

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

(An External Investment Pool)

For the Fiscal Years Ended  
June 30, 2016, and 2015



Sherrill F. Norman, CPA  
Auditor General

## **Board of Trustees and Executive Director of the 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 team leader was Barbara St. George, CPA, and the audit was supervised by Allen G. Weiner, CPA.

Please address inquiries regarding this report to Kathryn D. Walker, CPA, Audit Manager, by e-mail at [kathrynwalker@aud.state.fl.us](mailto:kathrynwalker@aud.state.fl.us) or by telephone at (850) 412-2781.

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**STATE BOARD OF ADMINISTRATION  
LOCAL GOVERNMENT SURPLUS FUNDS TRUST FUND (FLORIDA PRIME)  
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## SUMMARY

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### SUMMARY OF REPORT ON FINANCIAL STATEMENTS

Our audit disclosed that the basic financial statements prepared by the State Board of Administration (SBA) present fairly, in all material respects, the net position of the Local Government Surplus Funds Trust Fund (Florida PRIME) and the changes in net position 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

#### Investment Compliance Oversight

**Finding 1:** Our audit disclosed that the SBA did not always timely conduct risk-based investment compliance monitoring of the activities and investments of 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 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; and
- Complied with the various provisions of laws, rules, regulations, contracts, and Florida PRIME's investment policy 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, 2016, and 2015. We obtained an understanding of the 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, in both manner and substance, in accordance with governing provisions of laws, rules, regulations, contracts, and Florida PRIME's investment policy.

## AUDIT METHODOLOGY

The audit methodology 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.



Sherrill F. Norman, 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

### Report on the Financial Statements

We have audited the accompanying financial statements of the State Board of Administration (SBA) Local Government Surplus Funds Trust Fund (Florida PRIME), as of and for the fiscal years ended June 30, 2016, and 2015, and the related notes to the financial statements, which collectively comprise Florida PRIME's basic financial statements as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express opinions 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes

evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

### ***Opinions***

In our opinion, the financial statements referred to above, present fairly, in all material respects, the respective financial position of Florida PRIME as of June 30, 2016, and 2015, and the respective changes in financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Emphasis of Matters***

As discussed in Note I.A., the financial statements present only Florida PRIME and do not purport to, and do not, present fairly the financial position of the State of Florida as of June 30, 2016, and 2015, or the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note II. to the financial statements, Florida PRIME adopted the provisions of Governmental Accounting Standards Board Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements. Adoption of this statement resulted in additional disclosures related to fair value hierarchy and pricing sources in the notes to the financial statements. Our opinion is not modified with respect to this matter.

### ***Other Matters***

#### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that **MANAGEMENT'S DISCUSSION AND ANALYSIS** on pages 4 through 7 be presented to supplement the basic financial statements. Such information, although not a 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 about 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.

### ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated January 17, 2017, on our consideration of the 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 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the SBA's internal control over financial reporting and compliance.

Respectfully submitted,



Sherrill F. Norman, CPA  
Tallahassee, Florida  
January 17, 2017

# MANAGEMENT'S DISCUSSION AND ANALYSIS

YEARS ENDED JUNE 30, 2016, AND JUNE 30, 2015

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 governed by 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, 2016, and 2015. 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 8.

## 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.

The SBA presents the following Florida PRIME basic financial statements: Statements of Net Position and Statements of Changes in Net Position. The Statements of Net Position present information about the nature and amounts of Florida PRIME's assets and liabilities, with the difference reported as net position. The Statements of Changes in Net Position report the increase or decrease in net position during the year as a result of investment activities and participant contributions and withdrawals.

## FINANCIAL SUMMARY

The following Condensed Statements of Net Position and Condensed Statements of Changes in Net Position summarize Florida PRIME's financial statements for each of the last three fiscal years.

### Condensed Statements of Net Position

(in thousands)

	As of June 30,		
	2016	2015	2014
Total assets	\$ 7,837,778	\$ 7,013,345	\$ 7,252,017
Total liabilities	48,347	10,120	60,598
Net position	<u>\$ 7,789,431</u>	<u>\$ 7,003,225</u>	<u>\$ 7,191,419</u>

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

## Condensed Statements of Changes in Net Position

(in thousands)

	For the Fiscal Year Ended June 30,		
	2016	2015	2014
Changes in net position:			
Interest income	\$ 34,098	\$ 14,177	\$ 14,310
Investment expenses	(1,389)	(1,655)	(2,232)
Net income from investing activity	32,709	12,522	12,078
Distributions paid and payable	(33,482)	(12,522)	(12,078)
Participant contributions	16,263,782	15,880,965	15,058,443
Reinvested distributions	33,501	12,530	12,083
Participant withdrawals	(15,553,640)	(16,112,436)	(15,258,585)
Investment transfer from Fund B	43,336	30,747	101,385
Changes in net position	786,206	(188,194)	(86,674)
Net position, July 1	7,003,225	7,191,419	7,278,093
Net position, June 30	\$ 7,789,431	\$ 7,003,225	\$ 7,191,419

### FINANCIAL ANALYSIS

#### **Assets**

Total assets at the end of fiscal years 2016, 2015, and 2014 were \$7.84 billion, \$7.01 billion, and \$7.25 billion, respectively. The increase in total assets and net position in fiscal year 2016 was due primarily to participant contributions and investment transfers from Fund B exceeding withdrawals by \$753.5 million. The decrease in total assets and net position during fiscal year 2015 was mainly the result of participant withdrawals exceeding contributions and investment transfers from Fund B by \$200.7 million.

#### **Liabilities**

Total liabilities at the end of fiscal years 2016, 2015, and 2014 were \$48.3 million, \$10.1 million, and \$60.6 million, respectively. Liabilities increased by \$38.2 million in fiscal year 2016 following a decrease of \$50.5 million in fiscal year 2015. The increase in fiscal year 2016 was due to a \$38.2 million increase in unregistered deposits (deposits sent without prior notification to the SBA). Deposits sent in without being registered by participants are recorded as liabilities until the depositor is identified and credit is awarded to the participant. The decrease in fiscal year 2015 was primarily due to a \$59.5 million decrease in pending investment purchases that was partially offset by a \$9.3 million increase in unregistered deposits.

#### **Net Position and Changes in Net Position**

Florida PRIME's net position increased by \$786.2 million (11 percent) to \$7.8 billion at June 30, 2016, from \$7.0 billion at June 30, 2015, following a \$188.2 million (3 percent) decrease in the previous fiscal year from \$7.19 billion.

Net income from investing activity of \$32.7 million for the fiscal year ended June 30, 2016, was \$20.2 million higher than the \$12.5 million earned for fiscal year 2015, primarily due to higher investment

yields. Net income from investing activity for fiscal year 2015 was \$444 thousand higher than the \$12.1 million earned for fiscal year 2014, primarily due to lower investment expenses. After many years of maintaining a policy stance to keep overnight interest rates to nearly zero in an effort to help stabilize global financial markets, the Federal Reserve raised the target range for the federal funds interest rate by 0.25 percent in December 2015, with promises of more rate hikes to come if the economy continues to rebound.

Investment transfers from Fund B for fiscal year 2016 were \$43.3 million, an increase of \$12.6 million from fiscal year 2015. The \$30.7 million received for fiscal year 2015 was \$70.6 million less than the transfers received from Fund B for fiscal year 2014. Favorable market conditions allowed the Fund B manager to liquidate a portion of the Fund B investments from late 2012 to mid-2013, and again from late 2013 to mid-2014. All remaining Fund B investments were liquidated by the end of September 2014. The final transfer of \$43.3 million to eligible participants of the Local Government Surplus Funds Trust Fund, who had been entitled to, but had not received, a November 2007 interest payment on invested funds, was made in July 2015.

Total investment expenses of \$1.4 million decreased approximately \$266 thousand, or more than 16 percent, during fiscal year 2016. The decrease was primarily a result of a reduction in investment management fees, which were partially offset by an increase in administrative service charges and bank fees. Investment expenses decreased approximately \$577 thousand, or more than 25 percent, during fiscal year 2015 over 2014. This decrease was primarily a result of a reduction in investment management fees and administrative service charges, which were partially offset by an increase in bank fees. Total investment expenses in fiscal years 2016 and 2015 were 1.8 and 2.4 basis points, respectively, or 0.018 and 0.024 percent of average assets under management.

#### FINANCIAL HIGHLIGHTS

Florida PRIME is governed by Chapters 215 and 218, Florida Statutes, and SBA Rules, Chapter 19-7, Florida Administrative Code. 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.

Units of local government eligible to participate in Florida PRIME include, but are not limited to, any county, municipality, school district, special district, clerk of the circuit court, sheriff, property appraiser, tax collector, supervisor of elections, state university, state college, community college, authority, board, public corporation, or any other political subdivision or direct support organization of the State.

For the fiscal year ended June 30, 2016:

- Participant contributions increased 2.4 percent compared with the prior fiscal year, while participant withdrawals decreased 3.5 percent, resulting in net contributions of \$710.1 million.
- Net income from investing activity increased \$20.2 million over the prior fiscal year resulting in an average participant yield for the fiscal year of 0.42 percent, which was higher than the average participant yield of 0.18 percent for the prior fiscal year. The increase in net income from investing

activity was due primarily to an increase in interest rates during the second half of the fiscal year, following the December 2015 target range rate increase announced by the Federal Reserve.

- The SBA implemented a fee holiday beginning January 1, 2016, whereby all participants' monthly Florida PRIME expenses are offset using proceeds from liquidity redemption fees charged to participants in 2008. The total amount of fees offset during the period January 1, 2016, through June 30, 2016, was \$729 thousand.
- The number of active participants decreased from 790 to 775.

For the fiscal year ended June 30, 2015:

- Participant contributions increased 5.5 percent compared with the prior fiscal year, while participant withdrawals increased 5.6 percent, resulting in net withdrawals of \$231.5 million.
- Net income from investing activity increased \$444 thousand over the prior fiscal year; resulting in an average participant yield for the fiscal year of 0.18 percent, which was higher than the average participant yield of 0.17 percent for the prior fiscal year. The increase in net income from investing activity was due primarily to a decrease in investment management fees during the fiscal year. This decrease occurred because during the last half of the fiscal year, Florida PRIME held increased positions in two money market funds managed by Florida PRIME's investment manager. The fees earned by the investment manager from these positions offset the investment management fee otherwise payable to the investment manager by Florida PRIME.
- The number of active participants decreased from 862 to 790.

CONTACT INFORMATION
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These financial statements reflect only the transactions and balances for Florida PRIME. For additional information on Florida PRIME, 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**

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**State Board of Administration  
Local Government Surplus Funds Trust Fund (Florida PRIME)  
Statements of Net Position**

**As of June 30, 2016, and June 30, 2015  
(In Thousands)**

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 46,539	\$ 329,905
Investments:		
Certificates of deposit	2,404,957	1,945,617
Commercial paper	3,224,753	2,084,547
Repurchase agreements	140,000	425,000
Money market funds	1,512,112	1,382,969
Domestic corporate bonds and notes	308,607	701,128
Municipal bonds and notes	60,640	46,400
Foreign corporate bonds and notes (\$ denom)	135,722	94,428
Total investments	<u>7,786,791</u>	<u>6,680,089</u>
Interest receivable	4,393	3,326
Prepaid fees	23	20
Undistributed expenses	<u>32</u>	<u>5</u>
<b>Total Assets</b>	<u>7,837,778</u>	<u>7,013,345</u>
<b>LIABILITIES</b>		
Accounts payable and accrued liabilities	170	161
Distributions payable	62	54
Due to local governments	<u>48,115</u>	<u>9,905</u>
<b>Total Liabilities</b>	<u>48,347</u>	<u>10,120</u>
<b>NET POSITION</b>		
Held in trust for pool participants	<u>\$ 7,789,431</u>	<u>\$ 7,003,225</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 Position**

Years Ended June 30, 2016, and June 30, 2015  
(In Thousands)

	<b>June 30, 2016</b>	<b>June 30, 2015</b>
<b>ADDITIONS</b>		
Income from investing activity:		
Interest income	\$ 34,098	\$ 14,177
Investment expenses:		
Investment management fees	(350)	(690)
Administrative service charges	(761)	(702)
Bank fees	(179)	(162)
Compliance review fees	(57)	(61)
Standard and Poor's rating maintenance fees	(42)	(40)
Investment expenses	(1,389)	(1,655)
Net income from investing activity	32,709	12,522
<b>Total Additions</b>	32,709	12,522
 <b>DEDUCTIONS</b>		
Distributions paid and payable	33,482	12,522
<b>Total Deductions</b>	33,482	12,522
 <b>SHARE TRANSACTIONS</b>		
Participant contributions	16,263,782	15,880,965
Reinvested distributions	33,501	12,530
Participant withdrawals	(15,553,640)	(16,112,436)
Investment transfer from Fund B	43,336	30,747
<b>Net Increase (Decrease) Resulting from Share Transactions</b>	786,979	(188,194)
 Increase (decrease) in net position	 786,206	 (188,194)
 Net position, beginning of year	 7,003,225	 7,191,419
Net position, end of year	\$ 7,789,431	\$ 7,003,225

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

# **NOTES TO FINANCIAL STATEMENTS**

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## **I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The following summary of the significant accounting policies of the Local Government Surplus Funds Trust Fund (Florida PRIME) 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 the Florida Legislature effective October 1, 1977, (Chapter 218, Part IV, Florida Statutes). The law allowed the 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. 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**

Securities and Exchange Commission (SEC) Rule 2a-7 sets out certain requirements pertaining to money market funds required to register with the SEC under the Investment Company Act of 1940. Florida PRIME is not required to register (and has not registered) with the SEC; however, the fund is an external investment pool that has historically adopted operating procedures consistent with those required by SEC Rule 2a-7, which was significantly amended in 2014. In December 2015, the Governmental Accounting Standards Board (GASB) issued Statement No. 79, *Certain External Investment Pools and Pool Participants*, which addresses for certain external investment pools like Florida PRIME and their participants, the accounting and financial reporting implications that result from the SEC Rule 2a-7 amendments.

GASB Statement No. 79 allows an external investment pool for financial reporting purposes to elect to measure all of its investments at amortized cost if the pool meets certain criteria such as portfolio maturity, quality, diversification, and liquidity requirements, and transacts with its participants at a stable net asset value per share. Florida PRIME will seek to operate in a manner consistent with the

criteria and requirements of GASB Statement No. 79. Consequently, the SBA has elected to measure for financial reporting purposes all of Florida PRIME's investments at amortized cost.

### **C. Basis of Presentation**

These financial statements have been prepared in accordance with generally accepted accounting principles (GAAP). The 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 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 No. 79. 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. Cost or book value may be used as an estimate of fair value when an independent pricing source is not available.

### **G. Method Used to Determine Participants' Shares Sold and Redeemed**

Participants' shares are sold and redeemed in Florida PRIME at a stable net asset value per share and earnings are allocated at month-end 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, 2016, and June 30, 2015, 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 by the custodian bank. Florida PRIME's Investment Policy Statement provides that the custodian will, on a daily basis, mark to market the portfolio holdings of Florida PRIME and communicate both the amortized cost price and the market price to the SBA and the investment manager. The Investment Policy Statement also provides that the investment manager perform daily compliance monitoring of the amortized cost price and market price. The SBA performs periodic oversight, at least monthly, of the investment manager's compliance monitoring. When the deviation between the fair value and amortized cost of Florida PRIME exceeds 0.50 percent, Section 218.409(8), Florida Statutes, authorizes the Executive Director of the SBA to promptly consider what action, if any, should 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, the Executive Director will cause Florida PRIME to take such action as deemed appropriate to eliminate or reduce to the extent reasonably practicable such dilution or unfair results. For the fiscal years ended June 30, 2016, and June 30, 2015, the ratio of fair value to amortized cost was 100.01 percent and 100.00 percent, respectively.

## **K. Limitations on Participant Contributions and Withdrawals**

Florida PRIME currently has in place no limitations or restrictions on participant withdrawals, does not currently charge liquidity fees, and has not put in place a redemption gate. Each participant has the ability to withdraw 100 percent of its account balance any day Florida PRIME is open for business.

However, with respect to redemption gates, Section 218.409(8)(a), Florida Statutes, provides that the Executive Director may, in good faith, on the occurrence of an event that has a material impact on liquidity or operations of Florida PRIME, for 48 hours limit contributions to or withdrawals from Florida PRIME to ensure that the SBA can invest moneys entrusted to it in exercising its fiduciary responsibility. Such action must be immediately disclosed to all participants, the trustees, the Joint Legislative Auditing Committee, the Investment Advisory Council, and the Participant Local Government Advisory Council. The trustees shall convene an emergency meeting as soon as practicable from the time the Executive Director has instituted such measures and review the necessity of those measures. If the trustees are unable to convene an emergency meeting before the expiration of the 48-hour moratorium on contributions and withdrawals, the moratorium may be extended by the Executive Director until the trustees are able to meet to review the necessity for the moratorium. If the trustees agree with such measures, the trustees shall vote to continue the measures for up to an additional 15 days. The trustees must convene and vote to continue any such measures before the expiration of the time limit set, but in no case may the time limit set by the trustees exceed 15 days.

With respect to liquidity fees, Section 218.409(4), Florida Statutes, provides authority for the SBA to impose penalties for early withdrawal, subject to disclosure in the enrollment materials for Florida PRIME of the amount and purpose of such fees. At present, no such disclosure has been made or deemed necessary, as Florida PRIME does not charge liquidity fees.

## L. 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, 2016, and June 30, 2015, were \$349,760 and \$689,954, respectively. The decline in investment management fees in fiscal year 2016 was due to an increase in Florida PRIME's investment in two money market funds managed by Federated. Fees earned by Federated in those funds offset the investment management fee otherwise payable to Federated by Florida PRIME.

In accordance with SBA Rule 19-3.016(17), Florida Administrative Code, the SBA charges an administrative service charge to recover its costs related to operating Florida PRIME. The charge is taken out of the monthly earnings prior to the distribution of net earnings to participant balances each month. Currently, the SBA service charge is 1.0 basis point (.0001) on total Florida PRIME assets. Total administrative service charges incurred by Florida PRIME for the fiscal years ended June 30, 2016, and 2015, were \$760,662 and \$702,187, respectively.

Various bank fees (including transaction charges), custody fees, performance analytics, and consulting 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, 2016, were \$178,832, slightly higher than the \$162,063 in bank fees incurred during the prior fiscal year. Standard and Poor's (S&P) rating maintenance fees were \$42,541 and \$40,000 for the fiscal years ended June 30, 2016, and 2015, respectively. Compliance review fees were \$56,743 and \$60,690 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.

The SBA implemented a fee holiday beginning January 1, 2016, whereby all participants' monthly Florida PRIME expenses are offset using proceeds from liquidity redemption fees charged to participants in 2008. The total amount of fees offset during the period January 1, 2016, through June 30, 2016, is \$729 thousand. The financial statement expense amounts presented are the investment fees and administrative service charges incurred by Florida PRIME as a whole, and do not contain any reduction by the amount of the fee holiday given to participants. At June 30, 2016, the remaining balance of liquidity redemption money available to provide future fee holidays was \$1.5 million. This money will continue to provide monthly fee holidays to participants until it is exhausted.

## **M. 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 consisted 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 was administered by the SBA and the SBA distributed cash holdings from May 2008 through September 2014, to eligible Florida PRIME participants as they became available from maturities, sales, investment interest, and other income received from the assets in Fund B. These distributions are recorded on the Statement of Changes in Net Position as a Transfer from Fund B. With the September 2014 distribution, original principal balances were distributed in full to each participant.

Pursuant to Section 218.421(2)(e), Florida Statutes, in July 2015, the SBA transferred the residual cash held in Fund B to eligible participants of the Local Government Surplus Funds Trust Fund, who had been entitled to, but had not received, a November 2007 interest payment on invested funds. After this final transfer, Fund B was closed.

## **II. ACCOUNTING AND REPORTING CHANGES**

Florida PRIME implemented GASB Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements. Adoption of this statement resulted in additional disclosures related to fair value hierarchy and pricing sources in the Notes to Financial Statements.

Florida PRIME implemented GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, except for the provisions in paragraphs 18, 19, 23-26, and 40, which are effective for reporting periods beginning after December 15, 2015. This statement addresses accounting and financial reporting for certain external investment pools and pool participants. It establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes.

## **III. DEPOSITS AND INVESTMENTS**

### **A. Deposits**

Cash is held in deposit accounts at various financial institutions. These deposits totaled \$46,538,558 at June 30, 2016, and \$329,905,013 at June 30, 2015. 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 (QPD).

The State CFO determines the collateral requirements and collateral pledging level for each QPD 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.

At June 30, 2016, all deposits held in Florida PRIME were covered by Federal insurance or the State's collateral pool pursuant to Chapter 280, Florida Statutes. At June 30, 2015, Florida PRIME held an overnight time deposit of \$320 million that was exposed to custodial credit risk because it was uninsured and uncollateralized. Under the investment policy for Florida PRIME, the investment manager is allowed to invest in unsecured interest bearing deposits with banks if they have capital, surplus, and undivided profits of over \$100,000,000, or if the principal amount of the instrument is insured by the Deposit Insurance Fund which is administered by the Federal Deposit Insurance Corporation. This time deposit was held in a bank that met the \$100,000,000 requirement for capital, surplus, and undivided profits. All other June 30, 2015, deposits in Florida PRIME were covered by Federal insurance or the State's collateral pool pursuant to Chapter 280, Florida Statutes.

## **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 the 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 the SBA to administer its varied investment responsibilities. The Investment Policy Statement for Florida PRIME lists the following authorized principal investments:

- United States (U.S.) Treasury obligations.
- U.S. Government Agency obligations.
- 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.
- Insurance contracts, including guaranteed investment contracts, funding agreements, and annuities.
- Corporate debt securities, such as notes, bonds, debentures, commercial paper, interests in bank loans to companies, and demand instruments.
- 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.
- Asset-backed securities, which may be in the form of commercial paper, notes, or pass-through certificates.
- Municipal securities issued by states, counties, cities, and other political subdivisions and authorities.
- Foreign securities (i.e., U.S. dollar-denominated securities of issuers based outside the U.S.).
- Mortgage-backed securities representing interests in pools of mortgages. Mortgages may have fixed or adjustable interest rates.
- 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 Investment Company Act of 1940 (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.

- Shares of registered investment companies that are money market mutual funds, including those that are affiliated with Federated (Investment Manager).
- Special transactions, including repurchase agreements and delayed delivery transactions. Repurchase agreements are 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 the diversification, maturity, liquidity, and credit quality conditions required by GASB Statement No. 79. In buying and selling portfolio securities for Florida PRIME, the Investment Manager will comply with the conditions imposed by GASB Statement No. 79; 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 fair 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 fair value and amortized cost of Florida PRIME exceeds 0.50 percent, Section 218.409(8), Florida Statutes, authorizes the Executive Director to promptly consider what action, if any, should 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, the Executive Director will cause Florida PRIME to take such action as deemed appropriate to eliminate or reduce to the extent reasonably practicable such dilution or unfair results.

### **C. 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, 2016, and June 30, 2015 (expressed in thousands):

**As of June 30, 2016**

<b>Investment Type</b>	<b>Par</b>	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Range of Interest Rates<sup>(1)</sup></b>	<b>Range of Maturity Dates</b>
Certificates of deposit	\$ 2,405,000	\$ 2,404,957	\$ 2,405,560	.43%-1.04%	7/1/16-5/4/17
Commercial paper	3,228,811	3,224,753	3,225,176	.42%-1.22%	7/1/16-6/23/17
Money market funds	1,512,112	1,512,112	1,512,112	.25%-.41%	N/A <sup>(2)</sup>
Domestic corporate bonds & notes	308,606	308,607	308,607	.42%-1.50%	7/6/16-8/1/45 <sup>(3)</sup>
Municipal bonds & notes	60,640	60,640	60,640	.46%-.75%	4/1/24-3/1/39 <sup>(3)</sup>
Foreign corporate bonds & notes (\$ denom)	135,680	135,722	135,729	1.12%-3.13%	7/12/16-9/09/16
Repurchase agreements	140,000	140,000	140,000	.44%-.48%	7/1/16
<b>Totals</b>	<b>\$ 7,790,849</b>	<b>\$ 7,786,791</b>	<b>\$ 7,787,824</b>		

Notes: (1) The coupon rate in effect at June 30, 2016, is reported. If a security is discounted, the purchase yield is reported. The 7-day yield as of June 30, 2016, is reported for the money market funds. The yields fluctuate daily.

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

(3) Florida PRIME has one position in domestic corporate bonds and notes that it may tender for 100 percent of the principal amount, plus accrued interest with a minimum of seven days prior notification to the trustee of the bonds or notes. The final maturity date on this position is August 1, 2045.

Florida PRIME has three positions in municipal bonds and notes that it may tender for 100 percent of the principal amount, plus accrued interest with a minimum of seven days prior notification to the trustee of the bonds or notes. The maturity dates on these positions are April 1, 2024, January 1, 2036, and March 1, 2039.

**As of June 30, 2015**

<b>Investment Type</b>	<b>Par</b>	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Range of Interest Rates<sup>(1)</sup></b>	<b>Range of Maturity Dates</b>
Certificates of deposit	\$ 1,945,700	\$ 1,945,617	\$ 1,945,688	.11%-.65%	7/2/15-7/1/16 <sup>(2)</sup>
Commercial paper	2,085,000	2,084,547	2,084,616	.20%-.40%	7/1/15-5/10/16
Money market funds	1,382,969	1,382,969	1,382,969	.01%-.07%	N/A <sup>(3)</sup>
Domestic corporate bonds & notes	699,287	701,128	700,769	.29%-6.90%	7/1/15-7/21/16 <sup>(2)</sup>
Municipal bonds & notes	46,400	46,400	46,400	.03%	6/15/38 <sup>(4)</sup>
Foreign corporate bonds & notes (\$ denom)	93,965	94,428	94,418	.80%-2.63%	8/7/15-7/15/16
Repurchase agreements	425,000	425,000	425,000	0.11%	7/1/15
<b>Totals</b>	<b>\$ 6,678,321</b>	<b>\$ 6,680,089</b>	<b>\$ 6,679,860</b>		

Notes: (1) The coupon rate in effect at June 30, 2015, is reported. If a security is discounted, the purchase yield is reported. The 7-day yield as of June 30, 2015, is reported for the money market funds. The yields fluctuate daily.

(2) Florida PRIME has the option to extend the maturity date on one position in certificates of deposit on a monthly basis until the final maturity date of October 4, 2018. The maturity date on this position as of June 30, 2015, was July 1, 2016.

Florida PRIME has the option to extend the maturity date on several positions in domestic corporate bonds on a monthly basis until the final maturity dates of July 20, 2018, October 20, 2018, and March 7, 2019. The maturity dates on these positions as of June 30, 2015, were July 21, 2016, July 19, 2016, and July 6, 2016, respectively.

(3) Money market funds do not have a specified maturity date.

(4) Florida PRIME has one position in municipal bonds and notes that it may tender for 100 percent of the principal amount, plus accrued interest with a minimum of zero days prior notification to the trustee of the bonds or notes.

## D. Investments, Fair Value Hierarchy

Florida PRIME's investments are carried at amortized cost, but fair value is reported in certain note disclosures as required by GAAP. Florida PRIME's investments are measured and reported at fair value and classified according to the following hierarchy:

Level 1 – Investments reflect unadjusted quoted prices in active markets for identical assets.

Level 2 – Investments reflect prices that are based on inputs that are either directly or indirectly observable for an asset (including quoted prices for similar assets), which may include inputs in markets that are not considered to be active.

Level 3 – Investments reflect prices based upon unobservable inputs for an asset.

The categorization of investments within the hierarchy is based upon the pricing transparency of the instrument and should not be perceived as the particular investment's risk.

Debt securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Debt securities classified in Level 2 of the fair value hierarchy are valued using a pricing methodology that uses evaluation models, such as matrix pricing, to value securities based on a security's relationship to benchmark quoted prices. Debt securities classified in Level 3 of the fair value hierarchy are subject to being priced by an alternative pricing source utilizing discounted cash flow models and broker bids, or may have an estimated fair value equal to cost, due to the absence of an independent pricing source.

Certain investments, such as money market funds and repurchase agreements, are not included in the following tables because they are not negotiable instruments and are valued at cost.

Florida PRIME has the following fair value measurements as of June 30, 2016, and June 30, 2015 (expressed in thousands):

	June 30, 2016	Fair Value Measurements Using		
		Quoted Prices in Active Market for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Investments by fair value level:				
Debt securities:				
Certificates of deposit	\$ 2,405,560	\$ -	\$ 2,205,560	\$ 200,000
Commercial paper	3,225,176	-	2,990,177	234,999
Domestic corporate bonds & notes	308,607	-	308,607	-
Municipal bonds & notes	60,640	-	60,640	-
Foreign corporate bonds and notes (\$ denom)	135,729	-	135,729	-
Total debt securities measured at fair value	<u>\$ 6,135,712</u>	<u>\$ -</u>	<u>\$ 5,700,713</u>	<u>\$ 434,999</u>

	June 30, 2015	Fair Value Measurements Using		
		in Active Market for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Investments by fair value level:				
Debt securities:				
Certificates of deposit	\$ 1,945,688	\$ -	\$ 1,870,688	\$ 75,000
Commercial paper	2,084,616	-	1,984,616	100,000
Domestic corporate bonds & notes	700,769	-	700,769	-
Municipal bonds & notes	46,400	-	46,400	-
Foreign corporate bonds and notes (\$ denom)	94,418	-	94,418	-
Total debt securities measured at fair value	\$ 4,871,891	\$ -	\$ 4,696,891	\$ 175,000

## 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 in effect at June 30, 2016, investment credit risk and concentration of credit risk of debt securities were managed as follows:

- 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.
- 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.
- 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, 2016, and June 30, 2015 (fair values expressed in thousands):

Ratings <sup>(1)</sup>		Fair Value of Florida PRIME Investments as of June 30, 2016						
S&P	Moody's	Total	Certificates of Deposit	Commercial Paper	Money Market Funds	Repurchase Agreements <sup>(2)</sup>	Corporate & Municipal Bonds & Notes	Foreign Corp. Bonds & Notes (\$ denom)
AAAm		\$ 1,512,112	\$ -	\$ -	\$ 1,512,112	\$ -	\$ -	\$ -
AAA		24,120	-	-	-	-	24,120	-
AA		318,285	45,024	-	-	-	231,230	42,031
A		93,698	-	-	-	-	-	93,698
A-1		3,225,176	-	3,225,176	-	-	-	-
Not rated <sup>(1)</sup>	Aa	37,980	-	-	-	-	37,980	-
Not rated <sup>(1)</sup>	A	60,920	-	-	-	-	60,920	-
Not rated <sup>(1)</sup>	Not rated <sup>(1)</sup>	2,500,533	2,360,536	-	-	125,000	14,997	-
		<u>\$ 7,772,824</u>	<u>\$ 2,405,560</u>	<u>\$ 3,225,176</u>	<u>\$ 1,512,112</u>	<u>\$ 125,000</u>	<u>\$ 369,247</u>	<u>\$ 135,729</u>
Not rated <sup>(3)</sup>	Not rated <sup>(3)</sup>	15,000	Repurchase agreements					
		<u>\$ 7,787,824</u>	<b>Total</b>					

Notes: (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, if available. 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.

(2) Collateral underlying the repurchase agreements was not rated.

(3) Collateral for repurchase agreements which are explicitly guaranteed by the U.S. government do not require disclosure of credit quality.

Ratings <sup>(1)</sup>		Fair Value of Florida PRIME Investments as of June 30, 2015						
S&P	Moody's	Total	Certificates of Deposit	Commercial Paper	Money Market Funds	Repurchase Agreements <sup>(2)</sup>	Corporate & Municipal Bonds & Notes	Foreign Corp. Bonds & Notes (\$ denom)
AAA		\$ 1,382,969	\$ -	\$ -	\$1,382,969	\$ -	\$ -	\$ -
AA		902,662	199,982	-	-	-	691,343	11,337
A		123,907	-	-	-	-	40,826	83,081
A-1		2,084,616	-	2,084,616	-	-	-	-
Not rated <sup>(1)</sup>	Not rated <sup>(1)</sup>	2,185,706	1,745,706	-	-	425,000	15,000	-
<b>Totals</b>		<b>\$ 6,679,860</b>	<b>\$ 1,945,688</b>	<b>\$ 2,084,616</b>	<b>\$ 1,382,969</b>	<b>\$ 425,000</b>	<b>\$ 747,169</b>	<b>\$ 94,418</b>

Notes: (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, if available. 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.

(2) Collateral underlying the repurchase agreements was not rated.

With respect to the concentration of credit risk, at June 30, 2016, Florida PRIME did not have exposure of 5 percent or more to any single issuer. At June 30, 2015, 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, 2015

Issuer Name	Carrying Value	Percent of Portfolio Carrying Value	Fair Value	Percent of Portfolio Fair Value
Bank of America - Repurchase agreements <sup>(1)</sup>	\$ 425,000	6.36%	\$ 425,000	6.36%
JPMorgan Chase & Co. - Commercial Paper	\$ 289,939	4.34%	\$ 289,943	4.34%
JPMorgan Chase & Co. - Certificates of deposit	50,000	0.75%	50,075	0.75%
JPMorgan Chase & Co. - Domestic bonds and notes	15,000	0.22%	15,000	0.22%
JPMorgan Chase & Co. Total <sup>(2)</sup>	\$ 354,939	5.31%	\$ 355,018	5.31%
Sumitomo Mitsui Financial Group - Certificates of deposit	\$ 242,000	3.62%	\$ 241,998	3.62%
Sumitomo Mitsui Financial Group - Commercial paper	102,990	1.54%	102,993	1.54%
Sumitomo Mitsui Financial Group Total <sup>(3)</sup>	\$ 344,990	5.16%	\$ 344,991	5.16%
Wells Fargo & Company - Domestic bonds and notes	\$ 246,837	3.70%	\$ 246,838	3.70%
Wells Fargo & Company - Certificates of deposit	95,700	1.43%	95,688	1.43%
Wells Fargo & Company Total <sup>(3)</sup>	\$ 342,537	5.13%	\$ 342,526	5.13%

Notes: (1) 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.

(2) 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 JPMorgan Chase & Co. was caused by participant account movements.

(3) These percentages were calculated based on the holdings of the investment portfolio in accordance with GASB Statement No. 40. If the percentages were adjusted to consider the effects of a \$320 million time deposit, the percentage would have dropped to 4.9 percent, 0.1 percent below the 5.0 percent threshold.

## F. Investments, Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the 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, 2016, and June 30, 2015, all investments, except those in money market funds in which the SBA invests (i.e., in commingled funds with other investors), were held in the SBA's name by the 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, 2016, and June 30, 2015, at fair value (expressed in thousands), with the DWAM for each security type:

<b>As of June 30, 2016</b>		
<b>Investment Type</b>	<b>Fair Value</b>	<b>Dollar Weighted Average Maturity (in Days)<sup>(1)</sup></b>
Certificates of deposit <sup>(2)</sup>	\$ 2,405,560	40
Commercial paper <sup>(2)</sup>	3,225,176	58
Money market funds <sup>(3)</sup>	1,512,112	1
Domestic corporate bonds & notes	308,607	47
Municipal bonds & notes	60,640	7
Foreign corporate bonds & notes (\$ denom)	135,729	29
Repurchase agreements	140,000	1
Total	<u>\$ 7,787,824</u>	
<b>Portfolio dollar-weighted average maturity (DWAM)</b>		<b>39</b>

Notes: (1) Interest rate reset dates are used in the calculation of the DWAM.

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

(3) The DWAM of the underlying securities in the three money market funds at June 30, 2016, ranged from 19 to 28 days. However, the money market funds provided daily liquidity.

As of June 30, 2015

<b>Investment Type</b>	<b>Fair Value</b>	<b>Dollar Weighted Average Maturity (in Days)<sup>(1)</sup></b>
Certificates of deposit <sup>(2)</sup>	\$ 1,945,688	47
Commercial paper <sup>(2)</sup>	2,084,616	34
Money market funds <sup>(3)</sup>	1,382,969	1
Domestic corporate bonds & notes	700,769	68
Municipal bonds & notes	46,400	1
Foreign corporate bonds & notes (\$ denom)	94,418	137
Repurchase agreements	425,000	1
Total	<u>\$ 6,679,860</u>	
<b>Portfolio dollar-weighted average maturity (DWAM)<sup>(4)</sup></b>		<b>34</b>

Notes: (1) Interest rate reset dates are used in the calculation of the DWAM.

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

(3) The DWAM of the underlying securities in the three money market funds at June 30, 2015, ranged from 36 to 48 days. However, the money market funds provided daily liquidity.

(4) The total Portfolio DWAM does not take into account the \$320 million held in a time deposit at June 30, 2015. If the time deposit had been included, the total Portfolio DWAM would have been 32 days.

GASB Statement No. 79 also requires the portfolio of a qualifying external investment pool to maintain a weighted average life (WAL) of 120 days or less. A weighted average life measure expresses the average length of time that each dollar of principal remains unpaid without taking into account the maturity shortening features used in calculating the DWAM. Pursuant to the Investment Policy Guidelines, the Investment Manager will exercise reasonable care to maintain a maximum WAL within the range of 90 to 120 days for Florida PRIME. The WAL for Florida PRIME at June 30, 2016, was 58 days.

## H. Investments, Foreign Currency Risk

Investment policy guidelines prohibit the Investment Manager from purchasing investments denominated in foreign currency, therefore all Florida PRIME securities are U.S. dollar denominated. Florida PRIME was not exposed to foreign currency risk during the fiscal years ended June 30, 2016, and June 30, 2015.



Sherrill F. Norman, CPA  
Auditor General

# AUDITOR GENERAL STATE OF FLORIDA

Claude Denson Pepper Building, Suite G74  
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Tallahassee, Florida 32399-1450



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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 FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

We have audited, 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, the financial statements of the State Board of Administration (SBA) Local Government Surplus Funds Trust Fund (Florida PRIME), as of and for the fiscal year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise Florida PRIME's basic financial statements, and have issued our report thereon dated January 17, 2017, included under the heading **INDEPENDENT AUDITOR'S REPORT**.

### **Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the SBA's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the SBA's internal control. Accordingly, we do not express an opinion on the effectiveness of the SBA's internal control.

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 Florida PRIME's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control 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 material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Florida PRIME's financial statements are free from material misstatement, we performed tests of the 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*.

### **Additional Matters**

We noted an additional matter related to investment compliance oversight that we reported to management as Finding 1 in the ***FINDINGS AND RECOMMENDATIONS*** accompanying this report.

### **Management's Response to Finding**

The SBA's response to the finding described in the ***FINDINGS AND RECOMMENDATIONS*** accompanying this report is included as ***MANAGEMENT'S RESPONSE***. The SBA's response was not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it.

### **Purpose of this Report**

The purpose of the **INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS** is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the SBA's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the SBA's internal control and compliance. Accordingly, this report is not suitable for any other purpose.

Respectfully submitted,



Sherrill F. Norman, CPA  
Tallahassee, Florida  
January 17, 2017

## FINDINGS AND RECOMMENDATIONS

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### ADDITIONAL MATTER

#### Finding 1: Investment Compliance Oversight

To ensure that the external investment manager (investment manager) administers Florida PRIME in accordance with Securities and Exchange Commission Rule 2a-7,<sup>1</sup> the Investment Policy Statement for Florida PRIME (IPS), and contract terms, the State Board of Administration (SBA) should establish an investment compliance program for Florida PRIME that provides current and prospective Florida PRIME participants with assurance that Florida PRIME operates in a manner consistent with the expectations of safety, liquidity, and competitive returns of a money market fund with minimization of risks.

In our report No. 2009-124R (finding No. 3), we noted that the SBA had not established for Florida PRIME an investment compliance monitoring program that included risk-based testing of the Florida PRIME portfolio and investment purchases. In response to the finding, SBA management agreed to implement a fully documented investment compliance program for Florida PRIME that incorporated risk-based testing of the Florida PRIME portfolio and investment purchases.

The SBA's *Compliance Program Procedures* for Florida PRIME (*Procedures*), effective June 30, 2015, required the Director of Public Market Compliance to independently verify, using a risk-based approach, the accuracy of the information included in monthly compliance reports prepared by the Florida PRIME investment manager. Using this approach, each IPS parameter for the Florida PRIME portfolio and investment purchases was ranked as "High" or "Low" with respect to the level of risk associated with a potential breach of the IPS. The *Procedures* specified that, at least monthly, compliance with IPS parameters with risk rankings of "High" were to be independently verified and the test results to be reported to the Investment Oversight Group (IOG)<sup>2</sup> and the SBA Executive Director. In addition, any IPS parameters with a "Fail" status indicated on the investment manager's monthly compliance report, regardless of risk ranking, were to be reviewed by the IOG and reported to the Executive Director. IOG decisions regarding items identified during the independent testing and those reported by the investment manager were to be documented in IOG meeting minutes. The *Procedures* required the IOG, on an annual basis, to review and approve the risk rankings and the frequency of the SBA's independent verification of compliance with IPS parameters, and stated that the IOG may reevaluate more frequently if dictated by market conditions.

The *Procedures* identified various high-risk IPS parameters that were to be monitored by the SBA on a monthly basis. These parameters were:

- All securities must be U.S. dollar denominated.

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<sup>1</sup> According to the Investment Policy Statement for Florida PRIME, effective August 2, 2016, Florida PRIME will seek to operate in a manner consistent with the criteria and requirements specified in Governmental Accounting Standards Board Statement No. 79, *Certain External Investment Pools and Pool Participants*, rather than Securities and Exchange Commission Rule 2a-7.

<sup>2</sup> The IPS for Florida PRIME effective July 1, 2015, specified that the IOG (composed of the Chief Risk and Compliance Officer, the Senior Investment Officer for Fixed Income, the Director of Public Market Compliance, and the Director of Enterprise Risk Management) was to meet and report monthly to the Executive Director, except upon the occurrence of a material event. Also, the meeting minutes and a listing of participants were to be timely posted on the Florida PRIME Web site.

- A minimum of 10 percent of assets must be invested in securities accessible within 1 business day.
- A minimum of 30 percent of assets must be invested in securities accessible within 5 business days.
- The dollar weighted average maturity of the Florida PRIME portfolio must be less than or equal to 60 days.
- The weighted average life of the Florida PRIME portfolio must be less than or equal to 120 days.
- The Standard and Poor's weighted average life must be maintained within a range of 90-120 days.
- All securities must be rated as first-tier.<sup>3</sup>
- Unregistered securities must be eligible for sale to accredited investors or to qualified purchasers.

In addition, the *Procedures* specified that the SBA was to monitor the net asset value of Florida PRIME on a daily basis to ensure that the ratio of fair value to amortized cost remained at or above 99.75 percent.

Our audit procedures disclosed that the SBA did not always timely perform risk-based investment compliance monitoring for Florida PRIME. Specifically, we noted that, while the *Procedures* specified that compliance monitoring was to be performed at least monthly, the *Procedures* did not specify a time frame for reviewing the high-risk IPS parameters. For audit purposes, we considered the review of high-risk IPS parameters to be timely if the reviews occurred within 60 days of month-end. Our examination of SBA records disclosed that, for 4 months of the 2015-16 fiscal year, the reviews of the high-risk IPS parameters were performed 73 to 183 days (an average of 122 days) after month-end. Additionally, we noted that, contrary to the IPS, the last IOG meeting held during the period July 2015 through June 2016 was held in October 2015. The IOG meetings subsequently resumed in October 2016. In response to our audit inquiry, SBA management indicated that the SBA temporarily suspended the IOG meetings with the understanding that the independent compliance reviews would continue and the controls in place would continue to operate effectively.

The timely review of high-risk IPS parameters and the conduct of monthly IOG meetings are essential to ensure that the SBA takes timely and appropriate actions to address any items that fail to meet IPS compliance criteria and facilitates the SBA's ability to limit the amount of potential losses to Florida PRIME participants.

**Recommendation:** We recommend that SBA management enhance procedures to specify a time frame for conducting compliance monitoring and ensure that high-risk IPS parameters are timely reviewed. We also recommend that the IOG meet monthly in accordance with the IPS.

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<sup>3</sup> To be considered a first tier security, the IPS specifies that a security must be rated in the highest short-term rating category by one or more nationally recognized statistical rating organizations or be deemed to be of comparable quality thereto by the investment manager.

# MANAGEMENT'S RESPONSE

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EXECUTIVE DIRECTOR & CIO

January 13, 2017

Ms. Sherrill F. Norman, CPA  
Auditor General  
Office of the Auditor General of the State of Florida  
G74 Claude Denson Pepper Building  
111 West Madison Street  
Tallahassee, Florida 32399-1450

Dear Ms. Norman,

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, 2016. As recommended, we agree to enhance compliance procedures to specify a reasonable time frame for reviewing monitored compliance parameters. In addition, the Investment Oversight Group will meet in accordance with Investment Policy Statement requirements.

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

Sincerely,

A handwritten signature in black ink, appearing to read "Ashbel C. Williams".

Ashbel C. Williams  
Executive Director & Chief Investment Officer

cc: Ms. Kim Stirner, Chief Audit Executive, SBA  
Ms. Karen Chandler, Chief Risk & Compliance Officer, SBA  
Mr. Mike McCauley, Senior Officer – Investment Programs & Governance, SBA