

WASHINGTON STATE INVESTMENT BOARD
Audit Committee Meeting Minutes
June 11, 2013

The Audit Committee met in open public session at 10:01 a.m. at the Washington State Investment Board (WSIB) boardroom at 2100 Evergreen Park Drive Southwest, Olympia, Washington.

Committee Members Present: Natasha Williams, Chair
 Bill Longbrake
 George Masten
 Treasurer James McIntire (teleconferenced)
 Bob Nakahara
 Judi Owens

Members Absent: Senator Sharon Nelson

Others Present: Theresa Whitmarsh, Executive Director
 Victor Moore, Chief Operating Officer
 Gary Bruebaker, Chief Investment Officer
 Liz Mendizabal, Institutional Relations Director
 Shawna Killman, Audit Director
 Rodney Reynolds, Internal Auditor
 Kate Sandboe, Corporate Governance Officer
 Marie Bradbury, Program Specialist
 Mary Hougan, Administrative Assistant

 Steve Dietrich, Attorney General's Office
 Mark Raker, Peterson Sullivan LLP

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

Chair Williams called the meeting to order and took roll call.

ADOPTION OF THE MARCH 5, 2013, MINUTES

Ms. Owens moved to approve the March 5, 2013, Audit Committee meeting minutes. Mr. Masten seconded, and the motion carried unanimously.

EXTERNAL AUDIT

Financial Statement Auditor Independence Review

Ms. Killman explained the Board's Audit Committee Charter Policy 1.00.130 requires the Committee to review the independence of the external auditors by:

1. Obtaining statements from the auditors on relationships between the auditors and the WSIB;
2. Obtaining a listing of all services provided by the external audit firm from staff; and
3. Discussing the relationships with the auditors.

Peterson Sullivan LLP has performed the financial statement audit for the WSIB for seven years, and the upcoming fiscal year 2013 audit will mark the eighth year. Peterson Sullivan has confirmed their independence with regard to the WSIB in writing, and management prepared a list of all services provided by Peterson Sullivan to the WSIB since the Committee's last independence review.

Mr. Nakahara inquired about whether Peterson and Sullivan's merger with Clothier & Head PS would impact the firm's independence with regard to the WSIB. Mr. Raker indicated the merger will occur on July 1, 2013, and no issues are expected. He did, however, offer review of the firm's independence with respect to the WSIB after the merger, and subsequently reissue their confirmation of independence in writing to the Board. Mr. Nakahara agreed that would be appropriate.

2012 Conflict of Interest Policy Compliance Review

Mr. Raker stated the WSIB Conflict of Interest Policy 2.00.100 requires an annual review of Board and staff compliance conducted by an independent external auditor. The Board appointed Peterson Sullivan LLP to conduct the review for calendar year 2012. The review included statements of financial affairs reporting, gift reporting, travel paid for directly by outside sources, personal investments, and periodic training.

Mr. Raker described the testing performed by Peterson Sullivan. He stated there were a few exceptions noted in the report around travel and public disclosure reporting. There were no exceptions found around training or personal investments.

Mr. Longbrake inquired whether the exceptions related to travel were explained, and Mr. Raker indicated there was missing documentation from the files, but staff has updated processes designed to ensure the exceptions do not occur going forward.

The Committee directed Internal Audit to perform an interim review of travel costs paid for directly by outside sources during the first half of 2013. This effort will determine whether the improvements made by management have addressed the exceptions noted in the report. Internal Audit expects to be able to report the results at the September Audit Committee meeting.

[Treasurer McIntire was in attendance via teleconference at 10:08 a.m.]

INTERNAL AUDIT

Audit Recommendations Status Report

Ms. Killman reported on the status of staff's follow-up activities related to prior audit recommendations. Over the last quarter, six of eight prior recommendations were resolved by management; progress on the two remaining recommendations will be reported to the Committee at the next quarterly meeting.

Internal Audit Report 2013-06 Shott Capital

Mr. Reynolds provided background information on the Board's stock distribution manager, Shott Capital Management. He summarized the audit work performed during the audit, and the resulting conclusions that:

1. The stock distribution manager is complying with contract terms and conditions;
2. Stock distribution values and subsequent liquidation prices are accurate;
3. Differences between distribution and liquidation values are reasonable;
4. Broker fees charged are reasonable; and
5. The stock distribution manager and general partners distributing stock to the WSIB are independently audited by reputable firms.

This report does not contain any recommendations.

Ms. Williams asked where the audit testing and results are documented. Mr. Reynolds stated all work performed and results obtained are documented in the audit working papers, which are retained for reference purposes in future audits.

Internal Audit Report 2013-07 Computer Assisted Audit Techniques

Ms. Killman and Mr. Reynolds provided the results of the review of the Board's appropriated expenditures, using computer assisted audit techniques. The results of the audit support the overall conclusions:

1. Appropriated expenditures reviewed during the audit using computer assisted audit techniques were valid, supported, and allowable costs of the WSIB; and
2. WSIB computer system access security controls for the statewide expenditure systems reviewed are adequate, in place, and operating.

The report contained no audit recommendations.

Annual Internal Audit Plan Quarterly Status Report

Ms. Killman reviewed the Annual Internal Audit Plan Quarterly Status Report, noting that all planned audits for fiscal year 2013 have been completed. She also informed the Committee the State Auditor's Office has selected the WSIB as one of 11 state agencies they will include in a statewide audit of Contract Services. The report is expected to be issued by September 30, 2013, and will be forwarded to the Audit Committee and Board once received.

Fiscal Year 2014 Annual Internal Audit Plan

Ms. Killman explained the audit selections are made using a rigorous risk assessment process, as the WSIB does not have the resources to audit all areas every year. Ms. Killman confirmed the independence of the Internal Audit function at the WSIB, and stated Internal Audit has been free from interference in scoping of the audits, performance of the work, and reporting the reporting the results to the Board. Ms. Killman reviewed the risk assessment tool and cycle plan used to select the proposed audit areas.

Mr. Nakahara asked how closely Internal Audit works with the Enterprise Risk Management (ERM) team and Ms. Killman indicated she reviews the ERM heat maps covering the WSIB's core business processes, to ensure internal audit has not missed something in the audit risk assessment. She also confirmed the results typically reflect similar conclusions.

Using the process described, seven areas were selected:

1. Real Estate;
2. Private Equity;
3. Custody Bank;
4. Investment Performance Reporting;
5. Stakeholder Reporting;
6. Public Records Requests; and
7. Business Continuance Plan.

Ms. Killman also reviewed three other internal audit projects planned for the year: a peer review, financial statement auditor procurement, and a real estate operating company internal controls project.

Mr. Longbrake inquired whether there are adequate resources for the audit plan and Ms. Killman stated she is comfortable with current resources.

Mr. Nakahara asked what the impact will be on internal audit staff resources if the Board decides to appoint a different financial statement auditor. Ms. Killman indicated the current budget reflects the time necessary to perform the competitive procurement, as well as transition to a new external audit firm if that is the Board's decision.

Mr. Masten moved that the Audit Committee recommend the Board adopt the Fiscal Year 2014 Internal Audit Plan. Ms. Owens seconded, and the motion carried unanimously.

MANAGEMENT

Investment Referral Quarterly Report

Ms. Whitmarsh offered the information for the members' reference. There were three new referrals, one was turned down and two are under review by staff.

Sudan Engagement Response Follow-up

In 2012, the WSIB found 21 companies in our Public Equity portfolio that had been identified as having business operations in Sudan based on the Conflict Risk Network's "highest offender" list. The WSIB sent letters to each of these companies and received a response from Caterpillar and Egypt Kuwait Holding Co.

At its April 25 meeting, the Board asked for additional information on the companies in the WSIB's Public Equity portfolio that have been unresponsive to our engagement efforts and referred the matter to the Audit Committee's June meeting. Ms. Sandboe reported the WSIB has almost \$266 million invested in these 21 companies. Almost 74 percent are in passive assets between State Street Global Advisers (SSgA) and Black Rock. Of these companies, about 67 percent of our exposure is in Caterpillar: the only U.S. company on the list. Caterpillar's response to the letter stressed that they only sell to small companies and distributors and not the Sudan Government.

Of the remaining 33 percent of our exposure to Sudan, 24 percent are state-controlled companies, the majority being companies controlled by the Chinese government.

Ms. Williams queried the Committee for next steps. The Committee agreed to send a more strongly worded follow-up letter to the companies on the "highest offender" list that did not respond to the prior letter.

EXECUTIVE SESSION

Potential Litigation

Audit Director's Evaluation Follow-up Request

Chair Williams announced the Committee would go into executive session to review and discuss financial and commercial information relating to an investment since public knowledge regarding the discussion would result in loss to the funds managed by the WSIB or would result in private loss to the providers of the information, and then would discuss the performance of a public employee. The executive session is expected to last until about 11:30 a.m., at which time the Committee will reconvene in open session.

[The Committee went into executive session at 10:57 a.m., and reconvened in open session at 12:00 p.m.]

There was no further business to come before the Committee, the meeting adjourned at 12:00 p.m.