NOTES TO THE FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2013

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Local Government Investment Pool (LGIP) have been prepared in conformity with generally accepted accounting principles (GAAP). The Office of Financial Management (OFM) is the primary authority for the state's accounting and reporting requirements. OFM has adopted the pronouncements of the Governmental Accounting Standards Board (GASB) which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally. The more significant of the LGIP's accounting policies are as follows:

Reporting Entity – The LGIP was created by Chapter 294, Laws of 1986 and began operations in July 1986. The LGIP is a short-term investment pool of the state of Washington, available to eligible governmental entities as defined by Revised Code of Washington (RCW) 43.250.020. Participation in the LGIP is voluntary.

The LGIP is managed and operated by the Office of the State Treasurer (OST). The State Finance Committee is the administrator of the statute that created the pool and adopts appropriate rules. The State Treasurer is responsible for establishing the investment policy for the pool and reviews it annually. Any proposed changes are reviewed by the LGIP Advisory Committee. The terms of the policy are designed to ensure the safety and liquidity of the funds deposited in the LGIP.

The assets and liabilities of the LGIP are included in the Comprehensive Annual Financial Report of the state of Washington. However, the accompanying financial statements present only the LGIP and are not intended to present fairly the financial position of the state of Washington and the results of its operations in conformity with GAAP.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation – The accompanying financial statements are reported using the 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, regardless of the timing of related cash flows.

Investment and Deposit Activity – The OST has adopted a formal investment policy for the LGIP which is reviewed for possible revisions annually. The policy is to invest in high-quality, short-term instruments. Investments are restricted to fixed rate securities that mature in 397 days or less, floating and variable rate securities that mature in 762 days or less, and the portfolio maintains a weighted average maturity of 60 days or less and a weighted average life of 120 days or less. The State Treasurer has the sole responsibility to set investment strategy for the LGIP.

Investments, other than bank deposits, are valued at amortized cost. The bank deposits are valued at historical cost. Both valuation methods approximate fair value. Security transactions are reported on a trade date basis in accordance with GAAP. At fiscal year end, there were no pending trades.

Deductions, Penalties, and Income Distribution to Participants – An administrative deduction is assessed for the administration of the LGIP in accordance with Washington Administrative Code (WAC) 210-10-100. The deduction covers costs associated with the LGIP operations.

Overdraft penalties due to failure to wire funds by a pool participant (after notification to the State Treasurer of an intended transfer) are assessed to the pool participant responsible for the overdraft.

Through February 28, 2013, the expenses of operating the pool were covered through an administrative fee of 3.5 basis points, charged monthly to participants based on their average daily balance in the pool. Fees in excess of the expenses incurred for pool operation were rebated to participants based on their pro rata share of the average daily balance in the pool for the period of July 1, 2012 to February 28, 2013. The amount assessed for the administration of the LGIP during this period plus overdraft charges totaled $2,110,084.70. Expenses applied to this period were $546,050.81 resulting in a rebate of $1,564,033.89.

Beginning March 1, 2013, the LGIP changed to operating with a daily earnings factor. Net earnings are allocated to each LGIP account on a daily basis and credited to the account at the end of the month. On a daily basis, the total earnings, less the administrative fee, are allocated to the participants based on their pro rata share of the total deposits in the LGIP on that day. The daily expense factor is based on an estimate of the annual expenses to operate the LGIP and can be adjusted periodically.

The net administrative deduction for the fiscal year was 0.009 percent of each participant's average daily balance of the funds in the LGIP.

Participant Transactions – Participants can invest and withdraw their investments on a daily basis with a limit of one transaction per business day. The minimum transaction amount is five thousand dollars. There is no maximum transaction amount. For an investment or withdrawal of ten million dollars or more, a one-day notification prior to the transfer date is requested, but not required. The cut-off for same day deposits and withdrawals is 10 a.m. For all transactions greater than one million dollars, notification must be made by 9 a.m. However, participants may complete transactions greater than one million dollars when notification is made between 9 a.m. and 10 a.m., at the discretion of the OST. Factors considered are the timing of notification, the dollar amount, or any other issue that may affect OST's ability to accommodate the transaction. All participants are required to file with the State Treasurer a certified copy of an ordinance or resolution containing the names and titles of the officials authorized to invest or withdraw funds.

Distributions to local governments for state, federal, and local revenues electronically transferred utilizing the Treasury Management System can be directly invested in the LGIP. These investments are in addition to the one transaction per business day limit.

Service Providers – The State Treasurer oversees the operations of the LGIP and provides portfolio management and record keeping services. The costs for these services, together with professional fees, custodian fees, and other operating costs, are accrued and charged as an expense on a monthly basis.

Citibank N.A. provided securities lending services for the LGIP and served as securities custodian, maintaining custody of all investments other than deposits with qualified public depositaries.

Risk Management – The state of Washington continues to operate a risk management liability program pursuant to RCW 4.92.130. The state manages its tort claims as an insurance business activity rather than a general governmental activity. The state's policy is generally not to purchase commercial insurance for the risk of losses to which it is exposed. Instead, the state management believes it is more economical to manage its risks internally and set aside assets for claims settlement in an Internal Service Fund. A limited amount of commercial insurance is purchased for employee bonds and to limit the exposure to catastrophic losses. Otherwise, the risk management liability program services all claims against the state for injuries and property damage to third parties. The OST participates in the risk management liability program.

Securities Lending – The LGIP reports securities lent (the underlying securities) as assets in the Statement of Net Position. Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets only if the borrower defaults. Liabilities resulting from these transactions are reported in the Statement of Net Position. Securities lending transactions collateralized by securities that the LGIP does not have the ability to pledge or sell unless the borrower defaults are not reported as assets and liabilities.

2a-7 Like Pool – The LGIP is generally consistent with Rule 2a-7 money market funds, as currently recognized by the Securities Exchange Commission. 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. As such, investments are reported at amortized cost (which approximates fair value).

NOTE 2 – INVESTMENTS AND DEPOSITS

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates of debt instruments will adversely affect the fair value of an investment. The portfolio is invested in a manner generally consistent with the Securities and Exchange Commission's Rule 2a-7 of the Investment Company Act of 1940, i.e., money market funds, as it currently stands. Much of the Rule 2a-7 investment guidelines are directed towards limiting interest rate risk, in order to maintain a stable net asset value. For example, the LGIP's policy places a 60 day maximum on the weighted average maturity and a 120 day maximum on the weighted average life. Further, the maximum maturity of any security will not exceed 397 days, except for securities utilized in repurchase agreements and U.S. Agency floating or variable rate notes may have a maximum maturity of 762 days, provided that they have reset dates within one year and which on any reset date can reasonably be expected to have a fair value that approximates its amortized cost. As of June 30, the LGIP had a weighted average maturity of 58 days and a weighted average life of 98 days.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The LGIP investment policy limits the types of securities available for investment to obligations of the U.S. government or its agencies, obligations of government-sponsored corporations, banker's acceptances, commercial paper, deposits with qualified public depositaries, or obligations of the state of Washington or its political subdivisions. Banker's acceptances and commercial paper must be rated with the highest short-term credit rating of any two Nationally Recognized Statistical Rating Organizations (NRSROs) at the time of purchase. The LGIP currently does not have any banker's acceptances, commercial paper, or municipal bonds in its portfolio. The credit ratings and book values of the investments are as follows:

Investment Type	Moody's Rating	S & P Rating	Book Value
Repurchase Agreements	AAA	AA+	$ 1,797,874,000
U.S. Treasury Securities			
U.S. Treasury Bills*	AAA	AA+	$ 1,399,597,889
U.S. Agency Securities			
Federal Home Loan Bank	AAA	AA+	3,398,628,928
Federal Home Loan Mortgage Corp.	AAA	AA+	1,602,354,955
Federal Farm Credit Bank	AAA	AA+	802,684,860
Federal National Mortgage Assoc.	AAA	AA+	709,886,916
			6,513,555,659
Total			**$ 9,711,027,548**

*U.S. Treasury issues are explicitly guaranteed by the United States government and are not subject to credit risk.

Custodial Credit Risk – Custodial credit risk is the risk that, in the event of a failure of the counter party, the state will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The OST investment policy requires that securities purchased by the office are to be held by the master custodian, acting as an independent third party, in its safekeeping or trust department. Securities utilized in repurchase agreements are subject to additional restrictions. These restrictions are designed to limit the OST's exposure to risk and insure the safety of the investment. All securities utilized in repurchase agreements were rated AAA by Moody's and AA+ by Standard & Poor's. The fair value of securities utilized in repurchase agreements must be at least 102% of the value of the repurchase agreement.

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The OST mitigates concentration of credit risk by limiting the percentage of the portfolio invested with any one issuer. With the exception of U.S. Treasury and U.S. Agency securities, the OST mitigates concentration of credit risk by limiting the purchase of securities of any one issuer to no more than five percent of the portfolio. Repurchase agreements comprise 16.9% of the total portfolio. OST limits the securities utilized in repurchase agreements to U.S. Treasury and U.S. Agency Securities. OST requires delivery of all securities utilized in repurchase agreements and the securities are priced daily. At fiscal year end, U.S. Treasury securities comprised 13.2% of the total portfolio. U.S. Agency securities comprised 61.2% of the total portfolio, including Federal Home Loan Bank (31.9%), Federal Home Loan Mortgage Corporation (15.1%), Federal Farm Credit Bank (7.5%), and Federal National Mortgage Association (6.7%).

At fiscal year end, the LGIP had the following investments, deposits, and related maturities:

			Maturity	
Investment/Deposit Type	**Book Value**	**Fair Value**	**Less than 1 year**	**1-5 years**
U.S. Agency Securities	$ 6,513,555,659	$ 6,513,555,659	$ 6,035,423,773	$478,131,886
Repurchase Agreements	1,797,874,000	1,797,874,000	1,797,874,000	
U.S. Treasury Securities	1,399,597,889	1,399,597,889	1,399,597,889	
Interest Bearing Bank Deposits	743,434,082	743,434,082	743,434,082	
Negotiable Order of Withdrawal Accounts	136,200,614	136,200,614	136,200,614	
Time Certificate of Deposit Program	40,715,000	40,715,000	40,715,000	
Certificates of Deposit	2,000,000	2,000,000	2,000,000	
Total	**$10,633,377,244**	**$10,633,377,244**	**$10,155,245,358**	**$478,131,886**

Securities Lending – State statutes permit the LGIP to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The LGIP, which has contracted with a lending agent to lend securities in the LGIP, and receives earnings for this activity. The lending agent lends securities and receives collateral, which can be in the form of cash or other securities. The collateral, which must be valued at 102 percent of the fair value of the loaned securities, is priced daily and, if necessary, action is taken to maintain the collateralization level at 102 percent. However, cash collateral received from the lending of non coupon-bearing securities shall not be valued at less than 102 percent of fair value, but not to exceed par. The cash is invested by the lending agent in accordance with investment guidelines approved by the LGIP. The securities held as collateral and the securities underlying the cash collateral are held by the LGIP's custodian. One option available to the lending agent is to invest cash collateral into an OST account in the LGIP. Maturities of investments made with cash collateral are generally matched to maturities of securities loaned.

During the period, the LGIP lent U.S. Treasury securities in exchange for cash collateral. The cash collateral was reinvested in Repurchase Agreements. At fiscal year end, there were no securities on loan.

The LGIP investment policy requires that any securities on loan be made available by the lending agent for next day liquidity at the option of the LGIP. During the fiscal year, the LGIP had no credit risk exposure to borrowers because the amounts owed to the borrowers exceeded the amounts the borrowers owed the LGIP. Furthermore, the contract requires the lending agent to indemnify the LGIP if the borrowers fail to return the securities (and if collateral is inadequate to replace the securities lent) or if the borrower fails to pay the LGIP for income distribution by the securities' issuers while the securities are on loan. The LGIP cannot pledge or sell collateral securities received unless the borrower defaults. The LGIP investment policy limits the amount of reverse repurchase agreements and securities lending to 30% of the total portfolio. There were no violations of legal or contractual provisions, nor any losses resulting from a default of a borrower or lending agent during the fiscal year.

Repurchase Agreements – The fair value, plus accrued income, of mortgage-backed securities utilized in repurchase agreements with more than seven days remaining until maturity will be 105 percent of the value of the repurchase agreement. The fair value, plus accrued income, of securities utilized in all other repurchase agreements will be 102 percent of the value of the repurchase agreement. The securities utilized in repurchase agreements are priced daily and held by the LGIP's custodian in the state's name. Collateralized Mortgage Obligations (CMO) utilized in repurchase agreements must pass the Federal Financial Institutions Examination Council (FFIEC) test, or not exceed a volatility rating of V-5 by Fitch Investor Services, or a similar rating of a nationally recognized rating agency. At fiscal year end, repurchase agreements totaled $1,797,874,000.

Reverse Repurchase Agreements – State law also permits the LGIP to enter into reverse repurchase agreements, which are, by contract, sales of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities pledged as collateral by the LGIP underlying the reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in the fair value of the securities. If the dealers default on their obligations to resell these securities to the LGIP or to provide equal value in securities or cash, the LGIP would suffer an economic loss equal to the difference between the fair value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. During the fiscal year, there was no credit risk for the LGIP due to the fair value plus accrued interest of the underlying securities being less than the fair value plus accrued interest of the reinvested cash. At fiscal year end, there were no obligations under reverse repurchase agreements.

Deposits – All LGIP's deposits are either insured or collateralized. The LGIP's insured deposits are covered by the Federal Deposit Insurance Corporation (FDIC). Collateral protection is provided by the Washington Public Deposit Protection Commission (PDPC). The PDPC, created by the Legislature per Chapter 39.58 of the Revised Code of Washington, constitutes a multiple financial institution collateral pool. Pledged securities under the PDPC collateral pool are held by the PDPC's agent in the name of the collateral pool. At fiscal year end, deposits totaled $923,185,445.

NOTE 3 – SUMMARY OF ACTIVITY

A summary of LGIP activity, including reporting required by RCW 43.250.080, is as follows:

		FY 2013
Total Investment Purchases	$	201,464,352,490
Total Sales	$	21,906,107,830
Total Maturities	$	178,250,863,000
Total Net Investment Income	$	17,758,410
Administrative Expenses	$	820,200
Average Annualized Monthly Yield		.17 percent
Average Weighted Maturity		58 days
Average Weighted Life		98 days
Pool Participant Contributions	$	17,487,171,053
Pool Participant Distributions	$	15,700,259,153