

**WASHINGTON STATE INVESTMENT BOARD**  
**Audit Committee Meeting Minutes**  
**September 7, 2011**

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

Committee Members Present: Steve Hill, Chair  
Treasurer Jim McIntire  
Senator Lisa Brown (via teleconference)  
George Masten  
Bill Longbrake (via teleconference)

Committee Members Absent: Bob Nakahara  
Natasha Pranger

Others Present: Theresa Whitmarsh, Executive Director  
Victor Moore, Chief Operating Officer  
Shawna Killman, Internal Audit Director  
Rodney Reynolds, Internal Auditor  
Kate Sandboe, Corporate Governance Officer  
Beth Vandehey, Risk and Compliance Director  
Patty Davis, Administrative Assistant  
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.

**ADOPTION OF THE JUNE 7, 2011, MINUTES**

**Mr. Masten moved to approve the June 7, 2011, Audit Committee meeting minutes.  
Treasurer McIntire seconded the motion, and the motion carried unanimously.**

**INTERNAL AUDIT**

**Internal Audit Report – #2012– 01 Contracts**

Mr. Reynolds presented the Internal Audit Report. Overall, the audit found the WSIB is complying with state contracting policies and control procedures designed to ensure compliance is in place and operating. There are two audit recommendations concerning ongoing monitoring of contract terms.

The first is a level 2 recommendation and deals with contract monitoring. To address prior audit recommendations from September 2008, management established a control procedure where the Contracts unit would send contract compliance certificates to investment contractors each July. This procedure was established to ensure all contract terms are properly monitored, and monitoring activities are documented. During this audit, it was noted that compliance certificates were not sent in July 2010 and certificates had not been sent out as of early August 2011. Internal Audit recommends the Contracts unit follow established control procedures in a timely manner.

Management agrees with the recommendation, and indicated a number of factors contributed to the oversight in 2010. On August 18, 2011, contract compliance certificates were sent to 43 current investment management contractors. In addition, the process for 2012 has been added to the calendars of all parties involved, with the Contract Specialist assuming responsibility for overseeing this process in the future.

The second is a level 3 recommendation and relates to contract expiration. The Office of Financial Management (OFM) policy requires that written amendments to personal service contracts be signed prior to the contract expiration date. This audit revealed six of the 10 contract term amendments were not signed prior to the contract expiration date, and one was not dated. Internal Audit recommends control procedures be implemented that allow sufficient lead time for all parties to sign amendments prior to contract expiration.

Management agrees with the recommendation. To reduce the risk of contract amendments not being signed in a timely manner, management will increase the number of staff receiving contract expiration notices. The Contracts unit will implement procedures to confirm a course of action in response to the 60-day expiration notice, and the Contract Specialist will communicate lack of response to the respective member of executive management for timely resolution.

Mr. Moore stated that he fully agrees with the audit recommendation and appreciates the help of the auditors in finding solutions to this issue. He also regrets that audit recommendations were necessary.

Mr. Longbrake suggested that the WSIB not wait for the three-year cycle to check compliance on this issue. Mr. Reynolds indicated that a status report would be provided to the Audit Committee on a quarterly basis until resolved.

### **Audit Recommendations Status Report**

Ms. Killman presented the Audit Recommendations Status Report. There were three prior audit recommendations in progress.

The first recommendation was to reorganize the real estate investment files (both physical and electronic). Staff has indicated the physical files are complete, and the electronic files are still in process. Internal Audit will follow-up and report progress at the December 2011 Audit Committee meeting.

The second recommendation was to establish a tangible assets partnership oversight policy. This became necessary when the tangible assets portfolio was split off from the real estate portfolio. The search for a Senior Investment Officer for that new asset class continues, so staff continue to operate under the real estate policies and procedures, which Internal Audit feels is adequate.

The third recommendation suggests an update to the higher education permanent fund asset allocation. Staff is conducting meetings with various higher education stakeholders to assess their risk needs and preferences. Staff intends to complete the asset allocation study by December 2011.

### **Internal Audit Fiscal Year 2011 Performance Measures**

Ms. Killman presented the first internal audit performance measure dashboard report. During Internal Audit's last peer review, the consultant suggested implementing formalized performance measures. In response, the Audit Committee approved five performance measures.

During fiscal year 2011, four of the five performance measure targets were met. The performance measures are: 1) Develop and approve the fiscal year 2012 audit plan; 2) Spend a minimum of 60 percent of our time on direct audit services (82 percent of time was spent); 3) Obtain over 40 hours of continuing professional education per auditor; and 4) Report FY2011 performance measures outcomes at the September, 2011 Audit Committee meeting. The fifth performance measure was not met. That measure is: 5) Complete 80 percent of the scheduled audits. Internal Audit indicated the target was not met as they were too optimistic about the time necessary to complete the fiscal year 2010 Real Estate audit. That audit continued into 2011 using fiscal year 2011 available audit hours.

Mr. Longbrake expressed concern that Internal Audit may not have adequate resources to accomplish all the performance measures within a given cycle. Ms. Killman believes the level of audit resources at the WSIB is adequate. The results of fiscal year 2012 performance measures will further define resource needs with specific regard to the absence of the State Auditor's accountability work going forward.

## **MANAGEMENT**

### **Investment Referrals Quarterly Report**

Ms. Whitmarsh offered the information for the members' reference. She indicated the process is working well and provides transparency for the WSIB.

### **Update on Global Proxy Voting Guidelines Regarding Political Contributions**

Ms. Sandboe presented proposed language changes to the proxy voting guidelines, policy 2.05.200, regarding reporting political contributions and spending as requested by members at the June 2011 Audit Committee meeting. Members had requested that changes be made to make the policy more clear and specific. Glass Lewis assisted in drafting the proposed language changes. Discussion ensued regarding retaining language about judging a company's level of disclosure by a comparison to its peers. Concern was expressed that even a company with relatively poor disclosure could be deemed satisfactory in comparison to its peers. Chair Hill suggested changing the proposed wording on page 10, second paragraph, to end after the word 'donations'. Staff concurred with Chair Hill's suggestion, as did Treasurer McIntire and Senator Brown.

**Treasurer McIntire moved that the Committee recommend the Board approve the Global Proxy Voting Guidelines Policy 2.05.200 revision with the following amendment: On page 10, second paragraph, insert a period after the term 'about a company's political donations' and strike the rest of the paragraph. Mr. Masten seconded the motion, and the motion carried unanimously.**

### **Board Policy Compliance Review**

Ms. Vandehey presented the Board Policy Compliance Review. Specifically, this review covered Board policies and charters related to governance activities. There was high level of compliance with the governance rules and only one observation for this year. Ms. Vandehey expressed appreciation to Kristi Haines, Executive Assistant, for her excellent record keeping skills which makes the information easily accessible. The Board Education policy, 2.00.200, states that members are encouraged to attend one outside education event per year. Six Board members received outside education in 2011. Education summaries for 2009 and 2010 are included in the chart for your information. Fifteen internal education sessions on investment oversight were conducted at Board meetings in 2011. Staff suggested the Board may wish to revisit the governance rule, given the amount of internal education sessions provided. Ms. Whitmarsh requested feedback

from members regarding Ms. Vandehey's suggestion, especially in light of the state's budget challenges and travel restrictions.

Mr. Longbrake suggested the Board compensate by doing more internal training at Board meetings. Senator Brown and Treasurer McIntire requested more detail on course content of the external education list provided annually. Chair Hill recommended leaving the policy unchanged, given the extraordinary times, and maintaining caution on travel expenses was a prudent strategy. He further suggested that staff continue to monitor participation in both internal and external sessions. Chair Hill also suggested individual training for members relative to their committee assignments. Ms. Whitmarsh will bring both the internal and external educational opportunities to the Board for review and discussion later this fall. Mr. Masten expressed his opinion regarding the high value in attending the external educational opportunities and the discussions with peers regarding current investment issues.

### **Update on Risk Appetite Statements**

Ms. Vandehey presented the proposed changes to the Risk Appetite Statements as requested at the June 2011 Audit Committee meeting. All the suggested changes were vetted by the Enterprise Risk Management Team, as well as executive staff. Chair Hill commended staff on their work in incorporating the recommendations of the members. Mr. Longbrake requested the 'Investment Risk Appetite' page be changed by moving the "track long term trends for strategic impact on the total portfolio" from the 'will not' to the 'will' box.

**Mr. Masten moved that the Committee recommend the Board adopt the Risk Appetite Statements to include the changes proposed by Mr. Longbrake. Treasurer McIntire seconded the motion, and the motion carried unanimously.**

Ms. Whitmarsh clarified the Committee preferred the full presentation given by Ms. Vandehey at the June 2011 Audit Committee be presented to the Board at next week's meeting.

### **OTHER ITEMS**

#### **2012 Meeting Schedule**

Mr. Moore presented the 2012 meeting schedule for approval by the Committee.

**Mr. Masten moved that the Audit Committee accept the proposed meeting schedule for 2012. Treasurer McIntire seconded the motion, and the motion carried unanimously.**

There was no further business to come before the Committee and the meeting adjourned at 9:47 a.m.