

WASHINGTON STATE INVESTMENT BOARD
Audit Committee Meeting Minutes
September 9, 2008

The Audit Committee met in open public session at 8:56 a.m. at the Washington State Investment Board (WSIB) boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

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

Absent: Bob Nakahara

Others Present: Joe Dear, Executive Director
 Theresa Whitmarsh, Chief Operating Officer
 Gary Bruebaker, Chief Investment Officer
 Liz Mendizabal, Public Affairs Director
 Shawna Killman, Internal Audit Director
 Alicia Markoff, Portfolio Administrator
 Rodney Reynolds, Internal Auditor
 Kate Sandboe, Corporate Governance Officer
 Rita Wineinger, Administrative Assistant

 Steve Dietrich, Assistant Attorney General
 Tracy Aga, State Auditor's Office
 Steven Harding, Independent Fiduciary Services
 Carl Gilchrist, Barclays Global Investors
 Chad Spitler, Barclays Global Investors

[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.

[Mr. Kaminski joined via telephone at 8:58 a.m.]

AUDIT COMMITTEE EDUCATION SESSION
Audit Committee Oversight and Emerging Practices

At the request of the Audit Committee, Mr. Harding presented an education session regarding the basic elements of audit committee oversight, emerging issues, and common and best practices.

[Ms. Matheson arrived at 9:06 a.m.]

Basic elements of audit committee oversight are well documented in the WSIB Audit Committee Charter. Mr. Harding encouraged the Committee to continue with routine Charter reviews, which is a best practice, and noted the WSIB currently employs many of the industry's best practices. Ms. Matheson asked how deep the Audit Committee should look into practices and processes. Mr. Harding explained that it is an individual's responsibility as a fiduciary to be satisfied that practices are in compliance with policies.

ADOPTION OF THE APRIL 1, 2008, MINUTES

Mr. Masten moved to approve the April 1, 2008, Audit Committee meeting minutes. Mr. Ragan seconded, and the motion carried unanimously.

EXTERNAL AUDITS

State Auditor's Office Public Records Request Performance Audit Report

Ms. Aga presented the State Auditor's Office (SAO) Public Records Request Performance Audit Report. 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. Overall, the WSIB performed well. Management has taken action to implement improvements in response to the audit.

Ms. Matheson moved to recommend that the Board adopt the State Auditor's Office Performance Audit Report No. 1000011. Mr. Ragan seconded, and the motion carried unanimously.

INTERNAL AUDIT

Internal Audit Report 2008-03, Self-Directed Plan External Managers

Ms. Killman and Mr. Reynolds presented the Internal Audit Report 2008-03, Self-Directed Plan External Managers. The objectives of this audit were to determine compliance with related State Administrative and Accounting Manual (SAAM) requirements, Board policies, and written contract agreements; assess the adequacy of WSIB monitoring procedures and processes currently in place; and review performance reporting reliability and accuracy.

The audit found processes in place at the WSIB for the externally managed self-directed plan investment options are adequate to ensure compliance with SAAM requirements, Board policies and written contract agreements. Investment manager monitoring procedures, processes, and controls over performance reporting reliability and accuracy are also adequate. However, the following recommendations and associated management action plans to strengthen controls over manager and contract monitoring were noted during the audit:

1. Repeat Recommendation: WSIB staff should consider reviewing the SAS 70 audit reports of its external investment managers. This is a Level 2 recommendation.

Management's Action Plan: Management will ask finalists for all investment mandates to provide a SAS 70 report to the evaluation team upon notification they have been identified as a finalist. This will commence immediately with the finalists for the transition manager search now in process. In addition, as part of ongoing manager monitoring, staff will request copies of current SAS 70 reports, as well as disclosure of any noted exceptions during annual manager

reviews. This expectation will be discussed with contracts, compliance, and Public Equity staff so that each party is clear on its role in the process.

2. Recommendation: WSIB should ensure self-directed plan external managers have the required insurance coverage outlined in written contract agreements. Controls should be established to ensure the required contractors' certificates of insurance are received by the WSIB 15 days prior to the contract effective date, along with all renewal certificates. Documentation should be maintained in the contract files. This is a Level 2 recommendation.

Management's Action Plan: Management will undertake a review of the insurance requirements employed in the Board's current contract agreements to ensure compliance with existing terms and determine if the WSIB is following industry best practices regarding boilerplate contract language. For future contracts, the annual requirement for managers to submit proof of insurance certificates will be included in the contract attachment itemizing all reporting requirements.

3. Recommendation: WSIB should design and implement controls that ensure contract monitoring duties are clearly assigned to the appropriate areas within the organization, adequate monitoring is taking place, and those monitoring activities are documented. This is a Level 2 recommendation.

Management's Action Plan: Staff will discuss what additional controls and documentation would be valuable to ensure appropriate oversight of investment managers.

Chair Petit asked Ms. Whitmarsh to explain the breakdown in communication that resulted in the repeat audit finding regarding SAS 70 reports, which she did. Ms. Whitmarsh indicated that steps have been taken to immediately implement the resolution to this audit finding and will document completion of this, as well as future management actions to audit findings to ensure follow-up has occurred. Ms. Matheson asked if the Audit Recommendation Status Report was distributed to all staff when items were completed, which would add another layer of review prior to reporting completion to the Audit Committee. Ms. Whitmarsh indicated that the report is not distributed to all staff involved, but could be in the future. Ms. Whitmarsh further indicated that a full report regarding the resolution to this audit finding will be provided to the Audit Committee at its December 2008 meeting.

Mr. Ragan moved to accept Internal Audit Report 2008-03, Self-Directed Plan External Managers, and forward it to the Board for approval. Ms. Matheson seconded, and the motion carried unanimously.

Internal Audit Report 2008-04, Financial Control Systems (FCS)

Chair Petit called the Audit Committee into executive session to review and discuss information concerning audit recommendations for improving controls, the public discussion of which would result in loss to the funds managed by the WSIB. He indicated that the executive session was expected to last about 20 minutes, at which time the Audit Committee would reconvene in open session.

[The Audit Committee went into executive session at 10:16 a.m. and reconvened in open session at 10:53 a.m.]

Mr. Masten moved to accept Internal Audit Report 2008-04, Financial Control Systems, and forward it to the Board for approval. Mr. Ragan seconded, and the motion carried unanimously.

Audit Recommendations Status Report

Ms. Killman presented the Audit Recommendation Status Report. Since the last quarterly status report in April 2008, staff continues work on the remaining four recommendations. Management placed the scheduled completion date for the Alternative Investments Valuation on hold pending the hiring of a new Investment Accounting Controller.

Chair Petit asked for an update on the transition to JPMorgan. Ms. Whitmarsh indicated that JPMorgan is meeting their deadlines and, overall, staff is more satisfied than before. She added that this is a relationship that staff continues to actively manage.

[The Audit Committee recessed at 10:57 a.m. and reconvened in open session at 11:09 a.m.]

Fiscal Year 2008-2009 Internal Audit Plan

Ms. Killman presented areas selected for internal audit review in the coming year. During the Fiscal Year 2008-2009, the following six areas will be audited: custodian bank operations; trade processing, confirmation, and settlement; accounting, pricing, and unitization of the commingled trust fund, Plan 3 (TAP), and commingled bond fund; foreign country market entry application/tax registration; public equity investment contract/manager monitoring; and, limited liability company processes. In addition, the Information Services Board of the Department of Information Services requires each state agency to have an independent Information Technology Security Policy and Standards Compliance Audit once every three years, which will be due for the WSIB in 2009. Finally, in accordance with the International Standards for Professional Practice of Internal Auditing, a Quality Assessment Peer Review of the Internal Audit function is required once every five years, and will be conducted in 2009.

Mr. Ragan moved to recommend that the Board adopt the Fiscal Year 2008 - 2009 Internal Audit Plan. Ms. Matheson seconded, and the motion carried unanimously.

MANAGEMENT

Daily Valued Funds Policy Revision

Ms. Markoff presented proposed revision of the Daily Valued Funds Operation Policy, 2.14.300, due to the upcoming transition in investment options for the Deferred Compensation Program and the Defined Benefit participants. The changes to the policy are limited to the removal of the Horizon Funds and the inclusion of the WSIB Bond Fund as an investment component of the new Target Date Retirement Strategy Funds.

Mr. Ragan moved to recommend that the Board adopt the revisions to the Daily Valued Funds Operation Policy 2.14.300. Mr. Masten seconded, and the motion carried unanimously.

2009 Meeting Schedule

Mr. Dear presented the proposed Audit Committee meeting schedule for 2009. The dates selected are: March 3, June 2, September 1, and December 1.

Mr. Masten moved to approve the 2009 meeting schedule. Mr. Ragan seconded, and the motion carried unanimously.

Proxy Voting and Securities Lending

Ms. Sandboe presented information regarding proxy voting and securities lending. She explained that the current management contract with Barclays Global Investors (BGI) does not allow the WSIB to recall its U.S. equities that are out on loan. Mr. Gilchrist and Mr. Spitler presented securities lending and proxy voting cost/benefit analysis. This analysis was conducted looking at the current collective trust fund investment versus two other alternative structures: a separate account with limited lending or a separate account with no lending. The Committee discussed the pros and cons of securities lending in the current collective trust versus the benefits of voting those shares. No action was taken at this time.

Conflict of Interest Compliance Review and Personal Investment Reports

Mr. Dietrich provided the annual review of compliance with the gift, travel, and financial statement reporting requirements of the Ethics in Public Service Act and the Conflict of Interest Policy 2.00.100, as well as personal investment reports for Board members and staff. Board members and staff of the Board continue to demonstrate both an awareness and understanding of the Board's Conflict of Interest Policy and the State Ethics in Public Service Law. Full compliance was found with no exception.

Mr. Masten moved to recommend that the Board accept the Conflict of Interest Compliance Review and Personal Investment Reports. Mr. Ragan seconded, and the motion carried unanimously.

OTHER ITEMS

Nonvoting Board Member Term Expiration

Chair Petit discussed the upcoming term expiration of nonvoting Board member David Nierenberg, who indicated interest in continuing to serve on the Board.

Mr. Masten moved that the Audit Committee recommend to the Board the reappointment of Mr. David Nierenberg for another term. Mr. Ragan seconded and the motion passed unanimously.

There was no further business to come before the Committee and the meeting adjourned at 12:08 p.m.