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## **CULTURE OF COMPLIANCE**

Each year the California Public Employees' Retirement System (CalPERS) compiles an Annual Compliance Report for inclusion in the *Comprehensive Annual Financial Report* (CAFR). This year's report highlights activities and accomplishments for the Fiscal Year ending June 30, 2016.

Compliance is embedded into our strategy, culture, and day-to-day business operations as our activities and accomplishments directly support our organization's business plan and core values. CalPERS launched our compliance program in 2004 to support our commitment of strong ethics, compliance, and risk management practices. In 2015, we developed a new multi-year compliance plan, building upon the already effective compliance practices in place. This new compliance plan takes into account current industry trends along with management input in establishing compliance focused priorities.

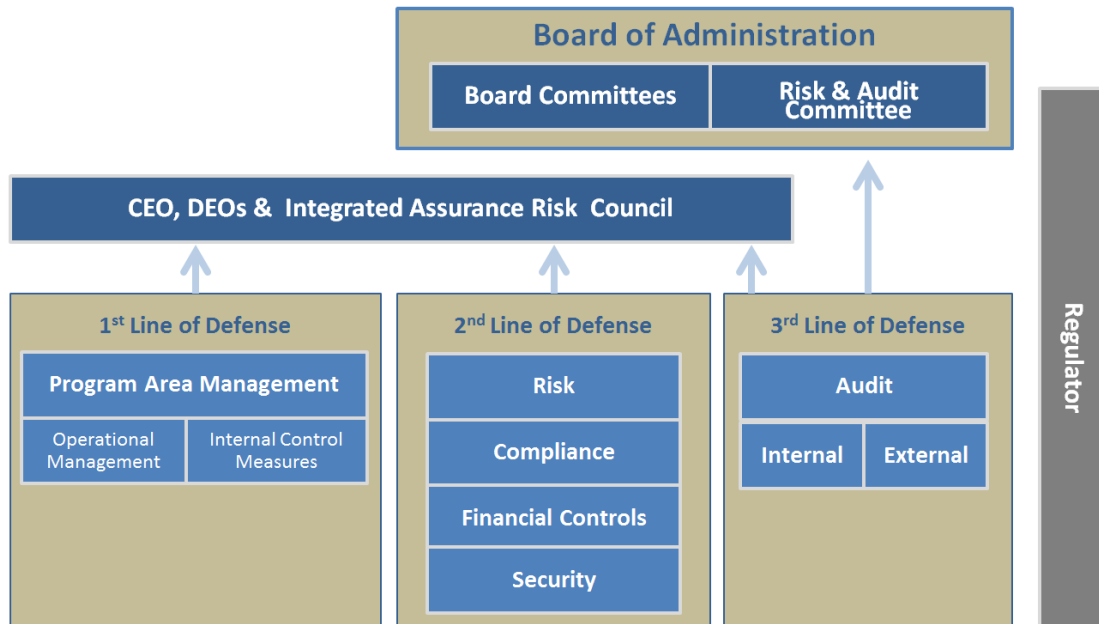
As part of implementing the compliance plan, we are developing frameworks and tools aimed at enhancing our control environment, addressing operating events, and improving the management of policies and delegations of authority. Additionally, the compliance plan focusses on fostering a compliance-aware culture through communication, education, and training. Fiscal Year 2015–16 is especially significant as it highlights activities and accomplishments during “Year One” of our compliance plan.

Compliance awareness, risk management and internal controls are integral to cultivating a high-performing, risk-intelligent, and innovative organization. To implement our governance, risk, and compliance practices, we have embraced an Integrated Assurance Model to promote a multi-faceted approach to compliance awareness and accountability. The model centers on a Three Lines of Defense framework, which promotes collaboration and an increased understanding of roles and responsibilities in an effort to detect and prevent instances of non-compliance.

The Board of Administration and executive management team provide direction and oversee the effectiveness of our organization's compliance practices using the Three Lines of Defense (*see* Figure 1).

- **First Line of Defense** – The first level of the control environment are the program areas, which perform day-to-day risk management activities.
- **Second Line of Defense** – Oversight functions, such as Enterprise Compliance and Enterprise Risk Management, set direction, define policy, and provide assurance.
- **Third Line of Defense** – Internal and external audits offer an independent challenge to the levels of assurance provided by program areas and oversight functions.

## INTEGRATED ASSURANCE MODEL: THREE LINES OF DEFENSE



(Figure 1)

The Integrated Assurance Model helps clarify roles and responsibilities and promote ownership of compliance throughout the organization. Through the Three Lines of Defense, CalPERS encourages a culture of “doing the right thing.” By fostering a work environment based on our core values of quality, respect, integrity, openness, accountability and balance, CalPERS also recognizes that “compliance is everyone’s responsibility.”

### FISCAL YEAR 2015-16 HIGHLIGHTS

Fiscal Year 2015-16 was a significant year for CalPERS as we began implementing our new compliance plan. Programs launched many initiatives and activities that laid the foundation for long-term success, focusing on five key areas: (1) roles and responsibilities, (2) operating event management, (3) control environments, (4) policy and delegation management, and (5) education and compliance awareness. These key areas provide the foundation for our compliance efforts and will continue to remain a focus for multiple years to strengthen CalPERS’ culture of compliance.

## **FIRST LINE OF DEFENSE**

The First Line of Defense in any control environment is program functional area management and staff, who are responsible for the performance of activities. In addition to performing day-to-day operations, the functional areas are responsible for compliance and risk mitigation. Highlights of our program area activities are described below.

### **HEALTH ADMINISTRATION**

In Fiscal Year 2015–16, CalPERS completed a multi-year Dependent Eligibility Verification project, conducted to ensure that only eligible dependents are enrolled in CalPERS health plans.

In accordance with California Code of Regulations Title 2, section 599.500(o), CalPERS clarified health enrollment eligibility standards for a parent-child relationship by requiring health plan subscribers to submit specific documents, in addition to the Affidavit of Parent-Child Relationship, to clearly substantiate the parental role within that dependent type.

As of September 1, 2015, a total of 18,282 ineligible dependents, 2.6 percent of the entire project's dependent population, were removed from coverage. Savings and claims cost avoidance are estimated to be almost \$122 million during Fiscal Year 2015-16. The initiative and its expected cost savings are part of CalPERS' ongoing endeavors to help our employers and members manage their health care costs.

Under the Affordable Care Act (ACA) CalPERS enhanced the compliance processes, by taking the following steps:

- Issued Circular Letter 600-064-15 to inform contracting public agencies of changes to reporting requirements for applicable large employers under sections 4980H and 6056 of the Internal Revenue Code and for providers of minimum essential coverage under section 6055.
- Partnered with the California Department of Human Resources and the State Controller's Office to identify process and financial impacts to the state including implementing changes to comply with Employer Shared Responsibility regulations, and the applicable large employer reporting requirements pursuant to the ACA on an ongoing basis.

- Collaborated with health plan partners to ensure accurate and timely minimum essential coverage reporting to the Internal Revenue Service and information statements to CalPERS members pursuant to section 6055 of the Internal Revenue Code.

In October 2015, CalPERS expanded eligibility for its Long-Term Care (LTC) Program to all classes of persons who meet the eligibility requirements of the Internal Revenue Code. This now includes current and former California Public Employees (including retirees) as well as grandparents, grandchildren, non-adult children, nephews, nieces, aunts, uncles, sons-in-law, daughters-in-law, brothers-in-law and sisters-in-law.

To improve our procurement process, CalPERS developed and executed a Pharmacy Benefit Manager (PBM) procurement using an innovative competitive solicitation process that assessed bidding firms' capabilities, management, work and staff plans, finances, and pricing. CalPERS also designed and produced model contracts with all pricing elements and negotiated pricing and contract terms with all final vendors prior to the CalPERS Board awarding a contract. This process significantly reduces the risk of nonperformance due to insufficient assessment of capabilities and secures pricing for the next five-year contract.

To ensure that resolutions are accurately and consistently completed, CalPERS conducted a review and revision of all health resolution templates that strengthened contract language during Fiscal Year 2015-16. The number of templates used by staff was reduced by 74 percent. This will also make maintenance more manageable and improve the health contracting process for public agencies and schools moving forward.

Finally, CalPERS completed a comprehensive compliance review of the CalPERS program that operates under the regulation of the Health Insurance Portability and Accountability Act (HIPAA). This included implementation of automated methods to evaluate our compliance with the policies specified in the Information Security Section of the California State Administrative Manual. Additionally, we performed an exhaustive analysis of privacy laws, regulations, and policies to create a library of standards that will enable measurement of compliance in regards to privacy.

### **PENSION ADMINISTRATION**

In an effort to address threats to our ability to provide pension funding, we have taken steps toward understanding and strengthening the ability of our fund to pay promised benefits. As a result of a process instituted by the Chief Financial Officer, the Finance, Investment, Actuarial and Communication and Stakeholder Relations offices have coordinated in an unprecedented

way to assess and address threats to our ability to maintain the necessary levels of pension funding. This process, deemed Asset Liability Management (“ALM”), provides an integrated ALM framework and establishes an ALM committee to oversee the process. We developed a funding risk mitigation concept that helps to pay down the pension fund's unfunded liability, providing greater predictability and less volatility in contribution rates for employers.

In November 2015, the CalPERS Board of Administration adopted the new Funding Risk Mitigation Policy to ensure that the CalPERS Fund is sustainable over multiple generations. The Funding Risk Mitigation Policy supports CalPERS’ goal to increase the long-term sustainability of pension benefits for its members. Based on an integrated asset liability management (ALM) framework, the approved policy supports the concept of reducing risk and volatility in the pension system by incrementally lowering the discount rate in years of good investment returns and adjusting the asset allocation to account for the new discount rate. The policy also includes periodic reviews to assess the progress toward reducing risk as part of the ALM process that will be presented annually to the Board of Administration. This enterprise-level discussion of risk enables us to assess and monitor the economic impacts of risk and helps to inform investment and strategic decisions. The Funding Risk Mitigation Policy is the ultimate product of this collaborative effort and seeks to help strengthen overall pension funding.

Our Disability Retirement program area began removing disability retirees from the retirement roll who were non-compliant with the re-evaluation process in accordance with the California Government Code. Those removed had failed to provide either medical substantiation for their claimed disability or visit an Independent Medical Examiner to validate an ongoing disability.

Effective April 2016, Section 555.5 was added in to Title 2 of the California Code of Regulations mandating appropriate interest when any payment owed to a participant from a defined benefit plan has been delayed beyond a reasonable administrative processing time. (2 Cal. Code Regs. section 555.5) In compliance with this newly approved regulation, we added the ability to automatically identify delayed retirement payments exceeding 45 days, calculate interest amounts, and provide a method for users to pay interest based on an approved claim.

We continued to provide our members with access to my|CalPERS, a secure self-service website to access real-time details and manage CalPERS accounts. This year, significant enhancements were made to improve my|CalPERS to ensure compliance, minimize risk, and enhance the user experience, including:

- Improved system validations by generating an error message for our business partners when reporting payroll that spans multiple employer and/or member contribution rates.

- Implemented system validations to require business partner certification of pay rates exceeding specified thresholds.
- Applied new logic to require payroll transactions to identify special compensation category and type for all members.
- Implemented new my|CalPERS system functionality for the Compensation Review Units (CRU) to increase our cross-divisional efficiencies that aid in maintaining the integrity of the fund and further reduce organizational risks.
- Automated my|CalPERS system reports that significantly reduced the manual production of reported required by GASB 68.

CalPERS restructured its Complementary Annuitant Premium Program to ensure compliance with statutes and regulations. We also completed User Access Review assessments to maintain member data integrity and privacy and restrict access to designated staff. We ensured increased quality outcomes by refining processes and strengthening procedures for member refund documentation.

During Fiscal Year 2015-16, we also developed new system functionality that allows for a more effective and accurate reconciliation of the annual and daily activity in the member record and employer risk pools. The automated functionality reports discrepancies between the member record, risk pools, and deductions from benefit roll. This allows staff to resolve reconciling items and complete reconciliations in a timely manner.

During Fiscal Year 2015–16, we produced 3,627 annual government-mandated actuarial valuations that set employer contribution rates and reported plan assets and liabilities for state and public agencies, schools, the Legislators’ Retirement System, the Judges’ Retirement Systems I and II, and the 1959 Survivor Benefit Program.

## **INTERNAL OPERATIONS**

### **Financial Controls & Reporting**

During Fiscal Year 2015–16, CalPERS developed new Enterprise Compliance Activity reports for management, which focus on improving the level of disclosure effectiveness. Our continual review and attention ensures that compliance reporting and disclosures remain timely and relevant.

In compliance with our enterprise-wide policy management process, we comprehensively reviewed and consolidated six actuarial policies into two new policies: the Actuarial Cost Method Policy and the Actuarial Amortization Policy. The new consolidated policies generally kept the same content of the past policies, but adds dollar billing for the unfunded liability portion of all public agency plans. Dollar billing allows unfunded liabilities to be invoiced monthly as a dollar amount.

Additionally, the Actuarial Amortization Policy added elements of the newly adopted Funding Risk Mitigation Policy. This review followed a collaborative process involving subject matter experts from across CalPERS and consultation with employers, employee organizations, and other stakeholders. The review ensures consistency with actuarial and policy management best practices.

In October 2015, we implemented the Treasury Management Reserves Policy and developed a funding contingency plan. The Treasury Management Reserves Policy was created to ensure the payment of member benefits and other obligations without interruption while optimizing the use of the fund assets. This policy reduces funding risk by implementing pre-funding processes for funds with large predictable outflows. The funding contingency plan defines the asset-based and financial options available to our organization, their usage criteria, and the management protocols to be followed during a liquidity event.

The CalPERS Budget is an annual financial plan, and its purpose is to promote long-term economic sustainability and responsible resource allocation to meet our mission of providing and maintaining retirement and health security for our members. We received Board approval for the CalPERS Budget Policy to ensure that our budgeting practices align with the allocation and use of resources to meet our organization's mission and strategic objectives. Establishing the policy ensures our organization maintains a fiscally sustainable balanced budget that translates the intentions of our strategic plan and objectives.

To meet statutory requirements, we also developed and submitted the following reports:

- Annual report to the Legislature, State Controller, Director of Finance, and Legislative Analyst Office within 100 days of adopting annual health premium increases and decreases that describes methods employed to moderate annual increases in premiums pursuant to the Budget Act of 2015 (Stats. 2015, Ch. 10, Sec. 2.00, Item 7900-015-0822 (2)).



- One-time report to the Joint Legislative Budget Committee and the Department of Finance on the administration of the State retiree health care program that details compliance with Government Code section 22844 and California Code of Regulations sections 599.516 and 599.517 pursuant to the Budget Act of 2015 (Stats. 2015, Ch. 10, Sec. 2.00, Item 7900-001-0950 (2)).

In March 2016, CalPERS received the first Semi-Annual Treasury Analysis and Liquidity Status Report. The report provided information regarding the funding coverage of our organization, including liquidity ratio and cash flow forecasting analysis. A coverage ratio analysis manages risk by indicating whether the fund is operating at inadequate or at excessive levels of liquidity during normal, stressed, and crisis scenarios. Cash flow forecasts were created for organizational areas where business activity can result in a material impact to our organization's liquidity.

This year, two additional types of internal reporting were added that validates the information used to calculate benefits and tax liabilities improving quality assurance related to the payment of benefits. This also improves the accuracy of tax reporting.

For the first time in 2015, we produced 3,627 Governmental Accounting Standards Board (GASB) 68 Cost Sharing and Agent Multiple Employer valuations. Once the first year of GASB 68 valuations were completed, we began the second year of GASB 68 valuations and immediately redesigned and transformed 3,195 GASB 68 Cost Sharing Multiple Employer valuations into two reports; one for miscellaneous plans and one for safety plans. A total of 432 GASB 68 Agent Multiple Employer valuations were also completed as part of this process.

GASB No. 72, Fair Value Measurement and Application, was implemented. It prescribes how assets and liabilities should be measured at fair value as well as expands disclosures related to fair value measurements.

### **Investment Office**

Investment Compliance and Operational Risk serves as an embedded compliance function and assists our Investment Office staff by ensuring compliance with key policies, laws, and regulations that impact the Investment Office.

In Fiscal Year 2015–16, CalPERS Investment Compliance and Operational Risk organized and administered investment compliance training for Investment Office employees. The training addressed ethics, conflicts of interest, and the impact of Dodd-Frank legislation on the private and public asset classes.

We substantially completed Phase II of the Investment Policy Revision Project to align our various asset class investment policies with the new Total Fund Policy framework. This was done in an effort to minimize complexity, improve transparency and strengthen processes, systems, governance and controls. The project resulted in a substantial reduction of investment policies, standardization and clarity of language, and efficiency for ongoing maintenance activities.

### **Human Resources**

In Fiscal Year 2015–16, we attained an enterprise-wide annual mandatory training completion rate of 99.3 percent, as of July 1, 2016. The training included Health Insurance Portability and Accountability Act (HIPPA), Information Security Awareness, and Working Values: Ethical Decision Making.

We also conducted an annual workforce analysis to establish an effective Equal Employment Opportunity (EEO) program and to provide EEO to all employees.

In support of labor relations activities, we achieved the following:

- Resolved 11 represented and excluded employee grievances at the lowest level
- Negotiated and implemented the Actuarial Study Program
- Continued work on the 5.10 and 14.8 Joint Labor Management Committee (JLMCs) to address issues of mutual concern and contracting out with the Service Employees International Union (SEIU) in a problem solving and information sharing context

### **Education & Training**

In compliance with CalPERS' related Board Member Education Policy(Government Code 20100), Board Members attended eight educational sessions for a total of 16.25 hours toward the 24-hours required in every two-year period. CalPERS also developed a program schedule to continue to offer sessions to assist Board members and designees in meeting the educational requirement on an ongoing basis. A report of Board member compliance was posted on the CalPERS website.

In support of State Administrative Manual section 5300, CalPERS implemented asset management software and strengthened internal software inventory processes and procedures.

For security awareness, a training program was enhanced to include ongoing phishing education exercises.

Additionally, 2,800 staff members were provided with information security training and we performed three independent information security assessments during the year.

To support and enhance understanding and compliance with the law of the CalPERS Public Records Act (PRA) process, we conducted a training session in February 2016 for all coordinators, backups, and managers. Training was also delivered to executive staff and senior leadership, as well as one-on-one training sessions with individual staff members, on the overall PRA process and statute.

We implemented mandatory contract manager training to strengthen controls and role clarity around contract management. Along with this training, we added processes and procedures, and developed reports to better assist with Small Business and Disabled Veteran Business Enterprise (DVBE) participation goals and annual reporting. These efforts contributed to CalPERS recognition, for the second consecutive year, as the Small Business and DVBE Advocate of the Year by the Department of General Services for exceeding participation goals.

### **Administration**

The California legislature enacted the California's Dymally-Alatorre Bilingual Services Act in order to ensure that California residents would appropriately receive services from public agencies regardless of the person's English language skills. Each state agency shall conduct a language survey and develop and update an implementation plan every two years (Cal. Gov't Code section 7299.4). This plan should identify significant problems or deficiencies and propose solutions where warranted. In compliance with this Code, we conducted a statewide language survey to determine the number of annual public contacts by native language, the number of bilingual employees in public contact positions, and available options to serve language needs. As a result of the survey, we were able to provide alternative complaint forms to customers with languages identified as frequently used both on the CalPERS' website and in regional offices.

Governor's Executive Order B-18-12 directed California state agencies and departments to take immediate steps to "green" the state's buildings, reduce greenhouse gas emissions and improve energy efficiency. Additionally, in order to address the anticipated statewide drought conditions, state agencies were also directed to establish baseline water use figures at their facilities going back to 2010, and to report annual water use. During Fiscal Year 2015-16, we continued to implement sustainable building practices and energy and water efficiency improvements in

compliance with these mandates. Water savings measures from January through December 2015 resulted in a 32 percent reduction (over 8 million gallons) compared to the 2010 water usage baseline. CalPERS headquarters energy use was reduced by 33 percent in 2015 based on the 2003 baseline through major data center energy efficiency projects.

CalPERS proudly supported “Sunshine Week 2015,” a week dedicated to promoting transparent and open government. We used established social media channels to share the goals of Sunshine Week and to remind the public about steps we have taken to become more transparent.

## **SECOND LINE OF DEFENSE**

CalPERS Enterprise Compliance Division and Enterprise Risk Management Division partnered and collaborated under the Second Line of Defense in order to provide oversight, guidance, and monitoring of governance, risk, and compliance activities. Through these efforts, we are able to support the organization in mitigating strategic and operational risks along with strengthening the organization’s control environment and promoting strong ethical business practices. To demonstrate this alignment, both divisions work closely together to develop and implement their annual plans.

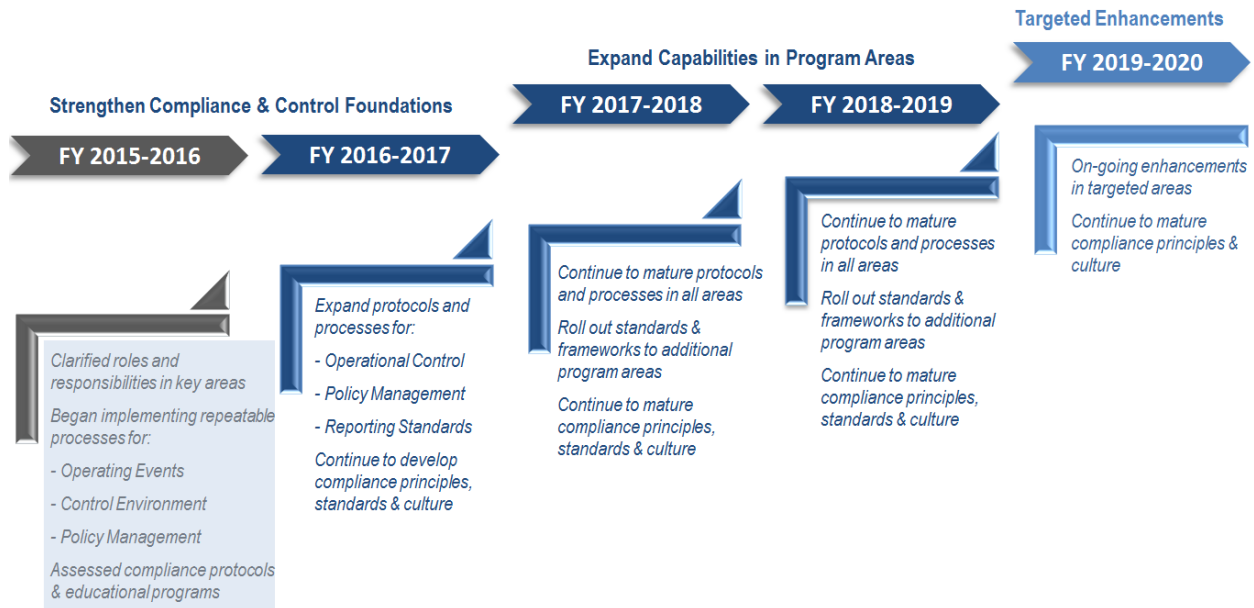
The Office of Audit Services, while independent and considered the Third Line of Defense, partnered with the Risk and Compliance divisions during the annual risk assessment process in an effort to strengthen their understanding of risks and mitigation strategies underway. The participation of the Office of Audit Services will ultimately help to maximize integrated assurance practices.

## **ENTERPRISE COMPLIANCE**

The mission of the Enterprise Compliance Division is to ensure that CalPERS maintains compliance with the letter and spirit of all applicable laws and regulations, in partnership with the areas responsible for delivering services (i.e. pension, administration, operations, customer support services.) The oversight role of the Enterprise Compliance Division, as a Second Line of Defense, was enhanced through compliance activity reporting and the creation of compliance governance structures. Through increased dialogue and awareness with program management, roles and responsibilities were clarified resulting in enhanced internal control functions, identification of new compliance priorities, and stronger partnerships throughout our System.

The implemented Five-Year Compliance plan is aimed at building and enhancing compliance capabilities to mature the program and is consistent with changes in the broader compliance

landscape (*see* Figure 2). The compliance plan focuses on strengthening our compliance and ethics program by fostering a culture of compliance, clarifying the compliance governance structure, and providing our Board and management with compliance tools and information to fulfill their oversight responsibilities.



(Figure 2)

We implemented the initial framework, outreach, and reporting structure of embedded compliance and risk programs for the Operations and Technology and Customer Services and Support branches. This helped to strengthen our own internal control processes and aid in role clarity. Previously implemented embedded compliance frameworks in our Investment Office served as a model for rollout to the rest of our organization. The embedded compliance and risk liaisons are responsible for working directly with their respective program areas and Enterprise Compliance and Risk divisions to enhance CalPERS' ability to identify and resolve compliance issues.

Liaisons communicate compliance efforts across their respective branches. The work performed this year allows for future program development and designation of staff to assist with the program. Effective July 1, 2016, new positions were approved for each embedded compliance and risk program area to assist with the branch-wide operating event reporting structure and additional compliance and risk activities in the upcoming year.

## **Operating Event Management**

An operating event management process is a systematic way to detect, correct, diagnose and resolve potential incidences of non-compliance or gaps in internal controls discovered during “day to day” operations. This approach empowers our program management and front line supervisors to identify, triage and resolve potential internal control and non-compliance issues.

The Operating Event Management process allows for aggregated reporting of operating events to management. The end result will be an enterprise-wide incident management system; allowing senior leadership to identify and track trends across our organization.

In Fiscal Year 2015–16, the operating event management process was rolled out to embedded compliance and risk liaisons in the Customer Service and Support and Operations and Technology branches. The system is also modeled on the existing processes used by our Investment Office embedded compliance and risk personnel.

## **Control Environment**

Program areas continue to develop and enhance standard operating procedures and processes to guide us in effectively carrying out business operations while promoting a culture of effective internal controls and compliance. A robust control environment allows us to (1) run our operations efficiently and effectively, (2) report reliable information to management and stakeholders, and (3) comply with applicable laws and regulations. Below is an overview of efforts that were completed in Fiscal Year 2015–16.

### Conflict of Interest Code

The Political Reform Act (Cal. Gov't. Code section 81000 et seq.) requires us to adopt and periodically update a Conflict of Interest Code (the Code). The Code designates positions at CalPERS that are required to file a Statement of Economic Interests - Form 700. The CalPERS Conflict of Interest Code (Code) was amended and approved by the CalPERS Board effective October 8, 2015. The revisions to the Code: (1) ensure that designated positions are reflected by state classification instead of working titles meaning greater alignment to statutory requirements; (2) organize disclosure categories at the agency-level rather than at the division-level which provides consistent levels of disclosure across the organization; and (3) promote further transparency.

Given the significant changes to the Code, 363 staff members were required to file a Statement of Economic Interests - Form 700 indicating their changed status under the Code. During

October and November of 2015, the Enterprise Compliance Division notified impacted individuals, and partnered with CalPERS' Legal Office to hold informal "office hours" to address any inquiries or concerns. As of December 7, 2015, all 363 staff members had filed their statements.

In accordance with the Political Reform Act, members of CalPERS Board, designated staff, and consultants are required to annually file a Form 700 - Statement of Economic Interests, disclosing their financial interests. Consistent with Fair Political Practices Commission (FPPC) requirements, CalPERS filing officer provided the oversight and monitoring of all filings. The 2015 Annual Form 700 Statements were due March 1, 2016, for elected Board Members and April 1, 2016, for all other filers. Enterprise Compliance began notifying affected individuals in January 2016. The Enterprise Compliance Division also partnered with CalPERS Investment and Legal offices to provide communications, training and office hours for staff to ask questions about the amended filing requirements. To ensure more complete and accurate filing, Enterprise Compliance staff made a significant effort to encourage electronic filing. As of April 1, 2016, 100 percent of CalPERS staff filers had completed their annual statements in a timely manner.

#### CalPERS Personal Trading Regulation

The Regulations Enacting Personal Trading Guidelines for CalPERS Employees Personal Trading ("Regulations") require that CalPERS covered persons and their spouses or registered domestic partners disclose personal investment holdings and use a personal trading pre-clearance system. (2 Cal. Code Regs. section 558.1) This requirement is intended to safeguard against trading with material non-public information and ensure that our staff meets their fiduciary obligations to our fund and members. Enterprise Compliance administers the regulations via an automated platform and provides additional safeguards thereby reducing the risk of restricted trading. Annually, covered persons are responsible for completing Personal Trading Attestations certifying they (1) have disclosed all covered accounts and (2) have read and understand the Regulations. As of June 30, 2016, all CalPERS covered persons had completed their Annual Attestation requirements.

#### Ethics Helpline and Citizen Complaint Act of 1997

CalPERS maintains and monitors a third-party hosted Ethics Helpline that provides a means to confidentially, anonymously and securely report allegations of unethical behavior. In compliance with the Citizen Complaint Act of 1997 (Cal. Gov't. Code section 8330 et seq.), CalPERS Online also provides a plain-language online form that members of the public may submit comments, complaints, or suggestions about our performance.

To strengthen our program, we refined administration and reporting procedures for the Ethics Helpline and Citizen Complaint portal. These process changes and enhancements to reports provide more meaningful information to our stakeholders and adds a means to measure the success, or need for improvements to our Ethics Program.

### **Policy and Delegation Management**

CalPERS has established enterprise-wide standards for delegations of authority and policy management consistent with professional best practice. These standards include templates, guidelines, definitions, process flows, and establishment of clear oversight and policy management roles and responsibilities. A policy governance group made up of representatives from our compliance, risk, legal, and human resources divisions was created to provide input on policies. The new policy changes will continue to promote and improve accountability, standardization, and good policy management practices. In turn, this will aid in compliance monitoring and testing.

### **Education and Awareness**

We have reignited awareness of compliance principles throughout our organization as a means to promote a culture of compliance. This was done by expanding its channels of communication by using tools such as the intranet, internal social media page (the SPARK), and enhanced classroom training. Enterprise Compliance also expanded and implemented compliance communication and branding efforts. An example of this is the Enterprise Compliance Division's involvement at the annual CalPERS Career and Education Fair. Compliance staff used creative methods, such the "Debunking Compliance Myths" true or false game to engage visitors.

During the month of September 2015, we hosted a workshop on internal controls, financial reporting, and audits for the CalPERS Board of Administration. An additional Board workshop was held in May 2016, which focused on risk and compliance management. These workshops served to strengthen our Board's understanding of the concepts and enable them to successfully fulfill their roles and responsibilities. Additionally, Enterprise Compliance offered new classroom training sessions to our executives and senior managers on a broad array of compliance and ethics topics. This included conflict of interest disclosure rules, travel guidelines, incompatible activities, and personal trading regulations. A "Compliance Town Hall," included customized compliance scenarios, was also held in May 2016 for managers in our Financial Office.



## **ENTERPRISE RISK MANAGEMENT**

The Enterprise Risk Management Division supports CalPERS Strategic Plan Goal B: Cultivate a high-performing, risk-intelligent and innovative organization. Enterprise Risk Management Division is responsible for developing, facilitating, and maintaining a risk-intelligent culture at CalPERS. This is accomplished by providing risk management training, conducting risk assessments, performing risk dashboard recalibration, and developing tools to assist our staff in identifying, monitoring, and responding to risks to our organization.

Risk assessments are performed to identify, analyze, evaluate, treat, communicate, and monitor risks on an on-going basis. Risk assessments provide effective and efficient deployment of enterprise risk management resources by addressing:

- Areas of high risk
- Risks that potentially impact multiple program areas
- Core business activities of our organization
- Assurance on management risk response
- Enhancement of a more robust risk management program

When assessments are performed systematically and consistently throughout CalPERS based upon the Enterprise Risk Management Framework and risk assessment criteria, management is empowered to focus our resources on the most significant risks and to make more informed risk decisions.

### **State Leadership Accountability Act (SLAA) (Formerly known as FISMA)**

The California State Leadership Accountability Act (SLAA), requires state agencies to “maintain effective systems of internal control, to evaluate and monitor the effectiveness of these controls on an ongoing basis, and to biennially report on the adequacy of the agency's systems of internal control” (Cal. Gov’t Code section 13400 et seq.) Effective June 24, 2015, SLAA was modified and updated through legislative action . The intent of the change is to provide the Department of Finance (DOF) with assurance that all levels of management are involved in evaluating, strengthening, and monitoring internal controls. SLAA requires each state agency to:

- Maintain effective systems of internal control
- Evaluate and monitor the effectiveness of these controls on an ongoing basis,
- Biannually report on the adequacy of the agency's systems of internal control

The SLAA reporting was completed and timely filed with the DOF on June 30, 2016.

### **Integrated Assurance Risk Assessment**

Enterprise risk management collaborated with the Enterprise Compliance Division and the Office of Audit Services to develop a joint assessment tool. They also collaborated to conduct the annual integrated assurance risk assessment interviews with each CalPERS division and senior executive. Upon completing the integrated assurance risk assessments, the three program areas convened to analyze findings. This analysis confirmed top enterprise risks and revealed common themes to consider when contemplating the most effective mitigation measures to determine if present mitigation plans are appropriate.

### **Risk Management Framework Revision**

In the spring of 2016, Enterprise risk management led an effort to revise the Enterprise Risk Management Framework. The objectives were to consolidate the current 30 risk domains into more manageable related categories with risk statements that more concisely state the risks from an enterprise perspective. The purpose of these efforts include:

- Focused risks and risk statements will lead to more concise and effective mitigation measures
- Consolidating risks with significant correlations provides the opportunity to implement mitigation strategies that are synergistic and produce an enterprise-wide impact
- Mitigation efforts should be aimed at risk drivers

As a result of the working group's efforts the 30 enterprise risks presented in November 2015 to the CalPERS Risk and Audit Committee meeting, were revised to 11 Enterprise Risks. In June of 2016, staff presented the revised framework and redefined 11 Enterprise Risks that was approved by our Board. In addition, the risk framework produced associated risk statements, identified the executive owner, and specified Board Committee oversight.

## **THIRD LINE OF DEFENSE**

Internal and external audits are the Third Line of Defense, offering an independent component to the levels of assurance provided by program areas and compliance and risk oversight functions.

## OFFICE OF AUDIT SERVICES

CalPERS maintains an effective audit program comprised of internal audits and contracting public agency reviews. Our internal auditors perform assurance and consulting work consistent with the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing.

In developing a risk-based audit plan, Audit Services coordinated its risk assessment activity with the Enterprise Compliance Division and Enterprise Risk Management Division to ensure proper coverage and minimize duplication of work while still achieving its respective objectives. Our organization benefits from an integrated assurance approach in identifying the gaps in risk assessment, compliance and internal controls while reducing cost and sharing information more effectively.

In 2015-16, our Audit Services reviewed 100 agencies for both compliance and census data testing and performed 25 limited scope reviews utilizing business intelligence for potential pension spiking. In 2014-15, we reviewed 85 agencies for compliance and performed census data testing on 40 agencies. As a result of the 125 compliance reviews, our Public Agency Team identified 643 compliance issues. Compliance reviews often identify misreporting prior to member retirement. The impact of misreporting could result in corrections to members' retirement benefits and increased workload to CalPERS in making those corrections.

As part of the review process, our staff educated employers on the Public Employees' Retirement Law requirements and also communicated the areas of non-compliance to CalPERS internal programs to assist them in identifying training needs for employers.

In Fiscal Year 2015-16, 35 internal audits were also completed. These audits included reviews of health premium receipts and disbursements, Administration of Old Age and Survivors Insurance program, Judges' Retirement System, myCalPERS Users Access Rights, PeopleSoft Human Capital Management, Information Technology Asset Management, health plan contract compliance, and external real estate manager contract compliance.

Additionally, we have engaged DOF to perform a quality assurance review (peer review) of our organization to ensure we comply with internal auditing standards. The report will be completed before the end of December 2016.