

WASHINGTON STATE INVESTMENT BOARD

Audit Committee Meeting Minutes

March 1, 2011

The Audit Committee met in open public session at 9:02 a.m. at the Washington State Investment Board (WSIB) boardroom at 2100 Evergreen Park Drive SW, Olympia, WA.

Committee Members Present: Steve Hill, Chair
Bill Longbrake
George Masten
Treasurer Jim McIntire

Committee Members Absent: Senator Lisa Brown
Bob Nakahara

Other Members Present: Judi Owens

Others Present: Theresa Whitmarsh, Executive Director
Victor Moore, Chief Operating Officer
Gary Bruebaker, Chief Investment Officer
Shawna Killman, Internal Audit Director
Rodney Reynolds, Internal Auditor
Kate Sandboe, Corporate Governance Officer
Phil Paroian, Senior Investment Officer – Public Equity
Beth Vandehey, Risk and Compliance Director
Jen Edwards, Compliance Officer
Alicia Markoff, Portfolio Administrator
Patty Davis, Administrative Assistant
Bill Kennett, Senior Investment Officer – Fixed Income
Steve Dietrich, Assistant Attorney General

[Names of other individuals attending the meeting are listed in the permanent record.]

Chair Hill called the meeting to order at 9:02 a.m. and took roll call.

INTERNAL AUDIT

Internal Audit Report – 2011-02 Fixed Income

Mr. Reynolds and Ms. Killman presented the Internal Audit Report for the Fixed Income investment program. The fixed income investments are in compliance with Board-adopted investment guidelines. Control procedures exist to ensure fixed income investments are independently verified, properly accounted for, and accurately reported to management and the Board in a timely manner. Electronic access to the fixed income trade processing system is appropriately limited and key person risk has been adequately addressed. The report contained one audit recommendation that each user have a unique login ID and password for the Board's portfolio order management system. Management concurs with the recommendation, and the implementation is nearly complete. At Chair Hill's request, Mr. Kennett detailed the trade execution process for members. Trades are executed electronically with signed paper backups. Mr. Hill commended Mr. Kennett for all the good work he and his team provide to the WSIB.

Audit Recommendation Status Report

Ms. Killman presented the Audit Recommendation Status Report. Since the last quarterly report in December 2010, five of the eight audit recommendations were resolved. JPMorgan's final audit recommendation was implemented, as were three Real Estate and Tangible Assets audit recommendations. Management also implemented procedures recommended by the State Auditor's Office related to certification of the review of the Board's Conflict of Interest Policy by new employees and Board members. Internal audit will continue to monitor the three recommendations that remain in progress, and report the status at the next Audit Committee meeting. Discussion ensued as to whether JPMorgan service has improved. Management indicated that the WSIB is generally happy with their service overall, and JPMorgan is trying to do a better job of being attentive to the needs of the Board.

[Treasurer McIntire arrived at 9:22 a.m.]

Mr. Longbrake asked whether there was a target completion date for the Higher Education Permanent Fund Asset Allocation Review recommendation, and Mr. Moore indicated he expected it would be completed in less than 30 days. Mr. Longbrake commended staff on an excellent report,

and encouraged the inclusion of target completion dates for all recommendations. When unusual situations preclude the assignment of an expected completion date, Mr. Longbrake suggested that additional comments be added for clarification.

APPROVAL OF THE JUNE 1, 2010, MINUTES

Mr. Masten moved to approve the December 7, 2010, Audit Committee meeting minutes. Mr. McIntire seconded, and the motion carried unanimously.

MANAGEMENT

Review Draft International Proxy Voting Guidelines

Ms. Sandboe reintroduced the proposed Global Proxy Voting Guidelines, which Committee members had previously reviewed at their December 2010, meeting. Ms. Sandboe presented a chart, requested by members at the December Audit meeting, comparing how significant proxy voting issues would be voted according to the WSIB's guidelines for U.S. companies, to how they would be voted for non-U.S. companies. Ms. Sandboe explained that all of the global equity fund managers had reviewed the WSIB's proposed new guidelines and found them to be very similar to their own guidelines. However, the fund managers had concerns about voting the WSIB's international proxies according to WSIB's guidelines rather than their own. Based on that feedback, staff now recommends the Board allow fund managers to vote the WSIB's international proxies according to the fund manager's guidelines. The fund managers are being asked to provide the WSIB with regular updates on how WSIB ballots are voted. Staff will use proxy voting research and vote recommendations from Glass Lewis & Co. to compare the votes cast by fund managers with the WSIB's guidelines and will report back to the Audit Committee. Chair Hill requested clarification of some of the terms included in the chart.

Treasurer McIntire stated he feels there is a benefit to having the fund managers vote the WSIB's non-U.S. proxies and provide regular voting reports to staff. He said it demonstrates the WSIB is paying attention to how its proxies are being voted and is holding the fund managers accountable.

**Mr. Masten moved that the Audit Committee recommend adoption of the Global Proxy Voting Guidelines by the Administrative Committee and Board.
Treasurer McIntire seconded, and the motion carried unanimously.**

Annual Investment Compliance Report

Ms. Vandehey and Ms. Edwards presented the Annual Investment Compliance Report.

Ms. Vandehey reported the compliance program monitors approximately 84 percent of the total assets and cannot be performed on commingled or index funds at this time. Ms. Vandehey provided historical information on the development of the Compliance Program. Chair Hill requested clarification on the difference between compliance and internal audit. Ms. Vandehey relayed that she views their role as a front line, day-to-day, control process. They provide management with timely compliance reporting. Internal audit provides the Board with periodic assurance the controls established by management are operating as intended, focusing their attention on risk across the audit universe.

The Public Equity, Fixed Income, Cash Overlay and Securities Lending funds were found to be 100 percent in compliance. The Asset Allocation fund was found to be 99.86 percent in compliance.

Ms. Vandehey confirmed the testing on asset allocation is for both the total Commingled Trust Fund and the manager level. Mr. Longbrake asked if the breach occurred because of good performance in the fund. Mr. Bruebaker responded that more of the rebalance comes as a result of market movement rather than cash flow. Most of these issues resolve themselves quickly. The policy was adjusted to allow the portfolios to stay out of balance for a time.

Mr. Hill asked how Compliance ensures the investment guidelines included in the investment manager contracts are all reflected in the JPMorgan Compliance System accurately. Ms. Vandehey reviewed the process she uses with JPMorgan to ensure that new contract guidelines are input correctly, and noted that periodic internal audits have also resulted in corrections. Contracts are also reviewed by counsel and Senior Investment Officers prior to implementation.

Ms. Edwards presented the compliance results for Private Equity, Real Estate, and Tangible Assets. In Private Equity, 130 funds were tested and found to be in compliance. In Real Estate and Tangible Assets, 14 investment vehicles were tested and found to be in compliance. In future years, a risk-based approach will be used to determine which investments will be tested.

Ms. Whitmarsh complimented the compliance team for their groundbreaking work. No other institutional investors have a program like this. Treasurer McIntire inquired how private equity partners feel about the program. The compliance team felt they were cooperative once they realized that staff was routinely testing the contract terms and that they had not done anything wrong to trigger a review.

Annual Daily Valued Funds Report

Ms. Markoff presented the Annual Daily Valued Funds Report. There were two immaterial errors in 2010. The first was a system error that occurred while processing a corporate action. The second error was human error that resulted from a transposition of numbers while recording a trade.

OTHER ITEMS

Procurement “Quiet Period” Discussion

Mr. Hill opened the discussion regarding the Board’s policy on quiet periods. He asked members for any suggested changes to the current policy. Mr. Moore reviewed the quiet period section of Policy 2.00.230. Mr. Moore advised that part of this session was to raise member’s awareness of the policy to safeguard the process. Discussion ensued regarding the different types of procurements and what types of communications are allowed within each type. Violation of the policy’s quiet period could result in the disqualification of a bidder. Members requested additional education, to include the types of communication that are allowed and prohibited. It was also recommended that the rules be clarified to potential vendors. Mr. Moore stated that the purpose of the policy is to ensure a fair and transparent procurement process. Ms. Whitmarsh indicated that she typically includes quiet period information in her monthly report, but she will make sure that this information is more evident. Mr. Longbrake recommended this issue also be incorporated into the annual ethics training.

Internal Audit Director Annual Performance Evaluation

Chair Hill announced the Committee would now go into executive session. The executive session is to review and discuss the performance of a public employee.

[The Committee went into executive session at 10:30 a.m., and reconvened in open public session at 10:49 a.m.]

There was no further business to come before the Committee and the meeting adjourned at 10:49 a.m.