

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, SEPTEMBER 25, 2018

9:00 A.M.

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

COMMITTEE MEMBERS:

Ms. Dana Hollinger, Chairperson

Mr. Bill Slaton, Vice Chairperson

Ms. Margaret Brown

Mr. John Chiang, represented by Mr. Matthew Saha

Mr. Richard Costigan

Ms. Priya Mathur

Ms. Betty Yee, represented by Mr. Alan Lofaso

BOARD MEMBERS:

Mr. Rob Feckner, Vice President

Ms. Adria Jenkins-Jones, represented by Mr. Ralph Cobb

Mr. Henry Jones

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

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P R O C E E D I N G S

CHAIRPERSON HOLLINGER: The Risk and Audit
Committee is now coming to order.

First order of business is the roll call.

COMMITTEE SECRETARY LEWIS: Dana Hollinger?

CHAIRPERSON HOLLINGER: Here.

COMMITTEE SECRETARY LEWIS: Margaret Brown?

COMMITTEE MEMBER BROWN: Here.

COMMITTEE SECRETARY LEWIS: Matthew Saha for John
Chiang?

ACTING COMMITTEE MEMBER SAHA: Here.

COMMITTEE SECRETARY LEWIS: Richard Costigan?

COMMITTEE MEMBER COSTIGAN: Here.

COMMITTEE SECRETARY LEWIS: Priya Mathur?

COMMITTEE MEMBER MATHUR: Good morning.

COMMITTEE SECRETARY LEWIS: Bill Slaton?

CHAIRPERSON HOLLINGER: I think he's in back,
but --

COMMITTEE SECRETARY LEWIS: Alan Lofaso for Betty
Yee?

ACTING COMMITTEE MEMBER LOFASO: Here.

CHAIRPERSON HOLLINGER: Oh, and please note Bill
Slaton just joined.

Okay. First order of business is approval of the
September 25th, 2018 Risk and Audit Committee agenda. Do

1 I have a motion?

2 COMMITTEE MEMBER BROWN: Moved approval.

3 COMMITTEE MEMBER MATHUR: Second.

4 CHAIRPERSON HOLLINGER: Moved by Brown, seconded
5 by Mathur.

6 All in favor?

7 (Ayes.)

8 CHAIRPERSON HOLLINGER: Any opposed?

9 Motion passes.

10 Next item is the executive report. And I call on
11 Marlene Timberlake D'Adamo.

12 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

13 D'ADAMO: Thank you. Good morning, Madam Chair, Committee
14 members. Marlene Timberlake D'Adamo, CalPERS team member.

15 Today you have one action item before you, the
16 Office of Audit Services Charter update. This item is
17 mandated by the International Standards for the
18 Professional Practice of Internal Auditing and requires
19 the Chief Auditor to periodically review the internal
20 audit charter and present to the Board for approval.

21 In addition, Enterprise Compliance will present
22 the 2017-18 Annual Compliance Report as an information
23 item. This item highlights activities and accomplishments
24 for the fiscal year, and the information is within and
25 included in the CAFR.

1 Lastly, Enterprise Risk Management will present
2 the suggested tolerance levels for the strategic risk
3 measures. These measures will monitor the degree of risk
4 CalPERS is prepared to accept for each measure based on
5 the Board's risk appetite.

6 The next Risk and Audit Committee meeting is
7 scheduled for November 14th, 2018 here in Sacramento, and
8 includes the independent auditor's report, the review of
9 the independent auditor's management letter, the finalist
10 selection for the independent financial statement auditor
11 and the enterprise risk management framework review.

12 Thank you, Madam Chair. This concludes my
13 report. And I would be happy to take any questions.

14 CHAIRPERSON HOLLINGER: Seeing no questions.

15 Do I have a motion to approve the June 20th, 2018
16 Risk and Audit Committee meeting minutes.

17 COMMITTEE MEMBER MATHUR: So moved.

18 COMMITTEE MEMBER COSTIGAN: Second.

19 CHAIRPERSON HOLLINGER: Moved by Mathur, second
20 by Costigan.

21 All in favor?

22 (Ayes.)

23 CHAIRPERSON HOLLINGER: Any opposed?

24 Motion passes.

25 Item 5 is information and consent items. And

1 I've had no requests to take anything off the calendar.

2 So we move to 6, which is an action agenda item.

3 And Ms. Chappuie could you please give us the Chief Office
4 of Audit Services Charter update.

5 CHIEF AUDITOR CHAPPUIE: Good morning, Madam
6 Chair and members of the Committee. Beliz Chappuie Office
7 of Audit Services. Agenda Item 6a is an action item.
8 Staff is requesting Risk and Audit Committee to approve
9 Office of Audit Services Charter update.

10 The International Standards for Professional
11 Practice of Internal audit -- in Internal Auditing require
12 the Chief Auditor to periodically review the internal
13 audit charter and present to senior management and the
14 Board for approval. The current Office of Audit Services
15 charter was reviewed and approved by the Finance Committee
16 in November 2011.

17 The audit charter documents the purpose,
18 authority, and the responsibility of CalPERS internal
19 audit activity. The charter also establishes the internal
20 audit activity's position within the organization,
21 including the nature of Chief Auditor's functional
22 reporting relationship with the Board, authorizes access
23 to records, personnel, and physical properties relevant to
24 the performance of engagements, and defines the scope of
25 internal audit activities.

1 The proposed updates are minor in nature and are
2 intended to further clarify the sections of
3 professionalism, independence, scope of work,
4 responsibility, and reporting and monitoring. The
5 red-lined version of the charter was included as an
6 attachment to the agenda item.

7 This concludes my presentation. And I'm happy to
8 answer any questions.

9 CHAIRPERSON HOLLINGER: Okay. Ms. Mathur.

10 COMMITTEE MEMBER MATHUR: Thank you.

11 I have a question on page three of the -- of the
12 draft of the revised charter. And I'm looking at
13 attachment 6A -- attachment 2, page three of six, the
14 red-lined in the first chap -- the first paragraph, the
15 last sentence. "The Chief Auditor shall have no roles
16 or -- and/or responsibilities that fall outside of
17 internal auditing. However, if the Chief Auditor is asked
18 to take on a role and/or responsibility outside of
19 internal auditing, safeguards will be established to limit
20 impairments to independence or objectivity".

21 This is new language. And I can appreciate that
22 I -- as I believe, maybe you can share the intent, is to
23 ensure -- is to ensure independence and not -- and
24 objectivity. So -- but maybe you can speak a little bit
25 to the addition of this language.

1 CHIEF AUDITOR CHAPPUIE: Sure.

2 COMMITTEE MEMBER MATHUR: Yeah.

3 CHIEF AUDITOR CHAPPUIE: When we were updating
4 the current charter, we followed the standards. So there
5 was suggested language to include in the charter. We
6 followed the suggested language and we compared it to our
7 existing charter, and we added the things that weren't
8 there. So it's pretty much following what the standards
9 and best practices require us to do.

10 COMMITTEE MEMBER MATHUR: In the industry?

11 CHIEF AUDITOR CHAPPUIE: Correct.

12 COMMITTEE MEMBER MATHUR: So I know that we have
13 a culture at CalPERS of sort of cross-enterprise
14 collaboration, and -- and that is generally a positive
15 thing. Of course, with respect to the internal auditor,
16 you, of course -- the Chief Auditor, you definitely want
17 this independence and this objectivity.

18 So I guess my question is, you know, the first
19 sentence and the second sentence seem a little bit at
20 odds, in that it's an absolute statement. The first
21 statement is that there shall be no roles or
22 responsibilities. And then the second is if you're asked
23 to, that you -- maybe you have to try to preserve -- you
24 know, limit impairments.

25 So maybe it shouldn't be quite so absolute the

1 first sentence. But as a general rule, the Chief Auditor
2 shall have no roles or responsibilities or -- or, you
3 know, they seem a little bit contradictory.

4 CHIEF AUDITOR CHAPPUIE: Right. So, in general,
5 the Auditor should not take any operational role in the
6 organization.

7 COMMITTEE MEMBER MATHUR: Sure.

8 CHIEF AUDITOR CHAPPUIE: However, because of the
9 knowledge and expertise that we also possess in our
10 office --

11 COMMITTEE MEMBER MATHUR: Right.

12 CHIEF AUDITOR CHAPPUIE: -- we're sometimes
13 expected to sit on committees as -- you know, as a
14 consultant in an advisory role. And it also helps us to
15 follow the progress and operations within organization.
16 So of several committees that I sit on, I'm an advisory
17 member. I don't vote on actions. I can't be part of --

18 COMMITTEE MEMBER MATHUR: Sure.

19 CHIEF AUDITOR CHAPPUIE: -- the decisions that
20 they take. However, it's also for me to be involved and
21 follow the operations.

22 COMMITTEE MEMBER MATHUR: So I think there could
23 be some language that we should add to make it a little
24 bit less absolute or maybe some -- maybe should articulate
25 that. It would be only in a consultative or advisory

1 capacity, never in a decision-making operational capacity.

2 I think that it needs a little bit more
3 clarification, because obviously your knowledge and
4 expertise is valuable to this organization, beyond just
5 the performance of the audits. But as you say, obviously,
6 you can't be a party to a decision that then your office
7 is auditing. That is -- that must be prohibited. So I
8 think --

9 CHIEF AUDITOR CHAPPUIE: We can work on revising
10 it a little bit.

11 COMMITTEE MEMBER MATHUR: -- somehow the language
12 doesn't quite get there.

13 CHIEF AUDITOR CHAPPUIE: Sure.

14 COMMITTEE MEMBER MATHUR: And I'm afraid I don't
15 have perfect language to offer.

16 CHIEF AUDITOR CHAPPUIE: Okay. We can work on
17 it.

18 COMMITTEE MEMBER MATHUR: Thank you.

19 CHAIRPERSON HOLLINGER: Ms. Brown.

20 COMMITTEE MEMBER BROWN: Thank you, Madam Chair.

21 I'm on that same page, but my question is with
22 the first change in the red-line, which says that,
23 "Internal auditors will remain from interference by any
24 element in the organization...". And then you say,
25 "...that threaten your ability to carry out internal audit

1 responsibilities in an unbiased manner".

2 So what type of interference would you have that
3 wouldn't cause you to -- that wouldn't threaten your
4 ability. I'm just trying to figure out what are those
5 interferences that we're talking about here.

6 CHIEF AUDITOR CHAPPUIE: This is to -- if any
7 interference that could preclude me from performing my
8 duties and responsibilities and losing my independence.
9 So I cannot just come up with a scenario right now. And
10 this is more to memorialize it in case something comes up.
11 Then I can just pull the charter up and say this would
12 interfere with my independence. And I have to refrain
13 from performing these duties.

14 CHAIRPERSON HOLLINGER: So it -- that's more
15 like, I guess, a fail-safe if something should happen,
16 that --

17 COMMITTEE MEMBER BROWN: Yeah. It just says that
18 threaten to carry out your internal audit. I'm just
19 trying to figure out, well, what interference would there
20 be? I just don't know why we would need to add the
21 additional thing. Just free from interference by any
22 element in the organization.

23 Anyways, I just didn't know what other
24 interference there would be.

25 CHIEF AUDITOR CHAPPUIE: These are the languages

1 that we pretty much pulled from the best practices and the
2 standards that --

3 COMMITTEE MEMBER BROWN: So you're just copying
4 a charter.

5 CHIEF AUDITOR CHAPPUIE: -- the charter --
6 we're -- right, it's not me --

7 COMMITTEE MEMBER BROWN: Okay.

8 CHIEF AUDITOR CHAPPUIE: -- interjecting or
9 inputting this language in here. It's pretty much the
10 recommended language in the charter, so we pretty much
11 copied from it.

12 COMMITTEE MEMBER BROWN: So I'm -- so there
13 hasn't been some other interference that's going on.

14 CHIEF AUDITOR CHAPPUIE: No, correct.

15 COMMITTEE MEMBER BROWN: Okay. Thank you.

16 CHAIRPERSON HOLLINGER: Yeah, it's more like if
17 something should happen in the future.

18 COMMITTEE MEMBER BROWN: Okay.

19 CHAIRPERSON HOLLINGER: Are you done?

20 COMMITTEE MEMBER BROWN: Um-hmm.

21 CHAIRPERSON HOLLINGER: Okay. Great. Thank you.
22 Mr. Slaton.

23 VICE CHAIRPERSON SLATON: Thank you, Madam Chair.
24 I want to go to page three -- or excuse me, five of six.
25 And in the internal audit plan, it says in the middle of

1 the first paragraph, "...including as appropriate any plan
2 amendments, special tasks, or projects requested by
3 management and RAC", this committee.

4 And then in the next sentence it says -- next
5 paragraph, "Any significant deviation from the..." -- oh,
6 I see. Wait a minute. "There's a prioritization based on
7 risk-based methodology including input of the executive
8 team and the Board".

9 So I'm trying to understand is it the Board, is
10 it RAC? There seems to be a little bit of a conflict
11 there as to who provides input. And here's where I'm
12 trying to get to. The more important question is this,
13 let's say I, as a Board member, have an issue that I think
14 warrants internal audit work. So I want to make sure
15 there's a process for me to raise that issue, and I would
16 think it would be with this Committee. And then this
17 Committee would debate that and decide whether to charge
18 you with that responsibility to go look at that particular
19 issue. Am I -- do we have that ability, and if we don't,
20 why not?

21 CHIEF AUDITOR CHAPPUIE: Yes, you do have that
22 ability. The reason it's documented here in this way, we
23 do -- during -- every year in the spring, we go through a
24 risk assessment process to identify those assignments that
25 we would like to conduct in the following fiscal year --

1 VICE CHAIRPERSON SLATON: Right.

2 CHIEF AUDITOR CHAPPUIE: -- because the universe
3 is huge, the resources are limited. We can't possibly
4 audit everything every year.

5 VICE CHAIRPERSON SLATON: Sure.

6 CHIEF AUDITOR CHAPPUIE: So in doing that,
7 there's three things we do. We also seek input from the
8 Board members through surveys. We send an electronic
9 survey to each and every Board member.

10 However, you're right, the Risk and Audit
11 Committee is carved out, and it has delegation from the
12 Board to oversee the audit function. The lines there --
13 it's beyond my role and responsibility how the
14 communication could come through the Board members to the
15 Risk and Audit Committee and be communicated to me. That
16 could be discussed further. And how -- this sentence just
17 refers to that risk assessment we conduct every year.

18 VICE CHAIRPERSON SLATON: Okay. So but you're
19 doing this -- you're essentially coming up with an audit
20 plan --

21 CHIEF AUDITOR CHAPPUIE: Right.

22 VICE CHAIRPERSON SLATON: -- once a year, based
23 on your judgment of the risk that we face, and the
24 resources that you have. And that's reviewed by us, and
25 we agree, okay, that's the plan.

1 CHIEF AUDITOR CHAPPUIE: Right.

2 VICE CHAIRPERSON SLATON: So now let's fast
3 forward three months and I've now raised an issue with RAC
4 that I think something needs to be -- I'd like something
5 to be looked at. And if the Committee agrees, then how do
6 we incorporate that?

7 CHIEF AUDITOR CHAPPUIE: Absolutely. That be
8 could communicated to us through the Risk and Audit
9 Committee, whether -- if it's a consulting engagement, we
10 already budget ours for consulting engagements just for
11 those needs, like you expressed. And sometimes it comes
12 through the executive team, sometimes those requests come
13 through the senior leadership as well.

14 We take those into consideration and we honor
15 those assignments throughout the fiscal year. We
16 certainly will take those into consideration, if there's a
17 need that comes to -- but how -- if you're asking me how
18 to communicate that through the process, it could be
19 communicated to us and then we'll update it on our
20 quarterly report to say that we're including these
21 assignments on our plan.

22 VICE CHAIRPERSON SLATON: I guess what I don't
23 see quite in here, I guess it's implied, but it's not in
24 here specifically that this Committee has the delegated
25 authority to essentially require you to look at something.

1 Now, in the other board I'm on, we -- that board,
2 we do have that ability to do that to direct the internal
3 auditor to be able to look at something if we, as a
4 committee, feel it's important enough. Now, I don't know
5 if that then has to go to the Board for a decision, or
6 whether it's totally delegated here.

7 But what I'm trying to get to is if, as an
8 individual Board member, we should not be able to direct
9 you to go look at something, as an individual Board
10 member.

11 CHIEF AUDITOR CHAPPUIE: Okay.

12 VICE CHAIRPERSON SLATON: But as Committee or as
13 a Board, we should have that ability to do that, if we
14 feel there's something that needs to be looked at.

15 CHIEF AUDITOR CHAPPUIE: Certainly. Okay. You
16 would like us to add in here?

17 VICE CHAIRPERSON SLATON: So that's what I'm --
18 that's what I'm looking for here, and I don't quite see
19 it --

20 CHIEF AUDITOR CHAPPUIE: Okay. We can add it
21 here.

22 VICE CHAIRPERSON SLATON: -- in the words.

23 CHIEF AUDITOR CHAPPUIE: We can add it in here.

24 CHAIRPERSON HOLLINGER: So what I'm seeing is --
25 and I'm not sure if we need a motion for this, because

1 this is an action item, Ms. Mathur's comment to add as on
2 Item -- Agenda Item 6a, attachment 2, three of six, "As a
3 general rule, the Chief Auditor shall have no roles and/or
4 responsibilities", to add that language, and then to
5 address Mr. Slaton to give the Risk and Audit Committee
6 having a delegated authority to direct the internal
7 audit -- Chief Auditor.

8 CHIEF AUDITOR CHAPPUIE: Okay.

9 CHAIRPERSON HOLLINGER: Did any -- do we need a
10 motion for that or...

11 COMMITTEE MEMBER MATHUR: (Nods head.)

12 CHAIRPERSON HOLLINGER: Okay. Does somebody want
13 to make that motion?

14 I don't think -- okay. Ms. Mathur.

15 COMMITTEE MEMBER MATHUR: I don't think in this
16 charter we can address the delegations of the -- from the
17 Board to the Committee. I think that is embedded in the
18 delegation to the Committee. So I would extract that from
19 what you were outlining.

20 CHAIRPERSON HOLLINGER: Okay.

21 COMMITTEE MEMBER MATHUR: I think if we want to
22 review the delegation, that's something that comes to the
23 Committee for review every year, as I recall. And so --
24 and we reviewed it, I believe, in March or April. I can't
25 recall exactly, but we certainly could look at that in

1 that regard.

2 But I appreciate your capturing my comment. And
3 I think putting in -- as a general rule --

4 CHAIRPERSON HOLLINGER: Right.

5 COMMITTEE MEMBER MATHUR: -- before the Chief
6 Auditor on page three. And then I would say, however, if
7 Chief Auditor is asked to take on a -- and maybe we should
8 be explicit about it being a consulting or advisory role
9 outside of internal auditing. So --

10 CHAIRPERSON HOLLINGER: Right. It should be --

11 COMMITTEE MEMBER MATHUR: So maybe sort of --
12 putting a boundary around what kind of role it could be,
13 or a non-operational non-decision make -- I don't know how
14 we're -- we can -- do you think -- do you think consulting
15 advisory would --

16 CHIEF AUDITOR CHAPPUIE: Yeah, yeah.

17 COMMITTEE MEMBER MATHUR: -- capture it.

18 Then I'm happy to make the motion to adopt this
19 with that change.

20 COMMITTEE MEMBER COSTIGAN: I'll second it.

21 CHAIRPERSON HOLLINGER: Okay.

22 COMMITTEE MEMBER MATHUR: Thank you.

23 CHAIRPERSON HOLLINGER: So it's made by Mathur,
24 seconded by Costigan.

25 All in favor --

1 VICE CHAIRPERSON SLATON: Whoa, whoa, whoa. Wait
2 a minute. I want to -- I want to -- can we discuss the
3 motion just a little bit?

4 CHAIRPERSON HOLLINGER: You're not --

5 VICE CHAIRPERSON SLATON: Yeah, I am. I'm on.

6 CHAIRPERSON HOLLINGER: Oh, I didn't realize.
7 Okay. It doesn't show up.

8 VICE CHAIRPERSON SLATON: Is that okay, Chair. I
9 just -- We have a motion and a second.

10 COMMITTEE MEMBER MATHUR: Yeah, he seconded it.
11 I made it and Costigan seconded it.

12 VICE CHAIRPERSON SLATON: Yeah. Okay. So I
13 just -- but the change does not include what I was
14 discussing.

15 COMMITTEE MEMBER MATHUR: It does not --

16 VICE CHAIRPERSON SLATON: It does not. Okay.

17 COMMITTEE MEMBER MATHUR: -- because that's part
18 of the delegation from the Board to the --

19 VICE CHAIRPERSON SLATON: But -- here's a fix of
20 it, because that could -- the delegation could come later.
21 The issue is whether this Board, or a Committee of this
22 Board, can direct the internal auditor to look at
23 something. And that could be by modifying the words,
24 "...including input from the executive team and the
25 Board", because the Board could do this. So if you change

1 the word "input" including direction -- if you put "change
2 input" to "direction" --

3 CHAIRPERSON HOLLINGER: Okay. This is on page
4 five of six.

5 VICE CHAIRPERSON SLATON: This is page five.

6 CHAIRPERSON HOLLINGER: On the internal audit
7 plan.

8 VICE CHAIRPERSON SLATON: Internal audit plan,
9 last paragraph on the page.

10 CHIEF AUDITOR CHAPPUIE: Second paragraph.

11 CHAIRPERSON HOLLINGER: Got it.

12 VICE CHAIRPERSON SLATON: And if you change the
13 word "input" to "direction", then it implies the Board
14 could do this. And then later on, if we choose to -- if
15 the Board wants to delegate that in the delegation to RAC,
16 that's fine. That could be accomplished. But it allows
17 the Board to direct the internal auditor to look at
18 something, if we feel, as a group, it needs to be looked
19 at.

20 CHIEF AUDITOR CHAPPUIE: May I suggest one
21 more --

22 VICE CHAIRPERSON SLATON: So I would ask if
23 that --

24 CHAIRPERSON HOLLINGER: Yeah, go ahead, Ms.
25 Chappuie.

1 CHIEF AUDITOR CHAPPUIE: What if we changed
2 that -- the word "Board" to "RAC", then the charter
3 requires the Risk and Audit Committee to direct me if an
4 assignment comes up, and then maybe the delegation could
5 be worked on later between the Board and the Risk and
6 Audit Committee, would that help?

7 CHAIRPERSON HOLLINGER: Well, could you -- I
8 couldn't really understand what --

9 CHIEF AUDITOR CHAPPUIE: In that second -- so in
10 the -- in the sec -- in the second paragraph under
11 internal auditing --

12 CHAIRPERSON HOLLINGER: Correct.

13 CHIEF AUDITOR CHAPPUIE: -- as Bill Slaton
14 suggested, we're going to switch -- change the word from
15 "including input" to "including direction from the
16 executive team and the Board", as it reads right now.

17 CHAIRPERSON HOLLINGER: Oh.

18 CHIEF AUDITOR CHAPPUIE: And I'm suggesting if we
19 change the Board to Risk and Audit Committee, would that
20 help? That way it has to come from the Risk and Audit
21 Committee, and then the Board and Risk and Audit Committee
22 work on the direction later. Would that help?

23 CHAIRPERSON HOLLINGER: Well, I find that would
24 be limiting its scope from the Board to narrowing the
25 scope to just the Risk and Audit Committee, and I'm not

1 sure that my --

2 VICE CHAIRPERSON SLATON: It's a sequence
3 problem.

4 CHAIRPERSON HOLLINGER: Right.

5 VICE CHAIRPERSON SLATON: Because right now we
6 don't have that delegated authority. Is that the point
7 Ms. Mathur I believe is making. So if you make it -- if
8 we're -- if this is an action item and you make it Board,
9 then the Board can choose later to delegate it. But I
10 would say it's -- the one other change I would suggest is
11 "...including direction of the executive team and/or the
12 Board", because the Board may want to have you look at
13 something. So it's really an and/or.

14 So if you leave it Board, then it later can be
15 changed to RAC, if we choose to as a group.

16 CHAIRPERSON HOLLINGER: Okay. Ms. Mathur.

17 COMMITTEE MEMBER MATHUR: So I -- if I'm
18 understanding Mr. Slaton's suggestion, it's not so much
19 whether it's the Risk and Audit Committee versus the
20 Board. It's more this word input versus direction. So I
21 guess -- I think what I'm understanding him to say, and
22 correct me if I'm incorrect, is that he doesn't want you,
23 the Chief Auditor, to just consider our input in the audit
24 plan. But that if we say we really -- we direct you to do
25 this, then that -- then you would take it on to the plan.

1 CHIEF AUDITOR CHAPPUIE: Absolutely, yes.

2 COMMITTEE MEMBER MATHUR: So I think it's maybe
3 really definitional question about the word "input", and
4 what does that mean.

5 CHAIRPERSON HOLLINGER: Well, direction implies
6 that we have delegated authority. Input is just input.

7 COMMITTEE MEMBER MATHUR: Well, I --

8 CHIEF AUDITOR CHAPPUIE: This is -- this is
9 during the risk assessment --

10 COMMITTEE MEMBER MATHUR: Yes.

11 CHIEF AUDITOR CHAPPUIE: -- and preparation of
12 the audit plan.

13 CHAIRPERSON HOLLINGER: Oh.

14 CHIEF AUDITOR CHAPPUIE: So we seek input from
15 the Board --

16 CHAIRPERSON HOLLINGER: Right.

17 CHIEF AUDITOR CHAPPUIE: -- the executive team,
18 the senior leaders, right? We seek input from all the
19 executive team --

20 COMMITTEE MEMBER MATHUR: My --

21 CHIEF AUDITOR CHAPPUIE: -- management team, I
22 would say, everybody, right, overseeing the organization,
23 the Board, executive team, and the senior leaders. And
24 then we also factor in our knowledge, and expertise, and
25 understanding, and then identify those auditable

1 assignments for the year.

2 COMMITTEE MEMBER MATHUR: I mean, ultimately, the
3 Board adopts the audit plan.

4 CHIEF AUDITOR CHAPPUIE: Correct.

5 COMMITTEE MEMBER MATHUR: I mean, the Committee
6 makes a recommendation to the Board to adopt the audit
7 plan. So, in effect, we do direct whether -- what's
8 included in the audit plan by that very action. So I
9 guess for my view, we don't necessarily need the word
10 "direct" in here. That we provide input --

11 CHAIRPERSON HOLLINGER: Right.

12 COMMITTEE MEMBER MATHUR: -- you incorporate it.
13 We review it. If we think something is missing, we again
14 provide input. You amend it and it comes back to us and
15 we ultimately adopt it.

16 So I personally think that we could leave the
17 word "input", and it would still go through it's regular
18 process of approval and we would -- the Board ultimately
19 has the opportunity to determine what is included in that
20 audit plan.

21 CHIEF AUDITOR CHAPPUIE: Correct. And that would
22 be the audit plan. However, like Bill Slaton said, as
23 assignments come up or if something comes up throughout
24 the year, we could always take that into consideration and
25 perform that assignment if Board directs us to do that --

1 COMMITTEE MEMBER MATHUR: Yeah.

2 CHIEF AUDITOR CHAPPUIE: -- in addition to the
3 audit plan. This is just specifically for preparation of
4 the audit plan.

5 VICE CHAIRPERSON SLATON: For the audit plan.
6 Okay. Well, like I said, I just want to make sure there's
7 a vehicle for if someone has an issue, they bring it
8 before the appropriate body of this Board, whether Board
9 or Committee, and then there's an ability to have that
10 issue looked at by your team. That's all I'm trying to
11 accomplish.

12 CHIEF AUDITOR CHAPPUIE: Absolutely. Absolutely.
13 It could be directly --

14 VICE CHAIRPERSON SLATON: So if we can do it
15 under these words, I'm fine.

16 COMMITTEE MEMBER MATHUR: I think the
17 appropriate --

18 CHAIRPERSON HOLLINGER: I'm fairly comfortable
19 that that exists.

20 VICE CHAIRPERSON SLATON: Okay. All right.

21 COMMITTEE MEMBER MATHUR: Just to close this out,
22 I think the appropriate mechanism is to, if you have a
23 concern to raise it with the Chair, say I'd like to put it
24 on the agenda, and then the Chair would work with the team
25 the put -- to agendize it, and then the Committee can make

1 a recommendation, and the Board can approve it.

2 CHAIRPERSON HOLLINGER: Yes.

3 VICE CHAIRPERSON SLATON: Okay I'm fine.

4 CHIEF AUDITOR CHAPPUIE: Perfect.

5 COMMITTEE MEMBER MATHUR: Thank you.

6 CHAIRPERSON HOLLINGER: So, Ms. Mathur, made a
7 motion to approve the charter with the amended language.
8 Mr. Costigan seconded the motion.

9 So all those in favor say aye?

10 (Ayes.)

11 CHAIRPERSON HOLLINGER: Any opposed?

12 Motion passes.

13 So we're now at 7a.

14 BOARD MEMBER JONES: Madam --

15 CHAIRPERSON HOLLINGER: Oh, I'm -- it doesn't for
16 some reason -- sorry, Mr. Jones --

17 BOARD MEMBER JONES: Okay.

18 CHAIRPERSON HOLLINGER: You're on. Oh, I just --
19 could you hit it again.

20 Go ahead.

21 BOARD MEMBER JONES: Okay. Thank you, Madam
22 Chair.

23 Yeah, I have a request, and I'm not so sure that
24 it's the Audit Committee that should consider it, or
25 whether it's the Governance Committee, or whether it's

1 Performance and Comp. And that is, is that recently we've
2 had to rely on a independent investigation on a number of
3 issues. And I think that we need to have a discussion or
4 consideration about establishing an Inspector General
5 position. And I want to -- to this Committee whether or
6 not this is the appropriate place to bring it back for
7 discussion, or whether it's Governance. And since the
8 President is here, she could also opine on that. So
9 that's what I would like.

10 CHAIRPERSON HOLLINGER: Well, it is regarding
11 risk to the system.

12 BOARD MEMBER JONES: Um-hmm.

13 CHAIRPERSON HOLLINGER: And I'm -- yeah, Matt,
14 can you tell us the appropriate committee to bring it up?

15 GENERAL COUNSEL JACOBS: It's not crystal clear,
16 but I would say it would probably be Governance.

17 CHAIRPERSON HOLLINGER: Okay. Ms. Mathur.

18 COMMITTEE MEMBER MATHUR: If I -- if I -- I would
19 just suggest, yes, I'm happy to have a conversation with
20 you. It's not on this agenda today, so we can't discuss
21 it.

22 BOARD MEMBER JONES: Yeah, but I wanted to raise
23 it, because I didn't know. I'm trying to -- a
24 clarification of which is the appropriate committee.
25 Okay.

1 COMMITTEE MEMBER MATHUR: Happy to have a
2 conversation with you about it.

3 BOARD MEMBER JONES: Okay. Thank you.

4 CHAIRPERSON HOLLINGER: Okay. Okay. So now,
5 that brings us to 7a the annual compliance reports. Ms.
6 D'Adamo.

7 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

8 D'ADAMO: Good morning. So this item, 7a, is the Annual
9 Compliance Report. It is an agenda item that you see
10 every year in September. And then it gets incorporated
11 into the CAFR as part of the November agenda item.

12 This agenda item is a little bit different this
13 year. We've modified it a bit. We've tried to streamline
14 it and highlight the work of the Enterprise Compliance
15 Branch, as well as the embedded compliance liaisons that
16 exist throughout the enterprise.

17 The integrated assurance model is something that
18 we talk about a lot and it's highlighted in this -- in
19 this document. It incorporates governance, risk, and
20 compliance practices as a multi-faceted approach to
21 promote compliance, awareness, and accountability. Our
22 model focuses on the three lines of defense framework,
23 which promotes collaboration and increased understanding
24 of roles and responsibilities.

25 The report highlights different activities within

1 the Enterprise Compliance Branch focusing on the
2 Enterprise Compliance Monitoring and Oversight Unit, the
3 Enterprise Ethical Standards and Investigations Unit,
4 Enterprise Policy and Delegation management, as well as
5 operations, communications, and reporting.

6 In terms of our embedded compliance efforts,
7 we've highlighted compliance activities within our Health
8 Policy and Benefits Branch, as well as customer services
9 and support, the investment Office, our operations and
10 technology branch, human resources services, and our
11 operations support services.

12 What you'll see from this document is that
13 enterprise compliance works very closely with many of the
14 divisions within the enterprise, and we're focused on
15 getting to our -- the conclusion of our five-year plan
16 which goes through 2020. At this point, I can stop and
17 take any questions if you have on the report.

18 CHAIRPERSON HOLLINGER: Seeing none -- oh, I'm
19 sorry. Ms. Mathur.

20 COMMITTEE MEMBER MATHUR: Sorry, Madam Chair.

21 First of all, I'm so thrilled to see the culture
22 of compliance front and center. We've talked about that
23 before, but I think that is -- that is important. I did
24 want to ask -- you know, obviously, we have embedded
25 compliance officers in the various divisions and branches,

1 as well as your compliance --

2 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

3 D'ADAMO: Um-hmm.

4 COMMITTEE MEMBER MATHUR: -- your stand-alone
5 compliance team. And you talked about on page six of 14
6 of the report that -- about the embedded Compliance
7 Program partnered with embedded compliance liaisons to
8 strengthen compliance controls, oversight, and awareness.
9 And I'm just wondering if you could give a little bit more
10 color to that and what does that look like? How do you
11 ensure that there's good communication between your
12 stand-alone team and the embedded compliance officers and
13 how that works in practice?

14 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE

15 D'ADAMO: Sure. So the Three Lines of Defense model is a
16 model that exists where the first line is essentially your
17 program areas. It's really where your compliance and your
18 risk activities take place. They actually own the
19 compliance and the risk that happens within those
20 programs.

21 Your second line of defense is essentially your
22 oversight team, which is us and others. There's a --
23 quite a few branches or divisions within compli -- CalPERS
24 that are second line of defense. And the role of second
25 line is really to provide assurance that the first line is

1 doing the things that they're supposed to be doing. It's
2 almost like a trust but verify sort of model.

3 And then the third line is actually your audit
4 group.

5 And so when you have your programs, your second
6 line, and your audit, you put together what looks like a
7 framework of three lines of defense, where there's work
8 that's being done, there's oversight and monitoring, and
9 then there's the validation that occurs within your
10 audit -- your audit department. And it really is a
11 circular sort of thing.

12 We actually engage in our enterprise --
13 Integrated Assurance Group, where we have a lot of the
14 groups in second and third line, where we get together and
15 we really go over what's happening within the enterprise.
16 We're making sure that we're not duplicating work. We're
17 making sure that we're really connected with what's
18 happening with the program areas.

19 And then within the embedded compliance liaisons,
20 Enterprise Compliance works with those team members.
21 They're designated individuals within the program areas
22 that I've listed here, where they're charged with
23 responsibilities of helping to build their individual
24 compliance programs, where they're helping us with
25 training, they're doing some monitoring. Really working

1 with them to make sure that we can assure ourselves that
2 the work that's being done at that first level is actually
3 being done. And that's really how they work together in
4 terms of first line and second line.

5 COMMITTEE MEMBER MATHUR: Okay. Thank you so
6 much.

7 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE
8 D'ADAMO: Sure.

9 CHAIRPERSON HOLLINGER: I wanted to really
10 applaud the team. And as you know, risk is near and dear
11 to my heart. So I really appreciate this three lines of
12 defense, and that we have those checks and balances,
13 really strengthening the governance, and the compliance,
14 and risk within the organization.

15 So thank you.

16 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE
17 D'ADAMO: Thank you.

18 CHAIRPERSON HOLLINGER: Next is, seeing no
19 further questions, 7b, Strategic Risk Measures Tolerances.

20 Mr. Grimes.

21 (Thereupon an overhead presentation was
22 presented as follows.)

23 CHIEF RISK OFFICER GRIMES: Good morning, Madam
24 Chair, Committee members. Board members, thank you for
25 attending. Forrest Grimes, CalPERS team.

1 Today, really this is a continuation of our June
2 conversation when we talked about strategic risk measures.
3 And today we're going to present risk tolerances for each
4 of the risk measures. This describes how much uncertainty
5 the Board is willing to accept for each of the enterprise
6 risks. And if you would mind -- if you wouldn't mind
7 turning to page 88 in your Board books, this is really the
8 attachment that lays out the thresholds -- the tolerances
9 rather.

10 And the tolerances are very similar to the
11 thresholds that you're very familiar with through the
12 enterprise performance reporting side. And with that,
13 what I'd like to do is really just to stop and ask you if
14 you have questions on the content or methodology of any of
15 the tolerances that we've selected. So with that, I'm
16 going to turn it back to you, Madam Chair.

17 CHAIRPERSON HOLLINGER: Thank you. I appreciate
18 that. Just a question. I noticed -- well, obviously, we
19 don't have the current status on this -- these reports
20 filled in. When can we -- what's the timeline for that.

21 CHIEF RISK OFFICER GRIMES: I'm so -- I'm so
22 pleased that you asked that.

23 (Laughter.)

24 CHIEF RISK OFFICER GRIMES: We plan on bringing
25 those -- we plan on -- if you like these -- these

1 tolerances, what the Risk team will do is we'll start
2 collecting data based on this information.

3 CHAIRPERSON HOLLINGER: Right.

4 CHIEF RISK OFFICER GRIMES: And then we will
5 bring back to you in February at the Risk and Audit
6 Committee in our semiannual update, basically what we
7 would propose to be what type of reports you're going to
8 see and the timing of those reports.

9 I can assure you that we're having pretty
10 detailed conversations with the -- within the enterprise
11 regarding how do these performance and risk measures
12 really integrate, and how should we be reporting them to
13 you. And so --

14 CHAIRPERSON HOLLINGER: Right.

15 CHIEF RISK OFFICER GRIMES: -- I think we'll be
16 giving that some, you know, ongoing thought and debate
17 between now and February, and then come back to you with a
18 recommendation.

19 CHAIRPERSON HOLLINGER: No, I appreciate that.
20 And I -- I really like the risk tolerance that you set
21 out. And obviously the -- the unfunded liability and the
22 focus, I applaud you. So thank you.

23 Ms. Mathur.

24 COMMITTEE MEMBER MATHUR: Thank you. So I just
25 want to -- if we could just review for a moment, the risk

1 tolerance --

2 CHIEF RISK OFFICER GRIMES: Certainly.

3 COMMITTEE MEMBER MATHUR: -- of where it has
4 attention required, monitoring required, managed
5 appropriately --

6 CHIEF RISK OFFICER GRIMES: Yes.

7 COMMITTEE MEMBER MATHUR: -- those percentages
8 are the probability of the event that's listed in the top
9 row occurring, right? So, for example, in the column two
10 PERF funding levels below 50 percent, attention is
11 required -- would be required if the probability of that
12 occurring was greater than 20 percent.

13 CHIEF RISK OFFICER GRIMES: Exactly. And I think
14 when you said probability, you hit on really the key term,
15 because the actuaries will be calculating that. And it's
16 really that probability of that event occurring --

17 CHAIRPERSON HOLLINGER: Right.

18 CHIEF RISK OFFICER GRIMES: -- that we're going
19 to be focused on. And I might, you know, just add that
20 you saw these as performance measures previously. And I
21 think that -- you know, I think it was July at the
22 off-site that really the Performance team really was kind
23 of telling you that we're moving this to the risk side.

24 CHAIRPERSON HOLLINGER: Right.

25 CHIEF RISK OFFICER GRIMES: And I think that you

1 can see that those are -- those are truly leading
2 indicators of potential funding risks. So I think they're
3 in the right place right now. And we're just really, you
4 know, following up on that to move them over to the risk
5 side.

6 COMMITTEE MEMBER MATHUR: I appreciate that. You
7 know, of course, these three -- these are clearly key
8 risks for CalPERS.

9 CHIEF RISK OFFICER GRIMES: Yes.

10 COMMITTEE MEMBER MATHUR: And they are, in some
11 ways, interrelated, and perhaps in some senses the
12 solutions to resolving one or the other of them might be
13 in conflict with the other. So, for example, to address a
14 funding level -- the Probability of a funding level below
15 50 percent might require an increase in employer
16 contributions so it could create it could impact the other
17 two risks components.

18 CHIEF RISK OFFICER GRIMES: Well, absolutely.
19 And I want to take you back to late 2017, when really the
20 full Board contemplated the ALM cycle, and really
21 discussed those really, you know, opposing risks in many
22 cases. And that's really where we resolved that, and
23 where you resolved that is to really kind of look at those
24 two opposing sides and determine what the right balance
25 is.

1 COMMITTEE MEMBER MATHUR: Yeah, exactly.
2 Terrific. Well, I think this is good work. Thank you so
3 much.

4 CHIEF RISK OFFICER GRIMES: Thank you.

5 CHAIRPERSON HOLLINGER: Seeing no further
6 questions.

7 We're on 7c, summary of Committee direction. Ms.
8 D'Adamo.

9 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE
10 D'ADAMO: Yes. The only direction that I have was the
11 conversation around the Audit Services Charter. And I
12 think that was --

13 CHAIRPERSON HOLLINGER: Right.

14 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE
15 D'ADAMO: -- pretty well defined. So that was all I had
16 for Committee direction.

17 CHAIRPERSON HOLLINGER: And those were my
18 directions as well -- or my notes as well.

19 Okay. So the Risk and Audit Committee is -- the
20 open session is -- is there anything else?

21 INTERIM CHIEF FINANCIAL OFFICER TIMBERLAKE
22 D'ADAMO: No. I just didn't know if there was any public
23 comment.

24 CHAIRPERSON HOLLINGER: No public comment. No, I
25 have gotten no requests to speak, so the -- anybody out --

1 have a request to speak that has not put it in?

2 Okay. So the open session is now closed.

3 (Thereupon the California Public Employees'
4 Retirement System, Board of Administration,
5 Risk & Audit Committee open session
6 meeting adjourned at 9:36 a.m.)

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

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

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

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

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

16 IN WITNESS WHEREOF, I have hereunto set my hand
17 this 30th day of September, 2018.

18
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20 

21
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23 Certified Shorthand Reporter
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