

WASHINGTON STATE INVESTMENT BOARD
Audit Committee Meeting Minutes
September 10, 2013

The Audit Committee met in open public session at 9:00 a.m. at the Washington State Investment Board (WSIB) boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Committee Members Present: Natasha Williams, Chair
 Bill Longbrake
 George Masten
 Treasurer James McIntire
 Bob Nakahara
 Senator Sharon Nelson

Other Members Present: Mike Ragan

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
 Kris Logan, Investment Accounting Controller
 Dino Patiag, Investment Accounting Analyst
 Steve Draper, Senior Investment Officer – Real Estate
 Beth Vandehey, Risk and Compliance Director
 Kate Sandboe, Corporate Governance Officer
 John Lynch, Contracts and Public Records Manager
 James Mackison, Director of Technology and Innovation
 Mary Hougan, Administrative Assistant

Mary Lobdell, Attorney General's Office
Dawn Cortez, Attorney General's Office

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

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

[Treasurer McIntire arrived at 9:03 a.m.]

[Senator Nelson arrived at 9:05 a.m.]

INTERNAL AUDIT

Internal Audit Report 2014-01 Public Records Requests

Mr. Reynolds presented the results of the Public Records Requests audit. Overall results showed WSIB is complying with state laws and agency policies related to public records requests, agency contact information and request procedures are readily accessible to the public, public records officers are sufficiently trained, and records are retained in compliance with the state-approved retention schedule.

The report contained one recommendation to document all public records request communications, in order to demonstrate the Board's compliance with the Public Records Act. Management agreed with the recommendation, and will implement procedures to ensure future telephonic communications are confirmed with a follow-up email.

Internal audit will follow-up and report the status of corrective action at the next quarterly Audit Committee meeting.

Mr. Nakahara referred to 20 out of 25 total public records requests received being tested, and two exceptions were noted. Mr. Nakahara asked Mr. Reynolds if he considered expanding the test selection. Mr. Reynolds indicated he started with a test selection of 15, and when the testing results identified two exceptions, he then expanded the selection to 20.

Mr. Longbrake asked management whether a checklist or tracking system to document the request progress from start to finish was in place. Mr. Lynch explained the process of logging public records requests, details regarding the two exceptions, and the improvements to be made by assigning tracking numbers to each request. Mr. Nakahara asked how much time is allowed for the WSIB to acknowledge receipt of the request. Mr. Lynch indicated five business days are allowed; however, approximately half of the requests received are responded to within one day.

Ms. Williams inquired about the public records tracking sheet. Mr. Lynch stated the process of logging public records requests will be improved by assigning tracking numbers to each request. The improved tracking sheet will be presented by Mr. Moore at the December Audit Committee meeting.

ADOPTION OF THE JUNE 11, 2013, MINUTES

Treasurer McIntire moved to approve the June 11, 2013, Audit Committee meeting minutes. Mr. Ragan seconded, and the motion carried unanimously.

Audit Recommendation Status Report

Ms. Killman reported on the status of follow-up activities related to prior audit recommendations. Over the past quarter, two of three prior recommendations were resolved by management. Sexual Harassment training was provided to all staff as required by state Civil Service Rules, and Internal Audit performed an interim review of the Board's 2013 travel paid for directly by outside sources, which confirmed WSIB is in compliance with state travel regulations.

Annual Internal Audit Plan Quarterly Status Report

Ms. Killman presented the Annual Internal Audit Plan Quarterly Status Report, noting all planned audits for fiscal year 2014 approved by the Board, and the expected completion dates are included in the report. Any changes to the plan will be reported to the Committee.

Fiscal Year 2013 Performance Measures Dashboard

Ms. Killman presented the fiscal year 2013 internal audit performance measures. Mr. Longbrake asked whether the auditor was close to meeting the 40-hour CPE requirement. Ms. Killman confirmed and noted the auditor had to cancel attendance at a class late in the year. Mr. Nakahara inquired as to any impacts on credentials, and Ms. Killman indicated this is strictly an internal quality performance measure and does not have any impact on internal auditor credentials.

2014 External Quality Assessment Planning

Ms. Killman explained that external quality assessments, also known as peer reviews, are required at least once every 5 years by the Institute of Internal Auditors (IIA) standards. The last external review received by the WSIB Internal Audit function was in June 2009. Planning is underway to ensure the next external quality assessment review is completed by June 2014.

Ms. Killman discussed the form and frequency of the external assessment, as well as the qualifications and independence of the external assessment team. With the support of the Audit Committee and executive management, the review team will be led by the head of Internal Audit at the Teacher Retirement System of Texas, with the assistance of a second member of the Association of Public Pension Fund Auditors (APPFA).

Mr. Ragan asked whether there will continue to be ample APPFA member candidates going forward to request participation on future assessment teams. Ms. Killman indicated that, with over 100 APPFA member organizations, she does not anticipate a shortage of APPFA members with the qualifications to conduct a review. The results of the WSIB Internal Audit quality assessment will be communicated to the Audit Committee in June 2014.

EXTERNAL AUDIT

State Auditor's Office Contracts Audit Update

At the June Audit Committee meeting, Ms. Killman informed the Committee the State Auditor's Office selected the WSIB as one of 11 state agencies in a statewide audit of Contract Services. Preliminary results were positive and the final report is expected to be issued in October 2013. The report will be forwarded to the Audit Committee and Board once received.

MANAGEMENT

2014 Meeting Schedule

Mr. Moore presented the proposed 2014 meeting dates of March 4, June 10, September 9, and December 2. Mr. Nakahara inquired if the dates were coordinated with the Public Markets Committee. Staff assured Mr. Nakahara that every effort would be made to do so.

Treasurer McIntire moved that the Audit Committee adopt the 2014 meeting dates as presented. The motion carried by unanimous consent.

Internal Audit Charter Policy Review

WSIB Internal Audit Charter Policy, 1.00.190, requires a three year review. Mr. Moore presented the policy with minor revisions.

Treasurer McIntire moved that the Audit Committee recommend the Board approve the Internal Audit Charter Policy, 1.00.190, with minor revisions. The motion carried by unanimous consent.

Investment Referral Quarterly Report

Ms. Whitmarsh presented the report to the Committee. There were four new referrals that continue to be evaluated by the investment team. Ms. Whitmarsh indicated the referral process is continuing to work well.

Board Policy Compliance Review

Ms. Vandehey presented the biennial compliance report on policies and charters and noted there was a high degree of compliance. The Audit Committee Charter requires the proxy and voting policy guidelines be reviewed annually. This is different from the other policies, which require a 3-year review. Ms. Vandehey suggested the Committee consider changing the review period to every 3 years.

Ms. Vandehey reported the Executive Director Performance Evaluation Policy 2.00.220 was last reviewed on April 16, 2009. Staff will present the policy to the Administrative Committee for review in September.

The Administrative Committee Charter Policy 1.00.120 calls for the Committee to provide the Board with recommendations of the suitability of office locations. Staff will present a

motion at the Administrative Committee in September, to approve the Seattle office as a suitable additional location to conduct WSIB business.

[Mr. Masten arrived at 9:54 a.m.]

Valuation Update

Mr. Patiag updated the Committee on the Duff & Phelps recommendations on valuations of private equity, real estate, and tangible asset classes. The analysis consisted of two projects.

Project 1 was an assessment of the current WSIB valuation policies. Mr. Patiag reported WSIB's existing valuation policies and procedures are within the top-tier of limited partners. WSIB investment teams are knowledgeable with regard to key value drivers and are keenly aware of circumstances that affect value. It is important WSIB policies and procedures continue to evolve to remain top-tier, as the industry continues to become more sophisticated. WSIB implemented the following:

- A formalized process for documenting valuation related items in advisory or other meetings;
- Monitoring significant events on top ten companies;
- Assessment of valuation consistency on commonly held companies; and
- Comparison of exit values to previous valuations.

Project 2 reviewed the valuation policies of 88 managers to determine whether the concepts of fair value are being followed. WSIB researched and worked with general partners (GPs) to address those that might not result in fair value. Ninety-four percent should result in fair value and 4 percent are still being analyzed.

Mr. Nakahara asked if we receive audited financial statements from our GPs and reviewed them. Ms. Logan indicated we do and the investment accounting unit reviews approximately 99 percent of the alternative asset portfolio. The review consists of verification of audit opinions, subsequent events, determination if audit adjustments have been made to valuations by the auditors, and other verification procedures. Mr. Nakahara asked if we also obtain management letters documenting deficiencies from our GPs. Ms. Logan indicated that we had requested this information several years ago and found them difficult to obtain. We currently do not receive such information.

Chair McIntire inquired about the availability of the management letter information from Real Estate Operating Companies (REOCs). Mr. Draper replied the WSIB has the authority to obtain any information it deems necessary from the REOCs. Ms. Logan indicated obtaining and reviewing the letters would be time consuming with limited additional benefit. We review the audited financial statements which would capture the significant issues related to valuations. Chair McIntire inquired about the timing of the valuations from the GPs. Ms. Logan informed the Committee the valuation reports are provided starting the first month following quarter-end and the majority are received by the third month following quarter-end, which is industry standard.

Mr. Longbrake inquired about the real estate holding categorized as yellow and comprising 8.2 percent of the real estate portfolio. Ms. Logan indicated the reason this particular GP was categorized as yellow was due to their complex valuation policy and requires further review and analysis. Staff believe this GP will be moved to green once this review is finished.

Company Engagement Plans

Ms. Sandboe presented on staff's proposal for next steps in the Corporate Governance Program. For the past several months, WSIB staff has been working with Hermes Equity Ownership Services (EOS) and eight pension funds in an effort to develop a program to

engage public companies on governance issues. Hermes EOS helps shareowners meet their fiduciary responsibilities and become active owners of public and private companies. The goal would be to target 40 companies in 2014, both U.S. and international, with a primary focus in the U.S. where the WSIB is likely to have more influence.

A longer-term engagement goal is to partner with the Millstein Center to develop additional governance metrics in relation to job creation, product innovation, and sustainability. Ms. Sandboe stated this research would assist with reframing the corporate governance debate to be more productive.

Mr. Nakahara inquired if WSIB would be engaging with Japanese companies. Ms. Sandboe replied that, as a result of our membership with the Asian Corporate Governance Association, WSIB has already been engaging with companies from Japan. Ms. Sandboe will update the Committee in December on progress with Hermes and the Millstein Center, and on a proposal for engagement.

EXECUTIVE SESSION

Audit Director's Compensation

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. She said the executive session was expected to last until about 11:00 a.m., at which time the Committee would reconvene in open session.

[The Committee went into executive session at 10:50 a.m., and reconvened in open session at 11:10 a.m.]

The Committee approved the Audit Director's compensation by unanimous consent.

There was no further business to come before the Committee, the meeting adjourned at 11:11 a.m.