

STATE OF RHODE ISLAND

Employees' Retirement System

Management Comments

FISCAL YEAR ENDED JUNE 30, 2022



David A. Bergantino, CPA, CFE, Interim Auditor General

Office of the Auditor General

General Assembly

State of Rhode Island



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February 1, 2023

JOINT COMMITTEE ON LEGISLATIVE SERVICES:

SPEAKER K. Joseph Shekarchi, Chairman

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Senator Jessica de la Cruz

Representative Christopher R. Blazewski

Representative Michael W. Chippendale

RETIREMENT BOARD OF THE EMPLOYEES' RETIREMENT SYSTEM OF THE
STATE OF RHODE ISLAND:

We have audited the financial statements of the Employees' Retirement System of the State of Rhode Island (the "System") for the year ended June 30, 2022 and have issued our report thereon dated December 28, 2022. The System's financial statements and our independent auditor's report thereon are included in a separate audit report entitled STATE OF RHODE ISLAND EMPLOYEES' RETIREMENT SYSTEM - FISCAL YEAR ENDED JUNE 30, 2022.

In accordance with *Government Auditing Standards*, we have also issued a report included therein on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. We reported a significant deficiency in internal control in that report. We noted no material weaknesses in internal control or material noncompliance.

We report other matters included herein as management comments which include recommendations to enhance internal control or result in other operational efficiencies.

Sincerely,

David A. Bergantino, CPA, CFE
Interim Auditor General

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND

FISCAL YEAR ENDED JUNE 30, 2022

MANAGEMENT COMMENTS

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Management Comment 2022-1**CONTRACTED INTERNAL AUDIT FUNCTION**

The Employees' Retirement System (System) had previously contracted with an external accounting/auditing firm to perform an internal audit function. That contract ended more than three years ago without replacement.

An internal audit function is an important overall component of management's responsibility to ensure designed controls are in place and operating effectively. The Government Finance Officers Association (GFOA) has adopted a best practice policy and recommends "that every government should consider the feasibility of establishing a formal internal audit function to help management maintain a comprehensive framework of internal controls".

Additionally, internal audit can provide information and assurance to the System's "audit committee" (ERSRI's Administration, Audit, Risk and Compliance Committee) as well as the overall Board about the effectiveness and compliance with the controls management has placed into operation. Due to the size of ERSRI, a contracted internal audit function is likely a cost-effective way to meet that overall objective.

The internal audit activities performed under the prior contracted arrangement were narrow in focus. Consideration should be given to establishing a risk-based work plan with input from ERSRI's Administration, Audit, Risk and Compliance Committee. Areas of higher risk may include the System's investments and the operation of the defined contribution plan which are largely performed by external entities.

RECOMMENDATIONS

- MC2022-1a Implement a risk-based internal audit work plan to guide the efforts of the internal audit function with input and approval from ERSRI's Administration, Audit, Risk and Compliance Committee.
- MC2022-1b Determine the necessary resources (personnel or contract) to implement ERSRI's contracted internal audit function based on the developed work plan.

Management's Views and Corrective Action Plan:

ERSRI is finalizing a Request for Proposal (RFP) to solicit bids from qualified firms to serve as ERSRI's internal audit function. The process will be performed with input and approval from the Administration, Audit, Risk and Compliance Committee of the Retirement Board.

Management Comment 2022-2**PENSION FUNDING POLICY**

With the implementation of Governmental Accounting Standards Board (GASB) Statements No. 67 and 68 regarding accounting for pension liabilities and related costs there was a "delinking" of accounting requirements from pension funding policies.

Previously, accounting guidance was also used as the basis for “acceptable” funding policies with GASB defining acceptable actuarial methods, amortization periods etc. Under the current guidance (GASB Statements No. 67 and 68) GASB only defines the accounting and disclosure requirements for pensions to be included in the financial statements of governments.

Funding policies used to determine actuarially required contributions typically differ from the accounting measure of pension liabilities. For example, the accounting measures for determining the net pension obligation to be included on a governmental statement of net position (balance sheet) reflects the fair value of pension plan assets at that date. For funding purposes, most plans use “asset smoothing” (generally over five years) that tempers the volatility in required contribution rates due to significant market valuation changes in any one year.

Consequently, most governments need to separately adopt funding policies to guide their funding decision over time while using the accounting measures in their financial statements prepared in accordance with generally accepted accounting principles.

Many of the funding policies employed for the System’s defined benefit pension plans are outlined in statute. In addition, other funding policies are considered as part of the Board’s annual acceptance of the actuarial valuations.

Organizations such as the Government Finance Officers Association and National Association of State Retirement Administrators recommend that governments establish and adopt comprehensive pension funding policies, which outline all the key provisions designed to responsibly fund a pension plan and calculate the employer actuarially determined contribution.

RECOMMENDATION

MC2022-2 Develop and adopt a formalized pension funding policy that incorporates statutory provisions as well as funding and actuarial policies approved by the Board of the Employees’ Retirement System.

Management’s Views and Corrective Action Plan:

The ERSRI Board annually approves an actuarial valuation report prepared by the System’s actuary. Within the valuation of each Trust, the valuation report defines the System’s funding policy and financing objectives. The approval of each valuation by the Board and the language that is prescribed in statute represents an acceptable funding policy.

ERSRI will work with its actuary to perform a gap analysis to determine any pension funding policies requiring documentation that are either not provided for in RI General Law or included within the valuation report that defines the System’s funding policy and financing objectives.

Management Comment 2022-3

SENIOR INFORMATION SECURITY OFFICER

ERSRI obtained a beneficial external security assessment of its information technology operations. One of the recommendations from that assessment included adding a senior information security officer with sufficient authority and resources to oversee and maintain an organization-wide information security

program. Corrective actions for other issues noted in the assessment are dependent on dedicated IT resources within ERSRI.

Most of ERSRI's information technology is performed by external entities which lessens the need to staff daily IT operations but increases the need to ensure adherence to overall security best practices and protocols. Information security is of critical importance for all entities involved in the collection, sharing, transmission, and storage of personally identifiable information (PII). A strong and well-designed information security program is essential for protecting an organization's communications, systems, and assets from both internal and external threats.

RECOMMENDATIONS

MC2022-3a Add a senior information security officer to enhance ERSRI's IT security program.

MC2022-3b Ensure IT security resources implement the required corrective actions recommended by the IT security assessment.

Management's Views and Corrective Action Plan:

ERSRI has received approval from the ERSRI Board for funding an FTE for this position. The position is included in the Board's recommended FY2024 budget request and is subject to approval by the Legislature.

Management Comment 2022-4

TIMELY REMOVAL OF AUTHORIZED SIGNATORIES FROM INVESTMENT ACCOUNTS

Communication of changes of authorized signatories for investment accounts to the System's investment companies is essential to maintaining adequate internal control over investments. We noticed an instance during our audit where a terminated employee, who was an authorized signatory for the System's investment account, did not have signature authorization removed from that account until 1 year after leaving employment.

RECOMMENDATION

MC2022-4 Develop and implement procedures and controls to ensure that personnel who terminate from the System or whose job responsibilities no longer require that they have signatory authorization for investment accounts be removed as authorized signatories in a timely manner.

Management's Views and Corrective Action Plan:

The Investment team has a complete listing of manager and consulting relationships relative to the Defined Benefit plan. The Investments Executive Aid will provide any staffing changes to all providers articulating such change and confirming signatory authority at that time as well.

Management Comment 2022-5**SERVICE ORGANIZATION CONTROL (SOC) REPORT REVIEW**

ERSRI utilizes multiple service organizations to meet its operating and financial reporting objectives including investment custody and investment accounting services provided by Bank of New York Mellon. Statewide efforts have been implemented to require auditee review and documentation of relevant SOC reports as part of an auditee's overall responsibility for implementing and monitoring internal controls. SOC review forms have been implemented by the State's Office of Accounts and Control to standardize and guide the review of relevant SOC reports.

Bank of New York Mellon also provides investment custodial services to other units of State government (e.g., custody of bond proceeds). The documentation available in fiscal 2022 for the review of the Bank of New York Mellon SOC report was oriented for custody services provided to other units of state government and not for the investment custody and investment accounting services provided for ERSRI. Consequently, the consideration of complementary user-entity controls was not fully considered and documented for controls over the ERSRI pooled investment trust.

Because ERSRI relies entirely on Bank of New York Mellon to hold and account for all the investments within the System's defined benefit plans, consideration of controls at the service organization and related user-entity controls is critical to the System's internal control structure over financial reporting. Review and documentation of the Bank of New York Mellon SOC report should be monitored by the System's Chief Financial Officer in conjunction with overall internal control monitoring.

RECOMMENDATIONS

- MC2022-5a Complete required SOC report review documentation with consideration of user-entity controls specific to investment activity within the System's pooled investment trust.
- MC2022-5b Include documentation of SOC reports applicable to the System's investments within the overall monitoring of internal control performed by ERSRI.

Management's Views and Corrective Action Plan:

The Investment Accounting Manager will work in tandem with the Deputy Chief Investment Officer to complete the SOC report review documentation as it relates to the System's pooled investment trust and overall monitoring of internal controls as they relate to investment activity. They will also work with the Auditor General's staff to ensure a better understanding of the SOC report review requirements and intent.