did not have access to and neither routinely reviewed nor reconciled the detail claims activity processed by the third-party administrators (TPAs) including what supports the IBNR liability for medical claims calculations to what was reflected in the books and records. In addition, there was no evidence that a retrospective analysis was performed to support the ongoing use of the System's estimate methodologies used.

We recommend that the System put in place a process that comprehensively reviews the IBNR estimates and the methodology used for reasonableness including for completeness and accuracy. Consistent with the prior year finding, the System should also review its oversight controls of the TPAs, reassess contract terms with the TPAs on claims information access and update its controls as deemed necessary. At a minimum, we would recommend that the System reconcile summary TPA claim activity to the detail claim activity on a regular basis.

#### *Management's Response*

Management concurs with the recommendation. The Health Plan Administration Division (HPAD) team completed and implemented Long Term Care Fund procedure and process changes for detailed claims reconciliation, effective January 2019 monthly financial activities. The HPAD team, in coordination with the State Controller's Office (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 was effective January 1, 2020.

#### *FY 2020 Update*

Management response to the FY17/18 and FY18/19 observation was completed and implemented by CalPERS as of January 2020.

#### *BDO Response*

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

## 2. PeopleSoft Developer Access (SOD)

In the prior year, we had observed that developers in PeopleSoft had access to the production environment, allowing them to bypass the program change management controls. As such, this posed as a potential segregation of duties issue.

### *Management's Response*

Management remediated the issue by removing developer access to the PeopleSoft production environment during the 2019-2020 year.

### *FY 2020 Update*

All developer's PeopleSoft FSCM production access was terminated on 11/19/2019 and Peoplesoft periodic user access control are designed to identify any potential segregation of duties matters going forward.

### *BDO response*

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