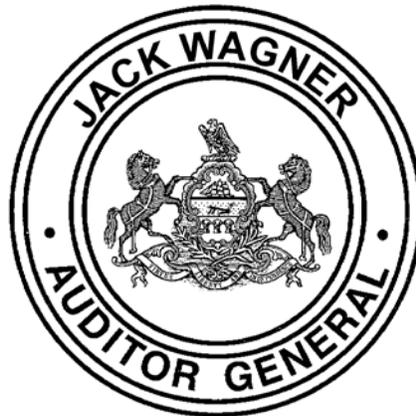


**COMMONWEALTH OF PENNSYLVANIA
TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS
INVEST DAILY AND INVEST COMMUNITY PORTFOLIOS**

AUDIT REPORT

FOR THE YEAR ENDED DECEMBER 31, 2011



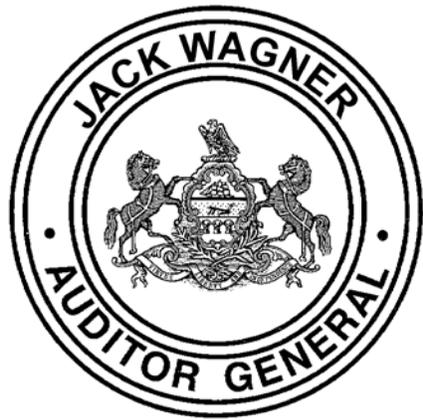
COMMONWEALTH OF PENNSYLVANIA
TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS
INVEST DAILY AND INVEST COMMUNITY PORTFOLIOS
HARRISBURG, PENNSYLVANIA

AUDIT REPORT
FOR THE YEAR ENDED DECEMBER 31, 2011

**TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS
DECEMBER 31, 2011**

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TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS
DECEMBER 31, 2011

BACKGROUND

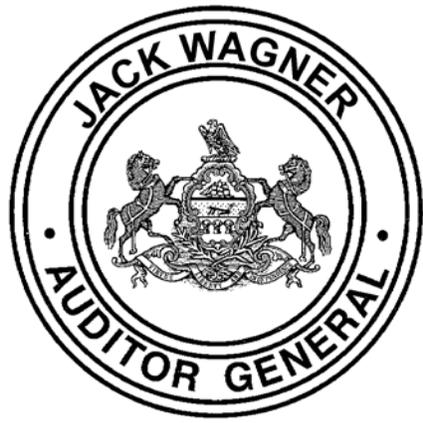
The INVEST Program for Local Governments (INVEST) is a diversified investment portfolio open to all local governments in the Commonwealth of Pennsylvania. INVEST operates by pooling local government funds and investing them under the investment expertise and integrity of the Treasury Department.

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.



Independent Auditor's Report

Shareholders
INVEST Program for Local Governments

We have audited the accompanying statements of fiduciary net assets, 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) as of December 31, 2011, and the related statements of changes in fiduciary net assets, operations and financial highlights for a share outstanding for the year then ended. These financial statements and financial highlights are the responsibility of the Treasury Department. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note A, the financial statements 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, 2011, 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.

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, 2011, and the results of their operations, changes in their fiduciary net assets and financial highlights for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 7 be presented to supplement the basic financial statements. Such information, although not 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 financial statements in an appropriate operational, economic, or historical content. 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 regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 19, 2012, on our consideration of the INVEST Program's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

October 19, 2012

JACK WAGNER
Auditor General

**TREASURY DEPARTMENT
 INVEST PROGRAM FOR LOCAL GOVERNMENTS
 FOR THE YEAR ENDED DECEMBER 31, 2011
 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 2011. Please read it in conjunction with the INVEST financial statements.

The financial statements consist of the Statement of Fiduciary Net Assets, Schedule of Investments, Statement of Operations, Statement of Changes in Fiduciary Net Assets 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 Assets (Amounts in Thousands)

	<u>2011</u>	<u>2010</u>	<u>Increase (Decrease)</u>	
			<u>Amount</u>	<u>Percent</u>
Daily and Community Pools				
Total Investments	\$468,671	\$549,209	\$(80,538)	(15%)
Other Assets and Liabilities	(9,535)	(122)	(9,413)	7716%
Total Net Assets	<u>\$459,136</u>	<u>\$549,087</u>	<u>\$(89,951)</u>	<u>(16%)</u>

Total Investments and Total Net Assets decreased by approximately 16% during calendar year 2011. The decreases are attributable to a combination of participants leaving the program, moving their contributions elsewhere, and the lower returns on fixed investment options. INVEST participants are primarily educational, governmental and charitable entities, which are largely dependent upon a favorable economic climate for revenues. In the 2011 economic climate, the INVEST participants’ share balances continued to be adversely impacted. With rates continuing to decline to all-time lows, participants looked elsewhere for better investment returns. This rate disadvantage provided incentives to participants to consider other options. The large increase in “Other assets and Liabilities” is due to portfolio trades that did not settle until January 18, 2012, combined with a large late day portfolio withdrawal.

**TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS
FOR THE YEAR ENDED DECEMBER 31, 2011
MANAGEMENT’S DISCUSSION AND ANALYSIS (Continued)**

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

	<u>2011</u>	<u>2010</u>	<u>Increase (Decrease)</u>	
			<u>Amount</u>	<u>Percent</u>
Daily and Community Pools				
Operating expenses:				
Administrative fees	\$ (448)	\$ (706)	\$ 258	(37%)
Non-operating revenues:				
Investment income	716	1,763	(1,047)	(59%)
Capital Share Transactions:				
Dividends distributed	(268)	(1,057)	789	(75%)
Shares issued	1,313,545	1,338,909	(25,364)	(2%)
Shares issued in lieu of cash distributions	248	878	(630)	(72%)
Shares redeemed	(1,403,745)	(1,377,113)	(26,632)	2%
Change in net assets	<u>\$ (89,952)</u>	<u>\$ (37,326)</u>	<u>\$ (52,626)</u>	

Administrative expenses are based on the average daily net assets. As the participant balances decline, the base to which administrative expenses are computed declines proportionately.

Investment Income decreased approximately 59% due to continuing lows in interest rates and declining participant balances than years past. During 2011, the Federal Reserve Bank federal funds rate opened at .17% in January. It fell to a low of .07% by year’s end. Most of the securities in this pool are Repurchase Agreements and Money Markets Funds, for which rates continued to remain around all-time lows. In an effort to combat the low rates, as of July 20, 2011 and until further notice, INVEST 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 decreases, income distributions decrease proportionately. Despite approximately 90% of the distributions being used to purchase shares, Shares Issued in Lieu of Cash distributions decreased due to the reduced amount of Investment Income as well as lower pool funds.

The decrease in Shares Issued is a direct correlation to the decrease in deposits to participant accounts. Low daily interest rates made local bank short term CD offerings more attractive to the educational, local government, and not for profit entities of these investment pools.

**TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS
FOR THE YEAR ENDED DECEMBER 31, 2011
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

Shares Redeemed increased by approximately \$26 million or about 2%. With low investment return rates, it was advantageous for some participants to invest their money in longer term vehicles that are currently yielding better overall returns.

The credit quality of each of the Portfolios during 2011 continues to be rated "AAAm" by the Standard & Poor's Corporation ("S & P's"). 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 ASSETS
AS OF DECEMBER 31, 2011**

ASSETS

Cash	\$	-
Investments, at value (cost \$413,478,181)		413,571,360
Income Receivable		16,744
Receivable for Investment Sales		<u>206,640,430</u>
Total Assets	\$	<u>620,228,534</u>

LIABILITIES

Disbursements in Excess of Cash	\$	7,413,823
Payable for Investment Purchases		206,726,721
Distributions Payable		35,193
Administrative Fees		<u>12,081</u>
Total Liabilities	\$	<u>214,187,818</u>
Net Assets	\$	<u><u>406,040,716</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
STATEMENT OF FIDUCIARY NET ASSETS
AS OF DECEMBER 31, 2011**

ASSETS

Cash	\$ -
Investments, at value (cost \$55,086,985)	55,099,478
Income Receivable	996
Receivable for Investment Sales	<u>26,520,229</u>
Total Assets	<u>\$ 81,620,703</u>

LIABILITIES

Disbursements in Excess of Cash	\$ 140,603
Payable for Investment Purchases	28,379,640
Distributions Payable	3,018
Administrative Fees	<u>2,616</u>
Total Liabilities	<u>\$ 28,525,877</u>
Net Assets	<u>\$ 53,094,826</u>

- 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, 2011**

<u>Description</u>	<u>Maturity</u>	<u>Face</u>	<u>Fair Value</u>
<u>U.S. Government Agency Obligations:</u>			
Fannie Mae Discount Note	1/4/12	\$ 7,500,000	\$ 7,499,950
Fannie Mae Discount Note	1/11/12	4,000,000	3,999,923
Fannie Mae Discount Note	2/1/12	13,500,000	13,498,191
Fannie Mae Discount Note	3/1/12	5,000,000	4,998,085
Fannie Mae Discount Note	3/21/12	15,000,000	14,996,833
Fannie Mae Discount Note	4/4/12	2,076,000	2,075,512
Fannie Mae Discount Note	5/1/12	12,000,000	11,991,934
Fannie Mae Discount Note	5/3/12	3,810,000	3,808,698
Fannie Mae Discount Note	8/31/12	3,795,000	3,792,270
Federal Farm Credit Bank	6/13/12	2,500,000	2,500,000
Federal Home Loan Bank Discount Note	3/1/12	2,500,000	2,498,918
Federal Home Loan Bank Discount Note	4/5/12	3,000,000	2,997,943
Federal Home Loan Bank Discount Note	4/16/12	2,500,000	2,498,234
Federal Home Loan Bank Discount Note	5/22/12	1,500,000	1,499,231
Federal Home Loan Bank Discount Note	6/25/12	5,960,000	5,956,504
Federal Home Loan Bank Discount Note	7/11/12	5,000,000	4,997,200
Federal Home Loan Bank Discount Note	7/18/12	2,000,000	1,998,120
Federal Home Loan Bank Discount Note	7/25/12	5,000,000	4,992,561
Federal Home Loan Bank Discount Note	9/4/12	10,000,000	9,993,825
Federal Home Loan Banks	7/25/12	5,000,000	4,999,719
Federal Home Loan Banks	8/1/12	2,500,000	2,500,000
Federal Home Loan Banks	1/8/13	2,500,000	2,500,000
Federal Home Loan Banks	1/18/13	7,500,000	7,500,000
Freddie Mac Discount Note	1/9/12	2,000,000	1,999,973
Freddie Mac Discount Note	1/23/12	6,500,000	6,499,682
Freddie Mac Discount Note	2/7/12	5,000,000	4,999,511
Freddie Mac Discount Note	2/14/12	4,500,000	4,499,725
Freddie Mac Discount Note	2/23/12	3,700,000	3,699,564
Freddie Mac Discount Note	3/5/12	10,000,000	9,998,666
Freddie Mac Discount Note	5/7/12	11,500,000	11,491,887
Freddie Mac Discount Note	10/1/12	2,905,000	2,901,020
International Bank for Reconstruction & Develop.	12/17/12	2,500,000	2,500,000
Total U.S. Government Agency Obligations		\$172,746,000	\$172,683,679

**TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**INVEST DAILY PORTFOLIO
SCHEDULE OF INVESTMENTS
AS OF DECEMBER 31, 2011**

<u>Description</u>	<u>Maturity</u>	<u>Face</u>	<u>Fair Value</u>
<u>Repurchase Agreements:</u>			
Bank of America Repo	1/3/12	\$101,466,721	\$101,466,721
Credit Suisse FB Repo	1/3/12	<u>36,760,000</u>	<u>36,760,000</u>
Total Repurchase Agreements		\$138,226,721	\$138,226,721
<u>Money Markets Funds:</u>			
Fifth Third Institutional Government Money Market Fund		\$ 20,000,000	\$ 20,000,000
Morgan Stanley Institutional Liquidity Funds		20,139,000	20,139,000
AIM STIT-Government & Agency Portfolio		20,000,000	20,000,000
AIM STIT-Treasury Portfolio		20,000,000	20,000,000
Federal Insured Cash	6/13/2049	<u>19,521,960</u>	<u>19,521,960</u>
Total Money Markets Funds		\$ 99,660,960	\$ 99,660,960
<u>Bank Deposits:</u>			
Metro Bank Deposits	7/30/2049	\$ 1,000,000	\$ 1,000,000
Meridian Bank Now	10/31/2049	1,000,000	1,000,000
Team Capital Deposit	7/30/2049	<u>1,000,000</u>	<u>1,000,000</u>
Total Bank Deposits		\$ 3,000,000	\$ 3,000,000
Total Investments (Cost \$413,478,181)		\$413,633,681	\$413,571,360
Net Other Assets and Liabilities			<u>(7,530,644)</u>
Net Assets Held in Trust for Pool Participants			<u>\$406,040,716</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, 2011**

<u>Description</u>	<u>Maturity</u>	<u>Face</u>	<u>Fair Value</u>
<u>U.S. Government Agency Obligations:</u>			
Fannie Mae Discount Note	1/4/12	\$ 2,500,000	\$ 2,499,984
Fannie Mae Discount Note	2/1/12	1,000,000	999,931
Fannie Mae Discount Note	3/1/12	1,000,000	999,617
Fannie Mae Discount Note	4/4/12	1,000,000	999,765
Fannie Mae Discount Note	5/1/12	1,500,000	1,498,991
Federal Farm Credit Bank	6/13/12	1,000,000	1,000,000
Federal Home Loan Bank Discount Note	1/18/12	2,100,000	2,099,941
Federal Home Loan Bank Discount Note	3/1/12	1,000,000	999,566
Federal Home Loan Bank Discount Note	4/16/12	1,000,000	999,294
Federal Home Loan Bank Discount Note	5/22/12	1,000,000	999,487
Federal Home Loan Bank Discount Note	6/11/12	400,000	399,605
Federal Home Loan Bank Discount Note	7/25/12	1,000,000	998,512
Federal Home Loan Bank Discount Note	9/4/12	1,000,000	999,382
Federal Home Loan Banks	9/7/12	1,000,000	1,000,000
Federal Home Loan Banks	1/18/13	2,000,000	2,000,000
Freddie Mac Discount Note	5/7/12	1,000,000	999,295
Freddie Mac Discount Note	10/1/12	1,000,000	998,630
Total U.S. Government Agency Obligations		\$20,500,000	\$20,492,000
<u>Repurchase Agreements:</u>			
Bank of America Repo	1/3/12	\$10,639,641	\$10,639,641
Credit Suisse FB Repo	1/3/12	13,240,000	13,240,000
Total Repurchase Agreements		\$23,879,641	\$23,879,641
<u>Money Markets Funds:</u>			
Fifth Third Institutional Government Money Market Fund		\$ 2,500,000	\$ 2,500,000
Morgan Stanley Government Portfolio		2,550,000	2,550,000
AIM STIT-Government & Agency Portfolio		1,511,000	1,511,000
AIM STIT-Treasury Portfolio		1,663,845	1,663,845
Federal Insured Cash	6/13/2049	2,502,992	2,502,992
Total Money Markets Funds		\$10,727,837	\$10,727,837

**TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**INVEST COMMUNITY PORTFOLIO
SCHEDULE OF INVESTMENTS (Continued)
AS OF DECEMBER 31, 2011**

<u>Description</u>	<u>Maturity</u>	<u>Face</u>	<u>Fair Value</u>
Total Investments (Cost \$55,086,985)		\$55,107,478	\$55,099,478
Net Other Assets and Liabilities			<u>(2,004,652)</u>
Net Assets Held in Trust for Pool Participants			<u><u>\$53,094,826</u></u>

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

**TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Invest Daily Portfolio</u>	<u>Invest Community Portfolio</u>
Operations		
Net increase in net assets resulting from operations	\$ 242,772	\$ 25,740
Dividends distributed from net investment income	(242,772)	(25,740)
Capital shares transactions (at \$1.00 per share)		
Proceeds from shares issued	1,255,773,655	57,771,802
Shares issued in lieu of cash distributions	220,620	27,663
Shares redeemed	<u>(1,349,358,519)</u>	<u>(54,386,811)</u>
Net increase (decrease) from capital shares transactions	\$ (93,364,244)	\$ 3,412,654
Net increase (decrease) in net assets	\$ (93,364,244)	\$ 3,412,654
Net assets		
Beginning of period	<u>499,404,960</u>	<u>49,682,172</u>
End of Period	<u>\$ 406,040,716</u>	<u>\$ 53,094,826</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, 2011**

	<u>Invest Daily Portfolio</u>	<u>Invest Community Portfolio</u>
Investment Income	\$ 647,161	\$ 69,296
Administrative Fee Expense	<u>(404,389)</u>	<u>(43,556)</u>
Net increase in net assets resulting from operations	<u>\$ 242,772</u>	<u>\$ 25,740</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, 2011**

	Invest Daily Portfolio	Invest Community Portfolio
Net Asset Value, Beginning of Period	\$ 1.000	\$ 1.000
Investment Activities:		
Income	0.0014	0.0013
Expense	(0.0009)	(0.0008)
Net Investment Income	0.0005	0.0005
Total From Investment Income	0.0005	0.0005
Distributions:		
Net Investment Income	(0.0005)	(0.0005)
Total Distributions	(0.0005)	(0.0005)
Net Asset Value, End of Period	\$ 1.000	\$ 1.000
Ratio of expenses to average net assets	-0.09%	-0.08%
Ratio of net investment income to average net assets	0.14%	0.13%
Total Return	0.05%	0.05%
Net Assets, End of Period	\$406,040,716	\$ 53,094,826

- 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, 2011
NOTES TO FINANCIAL STATEMENTS**

NOTE A – REPORTING ENTITY

The accompanying financial statements present, as of December 31, 2011, 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.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 Assets. 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, 2011
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.

NOTE C – PROGRAM MANAGEMENT

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 (formerly Wachovia) 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, 2011
NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE D – DERIVATIVE INSTRUMENTS

GASB Statement #53 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.

NOTE E – DEPOSIT AND INVESTMENT RISK

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, 2011, INVEST held deposits¹ in the amount of \$165,106,362. The Department confirms 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.

¹Includes Repurchase Agreements and NOW deposit accounts.

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**FOR THE YEAR ENDED DECEMBER 31, 2011
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 of the INVEST Program stipulates that investments of the INVEST Program shall be only investments as authorized by Pennsylvania statutes for respective shareholder participants. These investments include federal obligations, repurchase agreements and other debt instruments as authorized by statute. The Department places no limitations on investments in U.S. Government Agency Obligations. Treasury investment policy requires that at 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. During the year waivers were 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 of excess of 5% of holdings, these disclosures include:

<u>Issuer Name</u>	<u>Market Value</u>	<u>Percentage of Total Investments</u>
Bank of America Corp Repo	\$112,106,362	24%
Fannie Mae	73,659,684	16%
Federal Home Loan Bank	65,428,042	14%
Credit Suisse Repo	50,000,000	11%
Freddie Mac	48,087,953	10%
AIM STIT/INVESCO	43,174,845	9%
Total Issuer’s Above 5%	<u>\$392,456,886</u>	<u>84%</u>

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 41% of the INVEST portfolio is comprised of U.S.

**TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**FOR THE YEAR ENDED DECEMBER 31, 2011
NOTES TO FINANCIAL STATEMENTS (Continued)**

Government Agency Sponsored Enterprises. Money Market funds constitute approximately 24%² of the portfolio of which 19% are rated Aaa by Moody's. Repurchase agreements comprise of about 34% and are rated A-1 by S&P. The following table discloses amounts, by major credit quality rating category at December 31, 2011.

	<u>Total Market Value</u>	<u>Percentage</u>
Moody's Investor Services		
Aaa	\$ 88,363,845	19%
Standard & Poor's		
AA+	193,175,679	41%
A-1	162,106,362	34%
Total Rated	\$ 443,645,886	94%
Unrated Securities		
Federal Insured Cash	22,024,952	5%
Unrated Deposits		
Bank Deposit Accounts	3,000,000	1%
Total Unrated	\$ 25,024,952	6%
Grand Total	<u>\$468,670,838</u>	<u>100%</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 adopted by the Department, the weighted average maturity of each pool may not exceed 60 days. At December 31, 2011, the Department's fixed income portfolio had the following durations (in years) by fixed income sector:

²Within the 24% are included 5% of Federal Insured Cash that hold an industry-implied AAA rating.

**TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS**

**FOR THE YEAR ENDED DECEMBER 31, 2011
NOTES TO FINANCIAL STATEMENTS (Continued)**

Investment Type	Amount of Securities With Duration	Option Adjusted Duration	Amount of Securities With No Duration	% of Holdings
Money Markets	\$ -		\$110,388,797	24%
U.S. Government Sponsored Enterprises	183,675,679	0.32	9,500,000	41%
Repurchase Agreements	162,106,362	0.01	-	34%
Total Fair Value	\$345,782,041		\$119,888,797	99%
Cash and Cash Equivalents *			\$ 3,000,000	1%
Total Investments			\$468,670,838	100%

* 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, 2011, all INVEST investments are denominated in U.S. dollars. This did not change at any time during the year.

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

We have audited the accompanying statements of fiduciary net assets, 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) as of December 31, 2011, and the related statements of changes in fiduciary net assets, operations and financial highlights for a share outstanding for the year then ended and have issued our report thereon dated October 19, 2012. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the INVEST Program's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the INVEST Program's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the INVEST Program's internal control over financial reporting.

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 Program's financial statements will not be prevented, or detected and corrected on a timely basis.

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 deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the INVEST Daily and INVEST Community Portfolio financial statements are free of 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*.

This report is intended solely for the information and use of the Treasury Department as manager for the INVEST Program and is not intended to be and should not be used by anyone other than this specified party.

October 19, 2012

JACK WAGNER
Auditor General

**COMMONWEALTH OF PENNSYLVANIA
TREASURY DEPARTMENT
INVEST PROGRAM FOR LOCAL GOVERNMENTS
DECEMBER 31, 2011
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