



JAMES L. McINTIRE  
State Treasurer

State of Washington  
Office of the Treasurer

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October 27, 2011

The Honorable Christine O. Gregoire, Governor  
The Honorable Brian Sonntag, State Auditor  
Members of the State Finance Committee  
Members of the Joint Legislative Audit and Review Committee  
Participants in the Local Government Investment Pool

I am pleased to submit this Comprehensive Annual Financial Report (CAFR) of the state of Washington Local Government Investment Pool (LGIP) for the fiscal year ended June 30, 2011. This report has been prepared by the Office of the State Treasurer (OST) as required by Revised Code of Washington (RCW) 43.250.080. It includes only activity of the LGIP and does not include data or information related to other state agencies or funds.

Responsibility for the accuracy of the data, as well as the completeness and fairness of the presentation, including all disclosures, rests with management of the OST. To the best of our knowledge, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the LGIP.

Peterson Sullivan, LLP has issued an unqualified ("clean") opinion on the financial statements for the fiscal year ended June 30, 2011. The independent auditor's report is included in the financial section of this report.

Management's Discussion and Analysis (MD&A), immediately following the independent auditor's report, provides a narrative introduction, overview and analysis of the basic financial statements. The MD&A complements this letter and should be read in conjunction with it.

### **Profile of the LGIP**

The LGIP, created by the Washington State Legislature in 1986, is managed and operated solely by OST. The State Finance Committee administers the statute that created the pool and adopts appropriate rules. The State Treasurer established the LGIP Advisory Committee to provide advice on the pool's operation. The advisory committee includes 12 members selected from active pool participants. Eight members are appointed by participant associations, and four are appointed by the State Treasurer.

The LGIP is operated as a business enterprise within the framework of state laws and regulations. The LGIP's primary purpose is to provide an investment tool for eligible governmental entities. At their option, such entities may invest temporary cash surpluses to take advantage of the volume and expertise of the state's investment program to earn a competitive rate of return while maintaining security and liquidity. The objectives of the State Treasurer's investment program, in priority order, are safety, liquidity and return on investment.

**Investment Risk Profile**

The LGIP is considered extremely low risk. It is operated in a manner consistent with the Securities and Exchange Commission's Rule 2a-7 of the Investment Company Act of 1940. Rule 2a-7 funds are limited to high quality obligations with limited maximum and average maturities, the effect of which is to minimize both market and credit risk. The portfolio is made up of high-quality, highly liquid securities, and its relatively short average maturity reduces the pool's price sensitivity to market interest rate fluctuations. The LGIP also has a strong degree of asset diversification to minimize risk and maintain adequate rates of return.

The investment activity is guided by an investment policy, approved by the State Treasurer and operates under the standard of the prudent investor. OST operates the LGIP for investing cash in excess of daily requirements. Among the investments authorized by statute are: U.S. Treasury and agency securities, banker's acceptances, repurchase agreements, reverse repurchase agreements, commercial paper, and deposits with qualified public depositories.

The LGIP is managed diligently by professional treasury personnel to protect against losses from market and credit changes. However, the pool is not insured or guaranteed by any government. Therefore, the maintenance of principal is not fully assured.

**Economic Condition and Outlook**

The economic condition of the LGIP is based primarily upon investment earnings. Due to the short-term nature of the LGIP portfolio, and the types of investments utilized, the LGIP yields closely follow the targeted federal funds rate. With \$9.4 billion in net assets as of June 30, 2011, the LGIP produced an average monthly portfolio yield of .23 percent. The LGIP exceeded its benchmark by 21 basis points, resulting in \$19 million in additional interest income for participants.

Fiscal year 2011 was marked by sustained monetary policy by the Federal Open Market Committee (FOMC). The FOMC did not change its target for the federal funds rate from July 2010 through June 2011 stating that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations called for extremely low rate levels. The targeted federal funds rate began and ended the fiscal year at 0 to 1/4 percent.

The FOMC carefully monitored the economic outlook and financial developments and employed its policy tools to support economic recovery and price stability. During the period, the FOMC remarked that economic recovery continued, though at a rate insufficient to improve labor market conditions. Household spending expanded but remained constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business investment in equipment and software rose, however, investment in nonresidential structures continued to be weak and employers remained reluctant to add to payrolls. Furthermore, the housing sector continued to be depressed and commodity prices increased significantly.

The FOMC expects inflation to remain subdued for some time. Increased prices of energy and other commodities pushed up inflation although measures of underlying inflation continued to be somewhat low. The FOMC anticipates a gradual return to higher levels of resource utilization in the context of price stability. Longer-term inflation expectations remain stable.

During the first quarter of fiscal year 2012, the FOMC has maintained its target range for the federal funds rate at 0 to 1/4 percent anticipating that economic conditions are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013.

**Internal Controls**

Management is responsible for establishing and maintaining internal controls designed to ensure that the assets are protected from loss, theft, or misuse, and to ensure that adequate accounting data is compiled to allow for the preparation of financial statements in conformance with generally accepted accounting principles. Internal accounting controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost of controls should not exceed the benefits likely to be derived, and the evaluation of costs and benefits requires estimates and judgments by management. Management continues to assess the adequacy of its internal controls and make improvements when needed.

The State Treasurer maintains internal controls to protect against the loss of funds. Staff responsible for oversight of the pool receive daily reports monitoring investment operations to ensure compliance with the terms of the investment policy. In addition, a risk assessment and internal control evaluation is performed annually.

**Additional Information**

A section of the State Treasurer's website is dedicated to the LGIP. This CAFR, plus additional information for participants and interested parties, may be accessed through the OST website (<http://www.tre.wa.gov/>).

**Awards**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the LGIP for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2010. This was the fourteenth consecutive year the LGIP achieved this prestigious award. To be awarded a Certificate of Achievement, OST had to publish an easily readable and efficiently organized CAFR that satisfied both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. OST believes this CAFR continues to meet the Certificate of Achievement Program's requirements and will submit it to the GFOA to determine its eligibility for another certificate.

**Acknowledgments**

The preparation of this report was accomplished with the professionalism and dedicated services of personnel in OST's Accounting and Fiscal Services Division and its Investment Division. This CAFR reflects the State Treasurer's commitment to pool participants and citizens of the state of Washington to operate the LGIP in a responsible manner and to maintain financial statements in conformance with the highest standards of financial accountability.

Sincerely,



Shad Pruitt  
Deputy State Treasurer