

**STATE OF FLORIDA**  
**STATE BOARD OF ADMINISTRATION**  
**LOCAL GOVERNMENT SURPLUS**  
**FUNDS TRUST FUND**

---

**Financial Audit**

For the Fiscal Year Ended  
June 30, 2010



STATE OF FLORIDA  
AUDITOR GENERAL  
DAVID W. MARTIN, CPA

## STATE BOARD OF ADMINISTRATION

The State Board of Administration, Board of Trustees, is composed of the Governor, as Chairman, the Chief Financial Officer, as Treasurer, and the Attorney General, as Secretary. The Trustees delegate administrative and investment authority to an appointed Executive Director. Mr. Ashbel Williams served as Executive Director during the audit period.

The Auditor General conducts audits of governmental entities to provide the Legislature, Florida's citizens, public entity management, and other stakeholders unbiased, timely, and relevant information for use in promoting government accountability and stewardship and improving government operations.

The audit team leader was Matthew Tracy, CPA, and the audit was supervised by Allen Weiner, CPA. Please address inquiries regarding this report to Kathryn D. Walker, CPA, Audit Manager, by e-mail at [kathrynwalker@aud.state.fl.us](mailto:kathrynwalker@aud.state.fl.us) or by telephone at (850) 487-9085.

This report and other reports prepared by the Auditor General can be obtained on our Web site at [www.myflorida.com/audgen](http://www.myflorida.com/audgen); by telephone at (850) 487-9175; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

STATE BOARD OF ADMINISTRATION  
LOCAL GOVERNMENT SURPLUS FUNDS TRUST FUND  
TABLE OF CONTENTS

	PAGE NO.
EXECUTIVE SUMMARY .....	i
INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS .....	1
MANAGEMENT'S DISCUSSION AND ANALYSIS.....	3
BASIC FINANCIAL STATEMENTS .....	5
Statement of Net Assets .....	5
Statement of Changes in Net Assets .....	6
Notes to Financial Statements .....	7
1. Summary of Significant Accounting Policies .....	7
2. Deposits and Investments .....	10
3. Pending Matters - Closed .....	15
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i> .....	16

---

---

## EXECUTIVE SUMMARY

---

---

### Summary of Report on Financial Statements

Our audit disclosed that the financial statements prepared by the State Board of Administration (SBA) present fairly, in all material respects, the net assets of the Local Government Surplus Funds Trust Fund (LGIP) and the changes in net assets thereof in accordance with prescribed financial reporting standards.

### Summary of Report on Internal Control and Compliance

Our audit did not disclose any deficiencies in internal control over the LGIP's financial reporting that we consider to be material weaknesses.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* issued by the Comptroller General of the United States.

### Audit Objectives and Scope

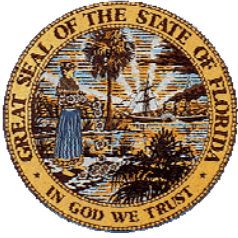
Our audit objectives were to determine whether the SBA had:

- Presented the LGIP's basic financial statements in accordance with generally accepted accounting principles;
- Established and implemented internal control over financial reporting and compliance with requirements that could have a direct and material effect on the financial statements;
- Complied with the various provisions of laws, rules, regulations, and contracts that are material to the financial statements;

The scope of this audit included an examination of the LGIP's basic financial statements as of and for the fiscal year ended June 30, 2010. We obtained an understanding of SBA's environment, including its internal control, and assessed the risk of material misstatement necessary to plan the audit of the basic financial statements. We also examined various transactions to determine whether they were executed, both in manner and substance, in accordance with governing provisions of laws, rules, regulations, contracts, and the LGIP investment policy.

### Audit Methodology

The methodology used in this report included the examination of pertinent SBA records in connection with the application of procedures required by auditing standards generally accepted in the United States of America and applicable standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States.



DAVID W. MARTIN, CPA  
AUDITOR GENERAL

# AUDITOR GENERAL STATE OF FLORIDA

G74 Claude Pepper Building  
111 West Madison Street  
Tallahassee, Florida 32399-1450



PHONE: 850-488-5534  
FAX: 850-488-6975

The President of the Senate, the Speaker of the  
House of Representatives, and the  
Legislative Auditing Committee

## INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the State Board of Administration's (SBA) Local Government Surplus Funds Trust Fund (LGIP), as of and for the fiscal year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of SBA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the net assets and changes in net assets of the LGIP and do not purport to, and do not, present fairly the operations of the State of Florida as of June 30, 2010, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the LGIP as of June 30, 2010, and the changes in its net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report on our consideration of SBA's internal control over financial reporting relating to the LGIP and on our tests of its compliance with certain provisions of laws, rules, regulations, contracts, and other matters included under the heading **INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that **MANAGEMENT'S DISCUSSION AND ANALYSIS** on pages 3 through 4 be presented to supplement the basic financial statements. Such information, although not a required part of the basic financial statements, is required by the Government Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Respectfully submitted,



David W. Martin, CPA  
December 17, 2010

**MANAGEMENT’S DISCUSSION AND ANALYSIS**

The State Board of Administration (SBA) is responsible for the management of the Local Government Surplus Funds Trust Fund (LGIP).<sup>1</sup> The SBA was established on June 21, 1929, pursuant to Chapter 14486, Laws of Florida (1929). The SBA was subsequently created as a constitutional body corporate on January 1, 1943, by Article IX, Section 16 of the State Constitution of 1885, as amended. The SBA was subsequently continued as a body corporate by Article IV, Section 4(e) of the State Constitution (1968), as amended. The SBA is composed of the Governor, as Chairman, the Chief Financial Officer, as Treasurer, and the Attorney General, as Secretary.

This discussion and analysis of the financial performance of the LGIP provides an overview of the LGIP’s financial activities for the fiscal year ended June 30, 2010.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

The financial statements provide financial information about the LGIP as an investment trust fund, a fiduciary fund type. Investment trust funds are accounted for using an economic resources measurement focus and the accrual basis of accounting. Earnings on investments are recognized as revenue when earned, and expenses are recorded when a liability is incurred.

The LGIP presents the following basic financial statements: a Statement of Net Assets and a Statement of Changes in Net Assets. The Statement of Net Assets presents all LGIP assets and liabilities with the difference reported as net assets. The Statement of Changes in Net Assets shows the increase or decrease in net assets during the year as a result of investment activities and participant contributions and withdrawals.

**FINANCIAL SUMMARY**

A summary comparison of the LGIP’s Statement of Net Assets at June 30, 2010, and 2009, is presented below (in thousands):

	Year Ended June 30	
	2010	2009
Total assets	\$ 5,483,034	\$ 5,997,756
Total liabilities	2,098	13,462
Net assets held in trust for pool participants	<u>\$ 5,480,936</u>	<u>\$ 5,984,294</u>

<sup>1</sup> Effective August 3, 2009, the LGIP was renamed as Florida PRIME. Since this was not a legal name change, these financial statements will continue using LGIP.

A summary comparison of the LGIP's Statement of Changes in Net Assets for the years ended June 30, 2010, and 2009, is presented below (in thousands):

	Year Ended June 30	
	2010	2009
Increase (decrease) in net assets:		
Net income from investing activity	\$ 16,269	\$ 88,429
Redemption fees	-	1
Distributions paid and payable	(16,269)	(88,429)
Participant contributions	12,653,338	9,363,390
Participant withdrawals	(13,278,921)	(10,581,058)
Transfer from Fund B	122,225	138,150
Total increase (decrease) in net assets	(503,358)	(1,079,517)
Net assets, July 1	5,984,294	7,063,811
Net assets, June 30	<u>\$ 5,480,936</u>	<u>\$ 5,984,294</u>

## FINANCIAL HIGHLIGHTS

Total assets at June 30, 2010, were less than total assets at June 30, 2009, mainly because participant withdrawals exceeded participant contributions during the fiscal year. Total liabilities at June 30, 2010, were less than total liabilities at June 30, 2009, due to the decrease in unregistered deposits (deposits sent without prior notification to the SBA) at June 30, 2010. Deposits sent in without being registered by participants are recorded as liabilities until the depositor is identified and credit is awarded to the participant.

Net income from investing activity for the year ended June 30, 2010, was significantly lower than previous fiscal years because of diminished average balances and depressed yields on short-term fixed income investments. Average balances were lower than the prior fiscal year due to participant withdrawals exceeding participant deposits. The Federal Reserve continued to adopt a monetary policy stance during the fiscal year that pushed overnight interest rates to nearly zero in an effort to help stabilize global financial markets. As a result of this policy, other Federal government economic stimulus measures, and slow economic growth, short-term interest rates were cyclically low.

During the fiscal year, SBA established a separate unit to provide oversight of its compliance and enterprise risk management policies and processes.

## CONTACT INFORMATION

These financial statements reflect only the transactions and balances for the LGIP. For additional information on this fund, please contact Robert Copeland, Senior Operating Officer, at the State Board of Administration, or visit SBA's website at <https://www.sbafla.com/prime/>.



STATE BOARD OF ADMINISTRATION  
LOCAL GOVERNMENT SURPLUS FUNDS TRUST FUND

**STATEMENT OF NET ASSETS**

As of June 30, 2010  
(In Thousands)

**Assets**

Cash and cash equivalents	\$ 1,945
Investments:	
Certificates of deposit, negotiable	1,425,500
Commercial paper	1,888,948
Money market funds	512,266
Domestic corporate bonds and notes	187,773
Foreign corporate note	75,000
Federal agencies	444,994
Repurchase agreements	945,000
Total investments	<u>5,479,481</u>
Interest receivable	1,588
Prepaid fees	19
Undistributed expenses	<u>1</u>
<b>Total Assets</b>	<u><u>5,483,034</u></u>

**Liabilities**

Accounts payable and accrued liabilities	102
Distributions payable	51
Due to local governments	<u>1,945</u>
<b>Total Liabilities</b>	<u><u>2,098</u></u>

**Net Assets**

Held in trust for pool participants	<u><u>\$ 5,480,936</u></u>
-------------------------------------	----------------------------

See accompanying notes to financial statements.

**STATE BOARD OF ADMINISTRATION  
LOCAL GOVERNMENT SURPLUS FUNDS TRUST FUND**

**STATEMENT OF CHANGES IN NET ASSETS**

Fiscal year ended June 30, 2010  
(In Thousands)

**Additions**

Investment operations:

Income from investing activity:

Interest income	\$ 17,768
Bank fees	(58)
Compliance review fees	(39)
Standard and Poor's rating maintenance fees	(19)
Investment management fees	(1,038)
Administrative service charges	<u>(345)</u>

Net income from investing activity 16,269

**Total Additions** 16,269

**Deductions**

Distributions paid and payable 16,269

**Total Deductions** 16,269

**Share Transactions**

Participant contributions 12,653,338

Participant withdrawals (13,278,921)

Transfer from Fund B 122,225

**Net Increase (Decrease) Resulting from Share Transactions** (503,358)

Total increase (decrease) in net assets (503,358)

Net assets, beginning of year 5,984,294

Net assets, end of year \$ 5,480,936

See accompanying notes to financial statements.

**STATE BOARD OF ADMINISTRATION  
LOCAL GOVERNMENT SURPLUS FUNDS TRUST FUND**

**NOTES TO FINANCIAL STATEMENTS**

Fiscal year ended June 30, 2010

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The following summary of the Local Government Surplus Funds Trust Fund's (LGIP) significant accounting policies is presented to assist the reader in interpreting the financial statements. These policies should be viewed as an integral part of the accompanying financial statements.

**a. Reporting Entity**

The State Board of Administration (SBA) is responsible for the management of the LGIP. The SBA was established on June 21, 1929, pursuant to Chapter 14486, Laws of Florida (1929). The SBA was subsequently created as a constitutional body corporate on January 1, 1943, by Article IX, Section 16 of the State Constitution of 1885, as amended. The SBA was subsequently continued as a body corporate by Article IV, Section 4(e) of the State Constitution (1968), as amended. The SBA is composed of the Governor, as Chairman, the Chief Financial Officer, as Treasurer, and the Attorney General, as Secretary.

The LGIP was created by act of the Florida Legislature effective October 1, 1977, (Chapter 218, Part IV, Florida Statutes). The law allowed SBA to manage investments on an individual basis or to establish a pooled account. The funds were managed on an individual basis until January 1, 1982.

Sections 218.40 through 218.415, Florida Statutes, and State Board of Administration Rules 19-7.001 through 19-7.017, Florida Administrative Code, promulgated pursuant to Section 218.405(4), Florida Statutes, govern the operation of the LGIP.

The assets and liabilities of the LGIP are included in the Comprehensive Annual Financial Report (CAFR) of the State of Florida. However, the accompanying financial statements present only the LGIP and are not intended to present fairly the financial position of the State of Florida and the results of its operations in conformity with generally accepted accounting principles.

**b. Regulatory Oversight**

The LGIP is not a registrant with the Securities and Exchange Commission (SEC); however, SBA has adopted operating procedures consistent with those required of an SEC 2a-7-like fund. A 2a-7-like external investment pool is one that is not registered with the SEC as an investment company, but nevertheless has a policy that it will, and does, operate in a manner consistent with SEC Rule 2a-7, which governs the operation of SEC regulated money market funds.

**c. *Basis of Presentation***

These financial statements have been prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and reporting principles.

The LGIP is reported as an investment trust fund, a fiduciary fund type.

**d. *Measurement Focus and Basis of Accounting***

The accompanying financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Basis of accounting refers to when revenues and expenses and the related assets and liabilities are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied. Investment trust funds are accounted for using the accrual basis of accounting. Earnings on investments, including interest income, are recognized as revenue when earned, and expenses are recorded when a liability is incurred.

**e. *Deposits and Investments***

Consistent with GAAP, the LGIP reports as “Cash and cash equivalents” all cash on hand and on deposit in banks, including demand deposits, time deposits, and nonnegotiable certificates of deposit.

The LGIP’s investments are recorded at amortized cost, consistent with GASB Statement Number 31. Fair values, for note disclosures, are calculated using quoted market prices. If quoted market prices are not available, the discounted cash flow model and broker quotes are used to price securities.

**f. *Method Used to Determine Participants’ Shares Sold and Redeemed***

In a manner similar to that used for SEC Rule 2a-7 money market funds, participants’ shares are sold and redeemed in the LGIP using the amortized cost method, which is consistent with the method used to report the LGIP’s investments. The amortized cost method calculates an investment’s value by adjusting its acquisition cost for the accretion of discount or amortization of premium over the period from purchase to maturity.

**g. *Legally Binding Guarantees***

The SBA has not provided or obtained any legally binding guarantees during the fiscal year ended June 30, 2010, for the LGIP.

***h. Involuntary Participation***

There is no requirement under Florida Statutes for any local government or state agency to participate in the LGIP.

***i. Frequency of Determining Fair Value of Shares***

The fair value of the investments of the LGIP is determined on a daily basis. SEC Rule 2a-7 requires that a periodic comparison be made between amortized cost and market value and that specific actions be taken if the two values differ by more than .50 percent. As of June 30, 2010, the ratio of fair value to amortized cost was 99.994 percent.

***j. Fees and Administrative Service Charges***

Federated Investment Counseling (Federated) is the investment manager for the LGIP. Federated charges an annual investment management fee based on the average daily net assets (i.e., average daily amortized cost) of the LGIP (excluding Federated money market fund balances), as follows:

First \$1 billion in Account Assets	3.5 basis points
Next \$1.5 billion in Account Assets	3.0 basis points
Next \$2.5 billion in Account Assets	2.5 basis points
Balance of Account Assets over \$5 billion	2.0 basis points

This fee is taken out of monthly earnings prior to the allocation of net earnings to participant balances. Total investment management fees incurred by the LGIP in the fiscal year ended June 30, 2010, were \$1,038,212.

In addition, SBA charges a .6 basis point charge (.00006) on total LGIP assets to cover the SBA’s administrative costs of the fund. These charges are taken out of the monthly earnings prior to the distribution of net earnings to participants each month. Total administrative service charges incurred by the LGIP for the fiscal year ended June 30, 2010, were \$344,852.

Various bank fees, including transaction charges, custody fees, and performance analytics fees are incurred by the LGIP. These fees are taken out of the monthly earnings prior to the distribution of net earnings to participant balances each month. The total bank fees incurred by the LGIP in the fiscal year ended June 30, 2010, were \$58,321.

Standard and Poor’s (S&P) rating maintenance fees of \$18,844 and compliance review fees of \$38,694 were incurred in the fiscal year ended June 30, 2010. The compliance review service fees resulted from the provisions of Section 218.405(3), Florida Statutes, which require that the trustees annually certify to the Joint Legislative Auditing Committee that the LGIP is in compliance with Florida law.

**k. Fund B Surplus Funds Trust Fund**

Pursuant to Section 218.417, Florida Statutes, the Fund B Surplus Funds Trust Fund (Fund B) was created in May 2008. Amounts credited to Fund B consist of the investments, interest earned, and reserve in Fund B of the LGIP. Fund B of the LGIP was originally formed as part of a restructuring of the LGIP in December 2007 to hold certain securities with limited liquidity.

Fund B is administered by SBA and SBA distributes cash holdings to the LGIP as they become available from maturities, sales, investment interest, and other income received from assets in Fund B. These distributions are recorded on the Statement of Changes in Net Assets as a Transfer from Fund B.

**2. DEPOSITS AND INVESTMENTS****a. Deposits**

At June 30, 2010, LGIP deposits totaled \$1,945,336. All deposits in the LGIP were covered by Federal insurance or the State's collateral pool pursuant to Chapter 280, Florida Statutes. Chapter 280, Florida Statutes, generally requires public funds to be deposited in a bank or savings association designated by the Chief Financial Officer (CFO) as authorized to receive deposits in the State and that meets the collateral requirements as set forth in Chapter 280, Florida Statutes.

The CFO determines the collateral requirements and collateral pledging level for each Qualified Public Depository following guidelines outlined in Department of Financial Services Rules, Chapter 69C-2, Florida Administrative Code, and Section 280.04, Florida Statutes. Eligible collateral includes Federal, federally-guaranteed, and state and local government obligations; corporate bonds; and letters of credit issued by a Federal Home Loan Bank. Other collateral may be eligible, with the CFO's permission.

**b. Investment Authority and Compliance**

The SBA has the authority to administer and invest the funds of the LGIP in accordance with Chapter 218, Part IV, Florida Statutes. The statute states SBA shall invest the moneys of the LGIP in the same manner and subject to the same restrictions as are set forth in Section 215.47, Florida Statutes, which identifies all authorized securities.

Section 215.47, Florida Statutes, includes a broad range of instruments to enable SBA to administer its varied investment responsibilities. The Investment Policy Guidelines (Guidelines) for the LGIP allowed only the following eligible investments:

1. United States (U.S.) Treasury obligations.
2. U.S. Government Agency obligations.

3. Insurance contracts, including guaranteed investment contracts, funding agreements and annuities.
4. Corporate debt securities, such as notes, bonds, debentures, commercial paper, interest in bank loans to companies, and demand instruments.
5. Bank instruments (including Yankee and Eurodollar), such as bank accounts, time deposits, certificates of deposit, and bankers' acceptances. Yankee instruments are denominated in U.S. dollars and issued by U.S. branches of foreign banks. Eurodollar instruments are denominated in U.S. dollars and issued by non-U.S. branches of U.S. or foreign banks.
6. Asset backed securities, which may be in the form of commercial paper, notes, or pass-thru certificates.
7. Municipal securities issued by states, counties, cities, and other political subdivisions and authorities.
8. Foreign securities (i.e., U.S. dollar-denominated securities of issuers based outside the United States).
9. Mortgage-backed securities representing interests in pools of mortgages. Mortgages may have fixed or adjustable interest rates.
10. Shares of registered investment companies that are money market mutual funds, including those that are affiliated with Federated (Investment Manager).
11. Special transactions, including repurchase agreements and delayed delivery transactions. Repurchase agreements involve transactions in which the LGIP buys a security from a dealer or bank and agrees to sell the security back at a mutually agreed-upon time and price. Delayed delivery transactions, including when-issued transactions, are arrangements in which the LGIP buys securities for a set price, with payment and delivery of the securities scheduled for a future time.

The primary investment objectives for the LGIP, in priority order, are safety, liquidity, and competitive returns with minimization of risks. This is accomplished by structuring the portfolio consistent with Part 270 of the Investment Company Act of 1940 (17 CFR 270.2a-7, Money Market Funds). In buying and selling portfolio securities for the LGIP, the Investment Manager will comply with the diversification, maturity, and credit quality conditions imposed by Rule 2a-7 under the 1940 Act; with the requirements imposed by any nationally recognized statistical rating organization (NRSROs) that rates the LGIP to ensure that it maintains a AAAm rating (or the equivalent); and with the investment limitations imposed by Section 215.47, Florida Statutes.

When the deviation between the market value and amortized cost of the LGIP exceeds 0.25 percent, the Guidelines required that the Investment Manager establish a formal action plan. The Guidelines also required that the Investment Oversight Group review the formal action plan and prepare a recommendation for the Executive Director's consideration.

When the deviation between the market value and amortized cost of the LGIP exceeds 0.50 percent, the Guidelines required that the Executive Director promptly consider what action, if any, would be initiated. Where the Executive Director believes the extent of any deviation from the LGIP's

amortized cost price per share may result in material dilution or other unfair results to participants, he will cause the LGIP to take such action as he deems appropriate to eliminate or reduce to the extent practicable such dilution or unfair results.

**c. *Investment Credit Risk and Concentration of Credit Risk of Debt Securities***

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Concentration of credit risk is the risk of loss attributed to the magnitude of the investment in a single issuer.

Pursuant to the Guidelines, investment credit risk and concentration of credit risk of debt securities will be managed as follows:

1. The Investment Manager will purchase short-term, high quality fixed income securities. To be considered high-quality, a security must be rated in the highest short-term rating category by one or more NRSROs, or be deemed to be of comparable quality thereto by the Investment Manager, subject to Section 215.47(1)(j), Florida Statutes.
2. The Investment Manager will perform a credit analysis to develop a database of issuers and securities that meet the Investment Manager's standard for minimal credit risk. The Investment Manager will monitor the credit risks of all the LGIP's portfolio securities on an ongoing basis by regularly reviewing the financial data, issuer news and developments, and ratings of NRSROs.
3. The Investment Manager generally will comply with the following diversification limitations that are additional to those set forth in Rule 2a-7. First, at least 50 percent of the LGIP assets will be invested in securities rated "A-1+" or those deemed to be of comparable credit quality thereto by the Investment Manager, subject to Section 215.47(1)(j), Florida Statutes. Second, exposure to any single non-governmental issuer will not exceed 5 percent (at the time a security is purchased) and exposure to any single money market mutual fund will not exceed 10 percent of the LGIP assets.

In the event that a security no longer meets the criteria for purchase due to default, event of insolvency, a credit rating downgrade or other material event (Affected Security), the Investment Manager must either dispose of the security within five business days or present a justification for the retention of the security to the Investment Oversight Group within three business days. If an Affected Security matures within five business days, no further action is required. An Affected Security may be held after five days only if the Executive Director has determined, based upon a recommendation from the Investment Manager and the Investment Oversight Group, that it would not be in the best interest of the LGIP to dispose of the security taking into account market conditions that may affect an orderly disposition.



The LGIP's credit quality ratings were as follows at June 30, 2010 (expressed in thousands):

Fair Value of LGIP Investments							Ratings <sup>1</sup>		
Certificates of Deposit	Commercial Paper	Money Market Funds	Domestic Corporate Bonds & Notes	Foreign Corporate Note (\$ denom)	Federal Agencies	Total	S&P	Moody's	
\$ .....	\$ .....	\$ 512,266	\$ .....	\$ .....	\$ .....	\$ 512,266	AAAm		
.....	.....	.....	.....	.....	445,015	445,015	AAA		
.....	.....	.....	68,129	.....	.....	68,129	AA		
.....	.....	.....	113,487	.....	.....	113,487	A		
.....	.....	.....	6,000	.....	.....	6,000	Not rated	Aa	
.....	1,889,082	.....	.....	.....	.....	1,889,082	A-1		
1,425,206	.....	.....	.....	74,982	.....	1,500,188	Not rated <sup>2</sup>	Not rated <sup>2</sup>	
\$ 1,425,206	\$ 1,889,082	\$ 512,266	\$ 187,616	\$ 74,982	\$ 445,015	\$ 4,534,167			
						Repurchase agreements	945,000	Not rated <sup>3</sup>	Not rated <sup>3</sup>
						Total	\$ 5,479,167		

<sup>1</sup>Ratings for investments are presented using S&P credit ratings. If S&P did not rate a security, then Moody's ratings are presented. All of the investments presented as "Not rated" had short-term issuer credit ratings that met the LGIP's investment and SEC Rule 2a-7 guidelines.

<sup>2</sup>S&P and Moody's did not report a credit rating for the foreign corporate note, but Fitch did rate this security as AA.

<sup>3</sup>Repurchase agreements are not negotiable instruments and do not carry individual security ratings.

With respect to the concentration of credit risk, at June 30, 2010, the LGIP had exposure of 5 percent or more to each of the following issuers (expressed in thousands):

Issuer Name <sup>1</sup>	Carrying Value	Percent of Portfolio Carrying Value	Fair Value	Percent of Portfolio Fair Value
Bank of America	\$ 610,000	11.13%	\$ 609,987	11.13%
Federal Home Loan Banks	444,994	8.12%	445,015	8.12%
Morgan Stanley	435,000	7.94%	435,000	7.94%

<sup>1</sup> The Bank of America holdings included overnight repurchase agreements of \$510 million and short-term bank notes of \$100 million, representing 9.31 percent and 1.82 percent of total carrying value. The Morgan Stanley holdings consisted entirely of overnight repurchase agreements. For purposes of SEC Rule 2a-7 exposure restriction calculations, acquisitions of repurchase agreements may be deemed to be acquisitions of the underlying securities, provided the obligation of the seller is fully collateralized. These agreements are fully collateralized. Consequently, they are not subject to SEC Rule 2a-7 issuer exposure restrictions. The Federal Home Loan Banks holdings are federal agency debt securities; therefore, under SEC Rule 2a-7 the Investment Manager is not prohibited from purchasing a concentration greater than 5 percent.

#### d. Investments, Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, SBA will not be able to recover the value of investment or collateral securities that are in the possession of an outside party.

The SBA's policy is that custodial credit risk will be minimized through the use of trust accounts maintained at top tier third party custodian banks. To the extent possible, negotiated trust and custody

contracts shall require that all deposits, investments and collateral be held in accounts in the SBA's name, separate and apart from the assets of the custodian banks.

At June 30, 2010, all investments, except those in money market funds which are not exposed to custodial credit risk, were held in SBA's name by SBA's custodial bank.

**e. Investments, Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of investments. Pursuant to the Guidelines, the Investment Manager will target a dollar-weighted average maturity range for the LGIP based on its interest rate outlook. The Investment Manager will formulate its interest rate outlook by analyzing a variety of factors, such as current and expected U.S. economic growth; current and expected interest rates and inflation; and the Federal Reserve Board's monetary policy. The Investment Manager will generally shorten the LGIP's dollar-weighted average maturity when it expects interest rates to rise and extend the LGIP's dollar-weighted average maturity when it expects interest rates to fall. The Investment Manager generally intends to maintain a dollar-weighted average maturity of 60 days or less for the LGIP. Next reset dates are used for investments with floating and variable interest rates to calculate weighted average maturity (WAM).

Presented below are the investments held in the LGIP at June 30, 2010, at fair value (expressed in thousands), with the WAM for each security type:

Investment Type	Fair Value	Weighted Average Days to Maturity <sup>1</sup>
Certificates of deposit <sup>2</sup>	\$ 1,425,206	48
Commercial paper <sup>2</sup>	1,889,082	41
Money market funds <sup>3</sup>	512,266	1
Domestic corporate bonds & notes	187,616	61
Foreign corporate note (\$ denom)	74,982	12
Federal agencies	445,015	206
Repurchase agreements	945,000	1
Total	\$ 5,479,167	
<b>Portfolio weighted average maturity</b>		<b>46</b>

<sup>1</sup> Interest rate reset dates were used in the calculation of the weighted average days to maturity.

<sup>2</sup> Certificates of deposit and commercial paper include domestic and U.S. dollar-denominated foreign issues.

<sup>3</sup> The weighted average days to maturity of the underlying securities in the three money market funds at June 30, 2010, ranged from 32 to 51 days. However, the money market funds provided daily liquidity.

**f. Investments, Foreign Currency Risk**

The LGIP may purchase only U.S. dollar-denominated securities. The LGIP did not have any foreign currency risk as of June 30, 2010. All investments were denominated in U.S. dollars.

**g. Securities Lending**

The LGIP did not participate in any securities lending programs in the fiscal year ending June 30, 2010.

**h. Summary of Investment Holdings**

The following table provides as of June 30, 2010, a summary of the fair value, carrying amount, the number of shares or the principal amount, ranges of interest rates, and maturity dates of each major investment classification (expressed in thousands):

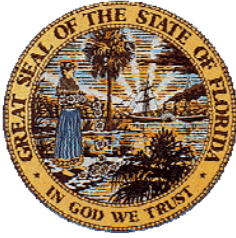
	Par	Carrying Value	Fair Value	Range of Interest Rates <sup>1</sup>	Range of Maturity Dates <sup>2</sup>
Certificates of deposit	\$ 1,425,500	\$ 1,425,500	\$ 1,425,206	.32% - .71%	7/16/10 - 6/27/11
Commercial paper	1,889,993	1,888,948	1,889,082	.25% - .61%	7/1/10 - 1/28/11
Money market funds	512,266	512,266	512,266	.03% - .22%	N/A
Domestic corporate bonds & notes	186,745	187,773	187,616	.33% - 5.0%	7/27/10 - 8/1/37
Foreign corporate note (\$ denom)	75,000	75,000	74,982	0.40%	12/11/10
Federal agencies	445,000	444,994	445,015	.40% - .65%	8/4/10 - 5/25/11
Repurchase agreements	945,000	945,000	945,000	.03% - .04%	7/1/10
Totals	<u>\$ 5,479,504</u>	<u>\$ 5,479,481</u>	<u>\$ 5,479,167</u>		

<sup>1</sup> The coupon rate in effect at June 30, 2010, is reported. If a security is discounted, the purchase yield is reported. The 7 day yield as of June 30, 2010, is reported for the money market funds. The yield fluctuates daily.

<sup>2</sup> Money market funds do not have a specified maturity date.

**3. PENDING MATTERS - CLOSED**

On March 3, 2010, the SEC completed its investigation relating to the purchase and sale of secured notes issued by KKR Atlantic, KKR Pacific, Ottimo, and Axon (among others) to the SBA on behalf of the LGIP and other funds by various broker-dealers and did not recommend any enforcement action by the Commission.



DAVID W. MARTIN, CPA  
AUDITOR GENERAL

# AUDITOR GENERAL STATE OF FLORIDA

G74 Claude Pepper Building  
111 West Madison Street  
Tallahassee, Florida 32399-1450



PHONE: 850-488-5534  
FAX: 850-488-6975

The President of the Senate, the Speaker of the  
House of Representatives, and the  
Legislative Auditing Committee

## INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

We have audited the financial statements of the State Board of Administration's (SBA) Local Government Surplus Funds Trust Fund (LGIP), as of and for the fiscal year ended June 30, 2010, and have issued our report thereon included under the heading **INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS**. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered SBA's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SBA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of SBA's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be

deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the LGIP's financial statements are free of material misstatement, we performed tests of SBA's compliance with certain provisions of laws, rules, regulations, contracts, and policies, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Pursuant to Section 11.45(4), Florida Statutes, this report is a public record and its distribution is not limited. Auditing standards generally accepted in the United States of America require us to indicate that this report is intended solely for the information and use of the Legislative Auditing Committee, members of the Florida Senate and the Florida House of Representatives, and other applicable parties and is not intended to be and should not be used by anyone other than those specified parties.

Respectfully submitted,



David W. Martin, CPA  
December 17, 2010