

MEETING
STATE OF CALIFORNIA
PUBLIC EMPLOYEES' RETIREMENT SYSTEM
BOARD OF ADMINISTRATION
RISK AND AUDIT COMMITTEE
OPEN SESSION

ROBERT F. CARLSON AUDITORIUM
LINCOLN PLAZA NORTH
400 Q STREET
SACRAMENTO, CALIFORNIA

WEDNESDAY, SEPTEMBER 16, 2015

12:04 P.M.

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CERTIFIED SHORTHAND REPORTER
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A P P E A R A N C E S

COMMITTEE MEMBERS:

Mr. Ron Lind, Chairperson

Mr. J.J. Jelincic, Vice Chairperson

Mr. Rob Feckner

Ms. Priya Mathur

Mr. Bill Slaton

Ms. Theresa Taylor

Ms. Betty Yee, represented by Alan Lofaso

BOARD MEMBERS:

Mr. John Chiang, represented by Ms. Christina Elliott

Mr. Richard Gillihan, represented by Ms. Katie Hagen

STAFF:

Ms. Anne Stausboll, Chief Executive Officer

Ms. Cheryl Eason, Chief Financial Officer

Mr. Matthew Jacobs, General Counsel

Ms. Beliz Chappuie, Chief Auditor

Ms. Carrie Lewis, Committee Secretary

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P R O C E E D I N G S

CHAIRPERSON LIND: All right. We're going to call the meeting of the Risk and Audit Committee to order

VICE CHAIRPERSON JELINCIC: Ahead of time.

CHAIRPERSON LIND: Ahead of -- yeah, that's right, one minute ahead of when we said we would.

VICE CHAIRPERSON JELINCIC: We should note that.

CHAIRPERSON LIND: And, Pam, thanks for quickly getting us in shape to do the meeting here.

So first we need the roll call, please.

COMMITTEE SECRETARY LEWIS: Ron Lind?

CHAIRPERSON LIND: Here.

COMMITTEE SECRETARY LEWIS: J.J. Jelincic?

VICE CHAIRPERSON JELINCIC: Here.

COMMITTEE SECRETARY LEWIS: Rob Feckner?

COMMITTEE MEMBER FECKNER: Good afternoon

COMMITTEE SECRETARY LEWIS: Priya Mathur?

COMMITTEE MEMBER MATHUR: Here.

COMMITTEE SECRETARY LEWIS: Bill Slaton?

BOARD MEMBER SLATON: Here.

COMMITTEE SECRETARY LEWIS: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Here.

COMMITTEE SECRETARY LEWIS: Alan Lofaso for Better Yee.

ACTING COMMITTEE MEMBER LOFASO: Here.

1 CHAIRPERSON LIND: Thank you. On to the
2 Executive Report. Cheryl Eason.

3 CHIEF FINANCIAL OFFICER EASON: Good afternoon,
4 Mr. Chair and Committee members. Cheryl Eason, CalPERS
5 staff. This afternoon's agenda focuses on two key items
6 that I'd like to bring to your attention. The finalist
7 selection for the actuarial parallel valuation and
8 certification services, and the request for the
9 interagency agreement for the external assessment of the
10 Office of Audit Services quality assurance and improvement
11 program.

12 In March, as you may recall, the Board approved
13 the release of a Request for Proposal seeking bid
14 proposals from qualified firms to provide actuarial
15 parallel valuation and certification services to CalPERS.

16 Based on the responses, today's Agenda Item 5a
17 represents those proposals that have passed the technical
18 valuation. Staff are seeking a recommendation from the
19 Committee today on the selection of finalists for
20 interview during the upcoming November Risk and Audit
21 Committee meetings.

22 The second action agenda item, 5b, is a request
23 to the Committee to approve CalPERS engagement with the
24 Department of Finance to conduct an external assessment of
25 the Office of Audit Services quality assurance and

1 improvement program.

2 This external assessment is required every five
3 years by the International Standards for the Professional
4 Practice of International Auditing to provide a mandatory
5 external assessment of the efficiency and effectiveness of
6 the CalPERS internal audit activity, as well as to
7 identify opportunities for improvement. Beliz Chappuie,
8 CalPERS Chief Auditor, will present these two agenda items
9 as we welcome her to her first Risk and Audit Committee
10 meeting.

11 Earlier this month, CalPERS hosted the Global CFO
12 Forum for the second consecutive year. Financial leaders
13 from 29 pension and sovereign funds representing six
14 countries, including Australia, Canada, China, Singapore,
15 Sweden, and the United States discussed relevant topics
16 facing pension funds, including funding risk management,
17 data security, and for the first time internal audit
18 issues.

19 I want to thank the Board members who were able
20 to attend the forum and to the staff for their efforts for
21 organizing another successful forum. I also wish to bring
22 to the Committee's attention that on Thursday afternoon,
23 the Board education program session focuses on internal
24 controls, financial reporting, and audits. This session
25 is planned as an interactive discussion to be led by Dr.

1 Robert Yetman from the UC Davis Graduate School of
2 Management.

3 The session focuses on effective risk oversight,
4 the role of internal and external audits, internal
5 controls, and the importance of financial reporting. Very
6 relevant and timely topics as we look ahead to the
7 Committee's November agenda, which includes several key
8 items. Specifically, the external auditor's report on the
9 audit of the CalPERS financial statements for the 2014/15
10 fiscal year, the finalist interviews for the actuarial
11 parallel valuation and certification services, and the
12 Request for Proposal for the selection of the independent
13 financial statement auditor for the audit years 2017 to
14 21.

15 Thank you, Mr. Chair. This concludes my report.
16 I'd be happy to take any questions.

17 CHAIRPERSON LIND: Thank you. I don't see any
18 questions.

19 We're on to action consent, the approval of the
20 minutes. I would note one correction to the minutes.
21 Where it says Agenda Item 3, action consent items, it --
22 the minutes say the Committee accepted the informational
23 consent items. It should say the action consent items.
24 That's the only correction I see.

25 We have it in front of us, right.

1 VICE CHAIRPERSON JELINCIC: Is that the change?

2 CHAIRPERSON LIND: That is the change.

3 COMMITTEE MEMBER MATHUR: Move approval.

4 COMMITTEE MEMBER TAYLOR: Second.

5 CHAIRPERSON LIND: Motion by Mathur, second by
6 Taylor to approve.

7 Did you want to speak on this?

8 VICE CHAIRPERSON JELINCIC: No. I just wanted to
9 ask the difference between what was in the iPad and this,
10 and you've answered that.

11 CHAIRPERSON LIND: Okay. All right. All in
12 favor of the motion say aye?

13 (Ayes.)

14 CHAIRPERSON LIND: Any opposed?

15 Motion carries.

16 We're now on to information consent items. I
17 have one request to remove an item, that is Item e, the
18 2014/15 annual compliance report. I don't see any other
19 requests from anyone.

20 Mr. Jelincic, you asked for that to be pulled
21 off, so I will turn it to you for comments.

22 Wait a minute.

23 VICE CHAIRPERSON JELINCIC: To what extent is
24 this agenda item management's statement, and to what
25 extent is it the Board's statement? So that's question

1 one.

2 CHIEF FINANCIAL OFFICER EASON: So the 2014/15
3 annual compliance report. It's included with the CAFR
4 every year. This is a compilation of all of the
5 compliance activities that have been going on throughout
6 the organization for that fiscal -- that particular fiscal
7 year. So it's really a -- it's a culmination of
8 management's activities around the compliance activities.

9 VICE CHAIRPERSON JELINCIC: Okay. And so it's
10 essentially a management report, rather than anything the
11 Board adopts.

12 The other issue I have, and I've raised it
13 before, is investment compliance and ICOR being part --
14 embedded in the Investment Office reporting up through the
15 Investment Office, rather than being over in ECOM. We
16 will -- I'm sure we will continue to have that discussion.

17 But one of the things you have said is that ECOM,
18 you know, monitors ICOR to make sure they're actually
19 doing their job. But I've been told by the union that
20 there are no longer any investment people in ECOM. And
21 part of the reason we had to create ICOR was because they
22 needed investment skills to be able to actually evaluate
23 whether it's going on. And so I just sort of see a
24 contradiction there. So I'd like you to comment on it.
25 And I will again put in a plug for moving investment

1 compliance over to ECOM.

2 CHIEF FINANCIAL OFFICER EASON: Thank you for the
3 question, Mr. Jelincic. I would also just -- I would just
4 want to point out that on that same item on page three of
5 19 of that particular agenda item, we talk about the three
6 lines of defense. And I think that helps to outline the
7 specific roles in effective risk management and control.
8 And to speak to your point about where ICOR reports, ICOR
9 really represents the first line of defense.

10 And in doing so, they work with operational
11 managers and staff in the Investment Office to ensure that
12 they're in compliance and that they're also implementing
13 the proper actions to address any process and control
14 efficiencies.

15 It's -- ECOM really represents the second line of
16 defense. And that really ensures that the first line of
17 defense is properly designed, it's in place, and it's
18 operating appropriately. ECOM is an oversight role as the
19 second line of defense. It identifies known and emerging
20 issues. It has -- it's to assist management in ensuring
21 that they're developing the processes. And also, it looks
22 for the completeness of reporting in compliance with laws,
23 regulations.

24 So I think in -- so to your point of the skills
25 required to be able to perform that oversight, I'm pleased

1 to say that in the four positions that the Board approved
2 in the budget process this year, we've been successful in
3 attracting additional staff to the ECOM team. And that
4 includes legal expertise. We have regulatory expertise.
5 We have auditors that have previously performed as
6 auditors. So I think that does allow us -- and we also
7 have people with investment background.

8 So I think we're starting to really build a
9 strong ECOM compliance team that will help to provide
10 oversight, not only in the investment field but -- area,
11 but also in other areas of the organization where
12 compliance also exists.

13 You're going to hear more about the three lines
14 of defense tomorrow at the education. And I think that
15 will give you an opportunity. And also, in November,
16 you'll hear the semiannual compliance report, and just
17 exactly all the activities that have been going on in the
18 compliance area to -- in the past -- in the past six
19 months.

20 VICE CHAIRPERSON JELINCIC: And my concern is if
21 the second line of defense doesn't have the skill set to
22 actually evaluate whether the first line did their job,
23 then I'm not sure that we've got the three lines. And so
24 that's the concern.

25 Thank you.

1 CHAIRPERSON LIND: All right. Thank you. We are
2 on to action agenda items, and the audit, in particular.
3 And, Beliz, welcome to the Risk and Committee.

4 And first up, we're going to talk about the
5 finalist section for the actuarial parallel valuation and
6 certification services.

7 CHIEF AUDITOR CHAPPUIE: Good afternoon, Mr.
8 Chair and members of the Committee. Beliz Chappuie,
9 CalPERS staff.

10 Agenda Item 5a is an action item related to
11 selection of finalists for actuarial parallel valuation
12 and certification services. Staff recommend the firms who
13 have passed a technical evaluation to the Board for
14 selection of finalists to appear before the Risk and Audit
15 Committee in November 2015 for an oral interview.

16 I'll go over what staff have completed so far,
17 and what the next step is in the process. In May, 2015,
18 CalPERS released RFP for actuarial parallel valuation and
19 certification services and received four proposals.

20 Staff reviewed these proposals and all four
21 passed the preliminary review and technical proposal
22 evaluation. Then the fee proposal evaluation was
23 performed, and the firms were ranked based on the fee
24 scores they received.

25 The first three firm's preliminary scores came in

1 very close. The fourth one, the score was significantly
2 less than the first three.

3 Staff also included the applicable incentive
4 points to the rankings for consideration during the
5 interviews. Finally, staff performed background and
6 reference checks and all finalists rated as satisfactory.

7 The firms that passed the technical proposal
8 evaluation, and selected as finalists by the Board are
9 eligible to move on to the interview phase.

10 The next step in the process. The selected
11 finalists will be invited to appear before the Risk and
12 Audit Committee in November, 2015. Each firm will have 30
13 minutes before the Risk and Audit Committee, which will
14 consist of a 10-minute presentation and a 20-minute
15 question and answer session.

16 The interviews will be evaluated using a
17 consensus scoring methodology. The Risk and Audit
18 Committee will determine a score as a group for each
19 finalist, and motion the interview score, with a maximum
20 of 700 points. Each proposer's interview score will be
21 combined with the fee proposal score and any applicable
22 incentive points for a total score. Then the proposals
23 will be ranked according to their total score from highest
24 to lowest.

25 I'm happy to answer any questions.

1 CHAIRPERSON LIND: Ms. Mathur.

2 COMMITTEE MEMBER MATHUR: Thank you. Well, thank
3 you very much for this. And given that the three
4 top -- the three -- that three of the four are very close
5 in ranking, I would move that we interview the top three
6 proposers and not the fourth one.

7 CHAIRPERSON LIND: All right.

8 VICE CHAIRPERSON JELINCIC: Second.

9 CHAIRPERSON LIND: There's a motion by Ms.
10 Mathur, a second by Mr. Jelincic.

11 You're on my screen here. Did you want to
12 comment on this?

13 VICE CHAIRPERSON JELINCIC: Yes. The -- this
14 morning Neal Johnson asked me if they had bid on the same
15 RFP, given the fee difference. And the thing that was
16 really striking is the fourth firm actually produced the
17 software that we use. So they're being asked to comment
18 on how well their own software works. And the fee was not
19 anywhere near what anybody was expecting. So I think we
20 interview the first three and leave the fourth one alone.

21 CHAIRPERSON LIND: Thank you. Yeah, J.J. and I
22 discussed there could be some potential entertainment
23 value in hearing the fourth firm explain why they're worth
24 so much more, but we don't have enough time for that. So
25 there's a motion on the floor to interview the top three.

1 Any other discussion?

2 Seeing none.

3 All in favor say aye?

4 (Ayes.)

5 CHAIRPERSON LIND: Any opposed?

6 That motion carries.

7 So next up is -- and Beliz, you're still up for
8 this, the interagency agreement for external assessment.

9 CHIEF AUDITOR CHAPPUIE: Yes. Agenda Item 5b is
10 an action item related to an interagency agreement for
11 external assessment of the Office of Audit Services,
12 quality assurance and improvement program.

13 Staff's recommendation is to approve to engage
14 the Department of Finance to conduct a mandatory external
15 assessment of the Office of Audit Services as required by
16 the International Standards for the Professional Practice
17 of Internal Auditing.

18 The standards require an external assessment of
19 the internal audit activity to be conducted at least once
20 every five years by a qualified independent assessor from
21 outside the organization. The external assessment
22 evaluates the internal audits activities conformance with
23 the standards and identifies areas for improvement.

24 For the chief audit executive to state in audit
25 reports that the internal audit was performed in

1 conformance with the standards, the external assessment
2 needs to demonstrate that the audit activity is in
3 conformance with the standards.

4 Staff considered three alternatives in
5 recommended the external entity to perform this review.
6 The first one was to arrange -- the first one was to
7 arrange an exchange of services with the California
8 Association of State Auditors. We did not recommend this
9 alternative, because it requires an exchange of services.
10 Office of Audit Services would need to commit staff to
11 perform future peer reviews of other organizations.

12 Currently, Office of Audit Services will not be
13 able to allocate resources to fulfill this level of
14 commitment while completing the annual audit plan
15 assignments.

16 The next alternative was to contract with an
17 external firm. We did not recommend this alternative,
18 because RFP process would prolong the procurement of the
19 external review services and generally cost more than the
20 State agency services.

21 And finally, the recommendation was to engage the
22 Department of Finance. And the Department of Finance is
23 the executive branch auditor with broad oversight
24 responsibilities that include quality assurance reviews,
25 as well as financial performance and information

1 technology audits.

2 Finance's quality assurance review will be
3 reimbursed through an interagency agreement for services
4 based on staff work, travel, and overhead costs.

5 I'll be happy to answer any questions

6 CHAIRPERSON LIND: Thank you. And we have one
7 from Ms. Taylor.

8 COMMITTEE MEMBER TAYLOR: So I just wanted to
9 make sure, this was -- and I'm -- because I'm knew, I
10 don't know this. These three alternatives were decided on
11 last time, and we're voting on the alter -- or you had
12 decided for Department of Finance, because the other two
13 were not viable alternatives, correct?

14 We're no longer considering the CASA for this at
15 all? Is that what I'm understanding? It is their
16 recommendation -- I'm confused.

17 CHIEF AUDITOR CHAPPUIE: Right. We're only
18 recommending the Department of Finance.

19 I just basically summarized the alternatives we
20 considered in the process.

21 COMMITTEE MEMBER TAYLOR: And I know Cheryl
22 talked to me about but it earlier, but I was still a
23 little confused. All right. Thank you.

24 CHIEF AUDITOR CHAPPUIE: Yes

25 CHAIRPERSON LIND: Mr. Jelincic.

1 VICE CHAIRPERSON JELINCIC: Well, I'm going to
2 move staff's recommendation. It shouldn't surprise
3 anybody that I don't want to contract it out to an outside
4 firm.

5 The one concern I do have, and I think we need to
6 think about going forward, is the CASA. Right now, we
7 don't have the staff to do that, and I appreciate it. But
8 it does create some cross-breeding and some exposure to
9 other areas and other -- get other people exposed to us.
10 And so I think there's actually something to be said for
11 being involved in that process. We don't have the current
12 staff, but I would certainly encourage you to think about
13 that as you build staff going forward.

14 And the one reservation about the Department of
15 Finance is they did it five years ago. And so there's a
16 certain -- one inbreeding and repetition, but given the
17 current alternatives it's clearly the way to go.

18 COMMITTEE MEMBER MATHUR: Second.

19 CHAIRPERSON LIND: Okay. I've got a motion and a
20 second to approve staff's recommendation.

21 Any other discussion on the motion?

22 And that was a motion by Jelincic, seconded by
23 Mathur.

24 All in favor say aye?

25 (Ayes.)

1 CHAIRPERSON LIND: Any opposed?

2 Motion carries.

3 Thank you.

4 We are on to public comment. I don't see any
5 little pieces of paper in front of me.

6 Is there anybody public comment?

7 Oh, yeah, little pieces of paper. Very funny,
8 J.J. All right. This meeting is adjourned.

9 (Thereupon the California Public Employees'
10 Retirement System, Board of Administration,
11 Risk and Audit Committee open session
12 meeting adjourned at 12:22 p.m.)

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C E R T I F I C A T E O F R E P O R T E R

I, JAMES F. PETERS, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing California Public Employees' Retirement System, Board of Administration, Risk and Audit Committee open session meeting was reported in shorthand by me, James F. Peters, a Certified Shorthand Reporter of the State of California, and was thereafter transcribed, under my direction, by computer-assisted transcription;

I further certify that I am not of counsel or attorney for any of the parties to said meeting nor in any way interested in the outcome of said meeting.

IN WITNESS WHEREOF, I have hereunto set my hand this 21st day of September, 2015.

JAMES F. PETERS, CSR
Certified Shorthand Reporter
License Number 10063