



**COMMONWEALTH OF PENNSYLVANIA**  
***TREASURY DEPARTMENT***  
**HARRISBURG, PENNSYLVANIA**

***SCHEDULE OF CUSTODY HOLDINGS***

**AS OF JUNE 30, 2007**

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**TREASURY DEPARTMENT**  
**JUNE 30, 2007**

**INTRODUCTION**

**Purpose**

The Department of the Auditor General conducts an annual examination of all securities and collateral in the custody of the Treasury Department (department). This examination is conducted under the authority of Act 184 of 1923, as amended (72 P.S. § 4364), which provides:

The Auditor General, through such agents as he may select, shall, at his discretion, but not less than annually, examine all the bonds, stocks, mortgages, or other securities, which under the law are deposited with the State Treasurer in whatever capacity, and shall verify the books in which a record is kept of all such bonds, stocks, mortgages, or other securities; and, for this purpose, the Auditor General is hereby authorized to employ such consultants, experts, accountants, or investigators as he may deem advisable. A record of the results and date of such examination and verification shall be made in a book or books kept for this purpose in the office of the Auditor General.

Prior to our release of this examination, Act 53 of 2008, effective July 4, 2008, amended Act 184 of 1923 and eliminated the Department of the Auditor General's requirement to examine all securities and collateral in the custody of the State Treasurer and permits the Department of the Auditor General to perform an annual audit. As a result, we have presented our results performed under the previous authority, but we have also discussed the effect of this examination based on the amended legislation.

**Objective and Methodology**

Our objective of the examination was to confirm the existence of all securities and collateral in the custody of the department, as reported in the Schedule of Custody Holdings, as of June 30, 2007.

To complete this objective:

- we inquired with department management as to any changes to the investment reports;
- we confirmed long-term securities and collateral with third-party depositories of the Bank of New York Mellon and short-term securities with various banks;
- we physically examined long-term securities and collateral held by the Bank of New York Mellon; and
- we physically examined securities held in the department's safe and vault.

**TREASURY DEPARTMENT**

**JUNE 30, 2007**

**BACKGROUND**

The Commonwealth's State Treasurer serves as chief executive officer of the department which, under the provisions of the Fiscal Code, (Act of 1929, P.L. 343, No. 176), as amended (72 P.S. § 1 et seq.), and the Administrative Code of 1929 (Act of 1929, P.L. 177, No. 175), as amended (71 P.S. § 51 et seq.), is responsible for the receipt, deposit, investment, and disbursement of all Commonwealth funds.

The department manages equity and fixed-income investments for Commonwealth agencies, the Tuition Account Program (TAP) and fixed income investments for local governments and charitable and nonprofit entities (INVEST). Additionally, the department is custodian for the Public School Employees' Retirement System, the State Employees' Retirement System, the Pennsylvania Municipal Retirement System, the State Workmen's Insurance Fund, the Workmen's Compensation Security Fund, and the Underground Storage Tank Indemnification Fund.

Sections 301, 301.1, 303, and 505 of the Fiscal Code and Section 1101.1 of the Administrative Code govern deposit and investment policies of the department.

Section 301 of the Fiscal Code requires the department to deposit all moneys received by the Commonwealth, including moneys not belonging to the Commonwealth but of which the department or the State Treasurer is custodian, in Commonwealth depositories approved by the Board of Finance and Revenue. All Commonwealth agencies having in their possession any moneys belonging to the Commonwealth must deposit them in Commonwealth depositories approved by the Board of Finance and Revenue in a manner and with such frequency as prescribed by the State Treasurer.

Securities purchased pursuant to Section 301.1 of the Fiscal Code and Section 1101.1 of the Administrative Code are normally held for the account of the department by the Custodial Investment Accounts at the Bank of New York Mellon or other depositories.

Section 303 of the Fiscal Code imposes custodial responsibilities on the department for securities received from any Commonwealth agency, board or commission. Section 303 also authorizes the department to contract and participate, either directly or indirectly, with the Depository Trust Company, or a similar depository company, for the deposit of securities and the execution of securities transactions.

Section 505 of the Fiscal Code requires that Commonwealth depositories secure deposits of Commonwealth monies by furnishing a bond secured by a surety company or individual sureties approved by the Board of Finance and Revenue. In lieu of a bond, Commonwealth depositories may secure deposits by depositing approved securities with the department, the Federal Reserve Bank of Philadelphia, the Federal Reserve Bank of Cleveland, or with an approved Commonwealth depository.

## **Independent Auditor's Report**

The Honorable Robin L. Wiessmann  
State Treasurer  
TREASURY DEPARTMENT  
Commonwealth of Pennsylvania  
Harrisburg, PA 17120

Dear Treasurer Wiessmann:

We were mandated by Act 184 of 1923, as amended (72 P.S. § 4364), to annually examine all securities and collateral in the custody of the State Treasurer. The accompanying Schedule of Custody Holdings as of June 30, 2007, represents all securities and collateral in the custody of the State Treasurer classified by investment type expressed at market value. Our mandate did not include verification of the accuracy of the investment type classifications and the valuations at market value. Our responsibility was to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining evidence supporting the Schedule of Custody Holdings as of June 30, 2007, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Our examination disclosed that the Treasury Department (department) did not require its custodian bank (the Bank of New York Mellon) to maintain securities and collateral in separate Commonwealth accounts at third-party depositories. Therefore, the department's securities and depositories held by some third-party depositories were commingled in the same account with securities and collateral of other custodian bank clients. These third-party depositories were not able to provide reports listing only the securities and collateral that they were holding for the department. As a result, we were unable to examine or verify more than \$81.7 billion of the \$127.6 billion of securities and collateral in the custody of the department as of June 30, 2007. These securities and collateral are reported in the Schedule of Custody Holdings as of June 30, 2007.

Because of the restriction on the scope of our examination discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on whether the schedule referred to above presents, in all material respects, the securities and collateral in the custody of the State Treasurer as of June 30, 2007. However, Act 53 of 2008, effective July 4, 2008, amended the authority (Act 184 of 1923) by which the Department of the Auditor General conducts this engagement. This law eliminates the requirement to examine all securities and collateral in the custody of the State Treasurer and permits the Department of the Auditor General to perform an annual audit. Consequently, our conclusion is presented for informational purposes.

This report is intended solely for the information and use of management of the department, the Pennsylvania Senate, and the Pennsylvania House of Representatives, and is not intended to be and should not be used by anyone other than these parties.

Sincerely,

August 11, 2008

JACK WAGNER  
Auditor General

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**SCHEDULE**



**SCHEDULE OF CUSTODY HOLDINGS**  
**JUNE 30, 2007**

	<u>Market Value</u>
<b>Investments:</b>	
Cash and Cash Equivalents	\$ 16,570,874,248
Net Receivable/Payable for	
Investments Purchased or Sold	(1,713,015,111)
Fixed Income	28,810,487,994
Equities	60,545,851,711
Real Estate	5,842,036,209
Alternative Investments	<u>16,465,076,948</u>
<b>Total Investments</b>	<u>\$ 126,521,311,999</u>
<b>Collateral:</b>	
Safekeeping Agencies	\$ 969,825,907
Banks	<u>202,177,857</u>
<b>Total Collateral</b>	<u>\$ 1,172,003,764</u>
<b>Total Investments and Collateral</b>	<u><u>\$ 127,693,315,763</u></u>

-The notes are an integral part of this schedule.-



**TREASURY DEPARTMENT**  
**JUNE 30, 2007**

**NOTES TO SCHEDULE**

**NOTE A – BASIS OF PRESENTATION**

The accompanying Schedule of Custody Holdings reports various types of domestic and international securities and collateral in the custody of the State Treasurer. The market values of the securities and collateral is reported to the State Treasurer by the Bank of New York Mellon. The department adjusts the total investment amount using the Net Receivable/Payable for Investments Purchased or Sold. The Receivable for Investments Sold represents funds due to be received for the sale of investments initiated on or before the end of the fiscal period, but whose transactions were not settled as of the close of business on June 30, 2007. The Payable for Investments Purchased represents funds due to be paid for the purchase of investments initiated on or before the end of the fiscal period, but whose transactions were not settled as of the close of business on June 30, 2007.

Collateral refers to securities held as surety for deposits with bank depositories and pledged to Commonwealth departments, boards, and commissions by various business concerns in compliance with statutory provisions or to guarantee performance of a contract.

**NOTE B – FLOAT INVESTMENT REPURCHASE AGREEMENTS**

As of June 30, 2007, the department invested \$429,000,000 in float investment repurchase agreements through the Treasurer's cash management program in conjunction with Wachovia Bank. This amount represents unrecorded Commonwealth deposits and checks that had not cleared. The amounts of these repurchase agreements are included in the Schedule of Custody Holdings within the classification of cash and cash equivalents.

**NOTE C – ESCHEAT SECURITIES**

We examined escheat securities held in the department vault. These securities were common stock, bonds, and certificates of deposit. The department values escheat securities as of the date the securities are liquidated. Therefore, the value of the escheat securities held in the department vault is not included in the accompanying Schedule of Custody Holdings as of June 30, 2007.

**NOTE D – SUBSEQUENT EVENTS**

Act 53 of 2008, effective July 4, 2008, amended the authority (Act 184 of 1923) by which the Department of the Auditor General conducts this engagement. This law eliminates the requirement to examine all securities and collateral in the custody of the State Treasurer and permits the Department of the Auditor General to perform an annual audit. Furthermore, it allows the Auditor General the discretion to either perform the audit independently or as part of any other annual audit.



**STATUS OF PRIOR AND CURRENT FINDING AND RECOMMENDATION**



## **TREASURY DEPARTMENT**

### **STATUS OF PRIOR AND CURRENT FINDING AND RECOMMENDATION**

#### ***Finding – Securities and Collateral in the Custody of the Treasury Department Could Not Be Examined or Verified***

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Our prior examination, dated December 7, 2007, of securities and collateral in the custody of the Treasury Department (department) and those held for the department's accounts as of June 30, 2006, found that it failed to require its custodian bank, the Bank of New York Mellon (Mellon), to maintain securities and collateral valued at more than \$62.8 billion in separate Commonwealth accounts at third-party depositories. However, due to modern-day investment practices, the department cannot require Mellon to maintain securities and collateral in separate Commonwealth accounts at these third-party depositories. As a result, based on our mandate to "examine" all securities and collateral in the custody of the State Treasurer, we were unable to "examine" the securities and collateral maintained at third-party depositories that are commingled, or in other words, not maintained in separate Commonwealth accounts. The department believed that the language in Act 184 of 1923, as amended, did not reflect modern realities of recording securities: "This long-standing problem is caused by a conflict between language in the statute directing the Auditor General to 'examine all the bonds, stocks, mortgages, or other securities' and both current business practices in the investment and banking industries and legal requirements placed on many depositories around the world." We agreed with the department's position and recommended that the department continue to seek legislation supported by the Department of the Auditor General to replace outdated language in Act 184 with new language that would permit us to use modern auditing techniques to fulfill this mandate.

During the current examination, we again found that the department did not require its custodian bank to maintain securities and collateral valued at more than \$81.7 billion in separate Commonwealth accounts at third-party depositories. However, during our review of subsequent events, we noted that Act 53 of 2008 effectively implemented our recommendation from the prior finding. This change, effective July 4, 2008, amends language in Act 184 and requires the Auditor General to perform an annual audit of the securities and collateral in the custody of the State Treasurer. This amendment permits us to use modern auditing techniques, such as sampling, and therefore eliminates the requirement to examine all securities and collateral in the custody of the department. As a result, the finding and recommendation are deemed to be resolved and no further corrective action is necessary.



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**DISTRIBUTION**

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***TREASURY DEPARTMENT  
AS OF JUNE 30, 2007  
DISTRIBUTION LIST***

The Honorable Edward G. Rendell  
Governor  
Commonwealth of Pennsylvania  
225 Main Capitol Building  
Harrisburg, PA 17120

The Honorable Donald L. Patterson  
Inspector General  
Executive House  
101 South Second Street, 3rd Floor  
Harrisburg, PA 17101

The Honorable Robin L. Wiessmann (3)  
State Treasurer  
129 Finance Building  
Harrisburg, PA 17120

Ms. Sharon Anderson (4)  
State Library of Pennsylvania  
Serials Records Section  
218 Forum Building  
Harrisburg, PA 17120

The Honorable Gibson E. Armstrong  
Chair  
Senate Appropriations Committee  
281 Main Capitol Building  
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Ms. Cynthia T. Cranmer, CPA (2)  
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Treasury Department  
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The Honorable Gerald J. LaValle  
Acting Democratic Chair  
Senate Appropriations Committee  
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Harrisburg, PA 17120

The Honorable Dwight Evans  
Chair  
House Appropriations Committee  
512-E, Main Capitol Building  
Harrisburg, PA 17120

The Honorable Mario Civera  
Republican Chair  
House Appropriations Committee  
245 Main Capitol Building  
Harrisburg, PA 17120

The Honorable Roger A. Madigan  
Chair  
Joint State Government Commission  
108 Finance Building  
Harrisburg, PA 17120

Mr. Philip R. Durgin, Executive Director  
Legislative Budget and Finance Committee  
400 Finance Building  
Harrisburg, PA 17120

This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at [www.auditorgen.state.pa.us](http://www.auditorgen.state.pa.us).