



Tel: 415-397-7900
Fax: 415-397-2161
www.bdo.com

Agenda Item 5b, Attachment 1

One Bush Street Suite 1800
San Francisco, CA 94104

November 22, 2024

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

To the Board of Administration,

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, 2024, 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,

Appendix I

Prior Year Control Deficiency

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

Automated Real Estate Investment System (AREIS) Database Administrator Access

BDO observed that seven developers of the Automated Real Estate Investment System (AREIS) have security administrative access to the database of AREIS. The database administrative access role provides users with the ability to deploy changes directly to the system without oversight.

We observed the users with database security administrative access have full access (read, write, and edit) to the database. This results in a segregation of duties conflict because it provides the individual with the potential ability to modify the report logic within the database without approval. Although CalPERS has segregated developers and deployers on the application level, having full access to the database can bypass the system functionality, which results in a segregation of duties conflict. Additionally, no audit is being performed of the system change log nor database log-in access report to check for and investigate anomalies.

Management has removed the developer group from the database. To strengthen the change management control environment, it is recommended that the change logs be reviewed on regular basis for appropriateness by an individual who does not have deploy access nor database rights to AREIS.

Management's Response

Management agrees with the observation and immediately removed access to the production database from the developer group. Going forward, to strengthen internal controls, changes logs will be reviewed on a systematic basis for appropriate access control.

Management's Response FY 2024 Update

Management concurs that this control deficiency was effectively remediated.

BDO FY 2024 Update Response

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

Prior Year Internal Control - Material Weakness

The following material weakness was communicated to management of the System in the previous fiscal year:

Long-Term Care Settlement Liability

Each year the System estimates the amount of liabilities associated with the long-term Care Fund future liabilities. Recently, there was a class action lawsuit settlement that impacted the probability, timing, and nature of those future liabilities. Generally accepted accounting principles require changes in estimates of claim costs to be recognized in the period those estimates are changed. In the draft financial statements, management's estimated long-term settlement liability balance was correct and supported, however the offsetting impact to other accounts as a result of changes were not.

BDO determined this error resulted from a material weakness in internal controls over financial reporting, specifically, the control surrounding reviewing the appropriate accounting and presentation of estimates related to the estimated settlement liability for the Long-Term Care Fund. The initial entry was recorded without properly considering all current information including details the settlement will have on future plan participation.

The error had a material effect on the financial statements of the Long-Term Care Fund and overstated the long-term future policy benefits liability and related expenses. The adjustment to correct the impact was proposed by BDO and corrected by management.

We recommend management implement a control for significant and unusual transactions where management ensures they obtain and consider all related information when assessing the appropriateness of accounting conclusions.

Management's Response

Management agrees with the observation and the entry to record the reduction in future benefits was included in the final financial statements. The timing of this transaction and the uncertainty in the legal outcomes created communication challenges that were not translated to the financial statements prior to audit review. To enhance internal controls going forward, Financial Reporting & Accounting Services (FRAS) will review any entries considered unusual to make sure all related information was considered within the transaction. If transactions are identified, FRAS will assess for proper classification and appropriately include the transactions in the year-end financial statements in accordance with accounting principles generally accepted in the United States of America.

Management's Response FY 2024 Update

Management concurs that this material weakness was effectively remediated.

BDO FY 2024 Update Response

Based on our audit procedures performed, we concur that this material weakness was effectively remediated.