

WASHINGTON STATE INVESTMENT BOARD
Audit Committee Meeting Minutes
April 1, 2008

The Audit Committee met in open public session at 11:02 a.m. at the Washington State Investment Board (WSIB) boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Committee Members Present: Mason Petit, Chair
George Masten
Sandra Matheson
Bob Nakahara (via telephone)
Mike Ragan

Absent: Charles Kaminski

Others Present: Joe Dear, Executive Director
Gary Bruebaker, Chief Investment Officer
Shawna Killman, Internal Audit Director
Rodney Reynolds, Internal Auditor
Kate Sandboe, Corporate Governance Officer
Rita Wineinger, Administrative Assistant

Paul Silver, Assistant Attorney General
Jim Brownell, State Auditor's Office
Mark Raker, Peterson Sullivan PLLC (via telephone)
Ray Holmdahl, Peterson Sullivan PLLC (via telephone)

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

Chair Petit called the meeting to order and roll call was taken.

ADOPTION OF THE FEBRUARY 5, 2008, MINUTES

Mr. Ragan moved to approve the February 5, 2008, Audit Committee meeting minutes. Ms. Matheson seconded, and the motion carried unanimously.

EXTERNAL AUDITS

State Auditor's Office Fiscal Year 2008 Accountability Audit – Entrance Conference

Ms. Killman introduced Mr. Brownell from the State Auditor's Office (SAO), who presented the WSIB's entrance conference for the Fiscal Year 2008 SAO Accountability Audit. The audit will cover the period beginning July 1, 2007, and ending June 30, 2008. The audit was planned using a risk-based audit approach in the areas of: accountability for public resources; compliance with state laws, regulations, and agency policies; financial statements; and federal compliance. The accountability and compliance audit will include the following areas: custodial bank transition, contracts, real estate, the Agreement Tracking System reconciliation with Financial Control Systems, investment holdings,

conflict of interest, and travel. The auditor has completed testing in the area of travel and found no exceptions.

Chair Petit asked if the audit of real estate is focused on valuations. Mr. Brownell responded that the auditor will be focused on the procedures and policies that the WSIB has in place to ensure those investments are in being managed according to state law.

In the area of financial statements, the State Auditor will place reliance on the independent certified public accounting firm audit of the WSIB statements that will occur later in the year. The SAO audit reports include: Accountability Reports, Independent Auditor's Comprehensive Annual Financial Report (CAFR) Opinion, and a Single Audit Report. Mr. Masten asked Mr. Brownell whether the SAO will review the work of the CPA firm's audit of the WSIB prepared statements. Mr. Brownell indicated that they would review the work in December.

Mr. Masten asked Mr. Brownell whether a tolerable misstatement threshold had been identified by the SAO for the statewide financial audit. Mr. Brownell indicated those calculations would be performed once the Fiscal Year comes to a close. Mr. Masten asked Mr. Brownell for the dollar amount of the threshold when he completes the audit.

Fiscal Year 2008 Financial Statement Audit – Approval of Scope of Work

Ms. Killman explained that the WSIB plans to have an independent auditor conduct an audit of the financial statements for Fiscal Year 2008. This will be the Board's third financial statement audit and will cover the period of July 1, 2007 through June 30, 2008. The audit will begin in September once the books are closed. By charter, the Audit Committee must approve the scope of services performed by external auditors. Ms. Killman presented the proposed Scope of Work for the Fiscal Year 2008 Financial Statement Audit, and noted the SAO will rely on the external auditor's opinion on WSIB's statements for the purposes of its statewide CAFR audit for the same fiscal year.

The Committee discussed and made a revision to the Scope of Work, Section B3, to state, "Conduct the audit in accordance with *accounting and* auditing standards generally accepted in the United States of America."

Ms. Matheson moved to approve the amended scope of work for an audit of the Fiscal Year 2008 Financial Statements prepared by the WSIB. Mr. Ragan seconded, and the motion carried unanimously.

Fiscal Year 2008 Financial Statement Audit – Independence Statement Review and Appointment of External Auditor (Peterson Sullivan)

Ms. Killman indicated that management would like to engage Peterson Sullivan PLLC to perform the independent audit of the Board's Fiscal Year 2008 financial statements. She presented a written statement from Peterson Sullivan, confirming their independence from the WSIB to the Audit Committee.

Mr. Ragan moved to appoint Peterson Sullivan PLLC to perform the Fiscal Year 2008 audit of the financial statements prepared by the WSIB. Ms. Matheson seconded, and the motion carried unanimously.

Mr. Holmdahl indicated that Peterson Sullivan PLLC has no problem with the change in the Scope of Work and also indicated that within the next 30 days, the auditor will be contacting Chair Petit to discuss governance.

State Auditor's Office Public Records Request Performance Audit Update

Ms. Killman explained that the WSIB was one of ten state agencies, ten counties, and ten cities selected by the SAO for a performance audit of its public records request policies and procedures. The audit consisted of ten unannounced public records requests received by each entity during December 2006, along with onsite audit work completed at the WSIB in May 2007.

In the preliminary report drafts received, the WSIB was considered responsive by the SAO in eight of the ten records requests, and was cited several times for best practices. In one of the two instances, a response was not issued to the requestor in error because the information requested was available on the Board's Web site. In the other instance, the SAO concluded the response provided by the WSIB did not conform to the request when an electronic link to another agency's report titled 2005, turned out to be 2004 data. WSIB then created the records requested for 2005 immediately.

Ms. Killman indicated that staff received the preliminary results of the audit almost a year ago in April 2007, and took action at that time to implement improvements suggested. Because the final report is due to be released prior to the next scheduled Audit Committee meeting, Ms. Killman will forward the final report in its entirety to the Audit Committee members as soon as it is made available. Given the length of preliminary drafts (151 pages), an excerpted version with a summary will also be provided for members' review.

In response to Chair Petit's inquiry regarding actions taken in response to the audit, Mr. Dear indicated that procedures have been changed to ensure the errors will not occur in the future.

INTERNAL AUDIT

Audit Recommendations Status Report

Ms. Killman presented the Audit Recommendation Status Report. Since the last quarterly report, staff has improved the investment performance reporting review process, updated its expected completion date for the recommendation related to investment performance report preparation, and began working with the Department of Retirement Systems (DRS) staff on the two daily valued fund audit recommendations reported at the last meeting, which resulted in resolution of one of them. There are currently four recommendations outstanding going into the next quarter.

The recommendation made by Peterson Sullivan associated with the WSIB alternative investment valuation policy implementation has an expected completion date of August 15, 2008, which coincides with the timing of the next financial statement audit. Mr. Nakahara asked the representatives from Peterson Sullivan to provide context on this audit recommendation by ranking the severity of the issues identified. Mr. Nakahara provided the definitions of the Internal Audit Recommendation Levels of severity used at the WSIB. In response to Mr. Nakahara's inquiry, both Mr. Raker and Mr. Holmdahl indicated this recommendation is considered to be a Level 2 which requires a change in process to address risks.

The second recommendation relates to automating the performance reporting process. This completion date has changed since the last report, based on the data warehouse project plan. There was a re-prioritization of the data warehouse deliverables to concentrate on the risk analysis piece as the first deliverable, and performance reporting as the second deliverable. The revised completion date is June 1, 2009.

The third outstanding audit recommendation relates to the need for a more robust investment performance reporting review process. Staff implemented changes when reviewing the last reports to the Board, so this recommendation is considered resolved.

The next recommendation was made by Peterson Sullivan and involves the preparation of risk disclosure schedules in the notes to financial statements. The completion of this work will also coincide with the upcoming financial statement audit, so Peterson Sullivan will review these improvements during their audit. In response to an inquiry by Mr. Nakahara regarding the severity of this recommendation, Mr. Raker indicated he considered this recommendation to be a Level 2, as well.

The fifth recommendation involves expired agreements between the WSIB and the third-party record-keepers noted during the Daily Funds internal audit. Management's action plan was to work with DRS to establish the appropriate written agreements outlining the responsibilities of the WSIB and third-party record-keepers with respect to the Daily Valued Funds. However, after a review of the expired agreements, WSIB's current Assistant Attorney General concluded the agreements outlining deadlines for daily pricing between the WSIB and the third-party record-keepers should not be contained in contracts, and should instead be addressed in operations guidelines. This recommendation is considered resolved, as staff has operations desk manuals in place that outline the daily fund time frames and deadlines.

The last recommendation related to the Daily Funds third-party record-keeper audits. Staff was to work with DRS to determine whether the required record-keeper audits covering those items not addressed in the SAS-70 audits have been performed, reports reviewed, and any issues appropriately resolved. DRS confirmed that those annual audits of the two record-keepers had not been performed since 2002. DRS has taken the lead on this because they hold the record-keeper contracts.

Ms. Matheson indicated the ICMA audit engagement will begin within the next month and will cover calendar years 2007, 2006, and 2005. If issues are noted, additional testing going back to prior years will be considered. She explained the Citistreet audit will begin in the near future in conjunction with its SAS-70 review. Ms. Matheson also indicated that an interagency agreement between the WSIB and DRS will also be strengthened.

Audit Committee Charter 1.00.130 Review and Update

Ms. Killman explained that, during a review of the Audit Committee Charter at the Committee's November 2007 meeting, members requested that the Committee's oversight responsibilities included in the Audit Committee Charter be mapped to the Audit Committee meeting agenda items.

It was decided that Chair Petit, Ms. Matheson, and Internal Audit would work together, and come back to the full Committee for further discussion and analysis. During the working sessions, the list of standing Audit Committee meeting agenda items increased, and potential charter revisions were

identified. The proposed revisions add clarity to Committee oversight responsibilities and capture requirements previously missing from the charter but found in other Board policies.

The Committee discussed the spreadsheets provided. Ms. Matheson asked that a footnote be added to clarify where items that are not specifically addressed by a standing Audit Committee agenda item are addressed. Ms. Matheson asked whether Peterson Sullivan had reviewed the analysis and Mr. Holmdahl indicated Peterson Sullivan will review the spreadsheets and provide input to the Committee during its upcoming financial statement audit.

Chair Petit moved to recommend that the Board adopt Audit Committee Charter 1.00.130 revisions. Ms. Matheson seconded, and the motion carried unanimously.

MANAGEMENT

Proxy Voting Policy 2.05.200 Review

Ms. Sandboe presented a change to the Proxy Voting Policy 2.05.200. The proposed change indicates that the WSIB will support the ability of shareholders to vote on compensation committee reports, thus creating another avenue by which it can hold a board accountable for its compensation practices.

The advisory vote to approve the reports of a compensation committee would serve as an effective, direct mechanism for enhancing transparency in setting executive pay, improving accountability to shareholders, and providing for a more effective link between pay and performance. While a vote to approve the report will not directly affect a board's ability to set compensation policy, it will allow shareholders to register their opinions regarding the company's compensation practices. The WSIB favors supporting the ability of shareholders to have additional opportunities to express opinions on executive compensation through the means of a shareholder vote.

Chair Petit indicated that he is very supportive of this and is excited that the WSIB is moving forward with a policy that matches that effort.

Ms. Matheson moved to recommend that the Board adopt Policy 2.05.200, Proxy Voting Guidelines, as amended, to include support for shareholder proposals giving shareholders an advisory vote on the compensation committee's report on executive compensation. Mr. Ragan seconded the motion and the motion carried unanimously.

OTHER ITEMS

There was no further business to come before the Committee and the meeting adjourned at 11:54 a.m.