

WASHINGTON STATE INVESTMENT BOARD
Audit Committee Meeting Minutes
June 10, 2014

The Audit Committee met in open public session at 9:04 a.m. at the Washington State Investment Board (WSIB) boardroom at 2100 Evergreen Park Drive Southwest, Olympia, Washington.

Committee Members Present: Joel Sacks, Chair
 Arlista Holman
 Bill Longbrake
 Treasurer James McIntire
 Bob Nakahara
 Senator Sharon Nelson

Members Absent: George Masten

Others Present: Theresa Whitmarsh, Executive Director
 Gary Bruebaker, Chief Investment Officer
 Victor Moore, Chief Operating Officer
 Kate Sandboe, Corporate Governance Officer
 Beth Vandehey, Risk and Compliance Director
 Shawna Killman, Audit Director
 Mary Hougan, Administrative Assistant

 Mary Lobdell, Attorney General's Office
 Mark Raker, Peterson Sullivan LLP
 Amy Barrett, Teacher Retirement System of Texas

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

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

ADOPTION OF THE MARCH 4, 2014, MINUTES

Ms. Holman moved to approve the March 4, 2014, Audit Committee meeting minutes. Senator Nelson seconded, and the motion carried unanimously.

Chair Sacks began the meeting by congratulating the WSIB on the review received by the State Auditors Office on state personnel service contracts. Of the 11 agencies audited, WSIB was the only agency that did not have a single exception.

EXTERNAL AUDIT

Calendar Year 2013 Conflict of Interest Policy Compliance Review Report

The annual WSIB Conflict of Interest Policy 2.00.100 review of Board and staff compliance was conducted by Peterson Sullivan LLP, an independent external audit firm. Mr. Raker described the testing performed and the results obtained. The report contained exceptions involving the timeliness of Board and staff submission of Statements of Financial Affairs, policy compliance certifications, and annual training.

Mr. Nakahara asked if the findings have been corrected since the review. Mr. Moore indicated all required reports and certifications have been filed, and training was provided to all members of the Board.

[Treasurer McIntire arrived at 9:14 a.m.]

INTERNAL AUDIT

External Quality Assessment Report

Ms. Barrett stated Internal Audit at the WSIB is required to comply with the Institute of Internal Auditors (IIA) *International Standards for the Professional Practice of Internal Auditing*. The Standards require that internal audit functions obtain external quality assessment reviews at least once every five years.

Ms. Barrett summarized the work performed included: 1) review, verification, and evaluation of the self-assessment prepared by the Internal Audit function; 2) review and evaluation of surveys completed by select Board members, management, and external service providers; 3) interviews with the Chair of the Board, current and former Audit Committee Chairs, three members of Executive Management, seven senior managers, Audit Director and staff, external audit manager, and former Assistant Attorney General; 4) review and evaluation of audit working papers; and 5) review and evaluation of the Internal Audit function's policies and procedures, annual risk assessment, annual audit plan, and other relevant supporting documents.

Ms. Barrett said, based on the information received and evaluated during the external quality assessment, the review team concluded the WSIB Internal Audit function "generally conforms" with the *International Standards for the Professional Practice of Internal Auditing*. This is the highest of three possible ratings and means that policies, procedures, and practices are in place to implement the Standards and other requirements necessary for ensuring the independence, objectivity, and proficiency of the internal audit function. Ms. Barrett noted the Internal Audit function has effective relationships with the Board and management and is well-respected and supported by them.

Ms. Barrett stated the Audit Director is highly valued both internally and externally. She identified several best practices the review team considered to be outstanding. Ms. Killman is collaborative, trusted, and contributes to the audit profession by serving on the Board of the Association of Public Pension Fund Auditors (APPFA). Ms. Killman led the recent development of a new website for APPFA, which greatly benefitted all members.

Ms. Barrett recommended opportunities for improvement that include: 1) discuss the level of involvement the Audit Committee desires in hiring, terminating, evaluating, and compensating the Audit Director, and approving an internal audit budget and resource plan; 2) implement an internal audit policy requiring audit staff to obtain a Certified Internal Auditor (CIA) designation; 3) report results of an annual internal audit quality self-assessment review to the Audit Committee; 4) discuss with the Audit Committee when changes to the audit plan are considered "significant" enough to require approval by the full Board; 5) the Audit Director should consider and offer alternatives to the Audit Committee for completing the current audit plan; and 6) formalize a process for holding audit entrance conferences.

[Senator Nelson left the meeting at 9:28 a.m.]

Chair Sacks asked about contingency planning with regard to the current fiscal year audit plan. Ms. Killman stated the options available to the Board include hiring an external audit service provider to perform audit work for a fee, offering a rotation to internal staff who need experience and/or credits to obtain a Certified Public Accountant (CPA) license, or, cycling the audits to another fiscal year, as long as each is completed within the audit cycle plan adopted by the Board.

Mr. Longbrake inquired about whether Ms. Barrett took the three-year audit cycle plan into account during her review. Ms. Barrett indicated she reviewed only the current fiscal year

plan, and said it can be difficult with a two-person staff to accomplish the schedule of audits planned. Ms. Killman confirmed the three-year audit cycle plan will be accomplished.

Chair Sacks asked Ms. Barrett to elaborate on the best practices reported, particularly around the risk assessment and the recommendation follow-up processes. Ms. Barrett said the risk assessment process followed by Internal Audit is well-understood by all staff interviewed, is collaborative, and involves open communication. The follow-up process used by Internal Audit is thorough, and helps ensure recommendations are fully addressed and implemented.

Ms. Killman indicated that improvement recommendations 1, 2, and 4 are open for Audit Committee discussion, analysis, and feedback; the others have already been addressed. Treasurer McIntire stated that unless there is an immediate need for the Audit Committee to make a decision, he would recommend there be further analysis, and decisions made at the September 9 Audit Committee meeting. Chair Sacks agreed, and asked to have this placed on the September meeting agenda.

[Senator Nelson returned to the meeting at 9:48 a.m.]

Audit Recommendation Status Report

Ms. Killman reported on the status of staff's follow-up activities related to prior audit recommendations. Over the last quarter, one of three recommendations was resolved by management, with the quarterly investment performance report review process expanding to include an independent check on information supplied by investment officers. Two recommendations in progress from the Real Estate Intermediaries and Operating Companies audit were summarized, along with completion dates.

Chair Sacks inquired further about the status of the planned hire by WSIB real estate intermediaries of a shared internal audit resource. Mr. Bruebaker responded that he is meeting with the intermediary CEOs, and is confident the action will be completed by the due date in the report.

Internal Audit will report progress toward completion at the next Audit Committee meeting.

Audit Plan Quarterly Status Report

Ms. Killman reviewed the Annual Internal Audit Plan Quarterly Status Report. She reported the Private Equity audit will be reported to the Committee in September, and the Custody Bank audit has been moved to the Fiscal Year 2015 Annual Internal Audit Plan given the timing of Board's book of record transition.

Fiscal Year 2015 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 the audits, performance of the work, and reporting the results to the Board. Ms. Killman reviewed the risk assessment tool and cycle plan used to select the proposed audit areas.

Using the process described, the eight areas selected were: 1) custody bank; 2) travel expenditures; 3) commingled funds monthly accounting, pricing and unitization; 4) asset allocation/rebalancing; 5) tangible assets investments; 6) Information technology (IT) security audit and data warehouse application controls review; 7) compliance monitoring – public markets investments; and 8) audit recommendation follow-up review.

Ms. Killman introduced Ashley Lillie, Internal Audit's summer intern. Ms. Lillie is a senior at Saint Martin's University studying Finance and Economics. Ms. Lillie will be performing the Audit Recommendation Follow-up audit and will report results to the Committee in September.

Treasurer McIntire moved that the Audit Committee recommend the Board adopt the Fiscal Year 2015 Internal Audit Plan. Ms. Holman seconded, and the motion carried unanimously.

[The Committee recessed 10:24 a.m., and reconvened in open session at 10:29 a.m.]

MANAGEMENT

Investment Referral Process Policy 2.05.800 3-Year Review

Mr. Moore noted there were no changes to the Investment Referral Process Policy which requires reaffirmation by the Board as part of the 3-year policy review.

Ms. Holman moved that the Audit Committee recommend the Board reaffirm approval of the Investment Referral Policy 2.05.800 with no recommended changes. Senator Nelson seconded, and the motion carried unanimously.

Investment Referral Quarterly Report

Ms. Whitmarsh offered the information for the members' reference. There were three new referrals that are under review by staff.

Corporate Governance Update

Ms. Whitmarsh reported WSIB has engaged in several institutional investor initiatives to promote better corporate governance, including the creation of performance metrics on long-term value creation. Ms. Whitmarsh recently attended a one day meeting on Inclusive Capitalism, co-sponsored by the Henry M. Jackson Institute in London and attended by leaders in business and finance from around the world. The forum focused on the function and role of capitalism in creating opportunity for all world citizens, with an interest in supporting initiatives that ensure the capital markets create a fair playing field for all.

Ms. Whitmarsh informed the Committee that WSIB was the only U.S. fund invited to participate in the Focusing Capital on the Long Term initiative sponsored by the Canadian Pension Plan Investment Board (CPPIB) and McKinsey consulting. WSIB serves on the leadership advisory council and Allyson Tucker is serving on the work streams. The initiative has four work streams, two of which the WSIB is a participant; improving corporate and investor dialogue and aligning investment beliefs and performance metrics to support long horizon investing. Ms. Whitmarsh will bring a report to the Board in July.

Real Estate Partners Governance and Internal Control Risk Review

Ms. Vandehey updated the Committee on the Real Estate Partners Governance and Internal Control Risk Review project. The team was assigned with analyzing and reporting on the operational back-office capabilities of four Intermediaries and five Real Estate Operating Companies (REOCs). Ms. Vandehey stated the team provided a list of risk management, internal controls, and governance processes to partners to help encourage best in class back-office operations. Additionally, the team established an ongoing monitoring and reporting program that will review back-office operations on a periodic basis.

EXECUTIVE SESSION

Audit Director Performance Evaluation

Chair Sacks announced the Committee would go into executive session to review the performance of a public employee. He said the executive session was expected to last until about 11:15 a.m., at which time the Committee would reconvene in open session.

[The Committee went into executive session at 10:56 a.m., and reconvened in open session at 11:27 a.m.]

There was no further business to come before the Committee, the meeting adjourned at 11:28 a.m.