

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

TUESDAY, APRIL 19, 2015

2:30 P.M.

JAMES F. PETERS, CSR
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A P P E A R A N C E S

COMMITTEE MEMBERS:

Mr. Ron Lind, Chairperson

Ms. Dana Hollinger, Vice Chairperson

Mr. J.J. Jelincic

Ms. Priya Mathur

Mr. Bill Slaton

Ms. Theresa Taylor

Ms. Betty Yee, represented by Alan Lofaso

BOARD MEMBERS:

Mr. John Chiang, represented by Mr. Eric Lawyer

Mr. Richard Gillihan, represented by Mr. Ralph Cobb

Mr. Henry Jones, Vice President

STAFF:

Ms. Anne Stausboll, Chief Executive Officer

Ms. Cheryl Eason, Chief Financial Officer

Mr. Matthew Jacobs, General Counsel

Ms. Tanya Black, Committee Secretary

Ms. Beliz Chappuie, Chief Auditor

Ms. Kami Niebank, Deputy Chief Compliance Officer

Ms. Renee Ostrander, Chief, Employer Account Management
Division

Ms. Marlene Timberlake D'Adamo, Chief Compliance Officer

A P P E A R A N C E S C O N T I N U E D

ALSO PRESENT:

Ms. Debbie Chan, Macias, Gini & O'Connell

Mr. Rick Green, Macias, Gini & O'Connell

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1 P R O C E E D I N G S

2 CHAIRPERSON LIND: Good afternoon, everybody.
3 I'm going to call the order the Risk and Audit Committee
4 meeting. Before we call the roll, I wanted to point out
5 there is an error on the iPad version of the agenda. It's
6 been corrected on the hard copy. But Mr. Feckner is not
7 on this Committee, and Ms. Hollinger is.

8 So with that would we please call the roll.

9 COMMITTEE SECRETARY BLACK: Ron Lind?

10 CHAIRPERSON LIND: Here.

11 COMMITTEE SECRETARY BLACK: J.J. Jelincic?

12 VICE CHAIRPERSON JELINCIC: Here.

13 COMMITTEE SECRETARY BLACK: Dana Hollinger?

14 COMMITTEE MEMBER HOLLINGER: Here.

15 COMMITTEE SECRETARY BLACK: Priya Mathur?

16 COMMITTEE MEMBER MATHUR: Here.

17 COMMITTEE SECRETARY BLACK: Bill Slaton?

18 COMMITTEE MEMBER SLATON: Here.

19 COMMITTEE SECRETARY BLACK: Theresa Taylor?

20 COMMITTEE MEMBER TAYLOR: Here.

21 COMMITTEE SECRETARY BLACK: Alan Lofaso for Betty

22 Yee?

23 ACTING COMMITTEE MEMBER LOFASO: Here.

24 CHAIRPERSON LIND: Thank you. So next up is the
25 election of Chair and Vice Chair. And for the election of

1 Chair, I'm going to turn the meeting over to J.J..

2 VICE CHAIRPERSON JELINCIC: Okay. Is there a
3 nomination for Chair of the Risk and Audit Committee?

4 Theresa.

5 COMMITTEE MEMBER TAYLOR: I would -- it would be
6 my honor to nominate Ron Lind for the Chair of Risk and
7 Audit Committee.

8 VICE CHAIRPERSON JELINCIC: Okay. Ron Lind has
9 been nominated.

10 Are there any other nominations?

11 Are there any other nominations?

12 For the third time, are there any other
13 nominations?

14 Seeing none, nominations are closed. The Chair
15 will entertain a motion to elect Ron by acclamation.

16 COMMITTEE MEMBER MATHUR: So moved.

17 VICE CHAIRPERSON JELINCIC: Moved by Priya.

18 COMMITTEE MEMBER SLATON: Second.

19 VICE CHAIRPERSON JELINCIC: Seconded by Bill.

20 Any discussion?

21 All in favor say aye?

22 (Ayes.)

23 VICE CHAIRPERSON JELINCIC: Opposed?

24 Condolences.

25 (Laughter.)

1 CHAIRPERSON LIND: Thank you very much. Okay.
2 (Applause.)

3 CHAIRPERSON LIND: Okay. With that, we now have
4 the election of Vice Chair of the Risk and Audit
5 Committee. I call on Mr. Slaton.

6 COMMITTEE MEMBER SLATON: Thank you, Mr. Chair.
7 It's my honor to nominate Dana Hollinger to be
8 Vice Chair of the Risk and Audit Committee.

9 CHAIRPERSON LIND: Okay. We have a nomination
10 for Dana Hollinger.

11 Are there any other nominations?

12 Any other nominations?

13 Any other nominations?

14 Okay. Nominations are closed.

15 Can we have a motion to elect Ms. Hollinger by
16 acclamation?

17 COMMITTEE MEMBER MATHUR: So moved.

18 VICE CHAIRPERSON JELINCIC: Second.

19 CHAIRPERSON LIND: I've got a motion by Taylor
20 and a second by Jelincic.

21 COMMITTEE MEMBER TAYLOR: It was a motion by
22 Priya.

23 CHAIRPERSON LIND: Oh, excuse me. Motion by
24 Mathur, seconded by Jelincic.

25 All right. A henry moment.

1 Okay. All in favor say aye?

2 (Ayes.)

3 CHAIRPERSON LIND: Any opposed?

4 Motion carries. Congratulations, Dana.

5 (Applause.)

6 CHAIRPERSON LIND: Oh, she is going to make you
7 change places. I guess we have traditions here we have to
8 maintain.

9 Okay. Now that we've taken care that piece of
10 moving the chairs business, let's move on to Executive
11 Report, Cheryl Eason.

12 CHIEF FINANCIAL OFFICER EASON: Thank you. Good
13 afternoon, Mr. Chair and Committee members. Cheryl Eason,
14 CalPERS staff. Let me be the first to extend my
15 congratulations to you, Mr. Lind, as continuing as the
16 Committee's Chair and welcoming Ms. Hollinger as the Vice
17 Chair. And I look forward to working very closely with
18 you and the Committee members in the upcoming year.

19 Today's agenda will focus on two action items.
20 The first is the review of the Risk and Audit Committee
21 delegation. The final delegation will be presented to the
22 full Board for approval next month.

23 The second action item is the review of the
24 independent auditor's management letter. The results
25 indicate no material weaknesses or significant

1 deficiencies. There are three key observations and
2 corrective actions that you'll hear about today. And for
3 those observations, we've planned to be completed no later
4 than the end of this calendar year.

5 The two information items being presented today,
6 firstly, the Chief Auditor will present proposed revisions
7 to the audit resolution policy based on feedback from last
8 week. And secondly, an update on the semi-annual
9 compliance plan to be introduced by the Chief Compliance
10 Officer for CalPERS.

11 The next Risk and Audit Committee meeting is
12 schedule for June 14th, 2016. And among the agenda items
13 will include the action item for the 2016/17 plans for the
14 Enterprise Compliance and Enterprise Risk and Office of
15 Audit Services, the independent auditor's 2016 annual
16 plan, and for information the semiannual risk dashboard.

17 Thank you, Mr. Chair. This concludes my report.

18 CHAIRPERSON LIND: Thank you. I think we have a
19 question.

20 Mr. Jelincic.

21 COMMITTEE MEMBER JELINCIC: This is in actually
22 reference to one of the consent items, 5d. We have
23 consistently had problems with compensation. And I hope
24 at some point in the meeting we can talk about what we are
25 doing to get these reported more accurately. It may be

1 part of the compliance report, but it's an issue that
2 needs to be addressed.

3 CHAIRPERSON LIND: Okay. We're on to action
4 consent items. I'm looking for a motion to approve the
5 November 17th minutes.

6 COMMITTEE MEMBER JELINCIC: Move it.

7 COMMITTEE MEMBER MATHUR: Second.

8 CHAIRPERSON LIND: Motion by Jelincic, second by
9 Mathur.

10 Any discussion?

11 All in favor say aye?

12 (Ayes.)

13 CHAIRPERSON LIND: Any opposed?

14 Motion carries.

15 I have no requests to move anything off of
16 consent.

17 So we are now on to Item number 6, Review of the
18 Risk and Audit Committee Delegation. Ms. Eason and Mr.
19 Jacobs it says here.

20 CHIEF FINANCIAL OFFICER EASON: Thank you. I can
21 certainly introduce the item. And if there's any
22 questions, I'm sure Mr. Jacobs would be happy to assist
23 me.

24 This is an action item with staff recommendations
25 to revise the Risk and Audit Committee delegation

1 resolution. The proposed changes are primarily
2 administrative in nature and they were designed to improve
3 the document flow by combining compliance risk and audit
4 activities into their individual items, and align with the
5 authority language in the Board Governance Policy.

6 There are some key changes that I'd like to point
7 out, including removing the reference to the State Peace
8 Officers and Firefighters defined contribution plans, as
9 these plans were terminated through legislation; adding
10 enterprise compliance and ethics to the legislative and
11 regulations items for clarification; and clarifying the
12 language regarding investment risk management, investment
13 policy compliance, and enterprise operating risk
14 management processes to align with the Investment
15 Committee delegation.

16 Based on feedback from several of the Board
17 members last week regarding our briefings, two suggested
18 changes were received. To maintain a separate line for
19 the oversight of the whistleblower and hotline process,
20 which was included in the agenda item in line 6 of Agenda
21 Item 6, Attachment 3 that can be found on page 47 of 105
22 of the iPad. So the suggestion being to keep that as a
23 separate line item.

24 And secondly, under the new Item number 8, the
25 word "actuarial" was inadvertently removed, and should be

1 added back into the front of the phrase parallel
2 valuations. That should now read actuarial parallel
3 valuations.

4 And with those changes, this is an action item
5 for the Board to consider to recommend approval for the
6 CalPERS Board to take place at the May 2016 Board meeting.

7 CHAIRPERSON LIND: Okay. I have one question.
8 Mr. Jelincic.

9 COMMITTEE MEMBER JELINCIC: I'll move the staff
10 recommendation with those two things.

11 CHAIRPERSON LIND: Thank you. Is there a second?

12 COMMITTEE MEMBER MATHUR: Second.

13 CHAIRPERSON LIND: Okay. A motion by Jelincic,
14 second by Mathur.

15 Any discussion?

16 All in favor say aye?

17 (Ayes.)

18 CHAIRPERSON LIND: Any opposed, say no?

19 Motion carries.

20 Thank you. Okay. Next, we're on to the audit.
21 And Beliz, I believe, is going to kick this off for us.

22 CHIEF AUDITOR CHAPPUIE: Good afternoon, Mr.
23 Chair and members of the Committee. Beliz Chappuie,
24 CalPERS staff.

25 Agenda Item 7a is an action item. Staff is

1 requesting Risk and Audit Committee to approve the Board's
2 independent financial statement auditors, Macias, Gini &
3 O'Connell, MGO's, draft management letter prepared as part
4 of the financial statement audit for the fiscal year ended
5 June 30, 2015.

6 The Board approved the basic financial statements
7 and accepted the independent auditor's report on November
8 17th, 2015. The independent auditor reviews the internal
9 controls over financial reporting, as a basis for
10 designing the audit procedures and is required by the
11 auditing standards to report their observations and
12 recommendations to enhance those controls. The draft
13 management letter also includes updated status on prior
14 year observations.

15 The management letter is considered a draft until
16 its approved by the Board, and subsequently signed by MGO.
17 The signed management letter will be distributed to the
18 Board, executive staff, and senior management. Presenting
19 with me today is Rick Green, the engagement partner with
20 MGO, as well as Debbie Chan, the director from the same
21 firm.

22 With that said, I would like to turn it over to
23 Rick and Debbie to discuss the observations included in
24 the draft management letter.

25 CHAIRPERSON LIND: Thank you. Welcome, Rick and

1 Debbie.

2 MS. CHAN: Thank you.

3 MR. GREEN: Thank you, Mr. Chair, and than you to
4 the members of the Audit Committee for the opportunity to
5 present our management letter to you. As has been stated,
6 this is the last product that is part of the June 30th,
7 2015 financial statement audit. And as part of performing
8 a financial statement audit, the independent auditor is
9 required to obtain an understanding of the internal
10 control structure over financial reporting in order to
11 plan and to perform the audit.

12 As a result of that work, and as I had indicated
13 in our meeting presenting the results of our work in
14 November, we did not note any material weaknesses or
15 significant deficiencies within the internal control
16 structure over financial reporting.

17 What we have before you today in this management
18 letter are three current year observations that are
19 intended to simply provide our recommendation to enhance
20 existing internal controls over the financial reporting
21 process.

22 And so, in other words, in my opinion, based upon
23 the results of our work, I believe that management has
24 fulfilled their responsibilities to design, implement, and
25 monitor internal controls over financial reporting to

1 ensure financial reporting that is free of material
2 misstatement, whether that misstatement is a result of
3 fraud or error.

4 With that said, and turning to the current year
5 management letter, I just want to summarize what we have
6 within this document. You have three current year
7 observations. The first relate to investment valuation.
8 The second relates to investments -- the commitment
9 disclosures associated with certain investments, and then
10 finally functionality that's associated to or with
11 my|CalPERS.

12 In addition to that, we have the status of five
13 comments that we presented in prior years. Four of those
14 five comments are recommendations and really the
15 corrective action plan that management has set forth has
16 been fully implemented to our satisfaction. There was one
17 prior year comment in which we did indicate that we
18 carried forward from a prior year, and that relates to the
19 investment commitment disclosure, and that is the current
20 year observation number two.

21 So, in my opinion, I believe that, again, the
22 results of our work do indicate there are some slight
23 improvements that could be made to the internal control
24 structure, at least as we observed that structure for the
25 course of our -- or during the course of our audit, but

1 significant improvement has been made, as well as
2 addressing the prior year comments as management has.

3 So with that said, I will take any questions
4 regarding these comments or we can go into further detail,
5 if you'd like, on the individual current year comments as
6 well. We're certainly prepared to do that. But first, I
7 wanted to just summarize and see if you had questions
8 regarding either current year or prior year.

9 CHAIRPERSON LIND: Question from Mr. Jelincic.

10 COMMITTEE MEMBER JELINCIC: I'm not sure whether
11 this question is directed to you or to staff or both. But
12 it refers to observation two, and C in particular, the
13 real estate investment having the unfunded commitments not
14 accurately reflected. Given AREIS, their system from when
15 I worked on it, they couldn't pass money unless it went
16 through AREIS, and yet somehow, the uncommitted wasn't
17 getting adjusted. And I'm just curious how it happened?

18 MS. CHAN: With respect to that item, this is
19 primarily linked to the timing difference. So a
20 commitment was funded as of June 30th of '15. The
21 approval was as of June 15, and the wire transfer was done
22 as of June 15. It's just the posting of the transaction
23 in AREIS was not captured until the beginning of July. So
24 it is a timing error within entering the information in
25 the system by the GP.

1 COMMITTEE MEMBER JELINCIC: Okay. That at least
2 explains it. Thank you.

3 CHAIRPERSON LIND: Ms. Taylor.

4 COMMITTEE MEMBER TAYLOR: So I'm seeing that you
5 have an issue this year, it's pretty much the same as in
6 2014, investment valuation process related to
7 reconciliation of determination of fair value of real
8 assets investments. So why has this -- why is this
9 continuing? What's the problem that we haven't resolved
10 this?

11 MS. CHAN: You're referring to item 1?

12 COMMITTEE MEMBER TAYLOR: Observation 1 and
13 then --

14 MS. CHAN: A1.

15 COMMITTEE MEMBER TAYLOR: I'm looking at, let's
16 see, page -- hold on, 53 of 105 on the iPad, but hold on
17 let me see what page it actually is.

18 COMMITTEE MEMBER MATHUR: Page two of the agenda
19 item.

20 COMMITTEE MEMBER TAYLOR: Page two of the agenda
21 item.

22 MR. GREEN: Yeah. The agenda item that -- the
23 agenda item paging that we have is Agenda Item 7a,
24 Attachment 1. And I think are you on page five of 21?

25 COMMITTEE MEMBER TAYLOR: Agenda 7a, Risk and

1 Audit, two of three.

2 COMMITTEE MEMBER MATHUR: Not the attachment.

3 COMMITTEE MEMBER TAYLOR: Not the attachment.

4 I'm just looking at the very front risk and audit agenda
5 item. So it actually has two tables there.

6 MS. CHAN: So observation number 1, with respect
7 to investment valuation for real assets. As Rick
8 mentioned earlier, this item is more this year is relating
9 to enhancing the internal process and control with respect
10 to reconciliation of appraised properties to the partner's
11 financial statements.

12 There's a separate area within INVO that is
13 responsible for looking at the reconciliation and the
14 appraisal. In the instances where they couldn't reconcile
15 the appraised value back to the GP's financial statements,
16 they would send the information to another group or
17 another unit within the Investment Office to follow up
18 with the GP.

19 And our recommendation here or our observation
20 here is that once that unreconciled appraisal was
21 forwarded to another unit, there was really no follow up
22 to ensure that that unreconciled item was addressed and
23 resolved properly.

24 COMMITTEE MEMBER TAYLOR: So was it? Do we know
25 if it was?

1 MS. CHAN: Ultimately, we didn't have an issue
2 with that. We were able to look at the supporting
3 document to ensure that it was okay, but this is just to
4 enhance the process, to make sure that there's document
5 procedure and control to do that going forward.

6 COMMITTEE MEMBER TAYLOR: So what was the 2014
7 issue? Was it the same thing --

8 MS. CHAN: No.

9 COMMITTEE MEMBER TAYLOR: -- it just hadn't been
10 resolved?

11 MS. CHAN: Actually, that's a good question. So
12 in the past, we had observations leading to investment
13 valuations, but the nature of those observations in the
14 past is different than the items that we noted here for
15 this year.

16 COMMITTEE MEMBER TAYLOR: What were they?

17 MR. GREEN: Well, they're all listed in great
18 detail in the status of prior year comments. Investment
19 valuation is just a broad category. And you can -- I
20 mean, if you go through the financial statements and look
21 at the disclosures that are associated with investments,
22 they could -- there could be problems in a variety of
23 different areas within the financial reporting process.
24 So we just use again the broad description of investment
25 valuation to capture our thoughts with the more detailed

1 specifics associated with the valuation issues in which we
2 identified being discussed further in the comments.

3 So again, if you look in the status of prior year
4 comments, the specific items within investment valuation
5 with which we had identified as particular issues are
6 detailed out there, but they are different than what we
7 had identified this year.

8 COMMITTEE MEMBER TAYLOR: My concern is with the
9 verbiage "fair value". And if we're not, you know,
10 getting the fair value from our GPs or however that's
11 occurring, and that happened the year before -- if they're
12 two different things and I have -- I'm not saying that,
13 but --

14 MR. GREEN: Yeah, I understand the terminology of
15 fair value is used multiple times. But unfortunately, in
16 the context of financial reporting, it has a variety of
17 different looks. It applies in a variety of different
18 areas, but I'll assure you that the comments in which
19 we -- that we had identified and made in prior year
20 associated with fair value are not the same this year.
21 They're completely different.

22 COMMITTEE MEMBER TAYLOR: They're completely
23 different.

24 MR. GREEN: Yes.

25 COMMITTEE MEMBER TAYLOR: They're not -- like

1 this -- you're saying -- this year was real assets, and
2 the previous year was something

3 MR. GREEN: Yes. And more importantly, it's a
4 different process and set of internal controls that are
5 driving these things. Had it been a fair value issue in
6 investment valuation that still flowed through the similar
7 process as internal controls, you know, that of '14 and
8 '15, well then it would be a carry-on of the current year
9 comment. And it would really be an indicator of broader
10 issues within the control structure, but it's not the
11 case. They're separate processes and separate internal
12 controls.

13 COMMITTEE MEMBER TAYLOR: Okay. Thank you.

14 CHAIRPERSON LIND: Mr. Slaton.

15 COMMITTEE MEMBER SLATON: Thank you, Mr. Chair.

16 This relates to the item on page nine of 21, and
17 it's observation number 3. And it's the last part of
18 that, "There we're also instances in which employers exist
19 in my|CalPERS multiple times and have more than one
20 my|CalPERS ID number". Other than that showing up, is
21 there a ripple effect of that? Is there any other
22 financial risk we have as a result of that being in there,
23 or does it just not look appropriate? Do we have
24 mispostings or chance of money going out or anything like
25 that?

1 MS. CHAN: Other than that, I mean, the issue of
2 improper financial reporting is -- the risk there is very
3 low. I think the key of this observation is just you
4 going in an if anything clear up, clean up my|CalPERS a
5 little bit more, with respect to the employer being
6 presented or included in the system more than once.

7 And this mainly pertains to the school district
8 as employers. Especially, the charter school, they change
9 name or -- and they don't terminate their hold name, so
10 they're being included twice in the system.

11 MR. GREEN: So in other words, there will be no
12 doubling up of information in any fashion, either through
13 the benefits, into the Actuarial Valuation System. That
14 is not the issue or the case, and thus it will not have an
15 impact on the financial reporting.

16 COMMITTEE MEMBER SLATON: So it doesn't create a
17 downstream problem in an audit -- in a subsequent audit of
18 a retiree getting the records messed up?

19 MS. CHAN: No.

20 MR. GREEN: That is -- you are correct.

21 COMMITTEE MEMBER SLATON: All right. Thank you.

22 CHAIRPERSON LIND: Ms. Mathur.

23 COMMITTEE MEMBER MATHUR: Yes. Well, appreciate
24 that in addition to sort of looking for material
25 weaknesses or significant deficiencies, you also look for

1 opportunities to help us to improve our processes. And I
2 think we've -- we have improved. I think we've seen just
3 even this whole process has improved. And management's
4 responsiveness to observations or other findings has
5 improved significantly over the past few years.

6 So with that I'm happy to move that this
7 Committee recommend to the Board to approve the draft
8 management letter as prepared by MGO for the year ended
9 June 30, 2015.

10 COMMITTEE MEMBER TAYLOR: Second.

11 CHAIRPERSON LIND: Okay. That's a motion by
12 Mathur second by Taylor.

13 On the motion, Mr. Jelincic.

14 COMMITTEE MEMBER JELINCIC: Well, I actually had
15 a comment that's not directly related to the motion, so I
16 can wait until we deal with that and then ask my question.

17 CHAIRPERSON LIND: Okay. Anything else on the
18 motion?

19 All in favor say aye?

20 (Ayes.)

21 CHAIRPERSON LIND: Any opposed?

22 Motion carries.

23 Okay. I've got -- request again. I accidentally
24 turned you off. Okay.

25 COMMITTEE MEMBER JELINCIC: When you do your

1 audit, you do not audit our controls.

2 MR. GREEN: Well, oops -- go ahead.

3 COMMITTEE MEMBER JELINCIC: And the -- I'm just
4 asking if it would -- going forward, should we think about
5 having our auditor actually do an audit and express an
6 opinion on our internal controls?

7 MR. GREEN: Yes, let me respond this way. There
8 are times within a standard financial statement audit
9 that's performed in accordance with the standards
10 promulgate by the AICPA, where actually do audit or test a
11 set of internal controls. And we actually do do it here
12 at CalPERS. So that's up and beyond just obtaining an
13 understanding of the control structure.

14 And when we choose to do that, it is
15 predominantly to make the audit more efficient, as far as
16 efficiency purposes. So, for example, the benefit payment
17 transaction stream, because of the number of transactions
18 and the dollar volume that is presented on the financial
19 statements, it is more efficient for us to test internal
20 controls, as opposed to individual transactions at year
21 end. So we do actually test internal controls under
22 certain circumstances.

23 However, as you have stated, we do not opine or
24 render an opinion on whether or not those internal
25 controls are operating as designed.

1 So with that said, and to your question
2 specifically, you know, would I recommend CalPERS to do
3 that? You know, I'm not in a position to make that
4 recommendation. But what I do recommend is that
5 management and those charged with governance, in this case
6 the Audit Committee, have a conversation about whether or
7 not such type of audit would be beneficial to the
8 organization. I could see some benefits. But also, I'll
9 tell you that in the public sector, it's not required as
10 it is in the private sector under the Sarbanes-Oxley Act,
11 and so you may have some challenges there with respect to
12 how that will be viewed and interpreted by the public.
13 But I think it is a conversation that perhaps the
14 management and the Audit Committee could have.

15 COMMITTEE MEMBER JELINCIC: Thank you.

16 CHAIRPERSON LIND: Thank you. Just back to the
17 management letter that we approved. I just wanted to say
18 that, as usual, this is good news, right? I mean, no
19 material weaknesses. Of course, that's always good news.
20 But, you know, given the size and complexity of this
21 organization to have three observations, I think, is
22 pretty outstanding. So I just wanted to, you know,
23 congratulate all of our staff members that are involved in
24 doing all the work day to day that, you know, generates
25 this ultimate audit and management letter. And, Rick,

1 thank you to you and your team for doing this.

2 MR. GREEN: Well, thank you for the opportunity
3 to serve CalPERS.

4 CHAIRPERSON LIND: All right. The next agenda
5 item is 8a, which is a audit resolution policy revision.
6 This is an information item.

7 Beliz.

8 CHIEF AUDITOR CHAPPUIE: Beliz Chappuie, CalPERS
9 staff again. I'll be providing and overview of the
10 revisions the Office of Audit Services has made to the
11 existing audit resolution policy. This policy is
12 consistent with the internal auditing standards, which
13 requires the Chief Auditor to establish a follow-up
14 process to monitor audit findings, to ensure management
15 actions have been effectively implemented, or that
16 executive staff has accepted the risk of not taking
17 action.

18 The audit resolution policy is updated
19 periodically, and was last updated in November 2013. The
20 key revisions made to the policy include the public agency
21 reviews, and acceptance of risk. Specifically, the public
22 agency reviews section has been made more consistent with
23 the internal audit section to include the Office of Audit
24 Services review and verification that corrective actions
25 have been implemented as identified in the final audit

1 reports.

2 The acceptance of risk section for both internal
3 audits and public agency reviews have been revised to
4 provide a process for enterprise-wide tracking of risk.
5 The internal audits findings unresolved for one year
6 section now includes the option for the division to
7 provide a written explanation and corrective action plan.

8 Finally, minor edits were made for consistent use
9 of terminology and clarification.

10 We have received feedback from Risk and Audit
11 Committee briefings, and we'll incorporate the suggested
12 modifications. To summarize, acceptance of risk section
13 will be clarified to state the divisions make accept the
14 risk of not implementing corrective action, as long as
15 it's in compliance with the PERL.

16 Regarding the statute of limitations and audits
17 of the retired employees, we'll incorporate the suggestion
18 in our audit plans going forward, where the statute of
19 limitations will be taken into consideration in defining
20 the scope of the assignments. We'll also change the use
21 of certain words, such as "shall" and "must", as
22 suggested.

23 This concludes my presentation, and I'll be happy
24 to take comments and feedback.

25 CHAIRPERSON LIND: Ms. Mathur.

1 COMMITTEE MEMBER MATHUR: Yes. Well, thank you.
2 I was just going to raise the issue of acceptance of risk,
3 which I thought was a little bit confusing. And I'm not
4 entirely clear what the parameters were. So I'm glad it's
5 going to be -- you're going to add the language about in
6 accordance with PERL.

7 And just to make sure that it is completely clear
8 that the public agency cannot accept the risk. It's only
9 CalPERS that can accept the risk. And really, when you're
10 saying acceptance of risk, it's deviation from the
11 recommendation in the audit that it is accept -- is an
12 acceptable substitute for the recommendations, correct?

13 CHIEF AUDITOR CHAPPUIE: Right. So the
14 resolution has two outcomes. The divisions would
15 implement the recommendation or they would have an
16 explanation as to why they would not be able to, or they
17 would accept the risk. Add, yes, it's CalPERS
18 organization division accepting the risk.

19 COMMITTEE MEMBER MATHUR: Okay. So I just -- one
20 of the things that I wanted to make sure was clear is that
21 accepting the risk -- it's sort of accepting the risk
22 perhaps of not implementing the recommendation, but there
23 might be an alternative that is also acceptable, so it's
24 not necessarily risky.

25 CHIEF AUDITOR CHAPPUIE: Correct. Yes. So --

1 and there could be -- well, the term -- and maybe it's the
2 terminology, because the standard, so this is in
3 conformance with internal auditing standards. And that's
4 the terminology they use there correct. So it could be
5 misleading a little bit the terminology.

6 COMMITTEE MEMBER MATHUR: I see. So this is
7 standard terminology, acceptance of risk.

8 CHIEF AUDITOR CHAPPUIE: Correct.

9 COMMITTEE MEMBER MATHUR: And it means -- it
10 doesn't necessarily mean that there's a lot of risk --

11 CHIEF AUDITOR CHAPPUIE: No.

12 COMMITTEE MEMBER MATHUR: -- associated with
13 accepting the risk. Okay.

14 CHIEF AUDITOR CHAPPUIE: And there's no 100
15 percent assurance, right? So the controls implemented
16 does not necessarily provide 100 percent assurance or the
17 division management may disagree with the auditor's
18 recommendation. At that point, that's their only option
19 to say, okay, how about this or we have compensating
20 controls so -- and we disagree with the auditors, so
21 therefore we suggest this instead.

22 COMMITTEE MEMBER MATHUR: Okay. So this is an
23 information item, because this is just a first reading,
24 but you'll bring back a second reading at the next
25 meeting, correct?

1 CHIEF AUDITOR CHAPPUIE: If that's the
2 preference, sure.

3 COMMITTEE MEMBER MATHUR: Okay. Thank you.

4 CHAIRPERSON LIND: Mr. Jelincic.

5 COMMITTEE MEMBER JELINCIC: Yeah. On the
6 acceptance of risk, for the internal audits, I clearly
7 understand that the organization may make a business
8 judgment that we will accept that risk, and we'll live
9 with it.

10 Where I remain confused is on the public agency
11 reviews, which we define as, "To ensure compliance with
12 the PERL, applicable regulations, and contractual
13 provisions". And then we go down and we say that, "CSS
14 management can accept the risk of not implementing." Why
15 would we accept the risk of not complying with the PERL or
16 the regulations or the contract?

17 CHIEF AUDITOR CHAPPUIE: This is new to -- so
18 this part of the policy has been revised, and we don't
19 have any examples of how this could come up, and we can
20 see examples of this.

21 But it's just to assure you that in the -- on the
22 internal audits side, we've only received a few of them
23 over the years, so this is not very common. Again, this
24 goes back to the terminology of internal audit standards
25 used. And these standard are followed by both public and

1 private entities. And the government entities, where we
2 have so many regulations and rules, it's almost
3 impossible, in most cases, to accept the risk. And that
4 goes back to your comment, so it would not be accepted any
5 ways.

6 COMMITTEE MEMBER JELINCIC: And if it wouldn't be
7 accepted, I'm not sure we ought to have a provision for
8 it. I mean, I can understand why we might be willing to
9 accept a public agency's corrective plan. But this seems
10 to me that's very different than saying, well, yeah, I did
11 this audit, found out that you're in violation of your
12 contract, but I'll accept that anyhow.

13 I just -- it's like fingers on the blackboard.
14 So you may want to think of some examples, or play with
15 the wordsmithing, or have legal bail both of us out.

16 GENERAL COUNSEL JACOBS: If I may. Matt Jacobs,
17 General Counsel. I think the purpose of this provision is
18 basically that a lot of times it's not crystal clear
19 whether you've got a violation or not. And it could be a
20 matter of conflicting regulations, policies, statutes, and
21 the like. And so it's -- this does not pertain to the
22 situation where the Office of Audits finds a definite
23 violation of the PERL, and, as you say, the agency says,
24 well, we'll just accept the risk. It's more of a
25 situation that's kind of in a very gray area. And after

1 discussion with OFAS and a determination with General
2 Counsel, and perhaps the Board -- excuse me, the
3 Committee, the -- it might be acceptable to the collective
4 people involved to move on. Is that fair, Beliz?

5 CHIEF AUDITOR CHAPPUIE: Sure. Thank you.

6 COMMITTEE MEMBER JELINCIC: Okay. But it seems
7 to me that that's not what this language says. So any
8 how, as you go forward, think about that, and you may want
9 to do some wordsmithing.

10 GENERAL COUNSEL JACOBS: Very well.

11 COMMITTEE MEMBER JELINCIC: Or you may want to be
12 able to convince me that I'm not reading what I think I'm
13 reading.

14 Thank you.

15 CHAIRPERSON LIND: Ms. Hollinger.

16 VICE CHAIRPERSON HOLLINGER: Yeah. Matt -- or
17 Mr. Jacobs I view this as, you know, sometimes in the
18 insurance world when you do a cost-benefit analysis,
19 you're -- you know, once you weigh it, yeah, I'm willing
20 to take that risk, kind of in that context. Am I wrong?
21 I mean, it's not necessarily we're -- I don't know.

22 GENERAL COUNSEL JACOBS: I think you're on the
23 right track, but I want to defer to Beliz on that.

24 CHIEF AUDITOR CHAPPUIE: Correct. Sometimes
25 there's also compensating controls where an auditor --

1 VICE CHAIRPERSON HOLLINGER: Right.

2 CHIEF AUDITOR CHAPPUIE: Right. And it's
3 meaningless sometimes what we recommend and the division
4 comes back and says, well, we already have this other
5 control in place --

6 VICE CHAIRPERSON HOLLINGER: It's like we have to
7 have the language but --

8 CHIEF AUDITOR CHAPPUIE: Correct, correct.

9 VICE CHAIRPERSON HOLLINGER: Thank you.

10 CHIEF AUDITOR CHAPPUIE: And Renee is here to
11 chime in.

12 VICE CHAIRPERSON HOLLINGER: Okay. Thank you.

13 EMPLOYER ACCOUNT MANAGEMENT DIVISION CHIEF
14 OSTRANDER: Renee Ostrander, CalPERS staff.

15 So to answer the questions on -- actually, a
16 common example that we have that occurs is we work with
17 our employers. There's a requirement that in payroll you
18 should be reporting your pay rates subspecial separate
19 from your special compensation, right? And special
20 compensation is identified. What will sometimes be found
21 by auditors, and included as a finding, is that they need
22 to be separating that pay rate from their special
23 compensation.

24 So typically, what we will do is we will work
25 with employers to correct it going forward. But, in

1 essence, there isn't anything that changes what that
2 employer is reporting. Overall, we would still be
3 collecting the same contributions. They would still go
4 into the same buckets. The actuarial work would still be
5 the same. When they go to retire, the retirement amounts
6 would still be calculated the same. Having them do that
7 extra work to back it out and then separately report it,
8 doesn't gain anything in terms of changes of what we would
9 make in the long term.

10 So that's a piece of we are accepting the risk to
11 leave them all together in the back. But going forward,
12 we would have them correct it and not closing that finding
13 until they fix it prospectively. So that's -- it's just
14 one. We have other examples, but that's pretty common for
15 us in our area.

16 CHAIRPERSON LIND: J.J..

17 COMMITTEE MEMBER JELINCIC: And I thank you for
18 that example, because it helps me understand what it is
19 that you mean by this.

20 EMPLOYER ACCOUNT MANAGEMENT DIVISION CHIEF
21 OSTRANDER: Absolutely.

22 COMMITTEE MEMBER JELINCIC: But I do appreciate
23 it. Thank you.

24 EMPLOYER ACCOUNT MANAGEMENT DIVISION CHIEF
25 OSTRANDER: Absolutely.

1 CHAIRPERSON LIND: All right. So you've got some
2 input from the Committee and you will come back with a
3 proposed final product at the next meeting, correct?

4 CHIEF AUDITOR CHAPPUIE: Great. Thank you.

5 CHAIRPERSON LIND: Thank you.

6 All right. We are now on to number 9a, the
7 Semiannual Compliance Plan Update.

8 And, Marlene, I think you are up.

9 (Thereupon an overhead presentation was
10 presented as follows.)

11 CHAIRPERSON LIND: Marlene and Kami.

12 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

13 Good afternoon, Chair, Vice Chair, ladies and
14 gentlemen of the Board. Marlene Timberlake D'Adamo,
15 CalPERS staff.

16 I am very happy to be here as the Chief
17 Compliance Officer at CalPERS, and I look forward to
18 working with each one of you in the future.

19 It is my distinct pleasure to introduce to you
20 Kami Niebank. Kami was recently, as of last week, named
21 the Deputy Chief Compliance Officer having recently served
22 as the Interim Chief Compliance Officer.

23 You will remember that Kami was here at this body
24 last year and presented to you the 2015-2017 compliance
25 plan, and she will be here today to provide you with an

1 update on that plan.

2 Lastly, I would like to thank Kami for her
3 stewardship of the Enterprise Compliance Division.

4 And with my remarks completed, I'd like to turn
5 it over to Kami.

6 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: Thank
7 you, Marlene. And this her 7th day on the job. I think
8 she's doing tremendous. She's a quick study and she's
9 going to be up to speed in no time.

10 So with that, Kami Niebank, CalPERS staff. And I
11 will go ahead and give you a brief overview of our
12 semi-annual status on the 2015-17 Compliance Plan.

13 --o0o--

14 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: I'm
15 just going to jump ahead and give you a few of the
16 highlights. So jumping ahead to this slide here is just
17 really to refresh your memory when we brought the plan
18 forward in last June. We said that this is really going
19 to be a multi-year plan. And so we're six months in to a
20 multi-year plan, so I just really want to make the point
21 that we're in design and build mode, just really
22 foundationally.

23 And so with that, we have a lot of core
24 foundational activities that we've been completing, but
25 not a lot of outcomes yet at this stage.

1 --o0o--

2 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: Moving
3 forward to this next slide. This view is kind of what I
4 would call a compliance score card, if you will. We built
5 this using both federal and industry standards on what are
6 the types of areas that compliance professionals look for
7 for a healthy compliance program. It's also something
8 that a regulator or an auditor would look for to
9 demonstrate a healthy compliance program. And the areas
10 that we have on the right-hand side are where we said we
11 would focus for 2015-17. And we've used some shading of
12 the boxes to show you all of the boxes that are white are
13 areas where we have work underway.

14 The distinction of the boxes with the dark
15 outline are those that we originally told you we would be
16 doing work in, and the ones without the dark black outline
17 are areas that we've actually undertaken additional work
18 that we hadn't actually planned to when we were back here
19 in June.

20 --o0o--

21 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: So
22 moving to this next slide, this is to give you a view of
23 the organization structure for enterprise compliance. I
24 think it's really important to point out that
25 predominantly the white boxes on the left-hand side is

1 what the legacy or traditional compliance program looked
2 like, and all of the blue boxes are new roles, new
3 functionality, new capabilities largely for the most part.

4 So as you can see, we've really been
5 transitioning the staff, identifying new functionality and
6 new capabilities based upon the compliance plan that we
7 put forward. And we've actually hired -- since July,
8 we've hired nine new staff in the compliance area, folks
9 who have, you know, great experience and education, who
10 have gone to law school, who have worked in securities
11 industry, who are very familiar with CalPERS organization
12 operations, who really want to be compliance
13 professionals. So I think we are really getting a great
14 solid team who's really interested and engaged in
15 compliance.

16 --o0o--

17 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: This
18 slide here, a couple of things that I want to point out.
19 This is a high level view of our workplan. I'm putting
20 this in front of you to make a couple of points.

21 One is that we're organizing the work around the
22 new organization structure. And the second thing I'd like
23 to point out is that we're only six months in to a
24 multi-year plan again. So we're really on -- again on
25 building out some of those new capabilities. And the last

1 thing, since this is a Risk and Audit Committee, and
2 before I get the question, the colors on the risk levels
3 is not necessarily indicators of being ahead or behind
4 from a status report perspective, but it's really to
5 demonstrate where I believe we have some capability and
6 capacity where we need to build out.

7 So pointing out that we've had some of the
8 enterprise ethics programs in place already. We're doing
9 some things around education and communication. I feel
10 more solid and strong about those.

11 The areas -- the last three years on the bottom
12 are brand new areas where we're really building out new
13 capability and new functionality. So it's red from more
14 of a current state of the function, if you will.

15 --o0o--

16 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: I've
17 also included in here some highlights of accomplishments,
18 and some planned expected activity over the next six
19 months. Again, this is as of December 31st. So some of
20 this work has already been underway. We've also used some
21 indicators kind of showing where we have things in either
22 plan and design phase, where we're in build, where we're
23 in implement or reinforce.

24 So a couple of the highlights that I'm really
25 proud about is the team has built new compliance activity

1 reporting. That's the second item up here. We hadn't had
2 demonstrated compliance activity reporting in the past.
3 So we have both a management level, which is a bit more
4 operational and bit more detailed. And then you had a new
5 report this month, that some of you I'm sure noticed that,
6 demonstrating the types of things we're starting to look
7 at. Again, it's work in progress over time. We'll
8 continue to mature the reporting as we, you know, have
9 more areas that we go into and really start to broaden our
10 oversight and monitoring role.

11 --o0o--

12 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: On the
13 next slide, also very, very proud of the team, and their
14 work around enterprise policy and delegation management.
15 They've done a tremendous amount of work in building out
16 some new tools, some frameworks, and some standards.
17 They've been doing a lot of education and communication,
18 made sure that we have a really strong governance and
19 control structure around policy and delegation management.
20 And one example would be the work that we did with the
21 Actuarial Office looking at their policies and
22 delegations. And I think you've seen some of those
23 policy -- or the Board at large have seen some of those
24 policies come forward.

25 Another area really proud of is working with

1 Donna Lum and Doug Hoffner's area to build out embedded
2 compliance programs. So that's really trying to make sure
3 that their areas have a real culture of compliance and
4 controls and strong ethics. They have above and beyond
5 identified folks on their team to be compliance liaisons,
6 work with us, and start to not only help give us feedback
7 on the types of things we're working on, but also to take
8 the initiative to what are their compliance priorities for
9 their own organizations. So they've done a tremendous
10 amount of work -- you know, effort to work with us on that
11 so far.

12 --o0o--

13 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: I think
14 that kind of concludes the things that I wanted to point
15 out. Again, just on the last slide to make the point that
16 Marlene and I will be back in June with the next phase of
17 the compliance plan and to give you updates.

18 So with that, I'll stop and answer any questions
19 you may have.

20 CHAIRPERSON LIND: Kami, thanks for the great
21 report and the great work. And, Marlene, thank -- welcome
22 to you, and thanks in advance for the work that you're
23 going to be doing for us. We're very excited to have you
24 here. We do have a question from Mr. Jelincic.

25 COMMITTEE MEMBER JELINCIC: Kami, you've heard me

1 talk about ICOR and where it goes. I recognize you're
2 looking at the structure. And so I will defer saying that
3 I think it's misplaced, reporting to the people that it's
4 supposed to be monitoring, especially when the people that
5 are supposed to be monitoring set their salaries.

6 But I also did want to give you a heads up that
7 we're going to have a workshop next month, I believe, and
8 I will be raising that issue at the workshop. But I think
9 it's something we really do need to look at in terms of
10 compliance and control.

11 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: Great.
12 Thank you.

13 CHAIRPERSON LIND: Ms. Taylor.

14 COMMITTEE MEMBER TAYLOR: Yeah. Thanks very much
15 for the report. Really, really good report. I liked
16 seeing that you're on your way to completing this. I had
17 one question on you amended and implemented Conflict of
18 Interest Code to streamline Form 700 designated positions.

19 And as I recall, if I'm thinking correctly, there
20 were additional positions indicated in that. And I just
21 kind of wanted you to go over for me how you came to
22 define those positions based on the Government Code?

23 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: That's
24 a great question. So what we had done in looking at the
25 way CalPERS had implemented their Conflict of Interest

1 Code is we would actually have someone, and let's say they
2 were an AGPA, an analyst position, in Donna Lum's area,
3 they may have been a code filer. But then you would go
4 over to Doug Hoffner's area and they wouldn't have been a
5 code filer.

6 And so we really tried to rather than area by
7 area let the management, you know, kind of decide what
8 level they wanted it to be for filers, we really looked at
9 the agency overall and decided that all management
10 positions had influence, because it's really about what's
11 their influence in the decision-making process. So we put
12 all management within the code. And then we also included
13 the more technical classifications, so investment officers
14 would be a good example.

15 So all the folks that were in more of a
16 generalist, like an SSA or AGPA, we removed those from the
17 code. We kept in those -- those more technical
18 classifications and all of management. So there was a bit
19 of changing, but it really helped us streamline to manage,
20 because when people move different parts of the
21 organization or we really tried to look at their different
22 level of influence in the organization, it was consistent
23 across the board with the new code.

24 COMMITTEE MEMBER TAYLOR: Okay. So let me make
25 sure I'm clear on this, because so -- an AGPA that may

1 have worked in some sort of procurement would have
2 influence. But say they moved over someplace else where
3 they didn't, their position no longer does have that
4 influence. So is it quite that easy or are you looking at
5 it in a more granular level?

6 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: We --
7 management also does still have the discretion, if they
8 felt a particular position in their area should be a code
9 filer, then they would go ahead and elect to have those
10 additional positions. So that is something we worked with
11 management as well.

12 But the code broadly overall, we tried to make it
13 consistent across the Board, and then work with management
14 if we felt there were additional positions who would be on
15 an elected -- elective sort of type to file, if that makes
16 sense.

17 COMMITTEE MEMBER TAYLOR: Right. And then
18 they -- would they carry that with them? Like say they
19 promoted elsewhere, they wouldn't carry that with them.

20 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK:
21 Correct.

22 COMMITTEE MEMBER TAYLOR: I just want to make
23 sure --

24 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK:
25 Correct.

1 COMMITTEE MEMBER TAYLOR: -- that we're not
2 mis-identifying people for code filers as well.

3 So thank you.

4 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: Um-hmm.

5 CHAIRPERSON LIND: All right. That's all the
6 questions I have on that item.

7 Thank you very much.

8 DEPUTY CHIEF COMPLIANCE OFFICER NIEBANK: Thank
9 you.

10 CHAIRPERSON LIND: And lastly, we have summary of
11 Committee direction. I think the only direction is coming
12 back to us on the audit policy revisions, right?

13 CHIEF FINANCIAL OFFICER EASON: That's right,
14 agenda Item 8a --

15 CHAIRPERSON LIND: Yes.

16 CHIEF FINANCIAL OFFICER EASON: -- we'll come
17 back with changes.

18 CHAIRPERSON LIND: I don't have any requests to
19 speak from the public. So we're going to adjourn to
20 closed session. And we need to clear the room, everybody,
21 except for Beliz. And Marlene and Wylie don't go too far.

22 This meeting is adjourned.

23 (Thereupon the California Public Employees'
24 Retirement System, Board of Administration,
25 Risk and Audit Committee open session

meeting adjourned at 3:19 p.m.)

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

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

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

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

14 IN WITNESS WHEREOF, I have hereunto set my hand
15 this 24th day of April, 2016.

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