

**STATE OF FLORIDA  
STATE BOARD OF ADMINISTRATION  
LOCAL GOVERNMENT SURPLUS  
FUNDS TRUST FUND (AN EXTERNAL  
INVESTMENT POOL)**

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**Financial Audit**

For the Fiscal Years Ended  
June 30, 2012 and 2011



## STATE BOARD OF ADMINISTRATION

The State Board of Administration's Board of Trustees is composed of the Governor, as Chair, the Chief Financial Officer, and the Attorney General. 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 Allen G. Weiner, CPA, and the audit was supervised by Kathryn D. Walker, 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 (FLORIDA PRIME)  
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## EXECUTIVE SUMMARY

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### 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 (Florida PRIME) 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 Florida PRIME'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; however, we noted an additional matter as summarized below.

#### ADDITIONAL MATTER

Finding No. 1: Our tests disclosed that Florida PRIME had purchased approximately \$221 million of ineligible Securities and Exchange Commission (SEC) Rule 144A securities during the 2011-12 fiscal year. We noted that controls to prevent and detect such purchases were not in operation. Upon notification, the one remaining SEC Rule 144A ineligible security still in inventory was sold by Florida PRIME.

### Audit Objectives and Scope

Our audit objectives were to determine whether the SBA had:

- Presented Florida PRIME's basic financial statements in accordance with accounting principles generally accepted in the United State of America;
- 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 Florida PRIME's basic financial statements as of and for the fiscal years ended June 30, 2012, and 2011. 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 Florida PRIME's 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

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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 (Florida PRIME), as of and for the fiscal years ended June 30, 2012, and 2011, 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 audits.

We conducted our audits 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 audits 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 audits provide 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 Florida PRIME and do not purport to, and do not, present fairly the operations of the State of Florida as of June 30, 2012, and 2011, and the changes in its financial position for the years 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 Florida PRIME as of June 30, 2012, and 2011, and the changes in its net assets for the years 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 Florida PRIME 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 6 be presented to supplement the basic financial statements. Such information, although not a required part of the basic financial statements, is required by the Governmental 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 audits 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  
February 1, 2013

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**

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**YEARS ENDED JUNE 30, 2012, AND JUNE 30, 2011**

The State Board of Administration (SBA) is responsible for the management of the Local Government Surplus Funds Trust Fund (Florida PRIME).<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 Chair, the Chief Financial Officer, and the Attorney General.

As management of the SBA, we offer readers of Florida PRIME's financial statements this overview and analysis of Florida PRIME's financial results and position for the fiscal years ended June 30, 2012 and 2011. We encourage readers to consider the information presented here in conjunction with the financial statements and notes to the financial statements, which begin on page 7.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

The financial statements provide financial information about Florida PRIME 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.

Florida PRIME 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 Florida PRIME's 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.

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<sup>1</sup> As of August 3, 2009, SBA began using the name "Florida PRIME" when referring to the Local Government Surplus Fund Trust Fund.

## FINANCIAL SUMMARY

A summary comparison of Florida PRIME's Statement of Net Assets at June 30, 2012, and the prior fiscal years at June 30, 2011, and 2010, is presented below (in thousands):

	<u>At June 30,</u>		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Total assets	\$ 6,754,150	\$ 6,824,328	\$ 5,483,034
Total liabilities	1,706	406	2,098
Net assets held in trust for pool participants	<u>\$ 6,752,444</u>	<u>\$ 6,823,922</u>	<u>\$ 5,480,936</u>

A summary comparison of Florida PRIME's Statement of Changes in Net Assets for the current fiscal year ended June 30, 2012, and the prior fiscal years ended June 30, 2011, and 2010, is presented below (in thousands):

	<u>Year Ended June 30,</u>		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Increase (decrease) in net assets:			
Net income from investing activity	\$ 19,665	\$ 17,771	\$ 16,269
Distributions paid and payable	(19,666)	(17,771)	(16,269)
Participant contributions	15,243,370	15,223,064	12,653,338
Participant withdrawals	(15,371,147)	(13,968,553)	(13,278,921)
Investment transfer from Fund B	56,300	88,475	122,225
Total increase (decrease) in net assets	<u>(71,478)</u>	<u>1,342,986</u>	<u>(503,358)</u>
Net assets, July 1	6,823,922	5,480,936	5,984,294
Net assets, June 30	<u>\$ 6,752,444</u>	<u>\$ 6,823,922</u>	<u>\$ 5,480,936</u>

## FINANCIAL ANALYSIS

### Assets

Total assets decreased by \$70.2 million (1%) from \$6.82 billion at June 30, 2011, to \$6.75 billion at June 30, 2012. At the end of fiscal year 2011, total assets were \$1.3 billion (24%) more than the \$5.48 billion at the end of fiscal year 2010. The decrease in total assets in fiscal year 2012 was due primarily to the fact that non-State participant withdrawals exceeded participant contributions by \$271 million while State participant deposits exceeded withdrawals by \$180 million. The increase in total assets during fiscal year 2011 was mainly the result of participant contributions exceeding participant withdrawals and the addition of \$326 million of moneys for State accounts that were previously invested in the SBA Commingled Asset Management Program Money Market Pool (CAMPMM).

### Liabilities

Total liabilities at June 30, 2012, were \$1.7 million, which was \$1.3 million higher than the total liabilities of \$400 thousand at June 30, 2011. The total liabilities at June 30, 2011, were \$1.7 million lower than the June 30, 2010, amount of \$2.1 million. The main reason for the increase in fiscal year 2012 was an increase in "Due to local



governments” due to an increase in unregistered deposits (deposits sent without prior notification to the SBA). The main reason for the decrease in fiscal year 2011 was a decrease in “Due to local governments” due to a decline in unregistered deposits. Deposits sent in without being registered by participants are recorded as liabilities until the depositor is identified and credit is awarded to the participant.

### **Change in Net Assets**

Net assets declined by \$71.5 million (1%) at June 30, 2012, from June 30, 2011. Net assets increased by \$1.3 billion (25%) from June 30, 2010, to June 30, 2011. Net assets at June 30, 2012, 2011, and 2010 were \$6.75 billion, \$6.8 billion, and \$5.5 billion, respectively. The main reason for the decrease (in fiscal year 2012) was non-State participant withdrawals exceeding contributions by \$271 million while State contributions exceeded withdrawals by \$180 million. The increase in net assets in fiscal year 2011 was due to the increase in non-State participant contributions exceeding withdrawals by \$1 billion and the addition of \$326 million of moneys for State accounts that were previously invested in the CAMPMM.

Net income from investing activity of \$19.7 million for the current fiscal year ended June 30, 2012, was \$1.9 million higher than the \$17.8 million earned for fiscal year 2011. Most of the increase in the current fiscal year was the result of higher average participant balances during the period. Net income from investing activity for fiscal year 2011 was \$1.5 million higher than the \$16.3 million earned for fiscal year 2010 because of increased average participant balances. The Federal Reserve continued a monetary policy stance (that began in the latter part of the 2009 fiscal year) to keep 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 remained at historic lows during recent fiscal years.

Investment transfers from Fund B of \$56.3 million for the current fiscal year ended June 30, 2012, were 36 percent less than the \$88.5 million received for fiscal year 2011. The \$88.5 million received for fiscal year 2011 was \$33.7 million (28 percent) less than the amounts received for fiscal year 2010. Investment transfers from Fund B have declined mainly because principal reductions in Fund B assets caused by refinancing activity have slowed year over year as mortgage rates have declined.

## **FINANCIAL HIGHLIGHTS**

The purpose of Chapter 218, Part IV, Florida Statutes, is to promote, through State assistance, the maximization of net interest earnings on invested surplus funds of units of local government, based on the principles of investor protection, mandated transparency, and proper governance, with the goal of reducing the need for imposing additional taxes. The primary investment objectives, in priority order, are safety, liquidity, and competitive returns with minimization of risks.

For the fiscal year ended June 30, 2012:

- Participant contributions were consistent with the prior fiscal year, while participant withdrawals increased 10 percent, resulting in net participant withdrawals of \$127.8 million.
- Net income from investing activity increased \$1.9 million over the prior fiscal year; however, the average participant yield for the fiscal year was steady at 0.28 percent, just under the average participant yield of 0.29 percent of the prior fiscal year. The increase in net income from investing activity was due to the higher average participant balances, as interest rates stayed at historic lows during the fiscal year. Average daily participant balances increased 9 percent over the prior fiscal year, even though total participant balances decreased by June 30, 2012.
- Investment transfers from Fund B decreased 36 percent from the prior fiscal year due to reduced asset balances in Fund B and decreased refinancing activity in Fund B mortgage collateral pools.

For the fiscal year ended June 30, 2011:

- Participant contributions increased 20 percent over the prior fiscal year, while participant withdrawals increased only 5 percent, resulting in net participant contributions of \$1.25 billion (\$920 million non-State participants and \$326 million from State participants who were previously invested in CAMPMM).
- Net income from investing activity increased \$1.5 million over the prior fiscal year; however, the average participant yield for the fiscal year was 0.29 percent, the same average yield as the prior fiscal year. The increase in net income from investing activity is due to the higher average participant balances, as interest rates stayed at historic lows during the fiscal year.
- Investment transfers from Fund B decreased 28 percent from the prior fiscal year due to reduced asset balances in Fund B and decreased refinancing activity in Fund B mortgage collateral pools.

### **CONTACT INFORMATION**

These financial statements reflect only the transactions and balances for Florida PRIME. For additional information on this Fund, please contact the State Board of Administration, Chief Operating & Financial Officer, 1801 Hermitage Boulevard, Suite 100, Tallahassee, Florida 32308 or visit SBA's website at <https://www.sbafla.com/prime/>.

**BASIC FINANCIAL STATEMENTS**

STATE BOARD OF ADMINISTRATION  
 LOCAL GOVERNMENT SURPLUS FUNDS TRUST FUND (FLORIDA PRIME)  
 STATEMENTS OF NET ASSETS  
 As of June 30, 2012, and June 30, 2011  
 (In Thousands)

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 1,099	\$ 215
Investments:		
Certificates of deposit	2,532,981	2,732,517
Commercial paper	1,810,308	1,977,209
Repurchase agreements	1,300,000	1,470,000
Money market funds	529,590	530,210
Domestic corporate bonds & notes	417,207	23,295
Municipal bonds & notes	89,135	12,700
Foreign corporate note (\$ denom)	55,001	45,000
U.S. Treasury notes	<u>15,177</u>	<u>30,056</u>
Total investments	<u>6,749,399</u>	<u>6,820,987</u>
Interest receivable	3,631	3,106
Prepaid fees	20	19
Undistributed expenses	<u>1</u>	<u>1</u>
<b>Total Assets</b>	<u>6,754,150</u>	<u>6,824,328</u>
<b>LIABILITIES</b>		
Accounts payable and accrued liabilities	342	136
Distributions payable	51	55
Due to local governments	<u>1,313</u>	<u>215</u>
<b>Total Liabilities</b>	<u>1,706</u>	<u>406</u>
<b>NET ASSETS</b>		
Held in trust for pool participants	<u>\$ 6,752,444</u>	<u>\$ 6,823,922</u>

The notes to the financial statements are an integral part of this statement.

**STATE BOARD OF ADMINISTRATION  
 LOCAL GOVERNMENT SURPLUS FUNDS TRUST FUND (FLORIDA PRIME)  
 STATEMENTS OF CHANGES IN NET ASSETS  
 Years ended June 30, 2012, and June 30, 2011  
 (In Thousands)**

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
<b>ADDITIONS</b>		
Investment operations:		
Income from investing activity:		
Interest income	\$ 21,402	\$ 19,314
Investment management fees	(1,154)	(1,002)
Administrative service charges	(411)	(378)
Bank fees	(68)	(63)
Compliance review fees	(63)	(62)
Standard and Poor's rating maintenance fees	(39)	(38)
Consulting fees (Education Center)	<u>(2)</u>	<u>.....</u>
Net income from investing activity	<u>19,665</u>	<u>17,771</u>
<b>Total Additions</b>	<u>19,665</u>	<u>17,771</u>
 <b>DEDUCTIONS</b>		
Distributions paid and payable	<u>19,666</u>	<u>17,771</u>
<b>Total Deductions</b>	<u>19,666</u>	<u>17,771</u>
 <b>SHARE TRANSACTIONS</b>		
Participant contributions	15,243,370	15,223,064
Participant withdrawals	(15,371,147)	(13,968,553)
Investment transfer from Fund B	<u>56,300</u>	<u>88,475</u>
<b>Net Increase (Decrease) Resulting from Share Transactions</b>	<u>(71,477)</u>	<u>1,342,986</u>
 Total increase (decrease) in net assets	 <u>(71,478)</u>	 <u>1,342,986</u>
 Net assets, beginning of year	 <u>6,823,922</u>	 <u>5,480,936</u>
Net assets, end of year	<u>\$ 6,752,444</u>	<u>\$ 6,823,922</u>

The notes to the financial statements are an integral part of this statement.

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**NOTES TO FINANCIAL STATEMENTS**

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**STATE BOARD OF ADMINISTRATION  
LOCAL GOVERNMENT SURPLUS FUNDS TRUST FUND (FLORIDA PRIME)  
Years ended June 30, 2012, and June 30, 2011**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The following summary of the Local Government Surplus Funds Trust Fund's (Florida PRIME's) 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 Florida PRIME. 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 Chair, the Chief Financial Officer and the Attorney General.

The Local Government Surplus Funds Trust Fund was created by act of 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. On August 3, 2009, the SBA began using "Florida PRIME" when referring to the Local Government Surplus Funds Trust Fund.

Sections 218.40 through 218.415, Florida Statutes, and State Board of Administration Rules 19-7.002 through 19-7.016, Florida Administrative Code, promulgated pursuant to Section 218.405(4), Florida Statutes, govern the operation of Florida PRIME.

The assets and liabilities of Florida PRIME are included in the Comprehensive Annual Financial Report (CAFR) of the State of Florida. However, the accompanying financial statements present only Florida PRIME 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**

Florida PRIME is not a registrant with the Securities and Exchange Commission (SEC); however, SBA has adopted operating procedures consistent with those required of an SEC Rule 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.

Florida PRIME is reported as an investment trust fund, a fiduciary fund type.

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

Basis of accounting refers to when the recognition of 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. The accompanying financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with GAAP. Under this method, earnings on investments, including interest income, are recognized as revenue when earned, and expenses are recognized when a liability is incurred.

**e. *Cash and Cash Equivalents***

Florida PRIME reports as “Cash and cash equivalents” all cash on hand and on deposit in banks, including demand deposits, time deposits, and non-negotiable certificates of deposit.

**f. *Investments***

Florida PRIME’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.

**g. *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 Florida PRIME using the amortized cost method, which is consistent with the method used to report Florida PRIME’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.

***h. Legally Binding Guarantees***

The SBA has not provided or obtained any legally binding guarantees during the fiscal years ended June 30, 2012, and June 30, 2011, for Florida PRIME.

***i. Involuntary Participation***

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

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

The fair value of the investments of Florida PRIME 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, 2012, and June 30, 2011, the ratios of fair value to amortized cost were 100.00 percent and 100.01 percent, respectively.

***k. Fees and Administrative Service Charges***

Federated Investment Counseling (Federated) is the investment manager for Florida PRIME. Federated charges an annual investment management fee based on the average daily net assets (i.e., average daily amortized cost) of Florida PRIME (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 Florida PRIME in the fiscal years ended June 30, 2012, and June 30, 2011, were \$1,154,443 and \$1,002,239, respectively.

In addition, SBA charges a .6 basis point charge (.00006) on total Florida PRIME 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 participant balances each month. Total administrative service charges incurred by Florida PRIME for the fiscal year ended June 30, 2012, were \$410,660 and for June 30, 2011, were \$377,879. Effective July 1, 2012, the SBA administrative fee will be increased to a 1.0 basis point charge on total Florida PRIME assets to adequately cover costs related to operating the fund

Various bank fees, including transaction charges, custody fees, consulting and performance analytics fees are incurred by Florida PRIME. 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

Florida PRIME for the fiscal year ended June 30, 2012, were \$68,035 and for June 30, 2011, were \$62,541. Standard and Poor's (S&P) rating maintenance fees were \$38,550 and \$38,000 for fiscal years ending June 30, 2012, and 2011, respectively. Consulting fees for the fiscal year ended June 30, 2012, were \$2,000 and were paid to set up the Education Center website for participants. Compliance review fees were \$63,251 and \$62,181 for those same years. 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 Florida PRIME is in compliance with Florida law.

### ***I. 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 Florida PRIME. Fund B of Florida PRIME was originally formed as part of a restructuring of the Local Government Surplus Funds Trust Fund in December 2007 to hold certain securities with limited liquidity.

Fund B is administered by SBA and SBA distributes cash holdings to Florida PRIME 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***

Cash is held in demand deposits at various financial institutions. These deposits totaled \$1,099,486 at June 30, 2012, and \$215,499 at June 30, 2011. All deposits in Florida PRIME 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 State of Florida Chief Financial Officer (State CFO) as a qualified public depository.

The State 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, 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 State CFO's permission.

### ***b. Investment Authority and Compliance***

The SBA has the authority to administer and invest the funds of Florida PRIME in accordance with Chapter 218, Part IV, Florida Statutes. The statute states SBA shall invest the moneys of Florida



PRIME 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 Statement for Florida PRIME lists the following authorized principal investments:

1. United States (U.S.) Treasury obligations.
2. U.S. Government Agency obligations.
3. Government securities, which are defined as any security issued or guaranteed as to principal or interest by the United States, or by a person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States; or any certificate of deposit for any of the foregoing.
4. Insurance contracts, including guaranteed investment contracts, funding agreements, and annuities.
5. Corporate debt securities, such as notes, bonds, debentures, commercial paper, interests in bank loans to companies, and demand instruments.
6. 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.
7. Asset-backed securities, which may be in the form of commercial paper, notes, or pass-thru certificates.
8. Municipal securities issued by states, counties, cities, and other political subdivisions and authorities.
9. Foreign securities (i.e., U.S. dollar-denominated securities of issuers based outside the United States).
10. Mortgage-backed securities representing interests in pools of mortgages. Mortgages may have fixed or adjustable interest rates.
11. Private placements of securities – The SBA has determined that Florida PRIME constitutes (i) an “accredited investor” as defined in Rule 501(a)(7) promulgated under the Securities Act of 1933, as amended (the Securities Act), as long as Florida PRIME has total assets in excess of \$5,000,000 and (ii) a “qualified purchaser” as defined in Section 2(a)(51)(A)(iv) of the 1940 Act, as long as Florida PRIME in the aggregate owns and invests on a discretionary basis not less than \$25,000,000 in investments, but does not constitute a “qualified institutional buyer” as defined in Rule 144A(a)(1) promulgated under the Securities Act. Florida PRIME is restricted from purchasing or acquiring securities or investments that would require Florida PRIME to represent in connection with such purchase or acquisition that it is a “qualified institutional buyer” as defined in Rule 144A(a)(1) promulgated under the Securities Act.
12. Shares of registered investment companies that are money market mutual funds, including those that are affiliated with Federated (Investment Manager).

13. Special transactions, including repurchase agreements and delayed delivery transactions. Repurchase agreements involve transactions in which Florida PRIME 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 Florida PRIME buys securities for a set price, with payment and delivery of the securities scheduled for a future time but no later than seven days in the future.

The primary investment objectives for Florida PRIME, 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 Florida PRIME, 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 (NRSRO) that rates Florida PRIME 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 Florida PRIME exceeds 0.25 percent, the Investment Policy Statement requires that the Investment Manager establish a formal action plan. The Investment Policy Statement also requires 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 Florida PRIME exceeds 0.50 percent, the Investment Policy Statement requires that the Executive Director promptly consider what action, if any, would be initiated. Where the Executive Director believes the extent of any deviation from Florida PRIME's amortized cost price per share may result in material dilution or other unfair results to investors or existing shareholders, he will cause Florida PRIME to take such action as he deems appropriate to eliminate or reduce to the extent reasonably practicable such dilution or unfair results.

**c. Violation of Investment Policy**

Florida PRIME Investment Policy restricts the Florida PRIME from purchasing or acquiring any security or investment that would require Florida PRIME to represent in connection with such purchase or acquisition that it is a “qualified institutional buyer” (QIB) as defined in SEC Rule 144A(a)(1).

On September 12, 2012, the SBA received notification from the Investment Manager that the Svenska Handelsbanken AB investment (\$45 million at par) purchased on September 20, 2011, and due to mature on October 16, 2012, was not an eligible investment for Florida PRIME. The Svenska Handelsbanken AB position was then sold on September 14, 2012.

Subsequent investigation of fiscal year 2011-12 investment purchases identified three additional ineligible investment purchases of JP Morgan Chase Putters/Drivers Trust notes, which occurred in February and March 2012 for par values of \$146.75 million, \$20 million, and \$9.135 million. All three of these securities were sold by the Investment Manager in May 2012 resulting in no realized gain or loss.

To prevent similar Investment Policy violations, the Investment Manager revised its compliance system to flag for further research all transactions involving SEC Rule 144A securities in order to mitigate the risk of purchasing an ineligible SEC Rule 144A security for the Florida PRIME.

**d. Summary of Investment Holdings**

The following tables provide a summary of the par value or share amount, carrying amount, fair value, range of interest rates, and range of maturity dates for each major investment classification as of June 30, 2012, and June 30, 2011, (expressed in thousands):

As of June 30, 2012					
Investment Type	Par	Carrying Value	Fair Value	Range of Interest Rates <sup>1</sup>	Range of Maturity Dates
Certificates of deposit	\$ 2,533,000	\$ 2,532,981	\$ 2,533,238	.18%-.55%	7/2/12-5/22/13
Commercial paper	1,811,400	1,810,308	1,810,293	.23%-.51%	7/2/12-1/3/13 <sup>4</sup>
Money market funds	529,590	529,590	529,590	.01%-.17%	N/A <sup>2</sup>
Domestic corporate bonds & notes	416,006	417,207	417,174	.18%-5.38%	7/27/12-7/1/29 <sup>3</sup>
Municipal bonds & notes	89,135	89,135	89,135	.18%-.30%	6/1/32-11/15/42 <sup>3</sup>
Foreign corporate note (\$ denom)	55,000	55,001	54,998	0.57%-3.45%	7/2/12-10/16/12
U.S. Treasury notes	15,000	15,177	15,180	1.75%	4/15/13
Repurchase agreements	1,300,000	1,300,000	1,300,000	.18%-.20%	7/2/12
Totals	<u>\$ 6,749,131</u>	<u>\$ 6,749,399</u>	<u>\$ 6,749,608</u>		

<sup>1</sup> The coupon rate in effect at June 30, 2012, is reported. If a security is discounted, the purchase yield is reported. The 7 day yield as of June 30, 2012, is reported for the money market funds. The yields fluctuate daily.

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

<sup>3</sup> Florida PRIME may tender these bonds and notes for 100 percent of the principal amount, plus accrued interest (if tendered between interest payment dates) with a minimum of 7 days prior notification to the trustee of the bonds or notes.

<sup>4</sup> Florida PRIME has the option to extend the maturity date on one position in commercial paper on a monthly basis until the final maturity date of November 4, 2014. The maturity date on this position as of June 30, 2012, is December 4, 2012.

Investment Type	As of June 30, 2011				
	Par	Carrying Value	Fair Value	Range of Interest Rates <sup>1</sup>	Range of Maturity Dates
Certificates of deposit	\$ 2,732,500	\$ 2,732,517	\$ 2,732,995	.18%-.61%	7/1/11-3/8/13
Commercial paper	1,977,769	1,977,209	1,977,377	.09%-.51%	7/5/11-12/8/11
Money market funds	530,210	530,210	530,210	.00%-.10%	N/A <sup>2</sup>
Domestic corporate bonds & notes	23,295	23,295	23,295	.18%-.19%	1/1/28-7/1/29 <sup>3</sup>
Municipal bonds & notes	12,700	12,700	12,700	.08%-.09%	8/15/25-8/1/31 <sup>3</sup>
Foreign corporate note (\$ denom)	45,000	45,000	45,014	0.31%	7/17/12 <sup>4</sup>
U.S. Treasury notes	30,000	30,056	30,081	0.75%	11/30/11
Repurchase agreements	1,470,000	1,470,000	1,470,000	.05%-.06%	7/1/11
Totals	<u>\$ 6,821,474</u>	<u>\$ 6,820,987</u>	<u>\$ 6,821,672</u>		

<sup>1</sup> The coupon rate in effect at June 30, 2011, is reported. If a security is discounted, the purchase yield is reported. The 7 day yield as of June 30, 2011, is reported for the money market funds. The yields fluctuate daily.

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

<sup>3</sup> Florida PRIME may tender these bonds and notes for 100 percent of the principal amount, plus accrued interest (if tendered between interest payment dates) with a minimum of 7 days prior notification to the trustee of the bonds or notes.

<sup>4</sup> Florida PRIME has the option to extend this maturity date on a monthly basis until the final maturity date of March 17, 2017. The maturity date as of June 30, 2011, is July 17, 2012.

### **e. 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 Investment Policy Statement, 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 Florida PRIME's portfolio securities on an ongoing

basis by reviewing the financial data, issuer news and developments, and ratings of designated NRSROs.

3. The Investment Manager generally will comply with the following diversification limitations that are additional to those set forth in SEC Rule 2a-7. First, at least 50 percent of Florida PRIME assets will be invested in securities rated “A-1+” or those deemed to be of comparable credit quality thereto by the Investment Manager (i.e., so long as such deeming is consistent with the requirements of the NRSRO’s AAAM (or equivalent) rating criteria), 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 Florida PRIME assets.

In the event that a security receives a credit rating downgrade and ceases to be in the highest rating category, or the Investment Manager determines that the security is no longer of comparable quality to the highest short-term rating category (in either case, a “downgrade”), the Investment Manager will reassess whether the security continues to present minimal credit risk and will cause Florida PRIME to take any actions determined by the Investment Manager to be in the best interest of Florida PRIME. The Investment Manager will not be required to make reassessments if Florida PRIME disposes of the security (or the security matures) within five business days of the downgrade.

In the event that a security no longer meets the criteria for purchase due to default, event of insolvency, a determination that the security no longer presents minimal credit risks, or other material event (affected security), the Investment Manager must dispose of the security as soon as practical consistent with achieving an orderly disposition of the affected security, by sale, exercise of a demand feature or otherwise. An affected security may be held 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 Florida PRIME to dispose of the security taking into account market conditions that may affect an orderly disposition.

Florida PRIME’s credit quality ratings were as follows at June 30, 2012, and June 30, 2011 (fair values expressed in thousands):

Ratings <sup>1</sup>		Fair Value of Florida PRIME Investments as of June 30, 2012					
S&P	Moody's	Total	Certificates of Deposit	Commercial Paper	Money Market Funds	Domestic Corporate & Municipal Bonds & Notes	Foreign Corporate Note (\$ denom)
AAAm		\$ 529,590	\$ .....	\$ .....	\$ 529,590	\$ .....	\$ .....
AAA		53,900	.....	.....	.....	53,900	.....
AA		169,151	.....	.....	.....	169,151	.....
A		43,272	.....	.....	.....	33,272	10,000
Not rated <sup>1</sup>	Aa	150,037	150,037	.....	.....	.....	.....
A-1		1,810,293	.....	1,810,293	.....	.....	.....
Not rated <sup>1</sup>	Not rated <sup>1</sup>	2,678,185	2,383,201	.....	.....	249,986	44,998
		<u>\$ 5,434,428</u>	<u>\$ 2,533,238</u>	<u>\$ 1,810,293</u>	<u>\$ 529,590</u>	<u>\$ 506,309</u>	<u>\$ 54,998</u>
Not rated <sup>2</sup>	Not rated <sup>2</sup>	1,300,000	Repurchase agreements				
Not rated <sup>3</sup>	Not rated <sup>3</sup>	15,180	U.S. Treasury notes				
		<u>\$ 6,749,608</u>	<u>Total</u>				

<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 Florida PRIME's investment and SEC Rule 2a-7 guidelines.

<sup>2</sup>Repurchase agreements are not negotiable instruments and do not carry individual security ratings.

<sup>3</sup>U.S. Treasury obligations do not carry individual security ratings, but carried overall ratings of AA+ by S&P, Aaa by Moody's and AAA by Fitch as of June 30, 2012.

Ratings <sup>1</sup>		Fair Value of Florida PRIME Investments as of June 30, 2011					
S&P	Moody's	Total	Certificates of Deposit	Commercial Paper	Money Market Funds	Domestic Corporate & Municipal Bonds & Notes	Foreign Corporate Note (\$ denom)
AAAm		\$ 530,210	\$ .....	\$ .....	\$ 530,210	\$ .....	\$ .....
AAA		7,700	.....	.....	.....	7,700	.....
AA		54,809	.....	.....	.....	9,795	45,014
Not rated <sup>1</sup>	Aa	5,000	.....	.....	.....	5,000	.....
A-1		1,990,877	.....	1,977,377	.....	13,500	.....
Not rated <sup>1</sup>	Not rated <sup>1</sup>	2,732,995	2,732,995	.....	.....	.....	.....
		<u>\$ 5,321,591</u>	<u>\$ 2,732,995</u>	<u>\$ 1,977,377</u>	<u>\$ 530,210</u>	<u>\$ 35,995</u>	<u>\$ 45,014</u>
Not rated <sup>2</sup>	Not rated <sup>2</sup>	1,470,000	Repurchase agreements				
Not rated <sup>3</sup>	Not rated <sup>3</sup>	30,081	U.S. Treasury notes				
		<u>\$ 6,821,672</u>	<u>Total</u>				

<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 Florida PRIME's investment and SEC Rule 2a-7 guidelines.

<sup>2</sup>Repurchase agreements are not negotiable instruments and do not carry individual security ratings.

<sup>3</sup>U.S. Treasury obligations do not carry individual security ratings, but carried overall ratings of AAA by S&P, Aaa by Moody's and AAA by Fitch as of June 30, 2011. In August 2011, the S&P downgraded U.S. obligations to a AA+ rating. Moody's and Fitch ratings on U.S. debt obligations remain unchanged.

With respect to the concentration of credit risk, at June 30, 2012, and June 30, 2011, Florida PRIME had exposure of 5 percent or more to each of the following issuers (carrying values and fair values expressed in thousands):

## As of June 30, 2012

Issuer Name	Carrying Value	Percent of Portfolio Carrying Value	Fair Value	Percent of Portfolio Fair Value
Bank of America - Domestic corporate bonds & notes <sup>1</sup>	\$ 250,000	3.70%	\$ 249,986	3.70%
Bank of America - Repurchase agreements <sup>2</sup>	900,000	13.33%	900,000	13.33%
Bank of America Total	<u>\$ 1,150,000</u>	<u>17.03%</u>	<u>\$ 1,149,986</u>	<u>17.03%</u>
Deutsche Bank - Certificates of deposit <sup>1</sup>	\$ 345,000	5.11%	\$ 345,037	5.11%
Deutsche Bank - Repurchase agreements <sup>2</sup>	400,000	5.93%	400,000	5.93%
Deutsche Bank Total	<u>\$ 745,000</u>	<u>11.04%</u>	<u>\$ 745,037</u>	<u>11.04%</u>
Royal Bank of Canada - Certificates of deposit <sup>3</sup>	<u>\$ 348,000</u>	<u>5.16%</u>	<u>\$ 348,163</u>	<u>5.16%</u>

<sup>1</sup> For purposes of the SEC Rule 2a-7 exposure restriction calculations, the Bank of America domestic corporate bonds & notes is considered a separate issuer position from the Bank of America collateralized repurchase agreements. Likewise, the Deutsche Bank certificates of deposit is considered a separate issuer position from the Deutsche Bank collateralized repurchase agreements.

<sup>2</sup> 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.

<sup>3</sup> Under SEC Rule 2a-7, liquidations are not required for exposures over 5 percent if the overage is caused by participant account movements (i.e., withdrawals). The excess exposure to Royal Bank of Canada was caused by participant account movements.

## As of June 30, 2011

Issuer Name	Carrying Value	Portfolio Carrying Value	Fair Value	Percent of Portfolio Fair Value
Bank of America - Commercial paper <sup>1</sup>	\$ 199,956	2.93%	\$ 199,975	2.93%
Bank of America - Repurchase agreements <sup>2</sup>	1,070,000	15.69%	1,070,000	15.69%
Bank of America Total	<u>\$ 1,269,956</u>	<u>18.62%</u>	<u>\$ 1,269,975</u>	<u>18.62%</u>
BNP Paribas - Commercial paper	\$ 38,950	0.57%	\$ 38,970	0.57%
BNP Paribas - Certificates of deposit	315,000	4.62%	315,173	4.62%
BNP Paribas Total <sup>3</sup>	<u>\$ 353,950</u>	<u>5.19%</u>	<u>\$ 354,143</u>	<u>5.19%</u>
Credit Agricole - Commercial paper	\$ 108,342	1.59%	\$ 108,360	1.59%
Credit Agricole - Certificates of deposit	236,000	3.46%	236,069	3.46%
Credit Agricole Total <sup>3</sup>	<u>\$ 344,342</u>	<u>5.05%</u>	<u>\$ 344,429</u>	<u>5.05%</u>
Morgan Stanley <sup>3</sup>	<u>\$ 400,000</u>	<u>5.86%</u>	<u>\$ 400,000</u>	<u>5.86%</u>
Societe Generale - Commercial paper	\$ 224,887	3.30%	\$ 224,951	3.30%
Societe Generale - Certificates of deposit	130,000	1.90%	130,019	1.90%
Societe Generale Total <sup>3</sup>	<u>\$ 354,887</u>	<u>5.20%</u>	<u>\$ 354,970</u>	<u>5.20%</u>

<sup>1</sup> For purposes of the SEC Rule 2a-7 exposure restriction calculations, the Bank of America commercial paper is considered a separate issuer position from the Bank of America collateralized repurchase agreements.

<sup>2</sup> 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.

<sup>3</sup> Under SEC Rule 2a-7, liquidations are not required for exposures over 5 percent if the overage is caused by participant account movements (i.e., withdrawals). The excess exposure to BNP Paribas, Credit Agricole, Morgan Stanley, and Societe Generale were caused by participant account movements.



**f. 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.

The SBA engaged BNY Mellon (Custodian) to provide asset safekeeping, custody, fund accounting, and performance measurement services to Florida PRIME. At June 30, 2012, and June 30, 2011, all investments, except those in money market funds in which the SBA invests (i.e. in commingled funds with other investors), were held in SBA's name by SBA's custodial bank.

**g. 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 Investment Policy Statement, the Investment Manager will target a dollar-weighted average maturity (DWAM) range for Florida PRIME 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 Florida PRIME's DWAM when it expects interest rates to rise and extend Florida PRIME's DWAM when it expects interest rates to fall. The Investment Manager will exercise reasonable care to maintain a DWAM of 60 days or less for Florida PRIME. For purposes of calculating DWAM, the maturity of an adjustable rate security generally will be the period remaining until its next interest rate reset date.

Presented below are the investments held in Florida PRIME at June 30, 2012, and June 30, 2011, at fair value (expressed in thousands), with the DWAM for each security type:

## As of June 30, 2012

Investment Type	Fair Value	Dollar Weighted Average Days to Maturity <sup>1</sup>
Certificates of deposit <sup>2</sup>	\$ 2,533,238	42
Commercial paper <sup>2</sup>	1,810,293	59
Money market funds <sup>3</sup>	529,590	2
Domestic corporate bonds & notes	417,174	78
Municipal bonds & notes	89,135	4
Foreign corporate note (\$ denom)	54,998	40
U.S. Treasury notes	15,180	289
Repurchase agreements	1,300,000	2
Total	<u>\$ 6,749,608</u>	
<b>Portfolio dollar-weighted average maturity</b>		<b>38</b>

<sup>1</sup> Interest rate reset dates are used in the calculation of the dollar-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, 2012, ranged from 42 to 52 days. However, the money market funds provided daily liquidity.

## As of June 30, 2011

Investment Type	Fair Value	Dollar Weighted Average Days to Maturity <sup>1</sup>
Certificates of deposit <sup>2</sup>	\$ 2,732,995	45
Commercial paper <sup>2</sup>	1,977,377	42
Money market funds <sup>3</sup>	530,210	1
Domestic corporate bonds & notes	23,295	7
Municipal bonds & notes	12,700	7
Foreign corporate note (\$ denom)	45,014	48
U.S. Treasury notes	30,081	153
Repurchase agreements	1,470,000	1
Total	<u>\$ 6,821,672</u>	
<b>Portfolio dollar-weighted average maturity</b>		<b>31</b>

<sup>1</sup> Interest rate reset dates are used in the calculation of the dollar-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, 2011, ranged from 40 to 53 days. However, the money market funds provided daily liquidity.

***h. Investments, Foreign Currency Risk***

Florida PRIME may purchase only U.S. dollar-denominated securities, and was not exposed to foreign currency risk during the fiscal years ended June 30, 2012, and June 30, 2011. All investments were denominated in U.S. dollars.



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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 (Florida PRIME), as of and for the fiscal year ended June 30, 2012, 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 was not designed to 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 Florida PRIME'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*.

We noted an additional matter which is described in finding No. 1 of the **SCHEDULE OF FINDINGS** section of this report.

Management's response to the findings described in the **SCHEDULE OF FINDINGS** section of this report is included as Exhibit A. We did not audit management's response and, accordingly, we express no opinion on it.

Our **INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON THE AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*** 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 applicable management and is not intended to be and should not be used by anyone other than those specified parties.

Respectfully submitted,



David W. Martin, CPA  
February 1, 2013

**STATE BOARD OF ADMINISTRATION  
LOCAL GOVERNMENT SURPLUS FUNDS TRUST FUND (FLORIDA PRIME)  
SCHEDULE OF FINDINGS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**BACKGROUND**

The State Board of Administration (SBA), pursuant to Florida law, is responsible for administering the Local Government Surplus Funds Trust Fund (Florida PRIME).<sup>2</sup> The Florida PRIME is composed of local government surplus funds deposited by participating local governments and is managed by an external investment manager.

The Florida PRIME is described as a “2a-7-like” pool, meaning that it is operated so as to reasonably comply with Securities and Exchange Commission (SEC) Rule 2a-7,<sup>3</sup> which establishes requirements relating to money market funds operated by SEC registered investment companies.

SBA management is responsible for the design and operation of internal controls which reasonably ensure compliance with SEC Rule 2a-7, applicable provisions of Florida law, and the Florida PRIME investment policy.

**ADDITIONAL MATTER**

**Finding No. 1: Purchase of Ineligible Rule 144A Securities**

Florida PRIME Investment Policy restricts the Florida PRIME from purchasing or acquiring any SEC Rule 144A security or investment that would require the Florida PRIME to represent, in connection with such purchase or acquisition, that it is a “qualified institutional buyer” (QIB) as defined in SEC Rule 144A(a)(1).

During the conduct of our audit, we questioned the eligibility of four SEC Rule 144A securities purchased for the Florida PRIME. Following audit inquiry, the Investment Manager acknowledged to the SBA that the securities (\$221 million in par value) were SEC Rule 144A securities and only available for resale to QIBs and, thus, ineligible for purchase by the Florida PRIME. One security was sold at a small gain in September 2012 upon notification of ineligibility, and the other three securities had been sold during the 2011-12 fiscal year at no gain or loss.

To ensure that only eligible securities were purchased, SBA relied on the Investment Manager to properly codify client restrictions in the Investment Manager’s automated portfolio management and trading systems. However, restrictions relating to SEC Rule 144A securities were not effectively implemented. Also, because the SBA believed that edits were in place, the SBA did not consider SEC Rule 144A(a)(1) noncompliance to be a high-risk investment compliance issue, and the SBA’s risk-based compliance program did not subject applicable SEC Rule 144A criteria to monthly monitoring. The existence of system checks or edits for SEC Rule 144A securities may have prevented the purchase of those ineligible securities.

We were advised that to prevent similar investment policy violations, the Investment Manager had revised its compliance system. Specifically, the Investment Manager’s trader will receive a “stop” message that will require an

<sup>2</sup> Part IV, Chapter 218, Florida Statutes.

<sup>3</sup> Title 17, Section 270, Code of Federal Regulations.

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override by the portfolio manager before the trade can be executed. The “stop” will trigger an additional checkpoint requiring the portfolio manager to review the offering documents to verify that the security is an eligible security.

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**Recommendation:** We recommend that SBA add verification of SEC Rule 144A security eligibility to Florida PRIME’s risk-based investment compliance program.

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EXHIBIT - A  
MANAGEMENT'S RESPONSE



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ASH WILLIAMS  
EXECUTIVE DIRECTOR & CIO

February 1, 2013

Mr. David W. Martin, CPA  
Auditor General  
Office of the Auditor General of the State of Florida  
G74 Claude Pepper Building  
111 West Madison Street  
Tallahassee, Florida 32399-1450

Dear Mr. Martin,

We have reviewed the preliminary findings and recommendations which may be included in a management letter on your audit of the financial statements of the State Board of Administration's (SBA) Local Government Surplus Funds Trust Fund (Florida PRIME) for the fiscal year ended June 30, 2012 and 2011. As recommended, we agree to add verification of SEC Rule 144A security eligibility to Florida PRIME's risk based compliance program. As of the September 2012 month-end reporting period, implementation actions include enhancement of compliance checks in the Investment Manager's automated compliance system, addition of a written representation from the Investment Manager as part of the monthly compliance checklist verifying that, "Unregistered securities must be eligible for sale to Accredited Investors or Qualified Purchasers," and SBA compliance staff review of the Bloomberg description for each security purchased on a monthly basis to screen for SEC Rule 144A investments that are only eligible to be sold to Qualified Institutional Buyers (QIB).

As always, we appreciate the Auditor General staff's diligence and professionalism.

Sincerely,

A handwritten signature in blue ink that reads "Ashbel C. Williams".

Ashbel C. Williams  
Executive Director & Chief Investment Officer

cc: Ms. Florida Rivera-Alsing, Chief Audit Executive, SBA  
Mr. Eric Nelson, Chief Risk & Compliance Officer, SBA  
Mr. Mike McCauley, Senior Officer – Investment Programs & Governance, SBA