

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 P STREET
SACRAMENTO, CALIFORNIA

TUESDAY, JUNE 20, 2017

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A P P E A R A N C E S

COMMITTEE MEMBERS:

Ms. Dana Hollinger, Chairperson

Mr. Ron Lind, Vice Chairperson

Mr. Rob Feckner

Mr. Richard Gillihan

Ms. Priya Mathur

Mr. Bill Slaton

Ms. Betty Yee, represented by Mr. Alan Lofaso

BOARD MEMBERS:

Mr. Henry Jones, Vice President

Mr. John Chiang, represented by Ms. Jeree Glasser-Hedrick

Mr. J.J. Jelincic

STAFF:

Ms. Marcie Frost, Chief Executive Officer

Mr. Matthew Jacobs, General Counsel

Ms. Marlene Timberlake-D'Adamo, Interim Chief Financial Officer

Ms. Beliz Chappuie, Chief Auditor

Mr. Forrest Grimes, Chief Risk Officer

Ms. Carrie Lewis, Committee Secretary

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

ALSO PRESENT:

Mr. David Bullock, Macias, Gini & O'Connell

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

Ms. Caroline Walsh, Macias, Gini & O'Connell

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P R O C E E D I N G S

CHAIRPERSON HOLLINGER: I'll call to order the Risk and Audit Committee. Yeah, we've got to get that's true.

Okay. Could the rest of Committee members come forward. Should we wait for Rob?

Is Rob coming?

Okay. First item of business is call to order and roll call.

COMMITTEE SECRETARY LEWIS: Dana Hollinger?

CHAIRPERSON HOLLINGER: Here.

COMMITTEE SECRETARY LEWIS: Ron Lind?

VICE CHAIRPERSON LIND: Here.

COMMITTEE SECRETARY LEWIS: Rob Feckner?
Richard Gillihan?

COMMITTEE MEMBER GILLIHAN: Here.

COMMITTEE SECRETARY LEWIS: Priya Mathur?

COMMITTEE MEMBER MATHUR: Hello.

COMMITTEE SECRETARY LEWIS: Bill Slaton?

COMMITTEE MEMBER SLATON: Here.

COMMITTEE SECRETARY LEWIS: Alan Lofaso --

ACTING COMMITTEE MEMBER LOFASO: Here.

COMMITTEE SECRETARY LEWIS: -- for Betty Yee?

CHAIRPERSON HOLLINGER: Great. Second item of business is the Executive Report by Marlene

1 Timberlake-D'Adamo.

2 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

3 D'ADAMO: Good morning. Thank you, Madam Chair, Vice
4 Chair and Committee members. Marlene Timberlake-D'Adamo,
5 CalPERS team member. I would like to provide you with a
6 preview of today's Risk and Audit Committee.

7 First, on consent, we have our standing items:
8 2017 and 2018 calendars, and a draft agenda for the
9 September 2017 meeting. On consent we also have provided
10 quarterly status reports for the Office of Audit Services,
11 And Enterprise Risk Management, and Enterprise Compliance.

12 Moving to the action addenda item, today we are
13 providing you with the annual plans for Compliance, Risk
14 Management, and Audit. Additionally, our independent
15 auditor, Macias, Gini & O'Connell, are here to present to
16 you their 2017-18 audit plan.

17 On Item 8a comes to you as an information item
18 from Forrest Grimes, CalPERS Chief Risk Officer. He will
19 provide an update on the Enterprise Risk Management
20 reports, including the Board risk appetite statements,
21 which is the next step in refining the enterprise risk
22 management framework.

23 The next Risk and Audit Committee meeting is
24 scheduled for September 14th, 2017, and includes external
25 audit fees, third-party valuation and certification of the

1 Judges' Retirement System, the Judges' Retirement System
2 II, the Legislators' Retirement System, 1959 Survivor
3 Benefit Program all as of June 30, 2016, and the annual
4 Compliance Report for 2016-17.

5 Thank you, Madam Chair. This concludes my
6 report. I would be happy to take questions.

7 CHAIRPERSON HOLLINGER: Thank you.

8 Any questions?

9 I also want to note for the record that Henry
10 Jones is here, and Jeree --

11 ACTING BOARD MEMBER GLASSER-HEDRICK:

12 Glasser-Hedrick.

13 CHAIRPERSON HOLLINGER: -- Glasser-Hedrick is
14 here, and J.J. Jelincic is here.

15 Action consent items. Approval of the February
16 13th Risk and Audit Committee minutes. I will entertain a
17 motion to approve.

18 COMMITTEE MEMBER MATHUR: So moved.

19 VICE CHAIRPERSON LIND: Second.

20 CHAIRPERSON HOLLINGER: Motion made by Priya
21 Mathur, favor -- seconded by Ron Lind.

22 All in favor of the motion?

23 (Ayes.)

24 CHAIRPERSON HOLLINGER: Approved.

25 So on 4a, or the consent items, I've not received

1 any requests to remove anything from the Consent Item.

2 So we can move on to Item 5, which is Enterprise
3 Compliance, Ms. D'Adamo.

4 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

5 D'ADAMO: Thank you.

6 CHAIRPERSON HOLLINGER: The 2017 and 2018
7 Enterprise Compliance Plan.

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

10 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

11 D'ADAMO: Thank you. I need to get the -- I always have
12 trouble working this.

13 Okay. Thank you. This is the 2017-18 Enterprise
14 Compliance Annual Plan.

15 --o0o--

16 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

17 D'ADAMO: And this is -- moving to slide 3, this is the
18 third year of our five-year plan. In years one and two,
19 we really focused on building and strengthening items, and
20 then in year three through five, if you noticed we're
21 looking at maturing processes and protocols, rolling out
22 standards, and improving compliance principles and
23 culture.

24 This slide is one that you guys have seen several
25 times, and it really sets the framework for the work that

1 we're doing as a result of our five-year plan, which was
2 approved originally in 2015.

3 --o0o--

4 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

5 D'ADAMO: On slide 3, this is another slide that you have
6 seen a couple of times. This is essentially looking at
7 the seven compliance elements, and then providing
8 information about our focus areas for 2017-18. And if you
9 look in the bottom right corner, the caption is expand the
10 focus areas for 2017-18.

11 Here, we're going to be working on program area
12 compliance design, policy and procedure standards, program
13 compliance monitoring, leadership and Board compliance
14 reporting, and education and training programs.

15 And I'll note that slides 6, 7, 8, and 9 actually
16 go into a little bit more detail about the specific tests
17 that we're going to be undertaking as a result of our
18 '17-'18 year. And what we're really trying to show is
19 that from the broad framework, we have a lot of things
20 that we're trying to do, and we're methodically going
21 through year by year and chipping away, and improving, and
22 adding to those things.

23 I will note also that the program itself is an
24 iterative process. And so what we do is we improve
25 things. We go back, we improve them some more. We

1 continue to focus on the things that we believe are really
2 important to helping us continue our program.

3 --o0o--

4 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

5 D'ADAMO: Slide 5 is essentially a snapshot, an overview
6 really, of the activities that we're going to be doing.
7 On the left side are the program areas. And then for the
8 middle and right side, we're giving you some information
9 about some of focus areas, as well as where we think we
10 are in the overall body of work as it relates to that
11 focus area.

12 And so our four focus areas for '17-'18 are that
13 ethics programs, policies and delegation management,
14 monitoring and oversight, and communications, education,
15 and reporting. And then as I mentioned in the middle, we
16 actually list some topics or some tasks that we're going
17 to be doing as a result of the time that we're spending on
18 those focus areas.

19 And I should note, I know others have said this
20 too, if, at any point, you have a question, just stop me
21 and we can -- we can talk about it.

22 --o0o--

23 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

24 D'ADAMO: On slide 6, we're getting into the specific
25 focus areas. So conflicts of interest -- on the ethics

1 side, conflicts of interests, ethics laws and policies, as
2 well as work on the ethics helpline management.

3 --o0o--

4 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

5 D'ADAMO: On slide 7, we're going to be looking at
6 delegations and policy management. And that really is the
7 bottom, I'll say, the framework for our Governance
8 Program. And so we really in looking at the Compliance
9 Program, we're really focusing on governance, which we
10 believe starts with the delegations and the policies.

11 --o0o--

12 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

13 D'ADAMO: And on slide 8, we're looking at compliance
14 monitoring and oversight. And here, we've been working
15 with this going on, I want to say, two years now in terms
16 of our embedded Compliance Program, where we are
17 designating liaisons and rolling it out gradually to the
18 program areas, but really working with them to help them
19 provide oversight and monitoring at the level.

20 And it's probably a good time to note that the
21 embedded compliance liaisons are really our first line of
22 defense. And as you know, we have a three lines of
23 defense model. The first line is the program areas,
24 second line would be your enterprise, risk, and
25 compliance, and third line would be your audit.

1 And so the three lines together, we hope provide
2 a tremendous level of assurance in terms of the work that
3 we're doing. And so the embedded Compliance Program that
4 we're doing is really working with those liaisons to help
5 them become compliance liaisons, understand compliance,
6 and then also do reporting back up through the enterprise,
7 so that we can provide you guys with the information that
8 you need to make the decisions that we ask you to make.

9 The other part of the embedded -- of the
10 Compliance Monitoring and Oversight Program is actual
11 enterprise compliance monitoring and oversight.

12 --o0o--

13 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

14 D'ADAMO: And then for slide 9, we're looking at
15 communication, education, and reporting. And these are
16 items that, in our program, are really important, because
17 they really provide the reinforcement. They provide the
18 culture. They provide a lot of the things that we need as
19 compliance professionals to make sure that the program is
20 working, that folks have recourse if they need it, that
21 there's monitoring that's being done, that there's
22 education and training. And the information, as I
23 mentioned before, it being provided to you that you need
24 in order to make your decisions.

25 So here, we've listed communication, education

1 and compliance reporting as some of the things that we're
2 going to be working on in 2017-18.

3 --o0o--

4 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

5 D'ADAMO: And that's actually a wrap-up of the program
6 itself. On slide 10, we've sort of summarized the wrap-up
7 of the annual plan. So we're maturing our processes and
8 protocols in the areas of oversight and monitoring. We're
9 rolling out standards and frameworks, in addition to the
10 program areas. We're continuing to mature compliance
11 principles, standards, and our culture. We're developing
12 knowledgeable compliance liaisons and additional program
13 areas. We're improving our compliance capabilities that
14 result in our strong internal control processes, and we're
15 expanding and enhancing reporting to include program
16 operations.

17 I believe that actually ends my presentation. So
18 if you'd like, I will take any questions.

19 CHAIRPERSON HOLLINGER: Thank you.

20 And I want to note for the record that Mr.
21 Feckner is in attendance.

22 COMMITTEE MEMBER FECKNER: He's not on your
23 committee.

24 CHAIRPERSON HOLLINGER: Pardon?

25 COMMITTEE MEMBER FECKNER: Go ahead.

1 CHAIRPERSON HOLLINGER: Okay.

2 Thank you very much for that very detailed
3 report.

4 Yes, Mr. Lind.

5 VICE CHAIRPERSON LIND: Thank you, Marlene. I
6 wanted to direct you to page seven of the report. I just
7 want to hear a little bit more about the policy management
8 part of this. I'm very interested in the policy
9 development training course, because I believe, you know,
10 as a Board -- and I think all boards have this same issue,
11 we need some maybe reminders or guidance around our roles,
12 around policy rather than procedure.

13 So can you talk a little bit more about where
14 we're moving with this?

15 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE
16 D'ADAMO: Yes. So we have a dedicated group within the
17 Enterprise Compliance that focuses on policy management.
18 And this group has for, I want to say two years now, this
19 year completing being the first full year, been really
20 working on strengthening our policy management.

21 And so what we mean by that is essentially taking
22 a holistic look at the way that we do policies, that --
23 how people are engaged in policies, the impact of
24 policies, as well as creating mechanisms for policies to
25 be housed, so that they're easily found, and also making

1 sure that policies do what they need to do in terms of the
2 how and the what.

3 And so what I say about that is making sure that
4 they answer all the questions that someone would need to
5 have answered, if they're going to have a policy that
6 applies to them. And this body of work was really a lot
7 of work. I have to give Sally Lee and her team a lot of
8 credit for this, because it was a really big effort where
9 they actually went around to all the divisions and, you
10 know, talked to them about these are the policies that we
11 have for you.

12 Are these the right policies, are the not?
13 Should these be procedures? Let's have conversations
14 around what's the policy and a procedure. How do you make
15 sure that a policy has the impact that you want it to
16 have? What are the questions that people might have as a
17 result of this? Who are the stakeholders that are
18 impacted when you do a policy?

19 We don't -- we don't -- we don't want it where
20 someone actually creates a policy, but nobody knows about
21 it. And so we've created this whole mechanism where, when
22 a policy is created, not only is it created, but people
23 are aware of it, they get a chance to know about it ahead
24 of time, and we even actually take that work up to the
25 executives as well, and let them know about policies that

1 are coming down the pike.

2 The idea being that there should never be a
3 surprise, and that policies should really be thoroughly
4 vetted, when they're created, because they really -- they
5 create that framework, that governance level that is
6 really every -- everything else is sort of underpinned by.

7 VICE CHAIRPERSON LIND: Great. Thanks.

8 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

9 D'ADAMO: So thank you for that question.

10 VICE CHAIRPERSON LIND: Look forward to hearing
11 more. Thank you.

12 CHAIRPERSON HOLLINGER: Thank you.

13 Seeing no further questions, I will entertain a
14 motion to approve the --

15 COMMITTEE MEMBER MATHUR: Move approval.

16 ACTING COMMITTEE MEMBER LOFASO: Second.

17 CHAIRPERSON HOLLINGER: Motion made by Mathur,
18 seconded by Alfon -- Lofaso.

19 All in favor?

20 (Ayes.)

21 CHAIRPERSON HOLLINGER: Motion passes.

22 Okay. Next, Mr. Grimes on Enterprise Risk
23 Management. The 2017 and 2018 Enterprise Risk Management
24 Plan.

25 (Thereupon an overhead presentation was

1 presented as follows.)

2 CHIEF RISK OFFICER GRIMES: Thank you, Madam
3 Chair. Nice to see you.

4 We don't have slides for this -- this one.

5 Nice to see Committee members and Board members.
6 Pending your approval, the Risk team will have three main
7 areas of focus in the coming year. The first will be
8 continuing facilitation of the Asset Liability Management
9 Program. Secondly, we want to continue to mature the
10 enterprise risk management framework. And thirdly, we
11 want to continue to drive risk awareness and cultivate a
12 risk intelligent organization through both stakeholder
13 engagement, as well as team member education.

14 And these are -- have been outlined for you in
15 the memorandum that you have. However, I certainly would
16 want to ask you if you have questions or want to drill
17 down deeper into any of these three areas. And I'd like
18 to engage you in that conversation, if you so choose.

19 Thank you.

20 CHAIRPERSON HOLLINGER: Thank you for your
21 report. I see no questions, so I will entertain a motion
22 to approve.

23 VICE CHAIRPERSON LIND: Move.

24 COMMITTEE MEMBER FECKNER: Second.

25 CHAIRPERSON HOLLINGER: Motion made by Lind,

1 seconded by Feckner.

2 So now, we'll move on to 7, Office of -- pardon
3 me.

4 All in favor?

5 (Ayes.)

6 CHAIRPERSON HOLLINGER: Okay. Motion grant --
7 motion approved.

8 Now, we'll move on to Item 7, Office of Audit
9 Services, Beliz Chappuie, on the 20 -- reporting on the
10 2017-2018 Office of Audit Services plan.

11 CHIEF AUDITOR CHAPPUIE: Good morning, Madam
12 Chair, members of the Committee. Beliz Chappuie CalPERS
13 team member.

14 Agenda Item 7a is an action item. Staff is
15 requesting Risk and Audit Committee to approve Office of
16 Audit Services proposed audit plan for fiscal year
17 2017-18. Office of Audit Services charter requires the
18 Chief Auditor to submit, at least annually, an internal
19 audit plan to the Committee and the Board for review and
20 approval.

21 Also, the internal auditing standards require the
22 Chief Auditor to establish a risk-based audit plan to
23 determine the priorities of the internal audit activity
24 consistent with the organization's goals.

25 In conducting the risk assessment, Office of

1 Audit Services, as the third line of defense, coordinated
2 its efforts with the second line of defense, the
3 Enterprise Compliance Division and the Enterprise Risk
4 Management Division.

5 Staff interviewed executive and senior management
6 teams, and sought input from the Board members through
7 surveys. Staff also incorporated their knowledge through
8 prior audits and findings, and took into consideration the
9 financial statement, and any other external audit
10 findings. Office of Audit services has two audit
11 programs, internal audits and public agency reviews.

12 To identify the internal audit assignments and
13 activities, staff established an audit universe of all
14 possible audits that could be performed for the
15 organization. Then staff evaluated multiple risk factors
16 to rank the activities. These risk factors included the
17 activity's contribution to the organization's goals,
18 changes in the operations and regulations, impact on the
19 financial statements, implemented controls, and prior
20 audit findings.

21 For the public agency reviews, staff performed
22 the risk assessment to identify high risk compliance areas
23 for review. Office of Audit Services plans to complete
24 four review cycles during fiscal year 2017-18 covering one
25 compliance area per each cycle. Using data analytics,

1 staff will identify high risk agencies for these
2 compliance areas for review.

3 Our goal is to identify approximately 60 agencies
4 for each compliance activity selected for review. During
5 the current fiscal year, we implemented our focused review
6 approach and completed four review cycles covering 246
7 agencies. We're currently issued the reports for cycle
8 three, and preparing draft reports for cycle four.

9 In preparing the internal audit plan, Office of
10 Audit Services also allocated resources to the consulting
11 engagements and special projects in order to provide
12 assistance to management.

13 In addition, Office of Audit Services coordinates
14 contracted external audits and reviews, including the
15 financial statement audit, GASB 68 and 75 audits, real
16 assets and other specialty investment audits, and
17 actuarial, valuation, and certification services.

18 As required by the internal auditing standards,
19 we'll remain responsive to the changes in the
20 organization's business rules, operations, program,
21 systems, and controls, and we'll review and update audit
22 plan for fiscal year 2017-18, as necessary.

23 Any modification to the audit plan will be
24 communicated to the Committee through the quarterly status
25 reports.

1 This concludes my presentation, and I'm happy to
2 answer any questions.

3 CHAIRPERSON HOLLINGER: Thank you very much.

4 Seeing no questions, I will entertain a motion to
5 approve the 2017-2018 audit.

6 COMMITTEE MEMBER GILLIHAN: Moved.

7 ACTING COMMITTEE MEMBER LOFASO: Second.

8 CHAIRPERSON HOLLINGER: Okay. Motion made by
9 Gillihan and seconded by Lofaso.

10 All in favor of the --

11 VICE CHAIRPERSON LIND: J.J. wants to speak.

12 CHAIRPERSON HOLLINGER: Oh, I'm sorry. I'm
13 sorry. Okay. Questions on the motion.

14 Mr. Jelincic.

15 BOARD MEMBER JELINCIC: Yeah, one of the -- sorry
16 about that.

17 One of the issues I have is an issue we've had
18 before. Are we doing enough audits? I mean, if -- when I
19 look at the number of audits we're going to do divided by
20 the number of employers, even assuming we did them all
21 randomly, it would only take us 100 years, since we
22 actually repeat and focus on some where we have problems.
23 You know, if you cut that in half, it takes 200 years.

24 So my question is, do you have enough auditors,
25 and are we doing enough audits?

1 CHIEF AUDITOR CHAPPUIE: Thank you for the
2 question. That's always the ongoing demand that we
3 can -- unfortunately, we can't perform 100 percent of the
4 agencies to include in our audits. However, we have
5 improved our approach, since then. We implemented our
6 approach this year, so it is risk based in compliance with
7 the auditing standards. And we doubled our capacity since
8 last year without increasing any number of staff.

9 However, we're are evaluating our approach,
10 especially -- I'm assuming your question is specific to
11 the public agency reviews. So at the end of this year, we
12 will assess and reconsider if we need to expand the number
13 of auditors we have to increase the number of reviews we
14 complete.

15 However, if you look at other agencies, STRS,
16 their audit -- internal audit organization, I am fully
17 aware that they're not conducting as many audits as we do.

18 So the idea of auditing is also risk based and
19 sample based, not necessarily 100 percent reviews of every
20 agency. So with that respect, as long as we target and
21 identify those areas that are high risk, utilizing the
22 data analytics, which we are doing, we are targeting those
23 areas in a more intelligent and knowledge based reviews.
24 So my opinion, I think we are hitting all those areas that
25 are of concern.

1 BOARD MEMBER JELINCIC: And I'm aware of the way
2 you've restructured who we audit and doing focused audits.
3 And I think that is a good use of resources.

4 But, you know, quite frankly if people know the
5 auditors are looking, they tend to be a little more
6 cautious. And so I would hope as you go forward, you at
7 least think about getting to the point where we, on
8 average, audit everybody every 50 years.

9 Thank you.

10 CHIEF AUDITOR CHAPPUIE: Thank you. We will
11 definitely take that into consideration.

12 CHAIRPERSON HOLLINGER: Thank you.

13 Mr. Slaton.

14 COMMITTEE MEMBER SLATON: Thank you, Madam Chair.
15 I've been an IRS taxpayer for, I don't know how to do the
16 math, a long number of years. I've never been audited.
17 It doesn't mean I don't pay attention to the risk of an
18 audit, and, you know, file my taxes appropriately.

19 So, you know, I think the measurement of how long
20 it takes to audit everybody, I'm not sure really bears on
21 the issue. And I think the risk assessment is really the
22 important issue, the same way the IRS does. It's a risk
23 assessment.

24 So -- but my question is, it seems like the
25 process is either audit or no audit. And my question is,

1 is there, for lack of a better term, junior audits? Are
2 there areas where we can go into and be effective at going
3 after certain areas, as opposed to conducting a full
4 audit, and therefore get more breadth out of our existing
5 staff?

6 CHIEF AUDITOR CHAPPUIE: And I think that's what
7 we're trying to accomplish with our current reviews.
8 I'm -- I'm not sure if you have had a chance to review
9 some of the reports we issued recently. One was special
10 compensation review, and the next one that is coming out
11 is related to contracting and active rate plans. So that
12 was more of a scope like you were describing.

13 COMMITTEE MEMBER SLATON: Of stratifying, based
14 on issue as opposed to based on

15 CHIEF AUDITOR CHAPPUIE: Exactly. So -- but we
16 can continue to have these discussions definitely,
17 especially I would like to hear more input from the Board
18 about the topics that you would be interested in us
19 reviewing.

20 COMMITTEE MEMBER SLATON: So that's taking the
21 topic and then selecting agencies --

22 CHIEF AUDITOR CHAPPUIE: Exactly.

23 COMMITTEE MEMBER SLATON: -- to go after that
24 particular topic

25 CHIEF AUDITOR CHAPPUIE: Exactly. Exactly.

1 COMMITTEE MEMBER SLATON: Okay. So they aren't
2 done as a -- is that more typical, rather than a quote
3 full audit? Is that the more typical approach?

4 CHIEF AUDITOR CHAPPUIE: It's still review. It's
5 not a full compliance review like we used to conduct in
6 the past, so it's more narrow scoped. So we are targeting
7 a compliance topic, but then increasing our coverage by
8 including more agencies in the review.

9 COMMITTEE MEMBER SLATON: Good. Okay. Thank
10 you.

11 CHAIRPERSON HOLLINGER: Okay. No further
12 questions, so we had the motion made by Gillihan and
13 seconded by Slaton.

14 So all in favor of the motion?

15 (Ayes.)

16 CHAIRPERSON HOLLINGER: Okay. Motion passes.

17 7b, the Independent Auditor's 2017 Annual Plan.

18 CHIEF AUDITOR CHAPPUIE: Good morning, Madam
19 Chair and members of the Committee. Beliz Chappuie,
20 CalERPS team member.

21 Agenda Item 7b is an action item. Staff is
22 requesting Risk and Audit Committee to approve the Board's
23 independent auditor MGO's audit plan for CalPERS financial
24 statements audit for the fiscal year ending June 30, 2017.

25 The presentation is to provide the Risk and Audit

1 Committee the opportunity to hear from the independent
2 auditor regarding their scope of services and deliverables
3 for the financial statement audit, and to enable the
4 Committee to ask questions.

5 Presenting with me today are staff from MGO,
6 Caroline Walsh, the engagement partner; David Bullock, the
7 consulting partner; and, Debbie Chan, Director.

8 With that, I would like to turn it over to
9 Caroline, David, and Debbie to present their audit plan.

10 MS. WALSH: Madam Chair, Vice Chair, members of
11 the Committee, Good morning. It is still good morning.

12 I wanted to take this opportunity to communicate
13 to you something that's very important for your governance
14 over the financial statements of CalPERS. And I wanted to
15 let you know that we very much appreciate that our
16 contract was renewed with CalPERS to perform the work, and
17 we hope to serve you with the same excellence and
18 responsive service that we have in the past.

19 (Thereupon an overhead presentation was
20 presented as follows.).

21 MS. WALSH: With that said, do we -- do we
22 operate the slides or... So we wanted to take a few
23 moments to provide you with an overview of the audit
24 process, and hopefully just hit the salient points of how
25 we conduct our audits.

1 --o0o--

2 MS. WALSH: So I am going to communicate a little
3 bit about our engagement team, our depth of experience,
4 the scope of our services and what deliverables you can
5 expect. And then also the independent auditor's
6 responsibilities. And I will touch briefly on
7 management's responsibilities for the financial
8 statements. Debbie Chan will speak a little bit about our
9 audit timeline. We're in the process of doing the audit
10 right now, and she will let you know what the key
11 milestones are.

12 And David Bullock will talk briefly about our
13 audit approach, and how it's risk based, and what areas we
14 believe are significant and of higher risk with respect to
15 your financial statements.

16 And then we'll talk a little bit about just a
17 couple accounting pronouncements that we'll have an impact
18 in the next year or so.

19 --o0o--

20 MS. WALSH: So with that said, we have assembled
21 an engagement team, where the people at the top of the
22 chart, myself and David, to a lesser extent, but also
23 Linda Hurley who will be our engagement quality control
24 partner, she will do an independent review of the
25 financial statements, are fairly new to the engagement. I

1 have served in the past five years as the engagement
2 quality review partner, so I'm quite familiar with the
3 financial statements of CalPERS. David is -- this will be
4 his second year serving.

5 Now, below that, we have the people who are
6 directing and actually performing the work, Debbie Chan
7 and Heather Jones. They've been on this engagement since
8 the inception of serving you. So this will be their 11th
9 year. So they bring to the table a depth of institutional
10 knowledge, so that we can conduct our audit efficiently
11 and effectively.

12 Serving them will be some managers and a senior
13 manager, who have collective experience of at least 10
14 years on the engagement. As part of our audit, we also
15 utilize consulting specialists. We utilize an actuary to
16 help us review actuarial valuations and assumptions.
17 Marilyn Oliver from Bartel and Associates has been with us
18 for -- this will be her 11th year. And Roger Burton will
19 help us in the health care area, and he's been with us for
20 four years.

21 So hopefully this demonstrates confidence that we
22 have -- we can plan and perform this audit in accordance
23 with your requirements.

24 --o0o--

25 MS. WALSH: So what is it that we do?

1 We basically audit your basic financial
2 statements, so what is the set of basic financial
3 statements?

4 Those constitute your -- the statement
5 themselves, which is the Statement of Fiduciary Net
6 Position, the Statement of Changes in Fiduciary Net
7 Position, and then the Statement of Cash Flows for your
8 enterprise fund operations.

9 That's -- our opinion is on those basic financial
10 statements. So we will issue an independent auditor's
11 report on them.

12 What is new this year is we are actually
13 performing our audit in accordance with government
14 auditing standards. What does that mean?

15 It's an additional level of standard issued by
16 the GAO, the Governmental Accountability Office, that adds
17 a few requirements over and above what the American
18 Institute of Certified Public Accounts requires when
19 performing a financial statement audit.

20 And one the primary results of that additional
21 audit standard is that we have to issue a report on
22 internal control over financial reporting, and on
23 compliance and other matters. Now, I'm here to tell you
24 that that's not going to change the amount.

25 CHAIRPERSON HOLLINGER: We have a question.

1 MS. WALSH: Sure.

2 CHAIRPERSON HOLLINGER: Okay. One second.

3 Mr. Slaton.

4 COMMITTEE MEMBER SLATON: Oh, well --

5 CHAIRPERSON HOLLINGER: I didn't know if you
6 needed clarification and what --

7 COMMITTEE MEMBER SLATON: Well, let me come to it
8 very quickly. So back on the organizational chart --

9 MS. WALSH: Yes.

10 COMMITTEE MEMBER SLATON: -- and you talked about
11 the length of time people have worked on the CalPERS
12 account.

13 MS. WALSH: Yes.

14 COMMITTEE MEMBER SLATON: And my experience in
15 overseeing audit from a governance standpoint is that one
16 of the things that becomes of concern is not having people
17 on an account so long that they develop relationships,
18 that, you know, it becomes kind of rote. And so either
19 changing the senior partner, the firm, or the people that
20 are working on it, at least from my background, would say
21 that's a good thing, as opposed to a bad thing.

22 So can you address this issue of having people
23 who've been working on this for so long at CalPERS in an
24 audit capacity, both the advantages and disadvantages.

25 MS. WALSH: Well, there's a couple schools of

1 thought with respect to that is, you know, how long does
2 familiarity breed maybe not the same kind of rigor and
3 independence as one might think? But as far as switching
4 it up, and that's one of the reasons I became the partner
5 on the engagement. I am the new eye. I am the chief
6 quality officer for our firm, so that is what I do
7 primarily. So I certainly look with the keen eye as to
8 what we're doing, and why we're doing it, and how we're
9 doing it.

10 David Bullock has just become familiar with this
11 engagement last year. Certainly not completely and
12 in-depth familiar, but he brings that perspective too.
13 And then the person who's going to do the independent
14 review of the report is totally not been involved in the
15 engagement.

16 So what the -- so let's talk about the -- an
17 organization of this size. There is a benefit to the
18 organization for individuals to understand the process,
19 and the controls in place, and understand the people, and
20 the systems. There's a benefit. There's a direct benefit
21 to that.

22 There's been a lot of discussion in the public
23 arena as to should there be mandatory rotation of audit
24 firms? Should there be mandate -- now, in the State, the
25 State actually passed legislation in 2014 that says if

1 you're going to audit a local agency, not a State agency,
2 you're going to have to have mandatory partner rotation
3 every six years.

4 Now, that's going to -- that's a State law. So
5 they felt that the partner rotation was sufficient to
6 counter any of those familiarity threats. Okay.

7 At the national level, the PCOB, who does the
8 private sector, has talked about that. And they have
9 concluded that it's not appropriate to have mandatory
10 auditor changes. They've done some studies out of the GAO
11 that says if you -- you know, the likelihood of fraud
12 occurring often occurs during the first couple of years a
13 new auditor comes into place, because they're not as
14 familiar with the organization, and they don't know what
15 they're looking for.

16 So given that, we feel that the depth of the
17 knowledge in the basic understanding of the complexity of
18 the systems at CalPERS, given my oversight, would be
19 sufficient to mitigate that threat. I hope that answers
20 your question.

21 COMMITTEE MEMBER SLATON: It does. Thank you.

22 CHAIRPERSON HOLLINGER: Thank you.

23 Mr. Jelincic.

24 BOARD MEMBER JELINCIC: Yeah, I am not a
25 proponent of mandatory rotation of firms. Although, I do

1 support mandatory rotation of the partner.

2 But 11 years gives you a lot of knowledge, but it
3 also builds a lot of relationships. If we were talking
4 about 20 years, I think people would clearly be
5 uncomfortable. Where does -- at what point does the value
6 of the experience offset the value of the relationship
7 building, and can that be mitigated by rotating one or the
8 other of those positions?

9 MS. WALSH: Well, it certainly could be mitigated
10 by that. But remember -- okay, so, like if you're talking
11 about a 20-year span, and you look at the evolution of
12 staff working on an engagement, they come up through the
13 ranks in differing roles, so that after 20 years, or after
14 even 10 or 11 years, you're either going to rotate into a
15 partner position, and then you're going to rotate off the
16 engagement, and then people below you are going to rotate
17 up. So over 20 years you should get that rotation that
18 occurs offhand. People leave all the time, and we have to
19 replace them.

20 Actually, you've been very fortunate in our
21 practice to have the consistency of the service team, and
22 that doesn't happen all the time.

23 BOARD MEMBER JELINCIC: So in the not too distant
24 future, we should expect Chan and Jones to become partners
25 and move on, is that what I'm hearing?

1 (Laughter.)

2 MS. WALSH: Perhaps well put a good word in for
3 the Deputy Director.

4 MS. CHAN: Chan and Jones don't want to become
5 partners.

6 No, just kidding.

7 (Laughter.)

8 BOARD MEMBER JELINCIC: Because 11 years -- 11
9 years is hitting --

10 MS. WALSH: Heather Jones will -- is a special
11 situation. She -- we retain her as a technical individual
12 who doesn't -- she only works on retirement systems. So
13 she's not like a full-time employee, but Debbie I think
14 she...

15 BOARD MEMBER JELINCIC: I'm trying to help you,
16 Debbie.

17 Thank you.

18 CHAIRPERSON HOLLINGER: Mr. Lofaso.

19 ACTING COMMITTEE MEMBER LOFASO: Thank you, Madam
20 Chair. I want to take you back to where I think you left
21 off. And if you hadn't a chance to explain this, I'll
22 yield, but you were mentioning certain government
23 standards provided by the Government Accounting Office.
24 And I was hoping you would compare and contrast those to
25 the GASB standards. Is one process and one rule based

1 or...

2 MS. WALSH: Well, okay, so let's differentiate
3 between GASB, which is the accounting standards, and the
4 Governmental Accountability Office issues auditing
5 standards. Those -- we refer to that as government
6 auditing standards. Those stands are predicated and
7 utilized every standard that the AICPA utilizes. And they
8 go one step above. And in the one area, as I mentioned,
9 they require you to report on internal controls and
10 compliance and other matters, and I can talk briefly about
11 that.

12 They also have a higher threshold for documenting
13 and invaluate -- evaluating independence. And they set
14 forth a bunch of significant threats, and you have to
15 address them in order to mitigate any of those threats.
16 None of those threats exist here, except the familiarity
17 threat, which we talked about that we look at and say
18 here's how we're mitigating that, so...

19 ACTING COMMITTEE MEMBER LOFASO: Thank you.

20 MS. WALSH: You're welcome.

21 CHAIRPERSON HOLLINGER: Please continue.

22 Please continue.

23 MS. WALSH: Continue. Okay. So this new -- this
24 new report on internal control over financial reporting
25 and compliance and other matters. So really that's not

1 going to change the work that we do over internal control.
2 It just requires us to tell you that we've looked at it,
3 we have not audited it, and we do not issue an opinion on
4 your internal control. But that is the report we would
5 communicate any material weaknesses and/or significant
6 deficiencies we've identified during the course of the
7 audit.

8 The other aspect is reporting on compliance with
9 material -- with laws and regulations that could have a
10 material impact on the financial statements. As part of
11 our audit process now, we certainly look at it. We look
12 at the PERL, we look at other State laws, regulations --
13 and maybe Debbie you can elaborate on that. And we assure
14 that you're in compliance with that. We've just never
15 reported that, oh -- we don't say you're in compliance,
16 but we say nothing has come to our attention during the
17 course of the audit that there was material noncompliance.

18 Now, the other matters aspect of it is the
19 government auditing standard says, gosh, if you're doing
20 your audit and you happen to stumble upon abuse, you will
21 so report it to the governance body.

22 I have yet to see a report that's ever reported
23 abuse. So I'm sure they exist out there. I just haven't
24 personally seen it in our client base. It becomes really
25 difficult for an auditor to make a judgment as to what

1 financial statements, whether they're caused by fraud or
2 error.

3 Now, accompanying the basic financial statements
4 are what we refer to as required supplementary
5 information. Those are not a part of those basic
6 financial statements. They're required by the
7 Governmental Accounting Standards Board to place the
8 financial statements in historical, economic, and
9 operational context. We do not issue an opinion on that
10 information, but we -- we indicate that it's there. And
11 we do apply procedures to it, but we're not going to opine
12 on it.

13 Those -- the following items are that required
14 supplementary information: The management discussion and
15 analysis, which is before the basic financial statements.
16 That's going to compare this year's operations and last
17 year's operations, and provide who, what, when, and,
18 where. Why did balances change, what caused them, and
19 provide insight into the financial statement reader as an
20 overview of the financial statements.

21 There's some other schedules that are required by
22 GASB 67. And those are in the back behind the notes to
23 the financial statements. That's the schedule of changes
24 in net pension liability or assets, if that's the case,
25 schedules of plan contributions, schedules of investment

1 returns, and schedule of claims development information
2 for your health care plan.

3 Now, that only applies to your single employer
4 plans, and your cost-sharing plans. That information is
5 not applicable to your age of plan.

6 --o0o--

7 MS. WALSH: In addition to that required
8 supplementary information is what we refer to as other
9 supplementary information. And that consists of the
10 schedules that I've outlined here. This is information.
11 In addition, we look at it in relationship to the
12 financial statements and our opinion on those supplemental
13 schedule are in relation to those financial statements.

14 Now, you prepare, what we call, a comprehensive
15 annual financial report. It includes all the information
16 I just described, but it also has other sections. There's
17 an introductory where you have a transmittal letter from
18 the Executive Director. You have an investment section.
19 You have an actuarial section, and you have a statistical
20 section.

21 While we read that information, and make sure
22 that there's nothing in that information that contradicts
23 what's in the basic financial statements, we do not audit
24 it and do not issue an opinion on it.

25 --o0o--

1 MS. WALSH: So with that, any questions, before
2 we move on?

3 CHAIRPERSON HOLLINGER: There are no questions.

4 MS. CHAN: Thanks, Caroline.

5 Our audit timeline for this year is consistent
6 with the prior years. We started the audit planning
7 process a few months ago, and we'll continue with this
8 process through the end of October. With respect to field
9 work, we have been on-site for interim work since May.
10 And we'll conclude the interim field work phase in July
11 with the completion of member census data testing.

12 We'll be back on site in August through October
13 to conduct our year-end testing of the financial statement
14 balances.

15 We'll issue the draft report in October, and
16 we'll present our audit results at the November Committee
17 meeting. Once we receive the signed management
18 representation letter, we'll issue the signed reports.
19 And that will be some time in October -- in November.

20 So that is our timeline, and I'll turn this to
21 David to talk about our audit approach.

22 MR. BULLOCK: Thank you.

23 --o0o--

24 MR. BULLOCK: So we've grouped our Audit into
25 three phases, as you can see planning, execution,

1 reporting. And just for clarification, you know,
2 execution is not as dramatic as it sounds. It's merely
3 the execution of tasks and audit procedures.

4 So for the planning phase, which Debbie just
5 described as our process right now, we're planning to
6 complete that by the end of this month. That's where we
7 document our understanding of the organization. That's
8 where we look at the internal controls, perform our risk
9 assessments, and we'll talk a little bit more about that
10 on the next slide, and basically complete our audit plan.

11 And that's the plan that we intend to move
12 forward with at the execution phase of the audit, and then
13 communicate the audit plan to you, and that's what we're
14 doing today.

15 For the next phase, we'll come out after the --
16 after management has an opportunity to close the books,
17 and we'll perform our audit procedures, we'll review the
18 financial statements, look for any subsequent event
19 disclosures. And then towards the end of that audit,
20 we'll obtain management representations and organize our
21 insights for purposes of a management letter.

22 And then at the conclusion of that, we'll enter
23 the reporting phase. That's where we produce our reports.
24 The first one is our opinion on the financial statements.
25 And that is presented in accordance with GAAP. The second

1 And this is obviously a very significant area.
2 We'll be looking to ensure that those valuations are in
3 accordance with accounting standards and the actuarial
4 standards of practice. We utilize specialists to help us
5 in that area.

6 The reasonableness of assumptions and methods
7 used to develop the evaluation, any analysis -- or we'll
8 perform analysis of any changes in the discount rate, if
9 this changes from the previous year, and then the member
10 census data. We'll be performing the testing on the
11 census data.

12 And we utilize the Office of Audit services in
13 past years to help us with that. This year we'll be
14 doing -- performing all those procedures ourselves. And
15 so we'll be going on-site to the various employers and
16 doing a sampling of member census data.

17 --o0o--

18 MR. BULLOCK: On the next slide, we've just
19 outlined some of the responses that we performed in
20 response to our risk assessment. We'll be reviewing
21 generally partner audited financial statements, as we look
22 at those private equities, and utilize our specialists for
23 investment valuations if that's appropriate.

24 For service organizations, we'll be looking at
25 those -- the reports that are done on those organizations,

1 such as custodial services, or third-party administrators
2 will be evaluating those reports.

3 We utilize the data extraction tool for
4 transactions or activities where there's significant
5 volume. And so we'll be utilizing those tools to analyze
6 the benefit payments and contributions. And then finally,
7 we're going to be utilizing specialists to help us
8 evaluate the actuarial valuations for the pension and the
9 health and long-term care.

10 --o0o--

11 MR. BULLOCK: Some of the recent developments
12 with GASB. You know, we talked a little bit about
13 generally accepted accounting principles. It's an
14 evolving set of accounting standards that GASB is
15 constantly retooling and trying to improve.

16 Some recent pronouncements that will be impacting
17 the organization are the one on fiduciary activities.
18 GASB felt there was a lot of inconsistency in how
19 organizations are presenting fiduciary activities. And we
20 don't believe this will have a significant impact to
21 CalPERS, because it doesn't change the reporting of
22 pension plans and OPEB plans here at CalPERS.

23 But the agency fund that you currently have, the
24 RBF fund, will be -- there will be a significant change to
25 that fund. And the current standard -- the current

1 standards allow you just to present a balance sheet, if
2 you will, of those agency funds.

3 And then under the new standards -- oh, question.

4 CHAIRPERSON HOLLINGER: Yeah. We have a
5 question.

6 Mr. Jelincic

7 BOARD MEMBER JELINCIC: Yeah, just a quick one.
8 I've got a number of them I'll come back. But what's RBF?

9 MS. CHAN: The Replacement Benefit Fund.

10 BOARD MEMBER JELINCIC: Thank you.

11 MR. BULLOCK: Thank you. We get accustomed to
12 using acronyms, so sorry about that.

13 And so that will be presenting a -- basically, an
14 income statement, if you will, or statement of flows, a
15 statement of changes in fiduciary net position.

16 And then GASB Statement 85 is the omnibus
17 statement. And this is where they captured kind of about
18 10 to 12 different practice issues. It encompass quite a
19 few categories, one of which is investments.

20 And there was confusion in implementing GASB 72,
21 where preparers were -- different preparers were
22 interpreting the guidance in different ways. And so they
23 just wanted to clarify that investments in money market
24 funds, and certain participating interest-earning
25 investment contracts aren't required to be carried to

1 amortize costs, but could be, if that was your -- if that
2 was your choice. And then also --

3 MS. WALSH: And just to clarify, GASB 72 is the
4 fair value standard in that you fair value your
5 investments, and you place them in a level of hierarchy
6 based on the quality of the inputs to estimate those
7 investments.

8 MR. BULLOCK: Thank you Caroline.

9 And then the other item we wanted to point out
10 that would have an impact here is just the treatment of
11 employer paid member contributions. And GASB clarified
12 for pension plans that they need to treat the member
13 contributions in the course with the plan terms. And some
14 of the employers were confused. They were -- with
15 presenting it, or there was inconsistencies and they would
16 present member contributions that they were making as
17 their own employer contributions.

18 And so GASB just wanted to clarify and ensure
19 consistency among reporting of those employer-paid member
20 contributions. So they provide a little bit of guidance
21 on the OPEB.

22 MS. WALSH: And that would require if an employer
23 picks up an employee share, that is still reported as an
24 employee contribution.

25 MR. BULLOCK: With that, if we have -- if you

1 have any questions, we'd be more than happy to answer
2 them.

3 MS. WALSH: Yeah. That concludes our formal
4 remarks.

5 CHAIRPERSON HOLLINGER: Thank you.

6 Mr. Lofaso.

7 ACTING COMMITTEE MEMBER LOFASO: Thank you, Madam
8 Chair.

9 Just on that last point, I hope I'm not walking
10 in a minefield. But I understood there have been some
11 discussions about various legal consequences of whether
12 the employer contribution is employer property or employee
13 property. Does the GASB rule track that exactly or are
14 legal consequences not necessarily related to how you all
15 do the accounting under the GASB rule?

16 MS. WALSH: Well, there's always a difference
17 between what legal requirements are and what accounting
18 requirements are. When developing and discussing how to
19 more appropriately report this, they did consider whether
20 or not the employer reports it as compensation to the
21 employee under the IRS rules, so -- but they basically
22 concluded for financial reporting, any employer pick up is
23 going to be an employee contribution as it's reported in
24 the financial statements.

25 ACTING COMMITTEE MEMBER LOFASO: Thank you.

1 CHAIRPERSON HOLLINGER: Mr. Jelincic.

2 BOARD MEMBER JELINCIC: I have a number of
3 questions, but I heard -- I thought I heard you say that
4 the draft report would be available in November, and the
5 final signed would be in December, and the --

6 MR. CHAN: The draft report will be available in
7 October, the end of October. And we plan to issue the
8 signed reports in November.

9 MS. WALSH: I think what typically happens, and
10 maybe you can correct me if I'm wrong, is that that draft
11 report is presented in the November --

12 MS. CHAN: In November -- correct.

13 MS. WALSH: At your November meeting. Once you
14 have that presentation and don't have any further comments
15 on it, then it's ready to be issued.

16 BOARD MEMBER JELINCIC: Okay. So from what the
17 Board will see, it's November -- November and December.
18 From what management gets, it's October and November, is
19 that --

20 MS. WALSH: I don't know when management
21 distributes it to the Board. We're pretty much done by
22 the end of October.

23 CHIEF AUDITOR CHAPPUIE: It's presented -- right.
24 We normally receive it from MGO at the end of October just
25 as we're preparing the agenda items for presentation in

1 November. That's around the same time.

2 BOARD MEMBER JELINCIC: Okay. So I thank you for
3 that. I have some serious questions about GASB 67 and
4 accounting for investments. The last time I asked the
5 questions it was found to be a violation of Bagley-Keene
6 Act. I understand -- I have put it in writing once again.
7 I understand it's being worked on, and you have seen at
8 least a draft. It hasn't been finalized, so I will defer
9 my questions on that, until I get a chance to see the
10 report.

11 But I do have some questions about 68. And in
12 your opinion, do you opine on the discount rate used to
13 calculate the liabilities?

14 MS. WALSH: Well, the opinion is inherent in the
15 fact that we've issued an opinion on the financial
16 statements as a whole. As part of the audit process, we
17 absolutely look at the discount rate and discuss that rate
18 with management and the Finance Office, and also in the
19 Actuarial Office, and the Chief Actuary.

20 We look at it in the context of what's currently
21 happening, your asset allocation methodology, and then our
22 actuarial specialist also look looks at it. So there's a
23 number of people looking at it. Questions are raised
24 about the appropriateness of that discount rate.

25 And I just want to caution everybody, the

1 discount rate used for GASB 68 reporting is and can be
2 necessarily different from the discount rate you use for
3 funding purposes. So we don't look -- we don't care what
4 you're doing with funding, except to the extent that
5 you've already decided that you're going to have a
6 decrement in your funding discount rate, and that is taken
7 into consideration when developing the GASB 68.

8 We have not -- we have not received the valuation
9 and the testing of that discount rate yet nor have we
10 devoted substantive attention to it at this point in time.

11 BOARD MEMBER JELINCIC: Okay. So my question is
12 going to be about the process and how you resolve it.

13 Quoting from the introduction to GASB 68,
14 "Projected benefit payments are required to be discounted
15 to their actuarial present value using the single rate
16 that reflects, one, the long-term expected return of
17 pension plan assets to the extent that the pension plan's
18 fiduciary net position is projected to be sufficient to
19 pay benefits, and pension plan assets are expected to be
20 invested using a strategy to achieve that return; and two,
21 a tax exempt high quality municipal bond rate, to the
22 extent that the conditions for use of the long-term
23 expected rate of return are not met".

24 That is from the introduction, but it's also
25 repeated in 31 for single family -- for single employers

1 and agents, and then somewhere in the 64, 69 for shared
2 costs.

3 We use -- we have said that our current discount
4 rate is seven and a after. We've announced that we're
5 going to be reducing it. We have a report of the
6 Investment Committee that says the expected return on the
7 portfolio is 5.8. And so how do -- you know, I realize
8 you haven't done it yet, but can you describe the process
9 of how you reconcile those two. I also --

10 MS. WALSH: Okay. So we look at all available
11 information. And so our current understanding, as
12 confirmed by our controller this morning, is that for
13 purposes of GASB 68, the Actuarial Office has determined
14 that a seven percent rate is appropriate. Now, seven
15 percent needs to be adjusted upwards, because that rate
16 nets admin expenses. And admin expenses are not supposed
17 to be embedded in the rate under GASB 68, so it will be --
18 it will be 7.15 percent as I understand it.

19 Now, remember, when you're looking at this
20 long-term rate of return, when an actuary looks at it --
21 I'm not an actuary, but as I understand the process to be,
22 you know, you've got to look in the long term. And the
23 actuarial community is -- they don't define what long term
24 is. That long-term period some actuaries may go out 30
25 years, some may go 40, some may go 50, some may go 60.

1 So it depends on the position they take with
2 respect to that. And as long as that's in the framework
3 of the actuarial standards of practice, then, you know,
4 our actuary looks at it and says, gosh, that's reasonable
5 in the circumstance.

6 Now, if you've got a 5.8 percent asset
7 allocation, really what I would ask is that, is that the
8 long-term expected rate of return, is that some shorter
9 period, or are you talking about long term? And that's
10 the information I really don't know yet.

11 BOARD MEMBER JELINCIC: And I know that you have
12 just begun this. I also, in the process of going through
13 68, found an interesting comment in about what's required
14 in the footnotes, and that is to identify the assets, and
15 their expected return for each of the categories. And I
16 don't know that I have seen --

17 MS. WALSH: I believe it's in there. The asset
18 allocation is in the footnotes.

19 BOARD MEMBER JELINCIC: Okay. I don't know --
20 but not only the allocation but the expected return of
21 each asset. And I don't remember seeing it in the
22 footnotes in the past. That's not to say it wasn't there.
23 It's just I don't remember seeing it, so -- but I will go
24 back and look.

25 MS. WALSH: Well, I can find --

1 BOARD MEMBER JELINCIC: And if it's not, it will
2 be there next time.

3 MS. WALSH: The required disclosure requirements
4 for that asset allocation is in the footnotes. I can't
5 tell you which note it is though. Okay.

6 BOARD MEMBER JELINCIC: I can look. Thank you.

7 CHAIRPERSON HOLLINGER: Thank you.

8 Any other questions?

9 Okay. I will -- since this is an action item, I
10 will entertain a motion.

11 COMMITTEE MEMBER MATHUR: Move approval.

12 CHAIRPERSON HOLLINGER: Okay. So moved by
13 Mathur --

14 VICE CHAIRPERSON LIND: Second.

15 CHAIRPERSON HOLLINGER: -- seconded by Lind.

16 All in favor?

17 (Ayes.)

18 CHAIRPERSON HOLLINGER: So approved.

19 The next item is Item number 8, Enterprise Risk
20 Management, the Semiannual Enterprise Risk Report that's
21 an information item only.

22 CHIEF RISK OFFICER GRIMES: Thank you, Madam
23 Chair. Forrest Grimes, CalPERS team again.

24 Good afternoon. I'm now know that I stand in
25 between you and lunch.

1 (Laughter.)

2 CHIEF RISK OFFICER GRIMES: And you don't have to
3 be in the risk business to know that that does carry some
4 risk with it.

5 (Laughter.)

6 CHIEF RISK OFFICER GRIMES: We're -- the risk
7 team has really been looking forward to this item. And
8 today, we want to walk you through the outcomes of the
9 January Risk Appetite Workshop that you participated in.
10 You may remember that Melissa and Rebecca and myself were
11 there to facilitate discussions, and then you voted on
12 outcomes.

13 And I want to refer you to page four of
14 attachment 2, and I believe that's page 90 in your iPads.
15 This tells you kind of where we're at in this process.
16 And this goes back to Item 6a as well, when we stated that
17 we were wanting to mature the risk framework this year.
18 You can see where we're at in that process on this page.

19 And basically, we're in the -- we're around 5:00
20 o'clock -- I'm sorry, around 3:30 on the right side there,
21 July 17. So that's where we're at, where we're starting
22 from. And basically, you may recall that you voted on the
23 nine of the 10 enterprise risks. And again, we excluded
24 pension funding from the discussion, because we thought
25 that would be better taken up throughout the ALM cycle,

1 and we think that you're going to be seeing and having
2 those discussions probably in the fall, along with the
3 other ALM work that the Board is doing.

4 The voting results appear on page -- on page four
5 of attachment 2, and that's 92 of your iPads. And
6 basically, these were taken from the voting results. And
7 this is really what we're here to discuss with you today.
8 If you turn to pages 95 and 96 of your iPads, and that's
9 included as attachment 3 for those in the audience, you
10 will see the statements that we have prepared for your
11 review today.

12 And with that, we really look forward and welcome
13 your feedback and comments, and would certainly like to
14 include any comments that you have in refining these
15 statements.

16 With that, I'm going to turn it over to you,
17 Madam Chair. Thank you.

18 CHAIRPERSON HOLLINGER: Thank you very much.

19 I see no comments, and being as it's an
20 information item, thank you very much for your report.

21 And let's see so -- oh, I'm sorry, Mr. Jelincic.

22 BOARD MEMBER JELINCIC: Yeah. On the one of two,
23 95 of the iPad, attachment 3, the benefit administration.
24 I wonder if we really mean that we will not accept any
25 loss due to internal process errors.

1 I think we may accept only minimal loss, but to
2 say we will not accept any loss. I don't think that
3 that's really where -- at least it's not where I am. It's
4 not where the Board -- I don't think it's where the Board
5 is. We actually have a process by which we wipe out stuff
6 every year, because it's insignificant and not
7 collectible, or you know, it's minimal.

8 So as you look at that, I'm not sure any loss is
9 really the right word.

10 CHIEF RISK OFFICER GRIMES: Thank you for your
11 comment, Mr. Jelincic. You know, I -- if -- can you go
12 back to the wheel diagram.

13 I think that really this is an iterative process
14 that we're really engaged in together. And if you kind of
15 look at the diagram is the implementation diagram
16 basically. I think that was page 90, right? You'll see
17 that we're going to be having these tradeoff
18 conversations, and that those actually are going to occur
19 between senior management and senior leadership teams
20 throughout the remainder of -- or the first quarter of the
21 next fiscal year.

22 So when we bring those back to you, back to this
23 Committee in November, I really want to point out that we
24 have always opportunities to refine our views on these
25 things. So Mr. Jelincic's point about any, I think,

1 really went to Mr. Gillihan's comments during the
2 workshop, which is really to fully engage, I think, to the
3 next level of maturity. We're going to have to really
4 have some trade-off conversations. And I think that we
5 will, but I just want to point out that we're really
6 working through maturing this framework.

7 BOARD MEMBER JELINCIC: Thank you.

8 CHAIRPERSON HOLLINGER: Thank you.

9 Ms. Mathur.

10 COMMITTEE MEMBER MATHUR: Yeah. No, I just
11 wanted to say that I think these -- you've captured well
12 sort of the discussion that we had at the off-site with
13 these risk appetite statements. It is still hard to fully
14 appreciate what each of them means in practice. And I
15 guess it will be tested if situations arise. But, to me,
16 this generally does capture where I was and where the
17 discussion led us.

18 So I thank you for putting this together. And
19 it's very -- I mean, this is very challenging and sort of
20 new territory to come up with these risk appetite
21 statements, but I think you landed on something good.

22 Thank you.

23 CHIEF RISK OFFICER GRIMES: Thank you very much.

24 CHAIRPERSON HOLLINGER: Thank you.

25 And I just have a suggestion regarding cyber

1 risks that maybe at some future time, we go through a
2 tabletop exercise of a cybersecurity event, just to
3 highlight the practice that we would -- that the Board
4 would need to go through, if an event were to occur. And
5 that would just be a suggestion for the future.

6 Well, that concludes the semiannual enterprise
7 risk report.

8 Ms. Timberlake-D'Adamo, I don't know that I heard
9 any Summary of Committee direction, did you?

10 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

11 D'ADAMO: I did not, other than what you just said.

12 CHAIRPERSON HOLLINGER: Yeah, other than what I
13 just said.

14 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

15 D'ADAMO: Do you want to make that a Committee direction
16 or --

17 CHAIRPERSON HOLLINGER: Yeah, my Board Members,
18 would you like that tabletop, just so we've gone
19 through -- yeah, at the off-site, just so -- yeah, so that
20 would be --

21 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

22 D'ADAMO: So a discussion around cyber --

23 CHAIRPERSON HOLLINGER: Well, just a -- how we
24 would react -- at an off-site. Yeah, not this one, but
25 just what a cybersecurity event to highlight the practice

1 and, you know, what the Board would need to do in the were
2 event likely to occur.

3 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

4 D'ADAMO: Okay.

5 CHAIRPERSON HOLLINGER: Okay. The Risk and Audit
6 Committee is now adjourned.

7 Thank you.

8 (Thereupon the California Public Employees'
9 Retirement System, Board of Administration,
10 Risk & Audit Committee open session
11 meeting adjourned at 12:14 p.m.)

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

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

That I am a disinterested person herein; that the foregoing California Public Employees' Retirement System, Board of Administration, Risk & Audit Committee open session meeting was reported in shorthand by me, James F. Peters, a Certified Shorthand Reporter of the State of California;

That the said proceedings was taken before me, in shorthand writing, and was thereafter transcribed, under my direction, by computer-assisted transcription.

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

IN WITNESS WHEREOF, I have hereunto set my hand this 26th day of June, 2017.

JAMES F. PETERS, CSR
Certified Shorthand Reporter
License No. 10063