

WASHINGTON STATE INVESTMENT BOARD
Audit Committee Meeting Minutes
September 1, 2009

The Audit Committee met in open public session at 9:09 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
 Treasurer Jim McIntire (via teleconference)
 Bob Nakahara

Other Board Members Present: Patrick McElligott

Absent: Senator Lisa Brown
 Steve Hill

Others Present: Theresa Whitmarsh, Acting Executive Director
 Gary Bruebaker, Chief Investment Officer
 Liz Mendizabal, Public Affairs Director
 Shawna Killman, Internal Audit Director
 Beth Vandehey, Risk and Compliance Director
 Rita Wineinger, Administrative Assistant

 Brian Buchholz, Assistant 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 9:09 a.m. and acknowledged there was not a quorum present and determined to delay action items until a quorum of members was present.

INTERNAL AUDIT

External Quality Assurance Review of the WSIB Internal Audit Function

Ms. Killman presented the results of the external quality assurance review of the Internal Audit function, which was performed in June 2009. She explained WSIB Internal Audit is required to comply with the Institute of Internal Auditors (IIA) *International Standards for the Professional Practice of Internal Auditing*, which includes an external quality assurance review at least once every five years. The review was conducted by an Internal Audit consultant and included the following: review, verification, and evaluation of the self-assessment documentation prepared by the Internal Audit Director; review and evaluation of 14 questionnaire surveys completed by management and a representative of the State Auditor's Office (SAO); interviews with Board members, WSIB staff, and SAO staff; review and evaluation of two complete audits performed during fiscal years 2008 and 2009; and review of Internal Audit's policies and procedures, annual risk assessment, annual audit plans, and other relevant documents.

The consultant concluded that the WSIB Internal Audit function “generally conforms” to the *Standards*, which is the highest of three possible ratings, meaning that policies, procedures, and practices are in place to implement the *Standards* and other requirements necessary for ensuring a professional Internal Audit activity.

The consultant also identified three areas for improvement. Internal Audit agrees with and has proposed changes to Board policies to address these improvements in the next agenda item.

In response to a question from Mr. Nakahara, Ms. Killman indicated the WSIB was given the highest rating possible by the consultant; however, she will find out what the other potential ratings are. Mr. Nakahara also asked whether the consultant reviewed Audit Committee meeting minutes. Ms. Killman indicated the consultant reviewed Committee mailing packets. In response to an additional question from Mr. Nakahara regarding performance measures and whether it is a good idea to have hard percentage goals included, Ms. Killman explained that Internal Audit has just started benchmarking activities and is finding WSIB is actually higher than those percentages noted in the report. Ms. Whitmarsh noted the performance measures listed in the report were examples and, with the help of the Audit Committee Chair and Internal Audit Director, will identify those considered most useful for the WSIB. Mr. Nakahara noted the usefulness of audit recommendations was the lowest rated area. Ms. Killman explained to him, this indicates a need to communicate more with the business units.

[Chair Petit arrived and a quorum was reached at 9:25 a.m.]

Audit Committee and Internal Audit Charter Updates

Ms. Killman presented proposed revisions to Audit Committee Charter 1.00.130 and Internal Audit Charter 1.00.190. The revisions: 1) reflect recent changes to the IIA *Standards*, 2) implement a peer review suggestion to include a review of the Internal Audit Director’s annual compensation and salary adjustments made by the Executive Director, 3) provide for changes to the Audit Committee oversight duties, and 4) add clarity regarding action items that are forwarded to the full Board as recommendations for approval. Mr. Nakahara inquired who the “vendors” are noted in the Audit Committee Charter. Ms. Killman explained those are consultants and auditors the Audit Committee hires.

Chair Petit moved to recommend that the Board adopt Audit Committee Charter Policy 1.00.130 and Internal Audit Charter Policy 1.00.190 revisions. Mr. Masten seconded, and the motion carried unanimously.

Audit Recommendations Status Report

Ms. Killman presented the Audit Recommendations Status Report. Since the last report in June, four audit recommendations were resolved related to the performance reporting improvements, third-party record keeper monitoring, Financial Controls System (FCS) user access reporting, and Limited Liability Company internal operating policies. In addition, the expected completion dates for two FCS recommendations were revised. Mr. Nakahara asked Ms. Killman to remind the Committee what the audit recommendation legend levels indicate. She replied that level two is a moderate risk.

MANAGEMENT

2010 Meeting Schedule

Ms. Whitmarsh proposed the 2010 Audit Committee meeting schedule for consideration. The proposed dates are: March 2, June 1, September 14, and December 7.

Chair Petit moved to accept the proposed meeting schedule for 2010. Mr. Masten seconded, and the motion carried unanimously.

Nonvoting Board Member Term Expirations

Chair Petit discussed the upcoming term expiration of nonvoting Board members Charles Kaminski and John Magnuson. Mr. Kaminski indicated interest in continuing to serve on the Board and Mr. Magnuson sent a letter indicating he will not seek re-appointment, but provided potential candidates with real estate expertise to serve as his replacement.

Ms. Whitmarsh referenced the nomination procedures for nonvoting Board members adopted by the Committee in 1993, explaining the Committee identifies candidates and could conduct interviews at the December meeting, with recommendations forwarded to the December Board Meeting. The Committee discussed the process and determined interviews will be conducted at the December meeting, unless the number of candidates to be interviewed would require more time, in which case the Committee could hold a special meeting in November.

Mr. Masten moved that the Committee request Board Members and staff and others who have knowledge make a recommendation to the Audit Committee. Chair Petit seconded, and the motion carried unanimously.

The Committee determined recommendations should be forwarded to the Committee by October 15, 2009.

Chair Petit moved that the Audit Committee recommend to the Board the re-appointment of Mr. Charles Kaminski for January 1, 2010, through December 31, 2012.

There was no second to the motion. The Committee determined it will review both upcoming vacancies and candidates together and make its recommendation at the December meeting.

ADOPTION OF THE JUNE 2, 2009, MINUTES

Mr. Masten moved to approve the June 2, 2009, Audit Committee meeting minutes. Chair Petit seconded, and the motion carried unanimously.

Board Policy Compliance Review

Ms. Vandehey presented the 2008-2009 Board policy compliance review. Overall, there is a very high degree of compliance with WSIB Board Governance policies and charters, with only two exceptions out of 260 tests. Since the last report in May 2007, the exception regarding adherence to quiet periods during Request for Proposal process is now in compliance; the exception that the Board adhere to monitoring the operating budget at the Administrative Committee has been achieved in part—the Administrative Committee continues to receive and act on forward-looking

budget proposals, but the Committee has not received budgeted to actual expenditure reports as required by the Charter. Going forward, the Executive Director has scheduled the budget to actual expenditure report as a standard agenda item for the November Administrative Committee meeting. There is one additional exception noted in the 2009 review. Board members are encouraged to participate in at least one WSIB-paid education event per year, in addition to any direct manager and partner conferences. In 2008, seven of the current Board members attended outside training according to agency records. This requirement encourages the Board members to obtain outside education.

The Committee discussed the reporting requirement for budget reports. Staff will add the discussion of frequency of financial reporting review to the next Administrative Committee agenda.

The Committee discussed the need for the outside education policy requirement. Mr. Masten commented it is a good policy to give Board Members external education. Ms. Whitmarsh explained a list of opportunities are compiled each year and approved by the Board.

Risk Analysis

Ms. Vandehey reminded the Committee of the Rick Funston's presentation at the Board off-site meeting in July regarding ten enterprise skills that he believes Boards must develop if they are to thrive and strive in turbulence. At that meeting Mr. Funston facilitated a discussion that let the Board to challenge its key business assumptions and develop strategies that would combine the best of both worlds (white and black swan) for improved strategic flexibility.

At the request of the Board, this is the first of several upcoming facilitated exercises to analyze five key business assumptions (white swans) and opposites of those assumptions (black swans). The Committee focused on the second key business assumption in the handout: the assumption that the WSIB will "stay the course" in any market condition.

The Committee was asked to consider a black swan scenario of the WSIB dramatically changing the asset allocation in response to market condition. The discussion focused on the impacts to the organization and the strategies that could be used in the event that a black swan scenario happened. Staff will continue to provide the opportunity to discuss key business risks at the Audit Committee in upcoming meetings.

OTHER ITEMS

There was no further business to come before the Committee and the meeting adjourned at 10:30 a.m.