

**STATE OF WASHINGTON
STATE INVESTMENT BOARD**

Audit Committee Meeting
Minutes

August 3, 2004

The Audit Committee met in open public session at 9:05 A.M. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive SW, Olympia, Washington.

Committee Members Present: John Charles, Chair
 Mike Murphy
 Charlie Kaminski
 George Masten
 Bob Nakahara

Committee Members Absent: Dave Scott
 Debbie Brookman

Others Present: Joe Dear, Executive Director
 Theresa Whitmarsh, Deputy Director for Operations
 Beth Vandehey, Internal Auditor
 Steve Draper, Senior Investment Officer – Real Estate
 Nancy Calkins, Senior Investment Officer – Public Equity
 Christina Blue, Administrative Assistant
 Paul Silver, Office of the Attorney General
 Jeanette Eckert, Louisiana State Employees' Retirement
 System (via teleconference for agenda item 2c only)

[Names of other individuals attending the meeting are not included in the minutes, but are listed in the permanent record.]

Chair Charles called the meeting to order at 9: 05 A.M., and identified Committee members present.

ADOPTION OF MINUTES – JUNE 1, 2004

Treasurer Murphy moved to approve the June 1, 2004, Audit Committee meeting minutes. Mr. Masten seconded and the motion passed unanimously.

INTERNAL AUDITOR REPORT

Audit Recommendations Status Report

Ms. Vandehey introduced the quarterly report of outstanding audit recommendations. Two items were completed since the last report in February 2004. First, the straight-through processing system through the Bloomberg Portfolio Order Management System (POMS) automates fixed income trade settlement and provides pre and post trade compliance monitoring capabilities. The second item completed was in the private equity group. They improved their review of the private equity annual financial statements through implementation of monitoring procedures. There are six remaining items from previous audits and four that have been added since last quarter.

Internal Audit 2005-01, Real Estate

Ms. Vandehey introduced the 2005-01 audit of real estate. The purpose of the audit was to first review the control environment of the internal investment unit and second to perform limited scope audits of real estate partners and advisors to determine they are providing the investment services outlined in the contract, have established adequate external controls, processes and procedures, maintain proper reporting to the Board and operate in the best interest of the Board. Prior Internal Audit recommendations from the 1999 audit were implemented shortly after the report was issued. Noteworthy accomplishments are improved two-page written investment recommendation Board reports, enhanced formal written annual review completed for each partnership, written organization assignment plan to mitigate key-man risk, and implementation of an annual partner/advisor meeting.

To mitigate key-man risk, increase the knowledge base of all staff, and improve communications between the unit and executive management the WSIB could adopt leading practices such as: enhancing written policies; implementing customer relationship management (CRM) software; increasing the use of outside consultants; and improving management and compliance monitoring of real estate contract terms and conditions within a database. Mr. Nakahara asked for clarification

concerning the recommendation to use outside consultants and/or auditors for special review projects. Ms. Vandehey responded that there is not enough audit staff for consultant type projects and the Real Estate unit does not have audit expertise.

Three Real Estate investment partners were selected for an audit based upon an assessment of risk through discussions with staff. These relationships with Hometown America, Principal Enterprise Capital (PEC) and Euroinvest represent 38 percent of the real estate portfolio. Overall these partners' investment programs are fundamentally sound and meeting or exceeding the investment expectations of the WSIB.

Mr. Masten asked if the security deposits received by Hometown America are maintained on site or pooled and invested. Ms. Vandehey responded that if they are receipted correctly they are centrally deposited in Chicago, however, without the recommended controls the property manager could put the receipt in, pocket the money and the central office might not be able to identify that the deposit is missing.

Treasurer Murphy asked if there was a separation of duties in accounting at PEC. Ms. Vandehey responded that there was not on the management team. Treasurer Murphy asked if one person was doing both sides of the transactions and Ms. Vandehey confirmed that was correct.

The Committee discussed the recommendations concerning documentation of financial arrangements made between PEC and third parties extensively. The Committee instructed the staff to obtain a legal analysis of the issues involved in the GMS/PEC payment before the September Board meeting.

The Committee discussed the recommendation concerning the need for further legal review of the potential conflict between the Euroinvest L.P. agreement and the Rockspring management agreement regarding allocation of travel expenditures. The Committee asked the staff to obtain a legal analysis before the next Board meeting. Mr. Kaminski asked if Ms. Vandehey was satisfied with Rockspring's response to her fourth recommendation. Ms. Vandehey stated she was satisfied, based on a recent conversation with Rockspring about the types of documentation they need to keep

and authorization processes they need to establish. Mr. Nakahara requested that the WSIB share its audit report with Rockspring's auditors. The Committee agreed and Ms. Vandehey said she would provide it.

Treasurer Murphy moved that the Audit Committee accept Internal Audit 2005-01, Real Estate and forward it to the Board for approval. Mr. Masten seconded and the motion passed unanimously.

The Committee took a break at 10:18 A.M. and resumed at 10:25 A.M.

Quality Assessment Peer Review Report

Chair Charles announced he would need to depart before the conclusion and ask Mr. Masten to finish up as Acting Chair. Chair Charles stated he had an opportunity to meet with Ms. Eckert and Mr. MacCabe as part of their peer review. Ms. Eckert was teleconferenced in and thanked the Committee for giving her the opportunity to participate and answer any questions. Ms. Vandehey presented an overview of the Quality Assessment Peer Review report conducted by Mr. David MacCabe and Ms. Jeanette Eckert.

Mr. Masten moved that the Audit Committee forward the report to the full Board. Treasurer Murphy seconded and the motion passed unanimously.

CONFLICT OF INTEREST POLICY 2.00.100 REVISION

Ms. Whitmarsh presented the proposed Conflict of Interest Policy revisions. The substantive changes cover situations where Board members or employees who solicit employment or are solicited for employment from a person or entity doing business with the WSIB. New policy language would require staff to notify the Executive Director of such situations and recuse themselves from WSIB dealings with that business partners.

Chair Charles left the meeting at 10:48 A.M.

The Committee discussed and approved revisions to the draft presented by staff.

Treasurer Murphy moved that the Audit Committee accept the changes as proposed and forward the amended Conflict of Interest Policy 2.00.100 as a consensus recommendation of the Audit Committee to the Board for approval. Mr. Masten seconded.

PROXY VOTING POLICY REVIEW PLAN

Ms. Calkins presented the Committee with a plan for enabling the WSIB to vote domestic equity proxies. As presented, the plan would have the WSIB assume the responsibility in 2006, since the staff needed to perform extensive work associated with proxy voting and would not be approved by the Legislature until late April, at the earliest. Treasurer Murphy expressed a strong desire for the staff to find a way for the WSIB to vote proxies in 2005. Mr. Kaminiski asked about the cost of the proxy voting activities versus proxy research. Mr. Masten requested more information on proxy voting and research services available. Mr. Dear said the staff would respond to the Board members' requests.

NONVOTING BOARD MEMBERS TERM EXPIRATIONS

Acting Chair Masten noted that the terms for Bob Nakahara and Jeff Seely expire at the end of 2004. He noted Mr. Nakahara's letter expressing his desire for reappointment. Mr. Dear stated that he was unable to contact Mr. Seely to find out if he was interested in being reappointed. The Committee recommends that Mr. Nakahara's name be forwarded to the September Board meeting for an additional term and when Mr. Seely responds that if he is still interested, that his name be forwarded as well.

Treasurer Murphy moved that the Audit Committee recommend to the Board that Mr. Nakahara be appointed to a three year term beginning January 1, 2005. Mr. Masten seconded. Treasurer Murphy moved that the Committee make a similar recommendation for Mr. Seely, if he desires to continue. Mr. Masten seconded.

These motions will be forwarded to the Board as a consensus of the Committee.

OTHER ITEMS

There being no further business to come before the Committee, the meeting adjourned at 11:55 A.M.