

**SCHOOL BOARD OF PINELLAS COUNTY**  
**INVESTMENT PORTFOLIO STATEMENTS**  
**June 30, 2012**

# ***SPENCE, MARSTON, BUNCH, MORRIS & Co.***

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## **INDEPENDENT AUDITOR'S REPORT**

To the School Board of Pinellas County

We have audited the accompanying statement of investment portfolio assets of the School Board of Pinellas County ("School Board") as of June 30, 2012, and the related statement of investment portfolio activity for the year then ended (collectively the "investment portfolio statements"). These investment portfolio statements are the responsibility of the School Board's management. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the investment portfolio statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the investment portfolio statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the investment portfolio statements referred to above present fairly, in all material respects, the financial position and results of investment activities of the School Board's investment portfolio as of and for the year ended June 30, 2012, in conformity with accounting principles generally accepted in the United States of America.

*Spence, Marston, Bunch, Morris & Co.*

Spence, Marston, Bunch, Morris & Co.  
Certified Public Accountants

January 30, 2013

**SCHOOL BOARD OF PINELLAS COUNTY**  
**STATEMENT OF INVESTMENT PORTFOLIO ASSETS**  
**June 30, 2012**

Mortgage-backed securities	\$ 236,728,997
Corporate asset-backed securities	35,965,714
Short-term government bond fund	36,468,045
State Board of Administration investment pool (Note 3)	974,477
Money market fund, interest bearing and demand deposit accounts	19,390,966
Accrued interest receivable	<u>756,995</u>
Total investment portfolio assets	<u>\$ 330,285,194</u>

See accompanying notes to investment portfolio statements

**SCHOOL BOARD OF PINELLAS COUNTY**  
**STATEMENT OF INVESTMENT PORTFOLIO ACTIVITY**  
**For the year ended June 30, 2012**

Interest revenue from U.S. government agency, mortgage-backed securities, corporate securities and other	\$ 8,780,509
Dividends received from government bond fund	550,135
Dividends received from money market funds	83,004
Amortization of premium	(46,168)
Interest revenue from State Board of Administration investment pool and money market fund	17,089
Interest revenue from interest bearing bank accounts	<u>79,273</u>
Portfolio income before fair value adjustment	9,463,842
Net decrease in the fair value of investments	<u>(6,776,938)</u>
Total portfolio income	<u>\$ 2,686,904</u>

See accompanying notes to investment portfolio statements

# **SCHOOL BOARD OF PINELLAS COUNTY**

## **NOTES TO INVESTMENT PORTFOLIO STATEMENTS**

### **(1) SIGNIFICANT ACCOUNTING POLICIES**

**Reporting entity** – The School Board of Pinellas County ("School Board") is part of the Florida system of public education. The School Board has direct responsibility for the operation, control and supervision of schools within the School Board district (Pinellas County, Florida) including investment of and accounting for School Board funds. These statements present only the investment portfolio of the School Board.

**Investment portfolio** – Florida statutes authorize the School Board to invest in obligations of the United States Treasury and United States agencies, certain State governmental investment pools, money market funds, and certain other prescribed investments. Expenses associated with the investment portfolio are absorbed by the School Board and are not included in the investment portfolio statements.

**Security valuation** – Investments in securities are valued at fair value in accordance with Statement No. 31 of the Governmental Accounting Standards Board (GASB 31), except those exempt from application of GASB 31. Investments exempt from GASB 31 are funds in the State Board of Administration (SBA) investment pool, money market accounts and interest earning investments that have a remaining maturity at time of purchase of one year or less.

Market values of investments in mortgage-backed securities and corporate asset-backed securities were obtained from the custodian on the last business day of the year. The SBA investment pool, managed by the State Board of Administration, is a "2a-7 like" pool, and is treated like a money market fund, using amortized cost to maintain a constant net asset value ("NAV") of \$1.00 per share, which approximates fair market value of the pool shares. However, see Note 3 regarding SBA Fund B. Fund B is accounted for as a fluctuating NAV pool. The NAV for Fund B is an estimate by the management of the SBA of current liquidation value that has been determined through a collaborative process among various pricing experts and sources in the marketplace. Market value of the short-term government bond fund is the quoted market price on the last business day of the year.

Investment securities, in general, are exposed to various risks, such as interest rate, credit and market risks. Due to the level of risks associated with investment securities, it is reasonably possible that changes in the valuation of investment securities will occur in the near term and that such change could materially affect the amounts reported in the Statement of Investment Portfolio Assets.

**Security transactions** – Purchases and sales are accounted for on a settlement date basis which is not materially different from a trade date basis. Interest income is reported as earned. Gains or losses on the sale of investments are recognized at the time the security is sold. Cost of securities sold is determined by the specific identification method.

**Use of estimates in the preparation of investment portfolio statements** – The preparation of investment portfolio statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of investments at the date of the investment portfolio statements and the reported amount of portfolio income during the reporting period. Actual results could differ from those estimates.

# SCHOOL BOARD OF PINELLAS COUNTY

## NOTES TO INVESTMENT PORTFOLIO STATEMENTS

### (1) SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

**Concentration of credit risk** – Management minimizes credit risk within the investment portfolio by investing primarily in securities of government sponsored entities, government agencies and other Aaa rated investments as rated by nationally recognized rating agencies. The portfolio includes cash equivalents maintained with various major financial institutions. Cash equivalents include investments in money market accounts. The State Board of Administration investment pool is managed by the State of Florida government (see Note 3). The government bond fund invests primarily in securities issued by the U.S. government or its agencies and government sponsored entities.

### (2) INVESTMENT PORTFOLIO

As of June 30, 2012, the School Board had the following investments: (Modified duration is in years.)

	<u>Fair Value</u>	<u>Modified Duration</u>
<b>Investment Type</b>		
Mortgage-backed securities	\$ 236,728,997	1.89
Corporate asset-backed securities	35,965,714	.65
Short-term government bond fund	36,468,045	-
SBA investment pool, excluding Fund B	49,209	-
SBA Fund B	925,268	5.73
Money market funds, interest bearing and demand deposit accounts	<u>19,390,966</u>	-
Total fair value	<u>\$ 329,528,199</u>	
Portfolio modified duration		<u>1.47</u>

**Interest rate risk** – The investment policy of the School Board provides that the weighted average duration of the investment portfolio shall not exceed five years.

As of June 30, 2012, the investment portfolio includes investments with a fair value totaling \$58,721,729 with floating or adjustable interest rates. \$55,770,079 is invested in floating rate bonds with coupon rates which reset monthly based on an index rate. \$2,951,650 is invested in floating rate bonds with coupon rates which reset quarterly based on an index rate. The rates on these investments range from .44% to 6.04%.

Mortgage-backed securities, including collateralized mortgage obligation bonds, and corporate asset-backed securities totaling \$272,694,711 are subject to the risk of prepayment when interest rates decline.

# SCHOOL BOARD OF PINELLAS COUNTY

## NOTES TO INVESTMENT PORTFOLIO STATEMENTS

### (2) INVESTMENT PORTFOLIO, CONTINUED

**Credit risk** – The investment policy states that the investments shall be of the highest quality as rated by either Standard and Poor's or Moody's investment rating services. Unrated mortgage-backed investments which are direct obligations of the U. S. Treasury or obligations of federal agencies and government sponsored entities are permitted by the investment policy. Investments not explicitly authorized by the investment policy are permitted provided that they do not exceed 5% of the total value of the investments. However, such investments must not be prohibited by State Statute.

The School Board's investments in the government bond fund, SBA investment pool Florida Prime (formerly LGIP) (Note 3), corporate asset-backed securities, mortgage-backed security bonds and money market funds are rated Aaa. The SBA Fund B (Note 3) is not rated. Government sponsored entities' mortgage-backed securities and collateralized mortgage obligations securities totaling \$152,999,805 are not rated by a rating agency; however, since these investments are collateralized by underlying mortgage guarantees, they are treated as if they are Aaa rated (See Note 4). Obligations explicitly guaranteed by the U.S. Government totaling \$48,274,906 are exempt from credit quality rating.

**Custodial credit risk** – The investment policy provides that all securities shall be designated as an asset of the School Board and held in safe-keeping by a third party custodian.

**Concentration of credit risk** – The investment policy states that the composition, and risk and diversification characteristics of the investment portfolio shall be structured to provide sufficient liquidity to meet obligations of the School Board in a timely manner, and to meet the investment objectives of the School Board, primarily, safety of capital and investment income.

Investments in one issuer that represent 5% or more of total investments as of June 30, 2012 are as follows (excluding securities explicitly guaranteed by the U. S. government, external investment pool, government bond fund and money market funds):

<b>Issuer</b>	<b><u>Fair Value</u></b>
Federal Home Loan Mortgage Corporation (see Note 4)	\$ 41,846,102
Federal National Mortgage Association (see Note 4)	<u>111,153,702</u>
Total fair value	<u>\$ 152,999,804</u>

The bank accounts in the investment portfolio are in banks which are qualified public depositories under the State of Florida Public Deposits Program, providing collateralization for public funds.

# **SCHOOL BOARD OF PINELLAS COUNTY**

## **NOTES TO INVESTMENT PORTFOLIO STATEMENTS**

### **(3) STATE BOARD OF ADMINISTRATION INVESTMENT POOL**

Due to extreme liquidity demands, the Trustees of the State Board of Administration (SBA) temporarily closed the SBA pooled fund (Pool) on November 29, 2007. On December 6, 2007, the Pool was re-opened and restructured, and approximately 14% of participant balances were transferred to a separate restricted account (Fund B). Participants' available liquid balances (Florida Prime, formerly LGIP and Fund A) were limited to 15% of their balance or \$2,000,000, whichever was greater. Withdrawals in excess of this amount were available for a redemption fee of 2%. Balances in Fund B were not available for withdrawal until investment cash flow was available. As investment cash flow was available, it was transferred from Fund B to Florida Prime fund, and available for 100% withdrawal. On December 23, 2008, all Florida Prime fund balances became 100% liquid. The SBA reported that through the end of November 2012, investors received distributions totaling 87.5% of their original balances in Fund B.

As of June 30, 2012, the School Board's balance in the Florida Prime fund and Fund B was \$49,209 and \$925,268, respectively. As of November 30, 2012, the balance in Fund B is \$978,535. The unrealized loss, as determined by management of the SBA, on the balance of the investment in Fund B at June 30, 2012 and November 30, 2012 was \$183,088 and \$25,949, respectively.

The SBA estimates the weighted average life, based on expected future cash flows, of Fund B at June 30, 2012, to be 5.73 years. However, because Fund B consists of restructured or defaulted securities, there is considerable uncertainty regarding the weighted average life.

### **(4) SIGNIFICANT RISKS AND UNCERTAINTIES**

The School Board invests in securities with contractual cash flows, such as asset-backed securities, collateralized mortgage obligations and commercial mortgage-backed securities, including securities backed by subprime mortgage loans. The value, liquidity and related income of these securities are sensitive to changes in economic conditions, including real estate value, delinquencies or defaults, or both, and may be adversely affected by shifts in the market's perception of the issuers and changes in interest rates.

In September 2008, as a result of market conditions and financial instability, the U. S. Treasury placed the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) into conservatorship under the Federal Housing Finance Agency (FHFA). FHFA will operate the organization as conservator until the entities are stabilized. As of June 30, 2012 both organizations remain under conservatorship.



# **SCHOOL BOARD OF PINELLAS COUNTY**

## **NOTES TO INVESTMENT PORTFOLIO STATEMENTS**

### **(5) RATE OF RETURN CALCULATION**

Total rate of return is determined by dividing investment income for the year by the average invested balance over the year.

For rate of return calculation purposes, the return includes the decrease in fair value of \$6,776,938 as reflected on the Statement of Investment Portfolio Activity for the year ended June 30, 2012. This decrease in fair value includes all changes in value (including purchases and sales) that occurred during the year.

The rate of return for the year ended June 30, 2012 is as follows:

Return	\$ 2,686,904
Average investment	\$ 356,946,594
Rate of return	.753%

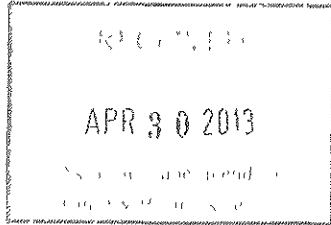
### **(6) SUBSEQUENT EVENTS**

The net decrease in fair value of investments since June 30, 2012 as reported on the School Board's internal records as of December 31, 2012 was approximately \$2,568,000.

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April 25, 2013

To the Investment Oversight Committee  
and Mr. Kevin Smith  
School Board of Pinellas County

In planning and performing our audit of the Investment Portfolio Statements of the School Board of Pinellas County as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the School Board's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the Investment Portfolio Statements, but not for the purpose of expressing an opinion on the effectiveness of the School Board's internal control. Accordingly, we do not express an opinion on the effectiveness of the School Board's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we considered to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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 misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies in the School Board's internal control to be material weaknesses:

To the Investment Oversight Committee  
and Mr. Kevin Smith  
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Our previous years' letters contained various findings of control deficiencies within the reconciliation process. It was recognized that management made changes to control procedures to address some of the weaknesses noted in the previous years' management letters; however, we noted continuing weaknesses during the current year engagement. Under generally accepted auditing standards, failure by management to resolve significant deficiencies and material weaknesses previously communicated is to be considered a material weakness.

We noted the following findings regarding the reconciliation system:

- We recognize that management has improved the reconciliation process including the timing of the preparation and review of the reconciliations. However, our review and testing of the various reconciliations indicated that there continues to be a delay in the timeliness of the reconciliations and the resolution of reconciliation differences.
- Reconciliations continue to include reconciling items which are differences in the balances between Sympro (the subsidiary), general ledger, and/or quarterly statement due to untimely correction of errors. For example, we noted that there were numerous errors corrected on the subsidiary and quarterly statement that were not carried through to the general ledger. Also, the Interest Earned and Fair Value Adjustment reconciliations include a reconciling item of \$497,821 which was corrected in the general ledger but not reflected in the quarterly statement.
- Reconciliations continue to include un-reconciled differences. Although the amounts are immaterial they could be made up of numerous material errors or reconciling items that net to an immaterial amount.
- Reconciliation for the US Bank money market fund reconciled the cash and cash equivalents balances and not the total market value, which includes the accrued interest on the account. The interest earned was recorded in Sympro but there was no interest accrued or an increase in the account balance for the interest, on the quarterly statement. Had the reconciliation used the total market value, it would have been apparent that the accrued interest was not recorded.

Management's response: *"The reconciliation process has been improved to the point that there is less than two months lag between month end and final approval of the reconciliation. Staff will continue to improve the process with an ultimate goal of 45 days between month end and final approval."*

To the Investment Oversight Committee  
and Mr. Kevin Smith  
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*As the timeliness of the reconciliation process has improved, the timeliness of correcting any reconciling items has also improved.*

*Staff has been and will continue to make every effort to ensure that all differences between the general ledger, subsidiary ledger and quarterly report are identified and corrected.*

*The mis-recording of accrued interest for the US Bank accounts has been corrected."*

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. We consider the following deficiencies in the School Board's internal control to be significant deficiencies:

We noted that various disclosures and information within the internally prepared quarterly statement as of June 30, 2012 were inaccurate. This comment was included in previous letters to management. Timely and accurate reporting to the Investment Oversight Committee enables the committee to be well informed in performing their function as stated in the Investment Policy.

The Manager of Cash & Investments did not complete eight hours of continuing education as required by the investment policy. Compliance with the investment policy is vital to safeguarding School Board funds and to fulfill the objectives set forth by the School Board's management.

Management's response: *"Since the addition to the department of the Cash & Investment Specialist position, the MCI has had the opportunity to address the notable weaknesses in the process for creating the quarterly investment report. A great deal of attention has been focused on two areas, 1) reducing manual input of information and 2) reconciling the quarterly report, prior to its completion and publication.*

*Staff recognizes the critical nature of continuing education for both the Manager, Cash & Investments and the Cash & Investments Specialist. In addition to making better use of available on-line training opportunities, a training update will be presented to the Investment Oversight Committee at each meeting."*

To the Investment Oversight Committee  
and Mr. Kevin Smith  
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**Other findings and recommendations:**

Management identified that the subsidiary is unable to correctly calculate the fair value adjustment for two of the Portfolio investments. If management cannot rely on the fair value adjustment calculated by the subsidiary, then management cannot properly monitor the performance of the Portfolio. We recommend management consider researching other programs that might better fit the needs of the Portfolio.

The written response included in this letter by management of the School Board Investment Portfolio to the material weaknesses and significant deficiencies identified in our audit have not been subjected to the audit procedures applied in the audit of the Investment Portfolio and, accordingly, we express no opinion on the response.

We will be pleased to discuss the above comments and recommendations in further detail at your convenience, to perform any additional study of these matters or to assist you in implementing the recommendations. We appreciate Andy Jacobsen's cooperation with our audit.

This communication is intended solely for the information and use of management, Investment Oversight Committee and others within the School Board of Pinellas County, and is not intended to be and should not be used by anyone other than these specified parties.

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