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**COMMONWEALTH OF PENNSYLVANIA**  
***TREASURY DEPARTMENT***  
***INVEST PROGRAM FOR LOCAL GOVERNMENTS***  
**INVEST DAILY AND INVEST COMMUNITY PORTFOLIOS**  
**HARRISBURG, PENNSYLVANIA**

**AUDIT REPORT**  
**FOR THE YEAR ENDED DECEMBER 31, 2012**

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**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS  
DECEMBER 31, 2012**

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**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS  
DECEMBER 31, 2012**

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**BACKGROUND**

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The INVEST Program for Local Governments (INVEST) is a diversified investment portfolio open to all local governments in the Commonwealth of Pennsylvania. INVEST operates by pooling local government funds and investing them under the investment expertise and integrity of the Treasury Department.

Any local government in the Commonwealth (county, city, borough, incorporated town, township, school district, authority or other similar general purpose unit of the government which is created by the Pennsylvania General Assembly) or other non-profit or quasi-governmental entity, Pennsylvania colleges and universities, fire companies and libraries may participate in INVEST. INVEST was implemented to provide local governments an alternative to existing investment methods.

INVEST consists of two rated portfolios, INVEST Daily and INVEST Community. INVEST Daily and INVEST Community have no minimum or maximum balance requirement, no minimum investment term and no minimum transaction size.

The investment objective of INVEST is to provide a low-cost liquid investment mechanism for local government which 1) is operated by prudent investment management, 2) provides a high level of security for the INVEST members, and 3) also meets their short-term cash needs. In an effort to achieve this objective, INVEST prioritizes its operations in the following manner:

- ***Safety of principal.*** INVEST maintains a stable net asset value of \$1.00 per \$1.00 invested to preserve the capital commitments of the INVEST members. Safety of principal is the foremost objective.
- ***Liquidity.*** The INVEST Daily and INVEST Community Portfolios maintain daily liquidity in order to meet any reasonably anticipated operational requirements of their members. Furthermore, the electronic transfer feature for deposits and withdrawals provides the fastest movement of funds available each day.
- ***Income.*** INVEST strives to provide the greatest possible market rate of return (after nominal fees are paid), while accounting for investment risk constraints and the cash-flow aspects of the investment pools.



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EUGENE A. DePASQUALE  
AUDITOR GENERAL

## Independent Auditor's Report

Shareholders  
INVEST Program for Local Governments

### **Report on the Financial Statements**

We have audited the accompanying statements of fiduciary net position, including the schedules of investments of the INVEST Daily and INVEST Community Portfolios (the two primary portfolios constituting the Commonwealth of Pennsylvania Treasury Department's INVEST Program for Local Governments), an investment trust fund of the Commonwealth of Pennsylvania, as of December 31, 2012, and the related statements of changes in fiduciary net position, operations and financial highlights for a share outstanding for the year then ended, and the related notes to the financial statements.

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

Management is responsible for the preparation and fair presentation of these financial statements and financial highlights 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 an opinion on these financial statements and financial highlights 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 and financial highlights are free of 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 and financial highlights, 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 and financial highlights 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 and financial highlights.

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

As discussed in Note A, the financial statements and financial highlights present only the INVEST Program for Local Governments and do not purport to, and do not, present fairly the financial position of the Commonwealth of Pennsylvania as of December 31, 2012, 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.

As discussed in Note A, the INVEST Program for Local Governments includes custom portfolios for certain shareholders, which are not reported as part of the accompanying financial statements.

### ***Opinion***

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of the INVEST Daily and INVEST Community Portfolios of the Treasury Department's INVEST Program for Local Governments as of December 31, 2012, and the results of their operations, changes in their fiduciary net position and financial highlights for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Other Matters***

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

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 8 be presented to supplement the financial statements and financial highlights. Such information, although not a part of the financial statements and financial highlights, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements and financial highlights 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 financial statements and financial highlights, and other knowledge we obtained during our audit of the financial statements and financial highlights. 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 Information*

The Background has not been subjected to the auditing procedures applied in the audit of the financial statements and financial highlights, and accordingly, we do not express an opinion or provide any assurance on it.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated October 21, 2013, on our consideration of Treasury's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. 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 Treasury's internal control over financial reporting and compliance.



October 22, 2013

EUGENE A. DEPASQUALE  
Auditor General

**TREASURY DEPARTMENT  
 INVEST PROGRAM FOR LOCAL GOVERNMENTS  
 FOR THE YEAR ENDED DECEMBER 31, 2012  
 MANAGEMENT’S DISCUSSION AND ANALYSIS**

This discussion and analysis of the INVEST Program’s performance provides an overview of the financial activities for calendar year 2012. Please read it in conjunction with the INVEST financial statements.

The financial statements consist of the Statement of Fiduciary Net Position, Schedule of Investments, Statement of Operations, Statement of Changes in Fiduciary Net Position and Financial Highlights for a Share Outstanding. Together these statements provide information about the activities of INVEST as a whole and present a longer term view of the program’s assets. These statements include all assets and liabilities using the accrual basis of accounting. All of the current year’s revenues and expenses are taken into account regardless of when the cash is received or paid.

**Comparative Condensed Statement of Fiduciary Net Position (Amounts in Thousands)**

	<u>2012</u>	<u>2011</u>	<u>Increase (Decrease)</u>	
			<u>Amount</u>	<u>Percent</u>
<b>Daily and Community Pools</b>				
Total Investments	\$532,760	\$468,671	\$64,089	13.7%
Other Assets and Liabilities	(74)	(9,535)	9,461	(99.2%)
<b>Total Net Position</b>	<u>\$532,686</u>	<u>\$459,136</u>	<u>\$73,550</u>	<u>16.0%</u>

Total Investments and Total Net Position increased by 13.7% and 16% respectively, during calendar year 2012. The increases are mainly attributable to a decline in Shares Redeemed and therefore, a higher percentage of deposits available to invest than the prior year. Calendar year 2012 saw Shares Redeemed decrease by \$198 million from 2011. With the combination of economic uncertainty due to the Presidential elections and low rates, participants looked to the safety of the Invest program with their deposits.

On 12/30/11, participant activity for the day resulted in a large negative balance. That led to an inflated “Other Assets and Liabilities” for 2011. On 12/31/2012, participant activity for the day resulted in a positive balance. This explains the large percentage decrease in “Other Assets and Liabilities” between the two years.

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS  
FOR THE YEAR ENDED DECEMBER 31, 2012  
MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)**

**Comparative Condensed Statement of Revenues and Expenses (Amounts in Thousands)**

	<u>2012</u>	<u>2011</u>	<u>Increase/(Decrease)</u>	
			<u>Amount</u>	<u>Percent</u>
<b>Daily and Community Pools</b>				
<b>Operating expenses:</b>				
Administrative fees	\$ (492)	\$ (448)	\$ (44)	9.8%
<b>Non-operating revenues:</b>				
Investment income	791	716	75	10.5%
<b>Capital Share Transactions:</b>				
Dividends distributed	(299)	(268)	(31)	11.6%
Shares issued	1,278,991	1,313,545	(34,554)	(2.6%)
Shares issued in lieu of cash distributions	254	248	6	2.4%
Shares redeemed	<u>(1,205,695)</u>	<u>(1,403,745)</u>	<u>198,050</u>	<u>(14.1%)</u>
<b>Change in Net Position</b>	<u>\$ 73,550</u>	<u>\$ (89,952)</u>	<u>\$ 163,502</u>	

Administrative expenses are based on the average daily net assets. As the participant balances increase/decline, the base to which administrative expenses are computed increases/declines proportionately. For 2012, administrative fees increased by 9.8% as the average daily net assets also increased.

Investment Income increased by approximately 10.5%, due to the increase in assets available to invest. In an effort to combat the low rates, as of July 20, 2011, INVEST indefinitely waived a portion of the management/administrative fee. The fee is adjusted to allow a minimum 5 basis point yield on participant accounts.

Likewise, as Investment Income increases, income distributions increase nearly proportionately. Dividends distributed and Shares Issued in Lieu of Cash increased 11.6% and 2.4% respectively, with more investment income generated by the pool.

The decrease in Shares Issued is attributed to the overall decrease in deposits to participant accounts. However, as mentioned previously, while deposits decreased, withdrawals decreased at a much higher rate. Shares Redeemed by Participants decreased by approximately \$198 million or about 14% from the prior year. With uncertain economic times ahead, Invest participants valued the safety of the Invest Pools over riskier investments in the financial markets.



**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS  
FOR THE YEAR ENDED DECEMBER 31, 2012  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

The credit quality of each of the Portfolios during 2012 continues to be rated “AAAm” by the Standard & Poor’s Corporation (“S&P”). This is the highest “S&P” rating available for funds of this type.

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**INVEST DAILY PORTFOLIO  
STATEMENT OF FIDUCIARY NET POSITION  
AS OF DECEMBER 31, 2012**

**ASSETS**

Cash	\$	340,000
Investments, at value (cost \$477,962,634)		478,063,391
Income Receivable		15,925
Receivable for Investment Sales		<u>247,610,751</u>
Total Assets	\$	<u>726,030,067</u>

**LIABILITIES**

Payable for Investment Purchases	\$	247,953,975
Distributions Payable		44,112
Administrative Fees		<u>35,359</u>
Total Liabilities	\$	<u>248,033,446</u>

<b>NET POSITION</b>	\$	<u>477,996,621</u>
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- The notes to the financial statements are an integral part of this statement. -

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**INVEST COMMUNITY PORTFOLIO  
STATEMENT OF FIDUCIARY NET POSITION  
AS OF DECEMBER 31, 2012**

**ASSETS**

Cash	\$	336,001
Investments, at value (cost \$54,687,145)		54,697,159
Income Receivable		1,988
Receivable for Investment Sales		<u>27,962,766</u>
Total Assets	\$	<u>82,997,914</u>

**LIABILITIES**

Payable for Investment Purchases	\$	28,299,134
Distributions Payable		3,996
Administrative Fees		<u>5,325</u>
Total Liabilities	\$	<u>28,308,455</u>

<b>NET POSITION</b>	\$	<u>54,689,459</u>
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- The notes to the financial statements are an integral part of this statement. -

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**INVEST DAILY PORTFOLIO  
SCHEDULE OF INVESTMENTS  
AS OF DECEMBER 31, 2012**

<u>Description</u>	<u>Maturity</u>	<u>Face</u>	<u>Fair Value</u>
<b><u>U.S. Government Agency Obligations:</u></b>			
Fannie Mae Discount Note	1/2/2013	\$ 2,000,000	\$ 1,999,989
Fannie Mae Discount Note	1/3/2013	3,050,000	3,049,976
Fannie Mae Discount Note	8/1/2013	16,900,000	16,882,263
Federal Farm Credit Bank	10/22/2013	2,500,000	2,499,738
Federal Farm Credit Bank	12/13/2013	5,000,000	4,999,289
Federal Farm Credit Bank Discount Note	6/24/2013	1,000,000	999,130
Federal Farm Credit Bank Discount Note	11/5/2013	3,500,000	3,494,460
Federal Home Loan Bank	5/2/2013	2,300,000	2,300,000
Federal Home Loan Bank	9/19/2013	5,000,000	4,999,726
Federal Home Loan Bank	10/4/2013	2,500,000	2,499,735
Federal Home Loan Bank	10/10/2013	2,500,000	2,499,903
Federal Home Loan Bank Discount Note	2/11/2013	2,500,000	2,499,488
Federal Home Loan Bank Discount Note	3/20/2013	6,200,000	6,197,383
Federal Home Loan Bank Discount Note	7/9/2013	1,000,000	998,845
Federal Home Loan Bank Discount Note	9/3/2013	3,850,000	3,845,022
Freddie Mac Discount Note	1/7/2013	3,345,000	3,344,910
Freddie Mac Discount Note	1/9/2013	8,600,000	8,599,656
Freddie Mac Discount Note	3/15/2013	2,000,000	1,999,230
Freddie Mac Discount Note	4/1/2013	8,000,000	7,996,000
Freddie Mac Discount Note	4/23/2013	23,500,000	23,486,320
Freddie Mac Discount Note	5/29/2013	2,500,000	2,498,253
Freddie Mac Discount Note	6/25/2013	1,000,000	999,125
Freddie Mac Discount Note	7/8/2013	10,000,000	9,990,208
Freddie Mac Discount Note	10/15/2013	10,208,000	10,193,013
Freddie Mac Discount Note	11/12/2013	1,500,000	1,497,506
International Bank for Reconstruction & Development Discount Note	1/2/2013	6,000,000	5,999,993
International Bank for Reconstruction & Development Discount Note	1/9/2013	25,000,000	24,999,556
International Bank for Reconstruction & Development Discount Note	1/17/2013	25,000,000	24,999,111

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**INVEST DAILY PORTFOLIO  
SCHEDULE OF INVESTMENTS (Continued)  
AS OF DECEMBER 31, 2012**

<u>Description</u>	<u>Maturity</u>	<u>Face</u>	<u>Fair Value</u>
<b><u>U.S. Government Agency Obligations:</u></b>			
International Bank for Reconstruction & Development Discount Note	1/18/2013	\$ 15,000,000	\$ 14,999,504
International Bank for Reconstruction & Development Discount Note	3/15/2013	<u>25,000,000</u>	<u>24,993,410</u>
<b>Total U.S. Government Agency Obligations</b>		\$226,453,000	\$226,360,742
<b><u>Repurchase Agreements:</u></b>			
Bank of America Repo	1/2/2013	\$119,500,000	\$119,500,000
Credit Suisse Repo	1/2/2013	<u>88,500,000</u>	<u>88,500,000</u>
<b>Total Repurchase Agreements</b>		\$208,000,000	\$208,000,000
<b><u>Money Markets:</u></b>			
Morgan Stanley Institutional Liquidity Federally Insured Cash Account	8/21/2021	\$ 20,139,912 <u>19,562,737</u>	\$ 20,139,912 <u>19,562,737</u>
<b>Total Money Markets</b>		\$ 39,702,649	\$ 39,702,649

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**INVEST DAILY PORTFOLIO  
SCHEDULE OF INVESTMENTS (Continued)  
AS OF DECEMBER 31, 2012**

<u>Description</u>	<u>Maturity</u>	<u>Face</u>	<u>Fair Value</u>
<b><u>Bank Deposit Accounts:</u></b>			
Metro Bank Deposits	7/20/2049	\$ 1,000,000	\$ 1,000,000
Team Capital Deposits	7/27/2049	1,000,000	1,000,000
First National Bank of PA	10/31/2049	1,000,000	1,000,000
Meridian Bank NOW	11/1/2049	<u>1,000,000</u>	<u>1,000,000</u>
<b>Total Bank Deposits</b>		\$ 4,000,000	\$ 4,000,000
<b>Total Investments (Cost \$477,962,634)</b>		\$478,155,649	\$478,063,391
<b>Net Other Assets and Liabilities</b>			<u>(66,770)</u>
<b>Net Position Held in Trust for Pool Participants</b>			<u><u>\$477,996,621</u></u>

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

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**INVEST COMMUNITY PORTFOLIO  
SCHEDULE OF INVESTMENTS  
AS OF DECEMBER 31, 2012**

<u>Description</u>	<u>Maturity</u>	<u>Face</u>	<u>Fair Value</u>
<b><u>U.S. Government Agency Obligations:</u></b>			
Fannie Mae Discount Notes	8/1/2013	\$ 2,000,000	\$ 1,997,880
Federal Farm Credit Bank	12/13/2013	1,000,000	999,858
Federal Farm Credit Bank Discount Note	6/24/2013	1,000,000	999,130
Federal Home Loan Bank	9/19/2013	1,000,000	999,836
Federal Home Loan Bank	10/17/2013	1,000,000	999,976
Federal Home Loan Bank Discount Note	9/3/2013	1,650,000	1,647,866
Freddie Mac Discount Note	1/7/2013	1,000,000	999,970
Freddie Mac Discount Note	1/9/2013	1,000,000	999,960
Freddie Mac Discount Note	3/15/2013	1,000,000	999,615
Freddie Mac Discount Note	4/23/2013	3,000,000	2,998,258
Freddie Mac Discount Note	5/29/2013	1,000,000	999,301
Freddie Mac Discount Note	10/15/2013	1,000,000	998,406
International Bank for Reconstruction & Development Discount Note	1/9/2013	1,500,000	1,499,973
International Bank for Reconstruction & Development Discount Note	1/17/2013	2,500,000	2,499,911
International Bank for Reconstruction & Development Discount Note	1/18/2013	4,250,000	4,249,859
International Bank for Reconstruction & Development Discount Note	3/15/2013	1,500,000	1,499,605
<b>Total U.S. Government Agency Obligations</b>		<b>\$ 25,400,000</b>	<b>\$ 25,389,404</b>
<b><u>Repurchase Agreements:</u></b>			
Bank of America Repo	1/2/2013	\$ 13,500,000	\$ 13,500,000
Credit Suisse Repo	1/2/2013	11,500,000	11,500,000
<b>Total Repurchase Agreements</b>		<b>\$ 25,000,000</b>	<b>\$ 25,000,000</b>

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**INVEST COMMUNITY PORTFOLIO  
SCHEDULE OF INVESTMENTS (Continued)  
AS OF DECEMBER 31, 2012**

<u>Description</u>	<u>Maturity</u>	<u>Face</u>	<u>Fair Value</u>
<b><u>Money Market Funds:</u></b>			
Federally Insured Cash	8/21/2021	\$ 2,508,220	\$ 2,508,220
Morgan Stanley Institutional Liquidity		<u>1,799,535</u>	<u>1,799,535</u>
<b>Total Money Markets</b>		\$ 4,307,755	\$ 4,307,755
<b>Total Investments (Cost \$54,687,145)</b>		\$ 54,707,755	\$ 54,697,159
Net Other Assets and Liabilities			<u>(7,700)</u>
<b>Net Position Held in Trust for Pool Participants</b>			<b><u>\$ 54,689,459</u></b>



**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**STATEMENT OF CHANGES IN FIDUCIARY NET POSITION  
FOR THE YEAR ENDED DECEMBER 31, 2012**

	<u>INVEST Daily Portfolio</u>	<u>INVEST Community Portfolio</u>
<b>Operations</b>		
Net increase in net position resulting from operations	\$ 264,078	\$ 35,203
Dividends distributed from net investment income	(264,078)	(35,203)
<b>Capital shares transactions</b> (at \$1.00 per share)		
Proceeds from shares issued	1,220,568,587	58,423,180
Shares issued in lieu of cash distributions	220,573	33,875
Shares redeemed	<u>(1,148,833,255)</u>	<u>(56,862,422)</u>
<b>Net increase from capital shares transactions</b>	\$ 71,955,905	\$ 1,594,633
<b>Net increase in net position</b>	\$ 71,955,905	\$ 1,594,633
<b>Net position</b>		
Beginning of period	<u>406,040,716</u>	<u>53,094,826</u>
End of Period	<u>\$ 477,996,621</u>	<u>\$ 54,689,459</u>

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

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**STATEMENT OF OPERATIONS  
FOR THE YEAR ENDED DECEMBER 31, 2012**

	<b>INVEST Daily Portfolio</b>	<b>INVEST Community Portfolio</b>
	<u>                    </u>	<u>                    </u>
Investment Income	\$ 699,235	\$ 92,360
Administrative Fees Expense	<u>(435,157)</u>	<u>(57,157)</u>
<b>Net increase in net position resulting from operations</b>	<u><u>\$ 264,078</u></u>	<u><u>\$ 35,203</u></u>

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

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**FINANCIAL HIGHLIGHTS FOR A SHARE OUTSTANDING  
AS OF DECEMBER 31, 2012**

	<b>INVEST Daily Portfolio</b>	<b>INVEST Community Portfolio</b>
<b>Net Asset Value, Beginning of Period</b>	\$ 1.000	\$ 1.000
<b>Investment Activities:</b>		
Income	0.0016	0.0016
Expense	0.0010	0.0010
Net Investment Income	0.0006	0.0006
<b>Total From Investment Income</b>	0.0006	0.0006
<b>Distributions:</b>		
Net Investment Income	(0.0006)	(0.0006)
<b>Total Distributions</b>	(0.0006)	(0.0006)
<b>Net Asset Value, End of Period</b>	\$ 1.000	\$ 1.000
Ratio of expenses to average net position	-0.10%	-0.10%
Ratio of net investment income to average net position	0.16%	0.16%
Total Return	0.06%	0.06%
<b>Net Position, End of Period</b>	<u>\$477,996,621</u>	<u>\$ 54,689,459</u>

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

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**FOR THE YEAR ENDED DECEMBER 31, 2012  
NOTES TO FINANCIAL STATEMENTS**

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**NOTE A – REPORTING ENTITY**

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The accompanying financial statements present, as of December 31, 2012, the financial results of the INVEST Daily Portfolio and INVEST Community Portfolio, the two rated portfolios of the local government investment pool. Custom pools are established to meet the specific liquidity and investment requirements of certain shareholders. The custom pools are not included in the accompanying financial statements.

The INVEST program for Local Governments (INVEST) aggregates the funds of local governments in external investment pools. The Treasury Department (Department) manages the local government investment pools, which make up the INVEST Program, by virtue of the authority set forth in the Fiscal Code at 72 P.S. § 3832. The INVEST Program is authorized to invest in federal obligations, repurchase agreements, and other debt instruments, subject to the provisions of the INVEST investment policy, local government participant statutory authority, and the guidelines of the rating agency Standard & Poor’s as described below.

The INVEST Program does not provide any guarantees against loss of principal, nor can it draw upon the taxing power of the Commonwealth of Pennsylvania. However, INVEST is managed to maintain a net asset value of \$1.00 per share to assure principal value and limit exposure to loss. The pools have the highest credit quality rating on the basis of portfolio assets, investment practices, diversification standards, operational controls and management oversight. INVEST Daily and Community portfolios received an “AAAm” investment rating from Standard & Poor’s (S&P), the highest rating available. This rating indicates a level of quality based on the types of investments, weighted average duration to maturity, net asset value, issuer exposure and other factors. The rating agency monitors the portfolios weekly.

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**NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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**Basis of Presentation:**

The INVEST financial statements have been prepared in accordance with accounting principles generally accepted in the United States applicable to governments.

INVEST is classified as an Investment Trust Fund and is reported using the economic resources measurement focus and the accrual basis of accounting. Under this measurement focus, all assets and liabilities associated with the operations of INVEST are included on the Statement of Fiduciary Net Position. Under the accrual basis of accounting, revenues are recognized in the fiscal year earned and expenses are recognized in the fiscal year incurred.

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**FOR THE YEAR ENDED DECEMBER 31, 2012  
NOTES TO FINANCIAL STATEMENTS (Continued)**

**Security Valuation:**

Investment securities of the portfolios are stated at amortized cost which approximates fair value. Repurchase agreements are reported at cost because they are non-participating interest earning investment contracts and the fair value is not significantly affected by the impairment of the credit standing of the issuer or any other factors.

**Net Asset Value Per Share:**

Participant shares are sold and redeemed at the net asset value per share. INVEST calculates the net asset value per share on each business day separately for each portfolio by dividing the value of the assets of each portfolio, less its liabilities, by the number of shares outstanding. Each INVEST portfolio maintained a stable net asset value of \$1.00 per share throughout the period. The pool has not provided any legally binding guarantees to support the value of the shares.

**Security Transactions and Investment Income:**

Security transactions are accounted for on the trade date of the security purchased or sold. Investment income is recorded on the accrual basis. The change in value is included in income.

**Distributions to Shareholders:**

Distributions from net investment income, including net realized capital gains, are declared daily and are paid on the first business day of the following month.

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**NOTE C – PROGRAM MANAGEMENT**

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The Department, as manager of INVEST, contracts with VTL Associates, LLC, to provide financial advisory services for the portfolios. The Department also contracts with Wells Fargo Bank and BNY Mellon, to provide banking and custodial services, respectively, for the INVEST portfolios. The custodian plays no role in determining the investment policies or in determining which securities are to be purchased or sold. Additionally, the Department contracts with the Nottingham Company to provide shareholder accounting services. The Nottingham Company also administers the website and processes the on-line participant-initiated transactions. The portfolios are not registered with the SEC.

To cover the costs of these services and other direct costs such as auditing, personnel, printing, and postage, the Department charges INVEST participants fee based upon average daily net assets. The maximum allowable fee is 11 basis points. The fee is currently being adjusted monthly to allow participants to realize a minimum of 5 basis point return on investment. The Department does not allocate indirect expenses to INVEST.

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**FOR THE YEAR ENDED DECEMBER 31, 2012  
NOTES TO FINANCIAL STATEMENTS (Continued)**

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**NOTE D – DERIVATIVE INSTRUMENTS**

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GASB Statement #64 requires disclosures about derivative financial instruments and other financial instruments with similar characteristics. This requirement is not applicable to INVEST because no derivative financial instruments are held or traded by the portfolios.

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**NOTE E – DEPOSIT AND INVESTMENT RISK**

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State and local governments, including school districts and other municipal entities, are required to classify their investments and deposits, excluding pools managed by governments and mutual funds, similar to INVEST, in defined categories of credit risk.

**Investments**

The Treasury Department (Department), other agencies in the primary government, and discretely presented component units (Commonwealth) categorize investments according to the level of investment risk assumed by the Commonwealth. The Department has formally adopted a written investment policy. Provisions of the written investment policy and current management of investments consider custodial credit risk, concentration credit risk, credit quality risk, interest rate risk, and foreign currency risk. The identified risks are discussed in detail below in accordance with GASB Statement 40. GASB 40 Note Disclosures are valued at amortized cost which approximates fair value as reflected in the Financial Statements.

**Custodial Credit Risk** - Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Department would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. In accordance with a contractual relationship between the Department and its custodial agents, all investments, where securities are used as evidence of the investment, are held in the name of the Commonwealth or the custodian. As of December 31, 2012, INVEST held repurchase agreements in the amount of \$233,000,000. The Department confirms that all counterparty transactions are collateralized at or above the investment policy required rate of 102% by US Government Obligations and/or Government National Mortgage Association Obligations. Repurchase Agreements collateral has maturity dates of 4 years or less. In addition, INVEST held deposits <sup>1</sup> in the amount of \$4,000,000.

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<sup>1</sup> Includes NOW and deposit accounts

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**FOR THE YEAR ENDED DECEMBER 31, 2012  
NOTES TO FINANCIAL STATEMENTS (Continued)**

**Concentration of Credit Risk** – Concentration of credit risk is the risk of loss attributed to the magnitude of the government’s investment in a single issuer. The investment policy stipulates that investments of INVEST must be authorized by Pennsylvania statutes for respective shareholder participants. These investments include federal obligations, repurchase agreements and other debt instruments. The Department places no limitations on investments in U.S. Government Agency Obligations. Treasury investment policy requires that at the time of purchase money market funds may not exceed 10% of the assets of any INVEST portfolio and no single issuer may exceed 5% of the assets of any INVEST portfolio. In the prior year, an indefinite waiver was issued to the investment policy which at year end allowed up to 100% of the assets of any INVEST portfolio to be invested in money market funds; however, the 5% single issuer limitation was still in effect. The Department places a 40% limit per assets of each pool for each counter party at S&P credit quality rating A-1+; and 25% limit for S&P credit quality rating level A-1 counterparties. GASB 40 requires disclosures of investment concentration in excess of 5% of holdings, these disclosures include:

<u>Issuer Name</u>	<u>Fair Value</u>	<u>Percentage of Total Investments</u>
Bank of America Repo	\$133,000,000	25%
International Bank For Reconstruction and Development Discount Note	105,740,922	20%
Credit Suisse Repo	100,000,000	19%
Freddie Mac	78,599,731	15%
Federal Home Loan Bank	<u>29,487,780</u>	<u>6%</u>
<b>Total Issuer’s Above 5%</b>	<b><u>\$446,828,433</u></b>	<b><u>85%</u></b>

**Credit Quality Risk** - Credit quality risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit quality risk of a debt instrument is measured by nationally recognized statistical rating agencies such as Moody’s Investors Services (Moody’s), Standard and Poor’s (S&P) and Fitch Ratings. The Department requires purchases of plan assets to be exclusively statutorily authorized investments including federal obligations, repurchase agreements and other debt instruments as authorized by Commonwealth of Pennsylvania statutes. Approximately 47% of the INVEST portfolio is comprised of U.S.

**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**FOR THE YEAR ENDED DECEMBER 31, 2012  
NOTES TO FINANCIAL STATEMENTS (Continued)**

Government Agency Sponsored Enterprises. Money Market funds constitute approximately 8% <sup>2</sup> of the portfolio of which 4% are rated Aaa by Moody's. Repurchase agreements comprise about 44% and carry an A-1 short-term rating by S&P. The following table discloses amounts, by major credit quality rating category at December 31, 2012.

	<u>Total Fair Value</u>	<u>Percentage</u>
<b>Moody's Investor Services</b>		
Aaa	\$ 21,939,447	4%
<b>Standard &amp; Poor's</b>		
AA+	251,750,146	47%
A-1	<u>233,000,000</u>	<u>44%</u>
<b>Total Rated</b>	\$506,689,593	95%
<b>Unrated Securities</b>		
Federal Insured Cash	22,070,957	4%
<b>Unrated Deposits</b>		
Bank Deposit Accounts	<u>4,000,000</u>	<u>1%</u>
<b>Total Unrated</b>	\$ 26,070,957	5%
<b>Grand Total</b>	<u><u>\$532,760,550</u></u>	<u><u>100%</u></u>

**Interest Rate Risk** - Interest rate risk is the risk that changes in interest will adversely affect the fair value of an investment. The Department measures interest rate risk using option adjusted duration. Duration is a measure of an investment's sensitivity to changes in interest rates. The higher the duration, the greater the changes in fair value when interest rates change. In accordance with the investment policy, the average weighted maturity of each pool may not exceed 60 days. At December 31, 2012, the INVEST's fixed income portfolio had the following durations (in years) by fixed income sector:

<sup>2</sup> Within the 8% are included 4% of Federal Insured Cash accounts that hold an industry-implied AAA rating.



**TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**FOR THE YEAR ENDED DECEMBER 31, 2012  
NOTES TO FINANCIAL STATEMENTS (Continued)**

<b>Investment Type</b>	<b>Amount of Securities With Duration</b>	<b>Option Adjusted Duration</b>	<b>Amount of Securities With No Duration</b>	<b>% of Holdings</b>
Money Markets	\$ 21,939,447	0.08	\$ 22,070,957	8%
U.S. Government Sponsored Enterprises	251,750,146	0.30		47%
Repurchase Agreements	<u>233,000,000</u>	0.01	<u>-</u>	<u>44%</u>
<b>Total Fair Value</b>	\$506,689,593		\$ 22,070,957	99%
Cash and Cash Equivalents *			\$ 4,000,000	1%
<b>Total Investments</b>			<u>\$532,760,550</u>	<u>100%</u>

\* Note: Investments Valued at Amortized Cost

**Foreign Currency Risk** - Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Department's policy requires all investments be denominated in U.S. dollars, issued under U.S. laws and regulations, designed for U.S. investors, and traded in U.S. markets. As of December 31, 2012, all INVEST investments are denominated in U.S. dollars. This did not change at any time during the year.



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EUGENE A. DePASQUALE  
AUDITOR GENERAL

**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***

*Independent Auditor's Report*

The Honorable Robert M. McCord  
State Treasurer  
129 Finance Building  
Harrisburg, PA 17120

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 accompanying statements of fiduciary net position, including the schedules of investments of the INVEST Daily and INVEST Community Portfolios (the two primary portfolios constituting the Commonwealth of Pennsylvania Treasury Department's INVEST Program for Local Governments) and the related statements of changes in fiduciary net position, operations and financial highlights for a share outstanding, as of and for the year ended December 31, 2012, and the related notes to the financial statements and have issued our report thereon dated October 21, 2013.

***Internal Control Over Financial Reporting***

In planning and performing our audit of the financial statements and financial highlights, we considered Treasury'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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Treasury's internal control. Accordingly, we do not express an opinion on the effectiveness of Treasury'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 the INVEST Daily and INVEST Community Portfolio 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 over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting 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 the INVEST Daily and INVEST Community Portfolio financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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*.

### **Purpose of This Report**

The purpose of this report 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 Treasury's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Treasury's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



October 22, 2013

EUGENE A. DEPASQUALE  
Auditor General

**COMMONWEALTH OF PENNSYLVANIA  
TREASURY DEPARTMENT  
INVEST PROGRAM FOR LOCAL GOVERNMENTS  
DECEMBER 31, 2012  
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