

**STATE OF WASHINGTON
STATE INVESTMENT BOARD**

Audit Committee Meeting
Minutes

March 17, 2005

The Audit Committee met in open public session at 9:00 A.M. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive SW, Olympia, Washington.

Committee Members Present: Debbie Brookman
 Charlie Kaminski
 George Masten
 Treasurer Michael Murphy
 Bob Nakahara

Committee Members Absent: John Charles
 Dave Scott

Other Board Members Present: Glenn Gorton
 Jeff Hanna

Others Present: Joe Dear, Executive Director
 Gary Bruebaker, Chief Investment Officer
 Theresa Whitmarsh, Deputy Director for Operations
 Liz Mendizabal, Public Affairs Director
 Beth Vandehey, Internal Auditor
 Nancy Calkins, Senior Investment Officer – Public Equity
 Linda Lester, Investment Officer – Public Equity
 Christina Blue, Administrative Assistant
 Paul Silver, Office of the Attorney General

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

Mr. Masten called the meeting to order at 9:00 A.M., and identified Committee members present.

ADOPTION OF MINUTES – DECEMBER 6, 2004

Treasurer Murphy moved to approve the December 6, 2004, Audit Committee meeting minutes. Ms. Brookman seconded and the motion passed unanimously.

INTERNAL AUDITOR REPORT

Public Equity Manager Barclays Global Investors (BGI) Audit 2005-03

Ms. Vandehey presented the internal audit report of Public Equity Manager Barclays Global Investors (BGI) as outlined in the *Fiscal Year 2005* Audit Plan. Ms. Vandehey explained this audit was a review of our largest equity manager. Ms. Vandehey presented a summary of the market value of holdings that BGI currently manages for the WSIB including the fees paid. Ms. Vandehey further explained that BGI makes up 32 percent of the WSIB's total portfolio at roughly \$19.5 billion and has been an investment manager for the WSIB for over 23 years since the first fund in June 1982. Ms. Vandehey said that emphasis was placed on reviewing BGI's internal corporate governance as BGI is such a large portion of our total portfolio and any negative news about BGI could impact the WSIB. Ms. Vandehey reported that BGI had an extensive corporate governance program that included: a written code of conduct, a risk management and compliance department, a corporate wide error tracking report which helped in quantifying risk, an internal audit division, and a formalized reporting line into a Board Committee which provides an oversight function. The overall assessment for BGI was good and no recommendations were made.

Treasurer Murphy moved that the Audit Committee accept the Public Equity Manager Barclays Global Investors (BGI) Audit 2005-03 and forward it to the Board for further approval at the April 21, 2005, Board meeting. Ms. Brookman seconded and the motion passed unanimously.

Fiscal Year 2004-2005 Audit Plan Update

Ms. Vandehey presented an update to the original Fiscal Year 2004-2005 Audit Plan. Ms. Vandehey explained that, due to BGI's inability to entertain a December audit, the audit of International Active Managers has been postponed from May until August.

Audit Recommendations Status Report

Ms. Vandehey presented an update to the Audit Recommendations Status Report. Staff has completed five of the nine outstanding audit recommendations since last quarter. Mr. Nakahara asked if any of the outstanding items were critical. Ms. Vandehey responded that the remaining items are all rated at medium. Mr. Dear said that one of the remaining items is to be completed by Financial Control Systems, and is on schedule; and that the others are software dependent and are scheduled to be completed as part of current information technology plan.

PROXY VOTING

Domestic Equity Proxy Voting Annual Report - 2004

Mr. Bruebaker presented the summary of the WSIB's 2004 Domestic Equity Proxy Votes. Barclays Global Investors (BGI) voted over 9,517 proxy issues for 3,673 companies. Of those votes, 78 percent were voted with management. Mr. Bruebaker informed the Committee that Attachment A highlighted the details of the votes for both 2003 and 2004. He stated that Kevin Cameron of Glass Lewis & Co would provide an update on the current proxy voting season and specifically discuss the executive compensation issue as it relates to proxy voting. Mr. Bruebaker also stated that Attachment B contained the 2005 Proxy Voting Procedures.

Proxy Voting Discussion of Executive Compensation and Current Season Issues Update

Mr. Kevin Cameron, Glass Lewis & Co. provided a brief update of the 2005 voting season. There have been roughly 250 meetings as of the first week of March, which have resulted in over 3,700 ballots. Mr. Cameron explained that if more than one account is held within a company, then each account is voted separately. Preliminary numbers show that the WSIB withheld votes from directors about 35 percent of the time, which is more stringent than BGI had been in the past. When votes are withheld, often the WSIB is dissatisfied with the director's performance which could result from differences of opinion relative to attendance record, compensation, audit independence, or off-shore issues. Mr. Cameron provided the Committee with an example of one of their research reports to illustrate how Glass Lewis analyzes executive compensation issues and compares a company's performance with their industry peers. Treasurer Murphy asked if the current CEO was a board member. Mr. Cameron responded affirmatively. Treasurer Murphy asked how Cabot compares to other companies regarding growth, stock price, and compensation. Mr. Cameron stated that if this information is available, Glass Lewis & Co. reviews it in compiling their report.

Mr. Cameron referenced a speech given by the Securities and Exchange Commission's (SEC) Allan Beller, Division of Investment Management, identifying six areas the SEC is worried about, one being the detailed disclosure of executive compensation. Mr. Cameron referenced a March 17, 2005, article from *The Wall Street Journal* regarding Tyco's deferred compensation as an example of how companies might defer cash bonuses in order to avoid reporting the compensation on the proxy statement. Mr. Masten asked if there were guidelines under a deferred compensation program about the percentage that can be deferred. Mr. Cameron stated that such restrictions did exist for qualified plans but most of these plans were non-qualified plans. Treasurer Murphy asked if the disclosed executive compensation includes bonuses paid for the year, even if the executive actually receives the payment in a following year. Mr. Cameron responded that, unlike an individual's cash basis reporting, when a company reports compensation, it usually includes all compensation earned including bonuses accrued for the year. Mr. Cameron and the Committee further discussed executive compensation and what the SEC is currently doing to address the issues and concerns. Mr. Cameron suggested that the WSIB form an alliance with other large institutional plans and make its views and concerns known to the SEC.

[The Committee recessed at 10:12 A.M. and reconvened in open session at 10:22 A.M.]

CONFLICT OF INTEREST POLICY 2.00.100 PROPOSED REVISION – GIFT REPORTING

Mr. Silver presented proposed revisions to the current Conflict of Interest Policy 2.00.100. The Board had requested a review of the gift reporting and monitoring section to address three areas: to make the requirements clearer as to what gifts are to be reported, make gift reporting coincide with the annual financial affairs reporting, and avoid the need for multiple reporting. Discussion ensued regarding the \$50 limit and the RCW citation for this requirement. Mr. Silver identified two proposed changes on page 7, allowing those WSIB Board members to submit a copy of the report currently submitted to the Legislature and change the reporting from monthly to annually. Treasurer Murphy asked who the reports are submitted to currently. Mr. Silver stated the reports are submitted to the Executive Director and the Legislature, but that the reports are reviewed by the Audit Committee. Treasurer Murphy asked if the language could be clarified as to whether the reports are to be submitted to the Executive Director versus the Audit Committee. Ms. Whitmarsh stated the report is currently a part of Assistant Attorney General's annual review and the conflict of interest review is submitted to the Audit Committee. Mr. Masten asked if there was a reason why the policy change could not be put off until the next Committee meeting. Mr. Dear stated that the next meeting is in May, which is after the end of the current Legislative session and that this issue could be postponed until then.

Treasurer Murphy moved that the Audit Committee defer action to the next meeting of the Audit Committee meeting. Ms. Brookman seconded and the motion passed unanimously.

OTHER ITEMS

Mr. Bruebaker presented the Committee with a copy of the speech from SEC's Allen Beller regarding Executive Compensation.

There was no further business to come before the Committee and the meeting adjourned at 10:33 A.M.