

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

ROBERT F. CARLSON AUDITORIUM
LINCOLN PLAZA NORTH
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SACRAMENTO, CALIFORNIA

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A P P E A R A N C E S

COMMITTEE MEMBERS:

Mr. David Miller, Chairperson

Ms. Lisa Middleton, Vice Chairperson

Ms. Margaret Brown

Ms. Fiona Ma, represented by Mr. Matthew Saha

Ms. Stacie Olivares

Mr. Jason Perez

Ms. Betty Yee, represented by Ms. Lynn Paquin

BOARD MEMBERS:

Mr. Henry Jones, President

Ms. Theresa Taylor Vice President

Mr. Rob Feckner

Ms. Eraina Ortega

Ms. Mona Pasquil Rogers

Mr. Ramon Rubalcava

STAFF:

Ms. Marcie Frost, Chief Executive Officer

Mr. Matthew Jacobs, General Counsel

Ms. Marlene Timberlake D'Adamo, Chief Compliance 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. Steve Franklin, BDO USA, LLP

Mr. Keith Hammond, BDO USA, LLP

Mr. Billy Kim, BDO USA, LLP

Ms. Sylvia Mak, BDO USA, LLP

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P R O C E E D I N G S

CHAIRPERSON MILLER: Okay. So we'll call the
Risk and Audit Committee meeting to order.

And the first order of business is roll call.

COMMITTEE SECRETARY LEWIS: David Miller?

CHAIRPERSON MILLER: Here.

COMMITTEE SECRETARY LEWIS: Lisa Middleton?

VICE CHAIRPERSON MIDDLETON: Present.

COMMITTEE SECRETARY LEWIS: Margaret Brown?

COMMITTEE MEMBER BROWN: Here.

COMMITTEE SECRETARY LEWIS: Matthew Saha for
Fiona Ma?

ACTING COMMITTEE MEMBER SAHA: Here.

COMMITTEE SECRETARY LEWIS: Stacie Olivares?

COMMITTEE MEMBER OLIVARES: Here.

COMMITTEE SECRETARY LEWIS: Jason Perez?

COMMITTEE MEMBER PEREZ: Here.

COMMITTEE SECRETARY LEWIS: Lynn Paquin for Betty
Yee?

ACTING COMMITTEE MEMBER PAQUIN: Here.

CHAIRPERSON MILLER: Okay. First order of
business is approval of the November 19, 2019 Risk and
Audit Committee timed agenda.

COMMITTEE MEMBER BROWN: Move approval.

VICE CHAIRPERSON MIDDLETON: Second.

1 CHAIRPERSON MILLER: Moved by Ms. Brown, seconded
2 by Ms. Middleton.

3 I'll call for the question.

4 All in favor say aye?

5 (Ayes.)

6 CHAIRPERSON MILLER: Any opposed?

7 The ayes have it. The item passes.

8 And onto the Executive Report. I'll call on
9 Marlene Timberlake D'Adamo.

10 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

11 Good -- I had written good morning, but it's
12 actually good afternoon now.

13 Thank you. Good afternoon, Mr. Chair, Madam Vice
14 Chair, Committee members. Marlene Timberlake D'Adamo,
15 CalPERS team member.

16 Today, we have two action items and one
17 information item. The two action items are agenda items
18 6a, which is the independent auditor's report for fiscal
19 career 2018-19. And agenda item 6b, the review o the
20 independent auditor's management letter. Both items are
21 being presented by Beliz Chappuie, CalPERS Chief Audit --
22 Auditor, and BDO, the independent auditor.

23 The last item on the agenda is an information
24 agenda item intended to provide an overview of several
25 areas of responsibility within CalPERS' integrated

1 assurance functions. Second would be to furnish a brief
2 history of the development of the Enterprise Risk
3 Management Framework, and provide an update on the current
4 state of CalPERS enterprise risks, and to respond to Risk
5 and Audit Committee direction provided on September 17th,
6 2019.

7 The next Risk and Audit Committee meeting is
8 scheduled February 19th, 2020 and includes the mid-year
9 plans for Enterprise Compliance and Enterprise Risk
10 Management.

11 Thank you, Mr. Chair. This concludes my report,
12 and I'd be happy to take questions.

13 CHAIRPERSON MILLER: Okay. I'm not seeing any
14 questions. So thank you, Ms. D'Adamo.

15 Moving on, we've got number 4, action consent
16 items, and that's the approval of the September 17th, Risk
17 and Audit Committee Meeting Minutes.

18 VICE CHAIRPERSON MIDDLETON: Move approval.

19 COMMITTEE MEMBER BROWN: Second.

20 CHAIRPERSON MILLER: Moved by Ms. Middleton,
21 seconded by Ms. Brown.

22 So I'll call for the question.

23 All in favor aye?

24 (Ayes.)

25 CHAIRPERSON MILLER: Any opposed?

1 Hearing none. The item passes.

2 Information consent items. I have had anybody
3 raise any concerns or want any of those pulled off.

4 So we'll move on to our first action agenda item,
5 the independent auditor's report. I'll call on Beliz
6 Chappuie to present that.

7 Good afternoon.

8 CHIEF AUDITOR CHAPPUIE: Good afternoon, Mr.
9 Chair and members of the Committee. Beliz Chappuie,
10 Office of Audit Services. Agenda Item 6a is an action
11 item. Staff is requesting the Risk and Audit Committee to
12 approve the Board's independent financial statement
13 auditor, BDO's audit reports for the fiscal year ended
14 June 30, 2019. BDO staff are here presenting with me
15 today. I would like to turn it over to them.

16 MR. KIM: Hello, Chairman, Vice chair, and
17 members of the Committee. My name is Bill Kim, partner at
18 BDO and represent BDO, your independent audit firm.

19 So thank you for us for this time for us to
20 present the results of the audit to you. Scope of the
21 audit was to cover the basic financial statements of
22 CalPERS for the year ended June 30, 2019. We have three
23 deliverables as part of agenda 6a that we have provided to
24 you. Two of them relate to audit opinions and the other
25 is related to our required communications report.

1 I'll first cover the two audit opinions first and
2 then we'll go through the required communications. So
3 attachment 1 is the independent auditor's opinion. So the
4 opinion includes discussion on management's responsibility
5 over the preparation and fair presentation of the
6 financial statements. The auditor's responsibility is
7 also covered within the report as well, and that is to
8 provide an opinion as to whether the financial statements
9 from a reasonable assurance standpoint is free of material
10 misstatement.

11 Happy to report our audit opinion is providing an
12 unmodified opinion, which essentially means it's a clean
13 report.

14 Attachment 3 is also another opinion that we are
15 required to provide under Government Auditing Standards.
16 It covers internal controls for financial reporting, as
17 well as over compliance.

18 Happy to also report that there are no material
19 weaknesses or significant deficiencies that we've
20 identified during the audit. Also, from a compliance
21 standpoint, the report concludes that we did not identify
22 any specific noncompliance matters that could have a
23 direct or material effect over the financial statements.

24 Now, in terms of the required communications
25 report. So this is attachment 2, which includes

1 communication that are required by our auditing standards
2 to provide to the governance body. I'll highlight a
3 couple of different areas, you know, within the report,
4 but not go through everything in there, a lot of which are
5 just standard required communications that we're required
6 to provide to you.

7 So first off, I want to first commend management
8 and their excellent cooperation and support. With the
9 short time frame that we've had since June getting engaged
10 and doing the work, it was really instrumental for them --
11 for all their support with all the requests that they
12 provided us and all the questions that they've answered
13 for us to be here today to -- in order to report to you.

14 So much credit goes to their hard work and
15 support. Second, another positive sign of a successful
16 audit is when there's no corrected misstatements proposed
17 or identified by your auditors. And happy to report that
18 that is the case this year. There are no corrected
19 misstatements that our team specifically had identified
20 and proposed to management to record.

21 Lastly, I also want to highlight a couple
22 different areas of higher risk, and just to provide some
23 more color as to the work performed over these areas.

24 So some of these higher risk areas are typically
25 considered to be higher risk because they could be

1 involved with significant judgment, complexity, errors of
2 estimate or a combination thereof.

3 And so one of the first areas that we had done
4 some additional work over is related to the estimated
5 insurance claims liability. This is for the Health Care
6 Fund. And so management uses and actuarial methodology
7 based on historical claims data.

8 And as part of the audit, we perform procedures
9 over the liability, perform various different analytical
10 analyses, performed sent through a confirmation to
11 third-party administrators, did some detail testing over
12 the accuracy and completeness of over the inputs,
13 particularly the historical claims data. We've also used
14 our actuaries to assist us in reviewing the methodology
15 calculation and the assumptions involved. And based upon
16 the work we performed, we noted no issues.

17 One of the other areas I wanted to highlight also
18 is related to the area of estimated liability for future
19 policy benefits. This is specifically for the benefits
20 that are paid for the beneficiaries related to the
21 Long-Term Care Fund. So this liability is derived by
22 management from a roll-forward method, including
23 assumptions from the latest valuation report.

24 We've audited the roll-forward, including
25 recalculation, and testing of the various different inputs

1 and including census information through sample testing.
2 We've also utilized actuaries as well to assist us in
3 reviewing the overall methodology, calculations,
4 assumptions, including the discount rate. And overall, we
5 took no exception to management's estimate.

6 The third area is an area of private equity, real
7 estate, real asset investments. And over on the end of
8 this table, we have Steve Franklin, who is also my
9 colleague. He is a partner also specializing in
10 investments. And so he responsible for assisting me in
11 leading the work over the audit of the investment area.
12 So he'll share about the work performed over this.

13 Steve.

14 MR. FRANKLIN: Thank you, yes. Hi. Again, my
15 name is Steve Franklin. I'm an audit partner at BDO. I
16 focus in the asset management space of our practice. And
17 I wanted to reiterate what Billy had mentioned earlier in
18 that the investment -- so -- sorry, let me step back. As
19 a part of the -- I was in charge of the investments
20 auditing of the audit. And so whether it was from the --
21 you know, level 1, level 2, level 3 securities, I was in
22 charge of that aspect, whereas Billy was in charge of the
23 overall audit. That was my focus.

24 And I wanted to reiterate how the investment
25 process went very smoothly. We had exceptional health

1 from the team. Michelle and everybody else in the
2 investment group, in the Invo Office, and on the -- in the
3 Finance Department. And so it was smooth and went very
4 well -- very smoothly.

5 The risk that we focused on was around the
6 private equity real estate assets, which is the lag
7 analysis. So there's a lag between when the initial
8 reporting is as of -- the values are as of 3-31 versus the
9 CAFR, which is as of 6-30. And we did our procedures over
10 3-31 and 6-30, where we sent confirmations to the
11 underlying managers and we obtained -- we did testing over
12 contributions and distributions, and -- in addition to
13 that, along with some month other procedures.

14 The analysis, in order to get comfortable with
15 the lag between 3-31 and 6-30, is we get analysis from
16 management that identifies what the value would as of 6-30
17 if we had used those figures. And we obtained that
18 analysis and then we do audit procedures over that
19 including tying the balances as of 6-30 that management
20 received to our work papers and the confirmation that we
21 independently did with -- as part of our audit procedures.

22 And as part of that, we noted no issues. We --
23 everything seemed appropriate based on our procedures.

24 The one point to highlight related to that was
25 the summary of audit adjustments. That was identified as

1 part of management knew, and that's on the last page of
2 the attachment. And this is to note a difference in the
3 fair value between 3-31 and 6-30. And I wanted to
4 highlight that the amount was immaterial, so it was below
5 our materiality standards. This is an adjustment -- and
6 adjusted misstatement that management new would be --
7 would knew -- be aware of because of the lag. And there's
8 a -- there's no control deficiencies -- significant
9 deficiencies or material weaknesses as a result of this.

10 And we have this often on some of our clients.
11 And so -- and my understanding is that this is consistent
12 with the previous years as well, where we had this lag in
13 this adjustment.

14 And that's all I would like to say. I don't know
15 if any -- that's what I would conclude with.

16 MR. KIM: Yeah. So that concludes our
17 presentation for Agenda Item 6a and we're happy to take
18 any questions.

19 CHAIRPERSON MILLER: Okay. Let's see. Questions
20 from the Committee?

21 I'm seeing none.

22 Oh, you're light is on. Oh, there we go. Okay.
23 Yeah. Now, I'm seeing they're popping up.

24 Okay. Margaret.

25 COMMITTEE MEMBER BROWN: Thank you, Mr. Chair.

1 Thank you for the presentation.

2 The question for the gentleman -- I'm sorry. I
3 forgot your name again.

4 MR. FRANKLIN: Steve Franklin.

5 COMMITTEE MEMBER BROWN: Steve. Okay. I'm
6 looking at attachment 2, page four of seven. And again,
7 I'm looking at what you considered to be potential
8 significant risks, which is the real asset investments in
9 the Health Care Fund estimated insurance claims due. So
10 on the real asset investment, it says you utilized
11 valuation specialists, so are those in-house people or did
12 you outsource that.

13 MR. FRANKLIN: Yes, they're in-house people.
14 Yeah.

15 COMMITTEE MEMBER BROWN: Is that you and other
16 people on your team?

17 MR. FRANKLIN: It's not me personally. There's
18 people within our -- within our firm that we would use.
19 So it wasn't me personally but I coordinated, and spoke
20 with them, and communicated with them.

21 COMMITTEE MEMBER BROWN: And so when you talk
22 about the valuation methodology and the key assumptions
23 included, is that what you're talking about how you go
24 from 3-30 to 6 -- 3-31 to 6-30 or I was really more
25 concerned about the testing or the sampling size, or your

1 sampling methodology, just how many or what's the dollar
2 value that you tested?

3 MR. FRANKLIN: Yeah. So we generally, as part of
4 the standard GAAP -- you know, GAS audit procedures, we --
5 there's various methodologies you can use, whether you
6 can -- and one of them is called -- is considered
7 sampling. And we have done -- we did sampling as part of
8 audit approach to value -- to test the valuation and the
9 existence of the private equity and the real asset
10 securities in the portfolio.

11 COMMITTEE MEMBER BROWN: So was there a dollar
12 value of that sampling or just a number that you picked?

13 MR. FRANKLIN: We -- if you look at some --

14 COMMITTEE MEMBER BROWN: Is it 10, or 10 billion,
15 or --

16 MR. FRANKLIN: Yeah, if you at the cover -- we
17 covered, I would say out of the real estate -- and I don't
18 have the numbers in front of me, but I would say we
19 probably covered, I would say, 60 -- between 60 and 70
20 percent of the assets.

21 COMMITTEE MEMBER BROWN: Oh. Okay.

22 MR. FRANKLIN: So it was a significant amount.
23 We -- also, part of what we do is we like to focus on the
24 higher significant assets, so some of the biggest real
25 estate ones. You know, we select those just because

1 they're so large and they're above our materiality, so
2 we'll select those. And then we will select additional
3 ones that may be lower -- have lower value. So we -- we
4 tried to get significant coverage. That's, you know, as
5 part of our -- our auditor judgment and our methodology,
6 that's what we like to do.

7 COMMITTEE MEMBER BROWN: Great. So that's
8 helpful to know that you tested between 60 and 70 percent,
9 as opposed to between 10 and 15 percent. Big, big
10 difference.

11 MR. FRANKLIN: Correct.

12 COMMITTEE MEMBER BROWN: And then I'd like to go
13 on to I have it as page 61. The analysis at the very end,
14 the observations. I think you talked about those a little
15 bit.

16 MR. KIM: Yeah.

17 COMMITTEE MEMBER BROWN: You talked about the
18 estimated claim liabilities. And did you talk to us about
19 the PeopleSoft developers, about the segregation of duties
20 as a finding? And my bigger concern is the status of
21 prior year observations. It looks like two of them are
22 still open, the third-party administrators and the census
23 data. So I'm wondering what you think about those things?

24 MR. FRANKLIN: Yeah, so I think that's part of
25 agenda 6b.

1 COMMITTEE MEMBER BROWN: Oh, I'm going ahead.

2 Okay. Well, I save those for later then.

3 Thank you.

4 CHIEF AUDITOR CHAPPUIE: Thank you, Ms. Brown.

5 They're separate agenda items, so I'll just introduce
6 those.

7 COMMITTEE MEMBER BROWN: Okay. I'll wait for
8 those.

9 CHIEF AUDITOR CHAPPUIE: Good afternoon again,
10 Mr. Chair, and members of the Committee. Beliz Chappuie.
11 Agenda Item 6b --

12 CHAIRPERSON MILLER: No. Hang on. I've got more
13 questions.

14 CHIEF AUDITOR CHAPPUIE: Oh, I'm sorry.

15 CHAIRPERSON MILLER: I'm just trying to figure
16 this thing out with all these numbers here.

17 CHIEF AUDITOR CHAPPUIE: Okay.

18 CHAIRPERSON MILLER: I don't have coordinating
19 names and numbers.

20 So, Ms. Middleton, and then we'll have Ms.
21 Olivares after.

22 VICE CHAIRPERSON MIDDLETON: All right.

23 CHAIRPERSON MILLER: Yep, you've got it.

24 VICE CHAIRPERSON MIDDLETON: Yeah. Very good.

25 Thank you, Mr. Chair. And I want to thank Mr. Kim, Mr.

1 Franklin, everyone from BDO that was involved. And the
2 Chair and I have had an opportunity to speak with you on a
3 few times leading up to today's meeting.

4 So this is overall what you would refer to as a
5 clean audit?

6 MR. KIM: Yes, that is the case.

7 VICE CHAIRPERSON MIDDLETON: Okay. And I --
8 you've made note of this, but I want to get you to repeat
9 it orally. Access to materials, was there anything that
10 you asked for that was not provided to you?

11 MR. KIM: No. Management had fully provided all
12 the things that we needed and requested.

13 CHAIRPERSON MILLER: And access to people and
14 individuals the same, were you able to interview, speak,
15 and spend as much time as you needed with any individual
16 that you asked to visit?

17 MR. KIM: Yes.

18 VICE CHAIRPERSON MIDDLETON: Okay. And was there
19 any reluctance on the part of management to provide any of
20 these materials?

21 MR. KIM: No. No, not to my knowledge. No.

22 VICE CHAIRPERSON MIDDLETON: All right. Thank
23 you.

24 CHAIRPERSON MILLER: Okay. It won't go.

25 Okay. And that should be you now, Ms. Olivares.

1 COMMITTEE MEMBER OLIVARES: Thank you.

2 Thank you. It was a very thorough, I think,
3 report. I wanted to understand what experience BDO has in
4 analyzing or evaluating institutional investment plans?

5 MR. FRANKLIN: We have -- I've been in -- working
6 in the industry for over 18 years. BDO serves some of the
7 largest asset managers in the country, so they -- we work
8 with several of the largest private equity firms, so some
9 of the firms that CalPERS actually invests in and some of
10 the largest venture capital firms in this space.

11 We also have -- we also serve some asset managers
12 as well. And I've been at a variety of firms across the
13 country and have significant experience with Level 1,
14 Level 2, Level 3 securities and doing audit procedures
15 around those securities.

16 COMMITTEE MEMBER OLIVARES: Does BDO provide
17 audit services for pensions of a similar size?

18 MR. FRANKLIN: You are the largest pension fund
19 that we work with in the county. I know that my colleague
20 Keith -- I don't know if maybe you want to comment.

21 MR. HAMMOND: Sure. Sure. BDO does one other
22 statewide pension system. We audit the State of
23 Delaware's pension system and as well as their OPEB plan.
24 We also audit a number of large multi-billion dollar city
25 pension plans. A number of those, while lower in dollar

1 value, are similar in asset mix, so portfolios that have
2 over 20 percent in alternative investments. So from the
3 government side, we would utilize somebody like Steve and
4 his team's experience help us audit those alternative
5 investments.

6 COMMITTEE MEMBER OLIVARES: Thank you.

7 And I just wanted to know what the threshold is
8 for materiality?

9 MR. FRANKLIN: Billy, do you want to comment on
10 that?

11 MR. KIM: Yeah. Our materiality is based upon a
12 measure of -- based upon total assets and so we look at a
13 measure around one to two percent, so it's still --

14 COMMITTEE MEMBER OLIVARES: One --

15 MR. KIM: Yeah, one to two percent. So it's a
16 pretty large -- you know, it comes out to a pretty large
17 number.

18 COMMITTEE MEMBER OLIVARES: That's very
19 significant for this size fund.

20 MR. KIM: Yeah, that is consistent with industry
21 standard, in terms of what we -- you know, consistent with
22 other engagements that we have, as well as other -- what
23 other firms would be --

24 COMMITTEE MEMBER OLIVARES: I must have missed
25 that in the report, because I don't think I saw that --

1 that definition.

2 Okay. Thank you.

3 CHAIRPERSON MILLER: Okay. Any -- don't look
4 like I have anymore questions. So this is an action item.
5 So I'll need a motion on 6a.

6 COMMITTEE MEMBER BROWN: Move approval.

7 COMMITTEE MEMBER OLIVARES: Second.

8 CHAIRPERSON MILLER: Okay. Moved and seconded.

9 That was moved by Ms. Brown, seconded by Ms. Olivares.

10 I'll call for the question.

11 All in favor, aye?

12 (Ayes.)

13 CHAIRPERSON MILLER: Any opposed?

14 Okay. Hearing none. The item passes.

15 We'll move on to 6b.

16 CHIEF AUDITOR CHAPPUIE: Good afternoon, Mr.
17 Chair and members of the Committee. Beliz Chappuie again.

18 Agenda Item 6b is also an action item. Staff is
19 requesting the Risk and Audit Committee to approve the
20 Board's independent financial statement auditor, BDO's,
21 draft management letter. I would like to turn it back
22 over to BDO staff.

23 MS. MAK: Thank you, Mr. Chairman, Vice Chair,
24 and members of the Committee. My name is Sylvia Mak. I'm
25 a director with BDO.

1 I'm here to present attachment 1 to Agenda Item
2 6b. This is our management letter as it relates to the
3 findings of internal controls.

4 We did observe two control deficiencies, either
5 of which were significant deficiencies or material
6 weaknesses. The first finding relates to the review of
7 the estimated claims liability. The Health Claims Fund
8 does record an estimated claims liability, which primarily
9 consists of two different types of estimate, those that
10 have been -- claims that have been reported, but not
11 settled, as well as claims that are incurred, but not
12 reported.

13 We did observe during the audit that the system
14 doesn't necessarily have a comprehensive review process
15 over the completeness and accuracy of such claims. Part
16 of this has to do with just a legacy issue of not having
17 access to the third-party administrator information --
18 claims information. And so one of our recommendations is
19 that management work with those third-party administrators
20 to obtain that information. Management has been working
21 on that as it's working on updating its contracts.

22 And then once that information is received to be
23 put into place controls to be able to reconcile the claims
24 detail to the amount that's reported. Management has
25 indicated to us that they believe that this will be put

1 into place as of January 1st, 2020. That kind of
2 coincides with the start of the new contracts as well.

3 The second finding relates to PeopleSoft and
4 developer access and segregation of duties. PeopleSoft is
5 the system's general ledger. We observed that the
6 developers have access to the production environment. And
7 that allows them to bypass the program change management
8 controls. As part of our audit, however, we did take it a
9 step further. We noted that there was that lack of
10 segregation of duties, but we also went and said, okay,
11 did this risk manifest itself during the year. We got
12 access to the access logs, and we did not observe
13 instances where the developers actually did go in and
14 access the production environment.

15 Upon informing management of this finding, they
16 took steps to correct it. And the developers no longer
17 have access to the production environment.

18 So, at this time, I'll open it up for questions.

19 CHAIRPERSON MILLER: Okay. I have questions.

20 Ms. Brown.

21 COMMITTEE MEMBER BROWN: So before I get to my
22 questions I tried to ask earlier, I want to -- I want to
23 go back to Ms. Olivares question on 6a about materiality.
24 I do agree with her. I mean, I think -- I would think
25 typically one is two percent is fine. But our pension --

1 our fund is so big that one to two percent ends up
2 becoming such a large number. So maybe we should look at
3 setting a dollar threshold to that materiality, as opposed
4 to just one to two percent, because I mean that's \$3
5 billion, right? So we want to -- we may want to take a
6 look at that.

7 All right. So back onto page 61, which is what
8 you were just talking about, the findings you observed.
9 What I want to know about is table 2, the prior year
10 observations. I don't like them when they carryover year
11 after year. So I don't if that's for the staff to answer,
12 Ms. Chappuie or if BDO has any comments on that. Did you
13 ask our staff about what's going on with the open or
14 unresolved items?

15 MS. MAK: We did inquire them of it. The open
16 item as it relates to number two, the TPA oversight
17 controls are -- that one is a actually very similar, if
18 not the same to our observation number one.

19 COMMITTEE MEMBER BROWN: Um-hmm.

20 MS. MAK: The fifth one, as it relates to the
21 census data, that -- the census data information, as you
22 can imagine, given the number of members in the system,
23 there's a lot of people. There's a lot of data. There
24 is -- you know, it's virtually impossible to have a
25 hundred percent accuracy in terms of that data.

1 Management has been working diligently to make sure they
2 scrub that data, so if they come across errors that
3 they're promptly corrected.

4 As part of our testing of the census data, we did
5 not observe any instances where the data seemed unusual.
6 So -- or that would have created a material adjustment, as
7 it relates to the financial statements.

8 We did observe instances where maybe the service
9 date might have been off, but it wasn't off significantly.
10 It might have been off by a day, a week, nothing in terms
11 of -- it wasn't like a year off or two years off. But
12 anything that we came across that looked unusual in terms
13 of inconsistent data, we inquired of the staff and they
14 were able to come back and show us support as to why --
15 what that -- where -- why there was that discrepancy.

16 COMMITTEE MEMBER BROWN: Thank you.

17 CHAIRPERSON MILLER: Seeing no more questions.
18 This is an action item. So I'm looking for a
19 motion.

20 COMMITTEE MEMBER BROWN: Move approval.

21 CHAIRPERSON MILLER: Moved by Ms. Brown.

22 COMMITTEE MEMBER PEREZ: Second.

23 CHAIRPERSON MILLER: Seconded by Mr. Perez.

24 I'll call for the question.

25 All in favor, aye?

1 (Ayes.)

2 CHAIRPERSON MILLER: Any opposed?

3 The ayes have it. The item passes.

4 And we'll move on to 7, information agenda items.

5 Back to you, Ms. D'Adamo.

6 (Thereupon an overhead presentation was
7 presented as follows.)

8 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

9 Okay. Back to me. So this agenda item was
10 designed to provide an overview of some of the functions
11 that make up CalPERS's integrated assurance framework.
12 With the recent changes to the Board's composition, this
13 is an ideal time to review some of the functions within
14 our integrated assurance model. And accompanying me is in
15 this presentation are Forrest Grimes and Beliz Chappuie
16 who will each talk about their respective functions within
17 integrated assurance. And so I'll start and then I'll
18 pass it off to each of them.

19 So appendix 1, this is slide 2 we're going to go
20 to. Oh, I'm the one that's going to it. Sorry about
21 that.

22 (Laughter.)

23 --o0o--

24 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO: So
25 this slide, for those of you who have been on the Board

1 for a little while, will see this as familiar. This is
2 the framework of how we describe our integrated assurance
3 model. And so what we have here is the Board and the Risk
4 and Audit Committee sort of covering all three areas. The
5 executive and senior leadership covering first and second
6 lines of defense. And then we have columns representing
7 each of the first, second, and third lines of defense.

8 And so for the way that we do integrated
9 assurance, the first line of defense represents the
10 program area management and employees. These are, what I
11 call, sort of the boots on the ground. These are the
12 folks that are actually writing the policies and
13 procedures. They're doing the work. They're managing the
14 risk. And we say that they own the risk and that
15 compliance is their responsibility as well. So they're
16 our first line -- what you'd call our first line of
17 defense.

18 The second line of defense is, what we call,
19 our -- is really the assurance part. And these functions
20 perform both internal control functions, as well as
21 provide assurance. And the assurance is really that the
22 first line is operating the way that it's supposed to
23 operate.

24 And so compliance and risk sits in that second
25 line. Audits sits in that third line. And so as you see

1 in the third column, the third line of defense is audit.
2 And they basically go and they provide a review of the
3 internal controls and they provide all the audits.

4 And then underneath that, we just -- this is new
5 to this slide is we've actually just described some of the
6 functions within those three lines of defense. And
7 sitting outside are other -- other entities that might
8 interact within our three lines, which would be regulators
9 and our external auditors, whom you've met -- just met.

10 --o0o--

11 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO: So
12 the next thing I wanted to really talk about was sort of
13 moving on to compliance. And so the question might be
14 well what is an effective Compliance Program? What is a
15 Compliance Program supposed to do?

16 And the way that we look at compliance is that
17 compliance is supposed to be effective in identifying,
18 preventing, and detecting misconduct and noncompliance
19 with laws, regs, and policies. So how does the Compliance
20 Program do that?

21 Typically, it's formal and -- I call it formal
22 and informal. Formal is really the independent review of
23 the programs, the internal controls, it's the reporting,
24 it's the benchmarking, it's all the documentation and the
25 things that you say.

1 The informal is culture: culture, which promotes
2 ethics, ethical behavior, and the CalPERS core value. And
3 so the way that we have our Compliance Program structured
4 it's a mix of both the culture and the formal.

5 So this slide here, slide 3, on governance.
6 Three through seven I'll talk about four main elements of
7 the Compliance Program. And these are designed to help us
8 prevent, detect, and correct noncompliance and misconduct.
9 The elements are governance, culture and ethics, training
10 and communication, and monitoring test -- monitoring and
11 testing and reporting. So I will try to, within a minute
12 for each slide, sort of walk through the slides.

13 --o0o--

14 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO: So
15 on the governance we do three things around governance and
16 compliance. We maintain policy governance, which means
17 that we maintain policies, we do work with the program
18 areas to make sure the policies are appropriate, that
19 they're appropriately authored, that they're appropriately
20 set up. We really believe that policy is one of the main
21 fundamental and foundational things that a Compliance
22 Program can do. It's part of the prevent. Identify,
23 prevent, detect, correct. And so we do a fair amount of
24 work on policy governance.

25 We also, within policy, make sure that when

1 policies are implemented that stakeholders are included,
2 that awareness is made, that really there's an effort to
3 make sure that, as policies are created, that they really
4 apply to the things that need to apply and they have the
5 maximum effect.

6 On delegations of authority, we actually maintain
7 delegations of authority too. Delegations of authority
8 are the -- it's the authority to provide certain
9 activities or to do certain activities. And so we believe
10 that delegations of authority are important, because they
11 really provide role clarity, and they provide clarity to
12 individuals about who's responsible for what, who has
13 authority to do what, and it's -- again, it's a basic
14 foundational item around governance.

15 And then four design compliance policies and
16 procedures, we believe that the design and the
17 implementation of compliance policies and procedures is
18 another foundational way that a Compliance Program can be
19 an effective program.

20 --o0o--

21 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO: On
22 culture and ethics. So I have a sign in my office
23 upstairs that says "Culture Trumps Compliance". And those
24 of us that are in the compliance business know that that
25 is, in fact, true. You can train, you can do all kinds of

1 things. You can beat people over the head. But if you
2 have a bad culture, you're going to be in trouble. And so
3 we spend a lot of time on how to measure culture, how to
4 make sure that our culture is moving in the right
5 direction. And so up on the slide are fourth things that
6 we do within our Compliance Program to help us manage,
7 maintain, and improve our culture.

8 So we measure CalPERS's culture. So we -- we
9 conduct an annual survey of employee compliance awareness
10 and we share those results with our integrated assurance
11 partners and CalPERS leadership.

12 On the promote culture of integrity, we use a
13 number of different tools to do this. We have discussion
14 guides where we allow people to go out and talk about
15 different compliance and ethics items with their groups.
16 We do spotlight articles on inside CalPERS, where we have
17 leadership discuss why ethics and compliance is important.
18 And we do -- we sponsor activities during National
19 Compliance and Ethics Week to engage team members in
20 conversations about compliance and ethics in a relaxed
21 informal atmosphere.

22 Promoting a culture of integrity is really
23 important, and it has a really high organizational value
24 for us.

25 On maintain reporting channels. Here, we produce

1 meaningful compliance reports that helpful fulfill
2 oversight responsibilities at all levels. For instance,
3 we do reporting to this Committee. And you saw that in
4 the consent items. On a quarterly basis, we're doing
5 reporting. We do reporting to executive and senior
6 management. And we're also doing reporting at operational
7 levels, which, in our case, would be like our Division
8 training coordinators and our compliance liaisons.

9 On the intake and triage employee reports, here
10 this is really talking about our ethics helpline. Our
11 ethics helpline is important. It is anonymous and
12 confidential and it represents a mechanism through which
13 individuals can go and seek redress or make complaints
14 without fear of retribution or retaliation. The outcomes
15 of our ethics helpline reporting is reported to this Board
16 and senior leadership.

17 --o0o--

18 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO: On
19 training and communication, again, this is one of the
20 foundational elements of a Compliance Program. It's about
21 prevent, for the training. And communication is also
22 about the prevent and detect. For us, on training and
23 communication, we conduct education and training programs
24 that communicate compliance requirements to team members,
25 external service providers and Board members.

1 We tailor training to different groups. We
2 provide and track online mandatory training for all
3 employees. In addition, we provide more tailored small
4 group training live training sessions to specific groups
5 of people, like our covered persons and our Form 700
6 filers. We also offer live large group training annually
7 on a variety of compliance-related topics. And finally,
8 we provide the -- those in senior leadership positions
9 with one-to-one compliance and ethics training as part of
10 their onboarding. So we take -- we take training very
11 seriously.

12 On measure training effectiveness, we measure
13 training effectiveness by testing the knowledge and
14 comprehension after online training by sending out surveys
15 after the training sessions. On the develop -- sorry --
16 and deliver communications content, we reinforce
17 compliance policies and procedures and CalPERS commitment
18 to an ethical culture with effective ongoing
19 communications.

20 Our annual Compliance Communications Plan seeks
21 to provide not only meaningful but timely compliance
22 communications throughout the year. And by developing our
23 plan on an annual basis, we ensure that team members are
24 consistently reminded about key compliance and ethics
25 issues. So, for instance, we do a gift policy reminder

1 around the holidays.

2 Multiple communication channels are used, and we
3 use inside CalPERS banners to coordinate with email
4 messages. We do online quizzes to supplement formal
5 memos. And we spread our message at CalPERS-wide events
6 that help ensure compliance and ethics can be seen as
7 something fun and approachable. And an example of that is
8 where we do Compliance and Risk Week and for national Take
9 Your Child to Work Day, we did an activity with the kids
10 that came in on compliance.

11 --o0o--

12 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

13 This slide on monitoring and testing compliance
14 reflects how we perform the monitoring and testing aspect.
15 On track the legal and regulatory environment, we help
16 ensure effective risk assessment mitigation, monitoring,
17 and reporting in order to reduce regulatory risk, increase
18 stakeholder trust, and support CalPERS's business
19 strategy.

20 For legal and compliance risk, we -- our process
21 includes strategies, tools, and partnerships needed to
22 identify risks quickly, assess and mitigate risks
23 appropriately, and report risks effectively to key
24 stakeholders. So an example of this is our compliance
25 risk assessments.

1 On the monitor risk exposure, compliance risk
2 exposure, we monitor changes to CalPERS's risk exposure on
3 an ongoing basis by monitoring both regulated employee
4 activities and metrics related to the Compliance Program's
5 activities. An example of that would be our Personal
6 Trading Regulation and Form 700 monitoring activities.

7 For test and audit, we test the existence and
8 efficacy of policies, procedures, and controls through
9 coordination with internal audits, enterprise risk, and
10 the performance of our own compliance targeted reviews and
11 monitoring activities.

12 Finally, on build risk-specific mitigation plans,
13 we create a consistent approach to mitigating identified
14 compliance risks by building risk-specific mitigation
15 plans.

16 --o0o--

17 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

18 Reporting. Enterprise Compliance evaluates the
19 effectiveness of the Program through metrics and
20 benchmarks and reports that information to key
21 stakeholders. I think of this as a feedback loop. And we
22 do this in a number of different ways. On the slide, it's
23 small for you to see, but it's an excerpt really of the
24 types of reporting that you see quarterly from us. And
25 we're reporting on a bunch of different topics.

1 We report to you quarterly. We report to the
2 execs monthly. We report to the liaisons monthly. During
3 times of training, we do weekly and daily reporting on
4 training requirements. So when we're getting close to
5 when training due dates come, we're constantly letting
6 people know where we're at, and making sure that they're
7 able to go -- go sit with the people that need to do the
8 training, so that we can achieve maximum number of
9 compliance with our training due dates.

10 And then finally, we benchmark our own program
11 maturity against our peers on an annual basis and we
12 report our progress to the Risk and Audit Committee.

13 --o0o--

14 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO: So
15 this slide serves as a recap. And it's really meant
16 for -- to visualize sort of how the Compliance Program
17 helps support CalPERS' performance objectives. On the
18 base is the foundation of governance, and then using
19 training and communication, culture and ethics, monitoring
20 and testing, and reporting. All of these things go
21 together to help us achieve the CalPERS performance.

22 And then at the conclusion of this presentation,
23 I would like to talk about new work Enterprise and
24 Compliance is engaging with the Investment Office. This
25 fiscal year, Enterprise Compliance has assumed investment

1 compliance activities previously performed within the
2 Investment Office.

3 Why?

4 With the changes being undertaken in the
5 Investment Office, including changes to strategies,
6 movement of activities and people, we've decided to
7 further segregate compliance activities between the
8 Investment Office and the enterprise. In essence,
9 compliance activities that may be deemed more second-line
10 have been moved out of the Investment Office leaving
11 Investment Office functions to perform first-line
12 activities.

13 And if you recall, when we looked at slide number
14 2, we talked about first-line activities are those
15 activities that are being performed in the business
16 essentially. They're boots on the ground. It's the
17 people that own the risk and that are doing the
18 compliance.

19 So how are we doing this?

20 Some responsibilities have been moved completely
21 over to compliance. An example or examples of those are
22 placement agent determination and reporting, contract
23 related disclosure and reporting, Form 700 advice and
24 training, personal trading advice and training, business
25 partner misconduct.

1 Activities completed and owned by ICOR, which is
2 Investment Controls and Operational Risk, will continue to
3 be monitored as will activities completed by other
4 activities of the -- other areas of the Investment Office.
5 And this approach is similar to the monitoring of
6 first-line defense activities in other areas of CalPERS.

7 In this respect, compliance activities are being
8 aligned to the role occupied by Enterprise Compliance,
9 while investment control and operational risk will be
10 aligned with ICOR. We believe that this separation will
11 help to clarify roles and will provide appropriate
12 segregation of duties and reduce potential for conflicts
13 of interest with respect to compliance activities
14 completed within the Investment Office.

15 With that, I will take questions, if there are
16 any.

17 CHAIRPERSON MILLER: Any questions?

18 No, not seeing any questions.

19 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

20 Thank you.

21 CHAIRPERSON MILLER: Thank you very much.

22 And on to Summary of Committee Direction.

23 CHIEF RISK OFFICER GRIMES: Actually, there's
24 three parts to the presentation, Mr. Chair.

25 CHAIRPERSON MILLER: Okay. My mistake.

1 CHIEF RISK OFFICER GRIMES: And I'm up next.
2 Forrest Grimes.

3 CHAIRPERSON MILLER: Okay. Welcome.

4 CHIEF RISK OFFICER GRIMES: I am the Chief Risk
5 Officer. And as such, I lead the Enterprise Risk
6 Management Division. That's commonly referred to as ERMD.
7 And the purpose of ERMD is to facilitate the development
8 and maintenance of a risk-intelligent culture and
9 framework, so that CalPERS risks are effectively managed.
10 Thank you.

11 --o0o--

12 CHIEF RISK OFFICER GRIMES: Oh, there we go.
13 Thank you, Beliz.

14 So for this part of the presentation, I've taken
15 really a two-part -- a two-pronged approach. I want to
16 provide you with a brief history of the development of the
17 Enterprise Risk Management Program here at CalPERS and
18 then really show you how ERMD supports the Committee's
19 delegated authority obligations. And then secondly, I
20 would like to report on the current state of enterprise
21 risks by updating the dashboard profiles and heat map at
22 the end.

23 So let's begin on page one of attachment 1. For
24 Committee members, that would be page 75 of your Board
25 books. The wheel diagram that you see on the screen and

1 before you depicts various touchpoints when ERMD actually
2 interacted directly with this Committee.

3 Back in 2016, ERMD began developing a new
4 dashboard, risk profiles, and heat map that really became
5 the cornerstone of the current enterprise risk management
6 framework.

7 So this particular activity fulfilled the
8 Committee's responsibility to approve and oversee
9 enterprise risk management -- the enterprise risk
10 management framework, which is part of your delegated
11 authority.

12 Examples of those documents appear on page three
13 of this presentation. And I'll see if I can get there for
14 the audience. That's page 77 of your Board books, but I'm
15 going -- those are just examples. We're going to get into
16 more detail on those later. I'm going to go back to the
17 wheel diagram on page 75 to really kind of get into what
18 we've done and how this really has interplayed with the
19 Risk and Audit Committee.

20 So basically, in January of 2017, ERMD conducted
21 a workshop with the Board to explore risk appetites. And
22 we brought back risk appetite statements in June of that
23 year, which we presented to this Committee. This really
24 satisfied the Committee's obligation from a delegation
25 perspective to set risk appetite and tolerances, excluding

1 investment risk, which is actually done in the Investment
2 Committee.

3 So today, the Committee -- I guess a question I
4 would ask, if I were you, is many of you were not here in
5 January of 2017. So basically, how do you have input into
6 the risk appetite of the Risk and Audit Committee today?

7 And that really would come later. Today, you
8 actually provide risk appetite guidance to staff through
9 risk tolerances that appear in the Strategic Risk Measure
10 Dashboard. And that was presented to you in Agenda Item
11 5d as a consent item and attachment 2. And sometime, if
12 you have time, look at pages 24 through 26, if you have
13 aren't already, and you can see those risk measures and
14 you can see the associated risk tolerances, which
15 basically, I think, are a much more effective way of
16 actually conveying your risk appetite to the team -- to
17 the CalPERS team.

18 So ERMD also provides an annual workplan and the
19 results of our annual risk assessment to the Committee
20 each year. Review and approval of the workplan fulfills
21 the Committee's obligation to approve and oversee risk
22 management strategy. The annual risk assessment provides
23 current data to help the Committee make risk-informed
24 decisions to support your oversight role.

25 --o0o--

1 CHIEF RISK OFFICER GRIMES: Slide two is page 76
2 of your Board books. And that summarizes really how ERMD
3 activities support the Committee's delegated authority
4 obligations. The Risk and Audit Committee delegation is
5 very clear. And the first six items really do pertain to
6 Enterprise Risk Management. And this really kind of ties
7 those obligations that you have as a Committee to the
8 functions that ERMD actually performs.

9 So before we go any further, I'm going to stop
10 here to see if you have any questions on the actual
11 framework and how we got to where we are today?

12 CHAIRPERSON MILLER: Yeah, we have a question
13 here from Mr. Jones.

14 PRESIDENT JONES: Oh, accident.

15 CHAIRPERSON MILLER: Oh, that was an accident.
16 Okay.

17 (Laughter.)

18 CHAIRPERSON MILLER: Okay. No. I'm seeing --

19 PRESIDENT JONES: I am awake.

20 BOARD MEMBER FECKNER: You finally got it figured
21 out and it wasn't --

22 (Laughter.)

23 CHAIRPERSON JONES: Yeah, I finally got it to
24 turn on. Okay.

25 (Laughter.)

1 CHAIRPERSON MILLER: So, okay, well moving right
2 along.

3 CHIEF RISK OFFICER GRIMES: Thank you for the
4 softball question, Mr. Jones. I appreciate that.

5 (Laughter.)

6 PRESIDENT JONES: You're welcome.

7 CHIEF RISK OFFICER GRIMES: Okay. I'm going to
8 shift gears and provide the Committee with the results of
9 our 2019 risk assessment and updates to the dashboard
10 profiles and heat map. The dashboard that appears in
11 attachment 2 -- and I'm going to see if I can get there.

12 --o0o--

13 CHIEF RISK OFFICER GRIMES: That's page 78 of
14 your Board books. This summarizes changes between 2018
15 and 2019. And this year pension funding, health care
16 administration, and benefit administration experienced
17 increases in perceived risk threats. As you can see,
18 information security, governance and control environment,
19 talent management, and business continuity saw reduced
20 risk concerns, while stakeholder confidence risk remained
21 unchanged.

22 The risk profiles that appear in attachment 4,
23 and those really are spread out between pages 80 and 96 of
24 your Board books, really provide the updates and the
25 methodology that was used to actually make these changes.

1 --o0o--

2 CHIEF RISK OFFICER GRIMES: The heat map included
3 as attachment 3, and that's on page 79 your Board books,
4 graphically depicts the results of this year's risk
5 assessment compared to prior year results score based on
6 probability, impact, and velocity.

7 And this concludes my portion of the
8 presentation, and I'm happy to answer any questions that
9 you have.

10 CHAIRPERSON MILLER: Questions?

11 I'm not -- there we go. Let me see, that is Ms.
12 Olivares.

13 COMMITTEE MEMBER OLIVARES: Thank you for this
14 presentation. I have a question about the information
15 asset risk, information security.

16 CHIEF RISK OFFICER GRIMES: Yes.

17 COMMITTEE MEMBER OLIVARES: So earlier we talked
18 about having \$50 million of cybersecurity insurance or
19 just securing that policy. Do you feel like that's
20 adequate?

21 CHIEF RISK OFFICER GRIMES: Yes, I do. I would
22 really -- you know, I'm just going to suggest that we
23 don't get into too much detail on the particulars of this
24 particular item, just due to the sensitive nature.
25 However, we did consult with outside counsel, we consulted

1 with our internal team, looked at our risk exposure in
2 depth, and we feel that -- that that was the right number
3 to choose.

4 COMMITTEE MEMBER OLIVARES: Thank you.

5 CHAIRPERSON MILLER: Okay. That's it for the
6 questions there.

7 On to Ms. Chappuie.

8 CHIEF AUDITOR CHAPPUIE: Thank you.

9 Moving on to the third line of defense, internal
10 audit. Office of Audit Services, I'm going to use the
11 acronym OFAS, is the internal audit function of CalPERS.
12 The mission of OFAS is to provide independent assurance
13 that CalPERS's assets are safeguarded, operating
14 efficiency is promoted, and compliance is maintained with
15 applicable laws, regulations, and policies.

16 --o0o--

17 CHIEF AUDITOR CHAPPUIE: OFAS has a charter that
18 is approved by the Risk and Audit Committee documenting
19 OFAS's authority, responsibility, purpose, and
20 independence, among other things.

21 --o0o--

22 CHIEF AUDITOR CHAPPUIE: Pursuant to Government
23 Code 13886.5, OFAS follows the International Professional
24 Practices Framework in performing its work. We refer to
25 the framework as the internal auditing standards, a.k.a.

1 the Red Book.

2 --o0o--

3 CHIEF AUDITOR CHAPPUIE: The Risk and Audit
4 Committee oversees key internal auditor activities,
5 including the approval of OFAS's risk-based annual audit
6 plan. In preparing this plan, OFAS collaborates with ECOM
7 and ERMD in conducting risk assessment meetings with
8 CalPERS management team and then providing assurance to
9 minimize the location of coverage.

10 --o0o--

11 CHIEF AUDITOR CHAPPUIE: Once the audit plan is
12 approved, OFAS performs the audit assignments. And audit
13 assignment involves various steps. It first -- it starts
14 with an entrance conference, where we engage with the
15 auditee. Auditee can either be a CalPERS division unit
16 for internal audits, or an agency for an employer
17 compliance review.

18 Auditors then perform their audit procedures
19 during the field work. They provide updates to the
20 auditee on the progress of the audit assignment during the
21 field work. They conduct a pre-exit meeting to share
22 their preliminary observations with the auditee.

23 Then auditors return to their office to complete
24 the documentation of their analysis and conclusions. And
25 they issue a draft report with their observations to the

1 auditee and conduct an exit conference. The auditee
2 responds to the draft report, which is then incorporated
3 in the final report.

4 Once the report is finalized, it is pre-released
5 to the executive team and then released to the Board
6 members. A copy of the report is sent to the auditee as
7 well. After the final report is issued, OFAS monitors the
8 corrective actions, in accordance with OFAS's audit
9 resolution policy, and provides status reports to the
10 executive team and the Risk and Audit Committee.

11 --o0o--

12 CHIEF AUDITOR CHAPPUIE: And as documented in the
13 Audit Resolution Policy, audit findings can be resolved in
14 one of two ways, Division management implements the
15 recommendation contained in the -- or recommendations
16 contained in the report or Division management accepts the
17 risk of not implementing the corrective action.

18 And this concludes my portion of the presentation
19 and I am happy to answer any questions that you may have.

20 CHAIRPERSON MILLER: Okay. It looks like we have
21 some questions. I have a quick question before we go to
22 Committee members. You mentioned two ways to respond.
23 Would a third be -- way be that Division management
24 proposes a different solution, or rather than accept the
25 recommendation or just not take the recommendation, not do

1 anything, maybe there's an alternative solution that they
2 may choose to implement?

3 CHIEF AUDITOR CHAPPUIE: We don't have that
4 option as available, so it generally fits in either/or.

5 CHAIRPERSON MILLER: Okay.

6 CHIEF AUDITOR CHAPPUIE: There's no third option.

7 CHAIRPERSON MILLER: Thank you.

8 Okay. We'll go to Mr. Jones.

9 PRESIDENT JONES: Yeah, thank you.

10 CHAIRPERSON MILLER: He's there this time.

11 PRESIDENT JONES: This time it's for real.

12 Yeah, this is relative to David's question. So
13 what if the audit has strong recommendations to make
14 change and there's still disagreement, there's no
15 escalation process where it's forwarded up to the Audit
16 Committee?

17 CHIEF AUDITOR CHAPPUIE: The escalation process
18 would kick in if there's a disagreement. And either the
19 General Counsel or myself disagree with that
20 recommendation or disagreement, then we would have to
21 escalate it up to the Risk and Audit Committee.

22 PRESIDENT JONES: Okay. So there it is -- there
23 is an escalation.

24 CHIEF AUDITOR CHAPPUIE: Yeah, and that's also
25 documented in our resolution.

1 PRESIDENT JONES: Okay.

2 CHAIRPERSON MILLER: Okay. Ms. Middleton.

3 VICE CHAIRPERSON MIDDLETON: All right. Let's
4 state right on that same theme. Have you had situations
5 where you have made recommendations and those
6 recommendations were not accepted?

7 CHIEF AUDITOR CHAPPUIE: It very rarely happens.
8 I think there was only one incident that -- or case during
9 the last four or five years. And that again, following
10 the Audit Resolution Policy, which was -- I informed the
11 Risk Management Division, Forrest, for him to track that
12 for the organization. It wasn't significant enough for us
13 to escalate it to the Risk and Audit Committee, but it's
14 being tracked by ERMD Division.

15 VICE CHAIRPERSON MIDDLETON: And how is that
16 ultimately resolved?

17 CHIEF RISK OFFICER GRIMES: There is a specific
18 policy on how this works. The way that I've really
19 treated this is that there is an internal organization
20 committee, which consists of the executive team with their
21 risk hats on called the Integrated Assurance Risk Council.
22 And if there is anything like that, I certainly would not
23 feel confident to make decisions on behalf of the
24 organization to accept risk myself, so I would vet that
25 with the internal team and they would ultimately advise

1 the rest of the team what we should be doing.

2 VICE CHAIRPERSON MIDDLETON: All right. Thank
3 you. I'd like to go back to slide 100 of 106, which
4 discusses the audit plan. Could you review for us how you
5 go about as an independent auditor -- internal auditor
6 making your decisions as to what are going to be the areas
7 that you want to audit during the course of a year?

8 CHIEF AUDITOR CHAPPUIE: Sure. So every year,
9 generally around springtime, we do various things. We
10 conduct meetings with the senior management team. We
11 conduct meetings with the executive team members. We also
12 send a survey to the Board members seeking their input.

13 All of that goes into a risk assessment matrix.
14 Then after the -- that feedback, we also incorporate our
15 knowledge and information based on prior year audits. We
16 have a universe of auditable activities in that
17 spreadsheet.

18 VICE CHAIRPERSON MIDDLETON: Um-hmm.

19 CHIEF AUDITOR CHAPPUIE: Based on this feedback,
20 we rank everything. And then, of course, we have limited
21 resources every year. We don't have unlimited resources
22 to conduct all the assignments in the universe, so it's
23 based on the number of man-hours we have available to us,
24 and taken into consideration the vacancies as well. So we
25 draw the line, and then everything above that -- that

1 bubbles above that is basically presented to the Risk and
2 Audit Committee on our audit plan for approval.

3 VICE CHAIRPERSON MIDDLETON: Okay. And are you
4 satisfied that you have the resources that you need to do
5 the audits that are necessary?

6 CHIEF AUDITOR CHAPPUIE: Thank you for that
7 question. I believe so. We have, for example, speaking
8 for the employer compliance reviews, or public agency
9 reviews, during the last four years, we've pretty much
10 doubled the number of reviews we are completing just
11 incorporating the LEAN processes in doing so without
12 adding any additional staff. And we're doing something
13 similar on the internal audits side, where we're just
14 improving the efficiencies, applying LEAN practices again,
15 improving the processes, and increasing the number of
16 reviews we're completing. I personally feel like we have
17 adequate coverage. However, I'm open to any suggestions
18 and feedback, if we need to do more reviews. I'm happy to
19 take that into consideration.

20 We do a lot more than other pension auditors and
21 audit shops. I know that for sure, because we're members
22 of the Association of Public Pension Funds Auditors and we
23 meet with them twice a year. They conduct conferences and
24 we do discuss and network with those folks. And several
25 locations I heard from them that we're doing a lot more

1 than they are. However, that has been the demand or
2 request from the Risk and Audit Committee and which we're
3 happy to honor and continue to do so.

4 VICE CHAIRPERSON MIDDLETON: Okay. And
5 ultimately, when it comes to a question of what gets
6 audited, who makes that final decision?

7 CHIEF AUDITOR CHAPPUIE: I do.

8 VICE CHAIRPERSON MIDDLETON: Thank you.

9 CHAIRPERSON MILLER: Thank you. Seeing no more
10 questions, thank you for the presentations and all the
11 fine work. It's very much appreciated.

12 And we'll move on to summary of Committee
13 direction. Ms. D'Adamo.

14 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO: So
15 I did not specifically take summary of committee
16 direction, other than Ms. Brown's comment about looking at
17 the materiality of the thresholds for the audits. Is that
18 a direction or is that a thought?

19 COMMITTEE MEMBER BROWN: I'd like us to. I don't
20 know if Ms. Olivares agrees.

21 CHAIRPERSON MILLER: There we go.

22 COMMITTEE MEMBER OLIVARES: Am I good?

23 Yes, I would like to see that. I would like to
24 know the percentage between that one and two percent, and
25 then the absolute value of that.

1 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

2 Okay. So what is the absolute value of the one
3 to two percent?

4 COMMITTEE MEMBER OLIVARES: No. So in terms of
5 what we found, in terms of the materiality threshold, so
6 it's within one to two percent.

7 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

8 Um-hmm.

9 COMMITTEE MEMBER OLIVARES: So where we are
10 percentage-wise within that range.

11 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

12 Okay.

13 COMMITTEE MEMBER OLIVARES: And then the absolute
14 value of that.

15 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

16 Okay.

17 COMMITTEE MEMBER OLIVARES: Thank you.

18 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

19 Thank you.

20 CHIEF EXECUTIVE OFFICER FROST: Just as a
21 suggestion on that Committee direction, the Chair and Vice
22 Chair could meet with your independent auditors. One of
23 the things that we would not have control over is how they
24 determine materiality, but you could certainly give input
25 and maybe reset some of those expectations as they do

1 their audit next year.

2 CHAIRPERSON MILLER: Yeah. Ms. Middleton.

3 VICE CHAIRPERSON MIDDLETON: Yes. I think this
4 question of what the standard materiality should be is an
5 appropriate one to review, but I would want us to look at
6 what are best practices. There are many other
7 organizations that are of equivalent size to CalPERS and
8 we should be consistent with what is best practices within
9 this industry.

10 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO: Got
11 it.

12 CHAIRPERSON MILLER: Okay. That's that.

13 And I don't have any indication of public
14 comment.

15 And so I think, unless there are any objections,
16 I will adjourn the meeting.

17 (Thereupon the California Public Employees'
18 Retirement System, Board of Administration,
19 Risk & Audit Committee open session
20 meeting adjourned at 3:49 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 25th day of November, 2019.



JAMES F. PETERS, CSR
Certified Shorthand Reporter
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