

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

Financial Audit

For the Fiscal Year Ended
June 30, 2009



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 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; by telephone at (850) 487-9024; 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
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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*; however, we noted an additional matter as summarized below.

ADDITIONAL MATTER

Finding No. 1: The SBA had not finalized and communicated for the LGIP a complete, risk-based investment compliance monitoring program, including provisions establishing members of the Investment Oversight Group, program objectives, control activities, and procedures.

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;
- Taken corrective actions for findings included in the prior audit report.

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, 2009. 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 to develop the findings 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.



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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 (LGIP), as of and for the fiscal year ended June 30, 2009, 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, 2009, 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, 2009, 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.

The **MANAGEMENT'S DISCUSSION AND ANALYSIS** (pages 3 through 5) is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Respectfully submitted,



David W. Martin, CPA
March 4, 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).¹ 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, 2009.

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, 2009, and 2008, is presented below (in thousands):

	Year Ended June 30	
	2009	2008
Total assets	\$ 5,997,756	\$ 7,064,678
Total liabilities	13,462	867
Net assets held in trust for pool participants	<u>\$ 5,984,294</u>	<u>\$ 7,063,811</u>

¹ Effective August 3, 2009, the LGIP was renamed as Florida PRIME.

A summary comparison of the LGIP’s Statement of Changes in Net Assets for the years ended June 30, 2009, and 2008, is presented below (in thousands):

	Year Ended June 30	
	2009	2008
Increase (decrease) in net assets		
Net income from investing activity	\$ 88,429	\$ 844,594
Net decrease in fair value of investments	.....	(191,590)
Net income from securities lending	.....	269
Redemption fees	1	7,233
Distributions paid and payable	(88,429)	(709,807)
Participant contributions	9,363,390	21,422,499
Participant withdrawals	(10,581,058)	(44,596,247)
Investment transfer from Fund B	138,150	.....
Investment transfer to Fund B	.....	(653,341)
Total increase (decrease) in net assets	(1,079,517)	(23,876,390)
Net assets, July 1	7,063,811	30,940,201
Net assets, June 30	<u>\$ 5,984,294</u>	<u>\$ 7,063,811</u>

FINANCIAL HIGHLIGHTS

The LGIP experienced turbulence in the fall of 2007 when participants, in response to fears about the quality and security of certain LGIP assets, withdrew an unprecedented \$12.2 billion in net funds in November 2007.

Interest earnings for the year ended June 30, 2009, were 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 adopted 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.

Working at the direction of SBA Trustees and the Florida Legislature, SBA management has implemented a series of major changes that have enhanced and strengthened the security of the LGIP.

- On June 27, 2008, SBA moved all remaining assets held in the LGIP Restricted Account² totaling \$653 million to the newly formed, legally separate Fund B Surplus Funds Trust Fund (Fund B), which was created by Section 218.417(1), Florida Statutes. In the current fiscal year, over \$138 million in liquid assets was transferred from Fund B to the LGIP. Fund B cash holdings are being distributed to participants as they become available from maturities, sales, and received income.
- Clifton Gunderson, LLP, conducted an independent investment compliance audit of the LGIP and other funds managed by SBA. The audit produced recommendations to enhance compliance, risk management, and investment policies which are in the process of being implemented.

² During the 2007-08 fiscal year, certain securities with limited liquidity were transferred from the LGIP to a temporary LGIP Restricted Account.

- The Participant Local Government Advisory Council was created to provide additional oversight to ensure that the LGIP is operated and managed in the best interest of the investors of the fund.
- The Legislature enacted legislation that provides LGIP participants with greater protection of their assets while establishing higher standards for governance, administration controls, investment policies and improved reporting of the LGIP's investment activities.
- SBA has begun an intensive reexamination and reengineering of its compliance and enterprise risk management policies and processes, with assistance from a consultant, Deloitte and Touche, LLP.
- The SBA engaged counsel to assess whether it should pursue legal action against the broker-dealers who sold certain investment grade securities to SBA that were subsequently rated to below-investment grade.

Reflecting these actions and others, the liquidity of the LGIP improved during the course of the fiscal year and on December 23, 2008, full liquidity for participants was restored.

These financial statements reflect only the transactions and balances for the LGIP. For additional information on this fund, please 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, 2009
(In Thousands)

Assets

Cash and cash equivalents	\$ 13,258
Investments:	
Certificates of deposit, negotiable	1,870,007
Commercial paper	1,494,739
Money market funds	252,371
Domestic corporate bonds and notes	102,754
Repurchase agreements	2,170,000
Federal agencies	<u>89,996</u>
Total investments	<u>5,979,867</u>
Interest receivable	<u>4,631</u>
Total Assets	<u>5,997,756</u>

Liabilities

Accounts payable and accrued liabilities	164
Due to local governments	<u>13,298</u>
Total Liabilities	<u>13,462</u>

Net Assets

Held in trust for pool participants	<u><u>\$ 5,984,294</u></u>
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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, 2009
(In Thousands)

Additions

Investment operations:

Income from investing activity:

Interest income	\$ 90,505
Bank fees	(64)
Legal fees	(10)
Standard and Poor's rating maintenance fees	(30)
Investment management fees	(1,592)
Administrative service charges	(380)
Net income from investing activity	88,429

Net increase (decrease) resulting from investment operations 88,429

Redemption fees 1

Total Additions 88,430

Deductions

Distributions paid and payable (88,429)

Total Deductions (88,429)

Share Transactions

Participant contributions	9,363,390
Participant withdrawals	(10,581,058)
Investment transfer from Fund B	138,150
Net increase (decrease) resulting from share transactions	(1,079,518)

Total decrease in net assets (1,079,517)

Net assets, beginning of year 7,063,811

Net assets, end of year \$ 5,984,294

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, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following summary of the Local Government Surplus Funds Trust Fund's (LGIP)¹ 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

¹ Effective August 3, 2009, the LGIP was renamed as Florida PRIME.

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, 2009, 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 one-half of one percent. As of June 30, 2009, the ratio of fair value to amortized cost was 100.025 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, 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, 2009, were \$1,592,372.

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 generally shown as "administrative charges" on the monthly participant statements. Total administrative service charges incurred by the LGIP for the fiscal year ended June 30, 2009, were \$380,371.

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, 2009, were \$63,996.

Standard and Poor's (S&P) rating maintenance fees of \$30,000 and legal fees of \$9,653 were incurred in the fiscal year ended June 30, 2009. The legal expenses 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.

2. DEPOSITS AND INVESTMENTS

a. Deposits

At June 30, 2009, LGIP deposits totaled \$13,258,184. 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, 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.

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 NRSRO, 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. 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. 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, 2009 (expressed in thousands):

Fair Value of LGIP Investments						Ratings ¹	
Certificates of Deposit	Commercial Paper	Money Market Funds	Domestic Corporate Bonds & Notes	Federal agencies	Total	S&P	Moody's
\$	\$	\$ 252,371	\$	\$	\$ 252,371	AAAm	
.....	.....	.....	37,999	90,250	128,249	AAA	
.....	.....	.....	35,017	.....	35,017	AA	
.....	.....	.....	24,035	.....	24,035	A	
.....	.....	.....	6,000	.....	6,000	Not rated	Aa
.....	1,290,393	.....	.....	.....	1,290,393	A-1	
.....	99,986	.....	.....	.....	99,986	A-2	
.....	104,658	.....	.....	.....	104,658	Not rated	P-1
1,870,668	.....	.....	.....	.....	1,870,668	Not rated	Not rated
\$ 1,870,668	\$ 1,495,037	\$ 252,371	\$ 103,051	\$ 90,250	\$ 3,811,377		
		Repurchase agreements			2,170,000	Not rated ²	Not rated ²
		Total			<u>\$ 5,981,377</u>		

¹ 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" either had issuer credit ratings that met the LGIP's investment guidelines, or were considered by the Investment Manager to have credit ratings that were equivalent to acceptable credit ratings under the LGIP's investment guidelines.

² Repurchase agreements are not negotiable instruments and do not carry individual security ratings.

With respect to the concentration of credit risk, except for investments in repurchase agreements, all exposure above 5 percent at June 30, 2009, was due to share withdrawals and/or market movements. At June 30, 2009, the LGIP had exposure of 5 percent or more to each of the following issuers (expressed in thousands):

Issuer Name	Carrying Value	Percent of Portfolio Carrying Value	Fair Value	Percent of Portfolio Fair Value
Bank of America ¹	\$ 1,645,000	27.51%	\$ 1,645,000	27.50%
Morgan Stanley ¹	700,000	11.71%	700,000	11.70%
State Street Bank & Trust Company	300,000	5.02%	300,194	5.02%
Bank of Tokyo-Mitsubishi Ltd., New York	300,000	5.02%	300,102	5.02%
Danske Corporation	299,762	5.01%	299,741	5.01%

¹ The Bank of America holdings included overnight repurchase agreements of \$1.47 billion and certificates of deposit of \$175 million, representing 24.58% and 2.93% of total carrying value. The Morgan Stanley holdings consisted entirely of overnight repurchase agreements. Under SEC Rule 2a-7, a fund is permitted to invest up to 25 percent of its total assets in a single issuer for a period of up to three business days. For purposes of SEC Rule 2a-7 exposure restriction calculations, however, acquisitions of repurchase agreements may be deemed to be acquisitions of the underlying securities, provided the obligation of the seller is fully collateralized. The underlying holdings for the repurchase agreements noted above, along with other applicable investments in the LGIP, did not violate the exposure limitations.

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 does not have an overall policy addressing custodial credit risk. However negotiated trust and custody contracts required that all investments be held in SBA's name by SBA's custodial financial institution at June 30, 2009.

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, 2009, at fair value (expressed in thousands), with the WAM for each security type:

Investment Type	Fair Value	Weighted Average Days to Maturity ¹
Certificates of deposit ²	\$ 1,870,668	67
Commercial paper ²	1,495,037	82
Domestic corporate bonds & notes	103,051	44
Federal agencies	90,250	199
Money market funds ³	252,371	1
Repurchase agreements	2,170,000	1
Total	\$ 5,981,377	
Portfolio weighted average maturity		46

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

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

³ The weighted average days to maturity of the underlying securities in the money market funds at June 30, 2009, was 49 days. However, the LGIP had 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, 2009. 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, 2009.

h. Summary of Investment Holdings

The following table provides as of June 30, 2009, 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 ¹	Range of Maturity Dates ²
Certificates of deposit	\$ 1,870,000	\$ 1,870,007	\$ 1,870,668	.40% - 1.68%	7/8/09 - 12/10/09
Commercial paper	1,497,000	1,494,739	1,495,037	.25% - 1.16%	7/1/09 - 12/7/09
Money market funds	252,371	252,371	252,371	0.20%	N/A
Domestic corporate bonds & notes	103,035	102,754	103,051	.60% - 3.75%	8/31/09 - 8/1/37
Federal agencies	90,000	89,996	90,250	.80% - .85%	3/11/10 - 6/22/10
Repurchase agreements	2,170,000	2,170,000	2,170,000	0.07%	7/1/09
Totals	\$ 5,982,406	\$ 5,979,867	\$ 5,981,377		

¹ The coupon rate in effect at June 30, 2009, is reported. If a security is discounted, the purchase yield is reported. The 30 day yield as of June 30, 2009, is reported for the money market fund. The yield fluctuates daily.

² Money market funds do not have a specified maturity date.

3. PENDING MATTERS

The SBA provided disclosure to LGIP participants on the <https://www.sbafla.com/prime> website and at a publicly noticed meeting in March 2008, that the Florida Department of Financial Services - Office of Financial Regulation, the SEC, the Financial Industry Regulation Authority and other persons were requesting documents and information from the SBA and investigating the events and occurrences 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. The investigations were acknowledged at various subsequent discussions of the LGIP in publicly noticed meetings and in press reports available to LGIP participants.

At the request of the SBA's General Counsel, on October 17, 2008, the SEC communicated an *Order Directing Private Investigation and Designating Officers to Take Testimony* (Order) that was dated July 31, 2008. In the furtherance of its investigation, the SEC took sworn testimony of several SBA employees in late October 2008, and on April 2, 2009, subpoenaed certain documents from the SBA. The Order and subsequent subpoenas have been published on the <https://www.sbafla.com/prime> website.

On March 3, 2010, the SBA received from SEC staff, notification that the investigation as to the SBA had been completed and that there was no intention to recommend any enforcement action by the Commission.



DAVID W. MARTIN, CPA
AUDITOR GENERAL

AUDITOR GENERAL STATE OF FLORIDA

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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 (LGIP), as of and for the fiscal year ended June 30, 2009, 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 *control deficiency* 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 misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects SBA's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the LGIP's financial statements that is more than inconsequential will not be prevented or detected by SBA's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by SBA's internal control.

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*.

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.

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 applicable parties.

Respectfully submitted,



David W. Martin, CPA
March 4, 2010

**STATE BOARD OF ADMINISTRATION
LOCAL GOVERNMENT SURPLUS FUNDS TRUST FUND
SCHEDULE OF FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

BACKGROUND

The State Board of Administration (SBA), pursuant to Florida law,¹ is responsible for administering the Local Government Surplus Funds Trust Fund (LGIP). The LGIP is comprised of local government surplus funds deposited by participating local governments, and Federated Investment Counseling serves as the investment manager for the LGIP.

The LGIP 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-7,² which establishes requirements relating to money market funds operated by SEC registered investment companies. Consequently, SBA management is responsible for the design and operation of internal controls which reasonably ensure compliance with Rule 2a-7 and related LGIP investment policy provisions.

ADDITIONAL MATTERS

Finding No. 1: Investment Compliance Monitoring

The establishment of an effective investment compliance monitoring program for the LGIP is necessary to ensure that the external investment manager administers the LGIP in accordance with Rule 2a-7, the LGIP’s Investment Policy Guidelines (Guidelines), contract terms, and Standard and Poor’s AAAM requirements, thereby providing current and prospective participants with assurance that the LGIP operates in a manner consistent with the safety, liquidity, and returns of a money market fund.

In audit report No. 2009-124R, we reported that SBA had not established, documented, and communicated a complete risk-based monitoring program for the LGIP. In response, SBA indicated that it agreed to finalize implementation of a fully documented investment compliance monitoring program and had hired a consultant to assist in this endeavor. Subsequently, in June 2009, the SBA received the final consultant’s report. Our current audit disclosed that SBA had made progress during the fiscal year ended June 30, 2009, in implementing a structured compliance monitoring program administered by the Investment Oversight Group (IOG). The program generated monthly and ad hoc reviews of the LGIP, improved documentation of reviews of investment manager data, as well as independent verification of LGIP compliance with selected Guideline requirements. However, we noted during our current audit that SBA still had not finalized and communicated a complete risk-based investment compliance monitoring program, including provisions establishing members of the IOG, program objectives, control activities, and procedures.

¹ Part IV, Chapter 218, Florida Statutes.

² Title 17, Section 270, Code of Federal Regulations.

The establishment of a documented risk-based monitoring program would better ensure clear communication of IOG membership, the actions to be taken by the IOG, how the work of the IOG is to be documented and retained, and who is accountable for performing and maintaining documentation of compliance work conducted. In response to inquiry, SBA management indicated that it was still in the process of formalizing written compliance procedures.

Recommendation: We recommend that SBA finalize and implement a documented, risk-based investment compliance monitoring program for the LGIP.

EXHIBIT A
MANAGEMENT'S RESPONSE



STATE BOARD OF ADMINISTRATION
OF FLORIDA

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CHIEF FINANCIAL OFFICER
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BILL McCOLLUM
ATTORNEY GENERAL
AS SECRETARY
ASH WILLIAMS
EXECUTIVE DIRECTOR & CIO

March 3, 2010

Mr. David W. Martin
Auditor General
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, FL 32399-1450

Dear Mr. Martin:

We reviewed the preliminary and tentative finding and recommendation related to your audit of the Local Government Surplus Funds Trust Fund Financial Statements for the fiscal year ended June 30, 2009. We offer the following response in regard to the information presented in the report.

Audit Recommendation: We recommend that SBA finalize and implement a documented, risk-based investment compliance monitoring program for the LGIP.

SBA Response: We agree with this recommendation and expect to have full implementation by fiscal year-end 2010. Significant steps have been taken to date to implement a risk-based compliance monitoring program for the LGIP, including:

- Effective 12/1/09, the organization was restructured to create a separate Risk Management & Compliance unit, headed by a Chief Risk & Compliance Officer who reports directly to the Executive Director & CIO. Significant resources have been allocated to the new unit to enhance the compliance function, consistent with recommendations received from the external consultant retained in FY2009 to evaluate the SBA compliance program.
- Executive Director Policy #10-064 "Senior Investment Group" (SIG) was updated effective 1/2/10 to incorporate Investment Oversight Groups (IOG) as standing sub-committees of the SIG and to set forth objectives and membership of IOGs. The IOGs' mandate per policy is to meet monthly (or on an ad hoc basis as circumstances dictate) to review compliance exceptions that may have a material impact on client portfolios and to develop and document responses to compliance exceptions. Membership of the Short-Term Fixed Income IOG (which is responsible for LGIP compliance) consists of:

- Deputy Executive Director
- Chief Risk & Compliance Officer
- Director of Fixed Income Compliance
- Senior Investment Officer of Fixed Income
- Director of Investment Risk Management

MANAGEMENT'S RESPONSE (CONTINUED)

Mr. David W. Martin

March 3, 2010

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- Procedures for the LGIP compliance process have been drafted by the Director of Fixed Income Compliance and are currently being reviewed.
- A preliminary risk assessment has been prepared for the LGIP compliance program by the Director of Fixed Income Compliance in conjunction with the Director of External Investment Manager Oversight. The risk assessment is currently being reviewed, and upon finalization will serve as the foundation for the "risk-based investment compliance monitoring program for the LGIP" as recommended by the Auditor General's staff.

We welcome the Auditor General's efforts and, as always, we appreciate your diligence and professionalism.

Sincerely,



Ashbel C. Williams
Executive Director & CIO