STATE OF ILLINOIS

OFFICE OF THE AUDITOR GENERAL

MANAGEMENT AUDIT

ILLINOIS SCHOOL DISTRICT LIQUID ASSET FUND PLUS

MAY 2005

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To the Legislative Audit Commission, the Speaker and Minority Leader of the House of Representatives, the President and Minority Leader of the Senate, the members of the General Assembly, and the Governor:

This is our report of the Management Audit of the Illinois School District Liquid Asset Fund Plus.

The audit was conducted pursuant to Senate Resolution Number 171, which was adopted April 22, 2004. This audit was conducted in accordance with generally accepted government auditing standards and the audit standards promulgated by the Office of the Auditor General at 74 Ill. Adm. Code 420.310.

The audit report is transmitted in conformance with Section 3-14 of the Illinois State Auditing Act.

WILLIAM G. HOLLAND
Auditor General

Springfield, Illinois
May 2005

REPORT DIGEST

MANAGEMENT AUDIT OF THE

ILLINOIS SCHOOL DISTRICT LIQUID ASSET FUND PLUS

Released: May 2005

State of Illinois
Office of the Auditor General

WILLIAM G. HOLLAND
AUDITOR GENERAL

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SYNOPSIS

The Illinois School District Liquid Asset Fund Plus (ISDLAF+) is an Illinois common law trust that was created in 1984 pursuant to provisions of the Illinois School Code. The ISDLAF+ offers shares in a manner similar to a money market mutual fund. Participants can choose from two different classes of shares (Liquid Class or the MAX Class). As of September 2004, the ISDLAF+ had approximately 400 participants including township treasurers, school districts, and community colleges and pooled funds totaling approximately $586 million.

Conflicts of Interest – Prior to July 2004, neither Trustees nor service providers for the ISDLAF+ were required to file conflict of interest statements or disclosure forms with the Fund. In July 2004, the ISDLAF+ Board of Trustees approved a motion requiring each voting Trustee to annually submit to the Secretary, copies of their economic interest disclosure forms that are filed annually with their respective county clerks. The motion also required Trustees to complete a Conflict of Interest Disclosure Statement. As of April 15, 2005, the Fund provided auditors with Conflict of Interest Disclosure Statements for all ten of the current voting Trustees and copies of the Statements of Economic Interest filed with the respective county clerks for nine of the ten Trustees. However, the July 2004 motion did not provide guidance regarding the types of relationships considered potential conflicts and the reporting process. Furthermore, service providers and contractors with the Fund are not required to file a disclosure with the ISDLAF+ Board.

Fund Performance - The ISDLAF+ Multi-Class Series performance for the period October 2002 through December 2004 was comparable to other similar funds, including other states' school district liquid asset funds and governmental pool indices. When compared to the Illinois Treasurer's Office Illinois Funds, the ISDLAF+ performed slightly better than the Illinois Funds in the **gross** rate comparison (i.e., before expenses are deducted); however, the Illinois Funds performed better than the ISDLAF+ in the **net** rate comparison (after expenses).

Management Controls - The ISDLAF+ has established a system of management controls for the monies invested by participants in the pooled funds of the Multi-Class Series. These include written investment policies, quarterly reporting to the Board of Trustees, weekly compliance reporting to the audit committee, and regular performance comparisons.

Matter for Consideration - Because it is unclear whether the Public Funds Investment Act specifically authorizes investment in banker's acceptances, we have included a Matter for Consideration for the Illinois General Assembly to consider defining the term "direct obligations of any bank" in the Public Funds Investment Act.

REPORT CONCLUSIONS

The Illinois School District Liquid Asset Fund Plus (ISDLAF+ or the Fund) is an Illinois common law trust that was created in 1984 pursuant to provisions of the Illinois School Code. The Fund offers shares in a manner similar to a money market mutual fund in which participants can choose from two different classes of shares. As of September 2004, the ISDLAF+ pooled funds totaled approximately $586 million.

The Declaration of Trust contains provisions that discuss the Fund and certain affiliates and their interests. The provisions contained in the Declaration of Trust generally allow for Trustees to have business interests similar to those of the Fund or to be interested in a transaction, provided the interest is disclosed and the action authorized by a majority vote of unaffiliated Trustees or a majority of participants. The Declaration of Trust contains a clause that allows the By-Laws of the Fund to contain more restrictive conflict of interest provisions. However, the By-Laws do not contain more restrictive provisions.

Prior to July 2004, neither Trustees nor service providers for the ISDLAF+ were required to file conflict of interest statements or disclosure forms with the Fund. In July 2004, the ISDLAF+ Board of Trustees approved a motion requiring each voting Trustee to annually submit to the Secretary, with a copy to the Fund counsel, copies of their economic interest disclosure forms that are filed annually with their respective county clerks. The motion also required Trustees to complete a Conflict of Interest Disclosure Statement. As of April 15, 2005, the Fund provided auditors with the Fund’s Conflict of Interest Disclosure Statements for all ten of the current voting Trustees and copies of the Statements of Economic Interest filed with the respective county clerks for nine of the ten Trustees. However, the motion did not provide guidance regarding the types of relationships considered potential conflicts and the reporting process. Furthermore, service providers and contractors with the Fund are not required to file a disclosure with the ISDLAF+ Board.

The Illinois State Treasurer’s Office and four liquid asset funds in other states were contacted to determine whether they had relevant conflict of interest reporting policies and procedures. The Treasurer requires all employees to disclose all matters that could reasonably be expected to interfere with the employee’s duties, as well as requires certain employees to file a Statement of Economic Interests with the Secretary of State (similar to the Statement of Economic Interests the ISDLAF+ Trustees file with their respective county clerks and now with the Secretary of the Board). One of the four other states’ funds contacted had also established specific policies defining what types of relationships constitute a conflict of interest.

The ISDLAF+ Multi-Class Series performance for the period October 2002 through December 2004 was comparable to other money market types of funds investing public funds. We compared 7-day annualized average yields for the ISDLAF+ with school district liquid asset funds in several other states. We also compared the ISDLAF+ with money market and governmental pool indices and the 4-week Treasury bill.

The ISDLAF+ Multi-Class Series consists of a Liquid Class, which offers daily liquidity, and a MAX Class, which generally requires a minimum deposit of 14 days. Over the past two years, ISDLAF+'s Liquid Class had a slightly lower net return than two of the three indices presented; however, it had a higher net return than that of two of the three other states' liquid asset funds presented. The ISDLAF+ MAX Class performance was comparable to the Standard and Poor's (S&P) indices and the 4-week T-bill and better than the iMoneyNet index. The MAX Class has been yielding approximately the same return as that of two of the three other states' liquid asset funds presented. When compared to the Illinois Treasurer's Office Illinois Funds, the ISDLAF+ performed slightly better than the Illinois Funds in the **gross** rate comparison (i.e. before expenses are deducted); however, the Illinois Funds performed better than the ISDLAF+ in the **net** rate comparison (i.e. after expenses).

Reports related to Fund performance are prepared and provided to the Trustees at each quarterly meeting. These reports contain average yield and return comparisons as well as a performance evaluation of the Multi-Class Series of the Fund. Although the Fund's Administrator prepares comparisons and provides them to Trustees at quarterly meetings, the ISDLAF+ annual reports distributed to Fund participants do not contain a performance comparison.

The ISDLAF+ has established a system of management controls for the monies invested by participants in the pooled funds of the Multi-Class Series. These include written investment policies, quarterly reporting to the Board of Trustees, weekly compliance reporting to the audit committee, and regular performance comparisons.

It is unclear whether the Public Funds Investment Act specifically authorizes investment in banker's acceptances. Although the Act includes a provision for the investment of funds in other investments constituting direct obligations of any bank, it does not define what these include. The Fund does invest in banker's acceptances, which an informal Attorney General opinion in 1997 determined were not permissible investments under the Public Funds Investment Act. We have included a Matter for Consideration for the Illinois General Assembly to consider defining the term "direct obligations of any bank" in the Public Funds Investment Act.

BACKGROUND

On April 22, 2004, Senate Resolution Number 171 was adopted directing the Auditor General to conduct a management audit of the Illinois School District Liquid Asset Fund Plus. The resolution asks the Auditor General to determine:

- Whether the Fund's provisions regarding conflicts of interest are sufficient and comparable to other pools investing public moneys;
- Whether the Fund's performance is comparable to other pools investing public moneys; and
- Whether controls are in place to adequately protect public moneys invested in the Fund. (page 3)

ILLINOIS SCHOOL DISTRICT LIQUID ASSET FUND PLUS

Illinois law allows township and school treasurers, community college districts, and educational service regions to join together in investing funds. Section 8-7 of the School Code permits township and school treasurers to join with other school districts, community colleges, and educational service regions for the purpose of investing funds (105 ILCS 5/8-7). A similar provision is included in the Public Community College Act, which permits community colleges to do the same (110 ILCS 805/3-47).

The Fund was created March 26, 1984.

The Illinois School District Liquid Asset Fund Plus (ISDLAF+) is an Illinois common law trust that was organized for the purpose of combining available investment funds so as to enhance the investment opportunities available to school districts and to increase the investment earnings accruing to the benefit of the respective school districts. A Declaration of Trust that governs the operations of the ISDLAF+ was adopted by the Fund's Board of Trustees and legally filed. The Fund was created March 26, 1984. In addition, the Trustees have formally adopted an Information Statement that also governs the ISDLAF+ operations and includes management and investment policies.

The Fund offers shares in a manner similar to a money market mutual fund. Participants can choose from two different classes of shares with the pooled funds of the Multi-Class Series. These include the Liquid Class and the MAX Class. The Liquid Class is a money market type of investment that offers daily liquidity and check-writing privileges. The MAX Class generally requires that a participant hold the shares for a minimum of 14 days. If MAX Class shares are redeemed early, the participant may be charged a penalty equal to 7 days interest at the current daily rate on the value of the redemption.

Digest Exhibit 1 presents the total net assets, investment income, and expenses of the ISDLAF+ Multi-Class Series as of the end of each fiscal year. The net assets for the Fund have ranged from approximately $410 million in fiscal year 2002 to almost $640 million in fiscal year 2003.

The Fund invests in high-quality, short-term debt instruments guaranteed by the full faith and credit of the United States, certain U.S. government agency obligations, commercial paper, bank obligations, and other obligations permitted by Illinois law, particularly the Public Funds Investment Act (30 ILCS 235).

Digest Exhibit 1
ISDLAF+ ASSETS, INVESTMENT INCOME, AND EXPENSES
Fiscal Years 2002-2004
(as of September 30)

	FY 2002	FY 2003	FY 2004
Total Net Assets	$409,645,436	$639,071,952	$585,667,597
Investment Income	$10,056,519	$6,599,448	$6,988,304
Expenses	$2,016,055	$2,375,099	$2,422,759

Source: OAG analysis of ISDLAF+ annual reports.

The majority of participants in the ISDLAF+ are school districts.

The Fund has approximately 400 participants including township treasurers, school districts, and community colleges. The majority of participants in the ISDLAF+ are school districts.

Management and Organization

The affairs and operations of the ISDLAF+ are governed and controlled by a Board of Trustees. Service providers hired by the Board perform all the day-to-day functions of the Fund. The service providers include an Investment Advisor, Administrator, Distributor, and Custodian. There is also a Subadvisor and a subcontractor for consulting and marketing. Several of these services are provided by related entities. Although the organization of school district liquid asset funds in other states varies, it is not uncommon for these types of funds to have the same service provider as the administrator and advisor of the fund like the ISDLAF+. (pages 3-10)

CONFLICTS OF INTEREST

The Declaration of Trust contains provisions that discuss the Fund and certain affiliates and their interests. The provisions contained in the Declaration of Trust generally allow for Trustees to have business interests similar to those of the Fund or to be interested in a transaction, provided the interest is disclosed and the action authorized by a majority vote of unaffiliated Trustees or a majority of participants. The Declaration of Trust contains a clause that allows the By-Laws of the Fund to contain more restrictive conflict of interest provisions. However, the By-Laws do not contain more restrictive provisions.

Prior to July 2004, neither Trustees nor service providers for the ISDLAF+ were required to file conflict of interest statements or disclosure forms with the Fund.

Prior to July 2004, neither Trustees nor service providers for the ISDLAF+ were required to file conflict of interest statements or disclosure forms with the Fund. In July 2004, the ISDLAF+ Board of Trustees approved a motion requiring each voting Trustee to annually submit to the Secretary, with a copy to the Fund counsel, copies of their economic interest disclosure forms that are filed annually with their respective county clerks. The motion also required Trustees to complete a Conflict of Interest Disclosure Statement. As of April 15, 2005, the Fund provided auditors with the Fund's Conflict of Interest Disclosure Statements for all ten of the current voting Trustees and copies of the Statements of Economic Interest filed with the respective county clerks for nine of the ten Trustees. However, the motion did not provide guidance regarding the types of relationships considered potential conflicts and the reporting process. Furthermore, service providers and contractors with the Fund are not required to file a disclosure with the ISDLAF+ Board.

In July 2004, the ISDLAF+ Board of Trustees approved a motion requiring each voting Trustee to annually submit to the Secretary, with a copy to the Fund counsel, copies of their economic interest disclosure forms that are filed annually with their respective county clerks.

Four liquid asset funds in other states were contacted to determine whether they had relevant conflict of interest reporting policies and procedures. Many of the other Government Investment Pools and School District Liquid Asset Funds that we reviewed had similar provisions regarding conflicts of interest as were found in the ISDLAF+'s Declaration of Trust. The ISDLAF+ Declaration of Trust provision, which calls for Trustees to disclose their interests, is not included in three of the four other states' school district liquid asset fund declarations of trusts that we reviewed.

One of the other states' funds responded that it had developed more specific policies. These policies included specific types of relationships that were considered conflicts of interest such as having a direct financial interest in any contractor, being an employee of any contractor, having low or zero interest loans from contractors, being involved in certain legal actions involving contractor organizations, or being an employee or having a contractual relationship with other similar funds.

The Illinois Treasurer's Employee Handbook requires employees of the Illinois Treasurer's Office to annually complete a Code of Ethical Conduct Investments and Loans Disclosure Form to disclose to the Office all matters that could reasonably be expected to interfere with the employee's duty to the Treasurer's Office, or with the employee's ability to render unbiased and objective advice, or create the appearance of impropriety in the Treasurer's Office. Specific employees are also required to complete the Secretary of State's Statement of Economic Interests.

The new conflict of interest reporting requirement adopted by the Board in July 2004 requires more disclosure to the Board than in previous years. However, the reporting requirements could be more specific regarding the types of conflicts that need to be reported. Also, given the competitive nature of the financial services being provided to the ISDLAF+, service providers and contractors with the Fund should also be required to file a conflict or economic interest disclosure with the ISDLAF+ Board.

We recommended that the Illinois School District Liquid Asset Fund Plus should establish specific written policies and procedures regarding conflicts of interest including the types of relationships that should be disclosed as well as the process of reporting conflicts. Such policies and procedures should include not only Fund officials but also service providers and other contractors. (pages 15-23)

FUND PERFORMANCE

The ISDLAF+ Multi-Class Series performance for the period October 2002 through December 2004 was comparable to other money market types of funds investing public funds. We compared 7-day annualized average yields for the ISDLAF+ with school district liquid asset funds in several other states. We also compared the ISDLAF+ with money market and governmental pool indices and the 4-week Treasury bill, as well as the Illinois Treasurer's Illinois Funds.

The ISDLAF+ Multi-Class Series performance for the period October 2002 through December 2004 was comparable to other money market types of funds investing public funds.

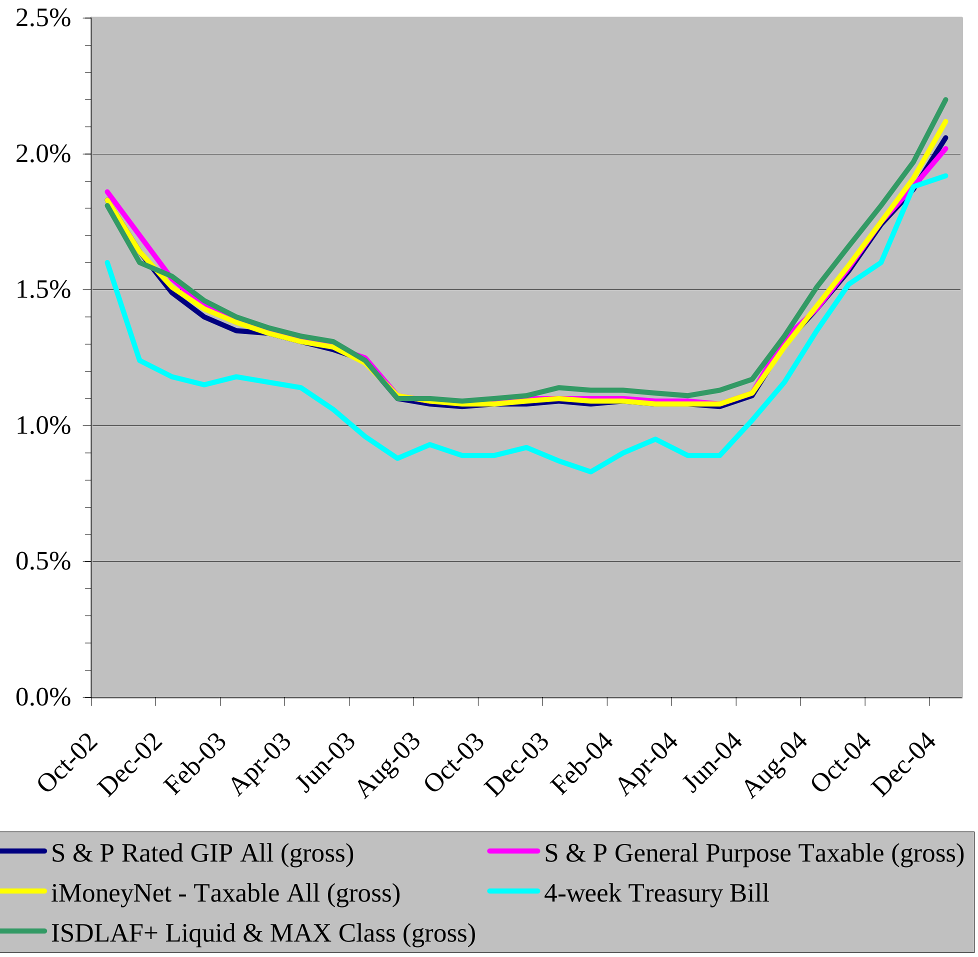
There are several variables that may have an effect on fund comparisons. These include the size and composition of the portfolio, the weighted average maturity (WAM), investment strategy, investment restrictions, services offered, and the fees and expenses charged to participants. These variables may have an effect on a fund's yield. For example, the ISDLAF+ portfolio's WAM is managed at 60 days or less. A portfolio that allows a higher WAM has the potential to earn a higher yield. An ISDLAF+ official noted that funds rated by Standard and Poor's (S&P) allow for a better comparison because non-rated funds can have more liberal or aggressive investment policies.

Indices

The ISDLAF+ Multi-Class Series consists of a Liquid Class and a MAX Class. Over the past two years, the ISDLAF+'s Liquid Class, which offers daily liquidity, had a slightly lower net return than two of the three indices presented. The ISDLAF+ MAX Class (which generally requires a minimum deposit of 14 days) performance was comparable to the S&P

indices and the 4-week T-bill and better than the iMoneyNet index. Digest Exhibit 2 shows that there was little difference among the ISDLAF+ gross return and the indices.

Digest Exhibit 2
COMPARISON OF ISDLAF+ MONTHLY ANNUALIZED GROSS RETURN WITH SELECTED INDICES AND BENCHMARKS
October 2002 through December 2004



Note: Gross returns for each ISDLAF+ class (Liquid and MAX) are not available because the Fund is a single series (with multiple classes).
Source: OAG analysis of average monthly returns of the ISDLAF+ and selected indices.

Other States' School District Liquid Asset Funds

Over the past two years, ISDLAF+'s Liquid Class performance was better than two of the three other states' funds that are presented in Digest Exhibit 3.

We collected available yield data for other states' school district liquid asset funds for the period of October 2002 to December 2004. Digest Exhibit 3 shows the average 7-day yield comparisons for the Liquid and MAX Classes, respectively, among school district liquid asset funds in other states.

Digest Exhibit 3
AVERAGE OF 7-DAY YIELD FOR ISDLAF+ AND FUNDS IN OTHER STATES
October 2002 through December 2004

	ISDLAF+	Minnesota	Michigan	Nebraska
Liquid Class	0.84%	0.60%	0.67%	0.90%
MAX Class	0.99%	0.99%	1.02%	0.90%

Note: Nebraska's school district liquid asset fund has only one class of shares.
Source: OAG analysis of daily 7-day yields.

Over the past two years, ISDLAF+'s Liquid Class performance was better than two of the three other states' funds that are presented in Digest Exhibit 3. Nebraska's school district liquid asset fund has only one class of shares. This is why it had a higher return in the Liquid Class comparison, but the lowest return on average when compared to MAX Class returns. The ISDLAF+'s MAX Class has been yielding approximately the same return as that of the other two funds with both a Liquid and MAX class.

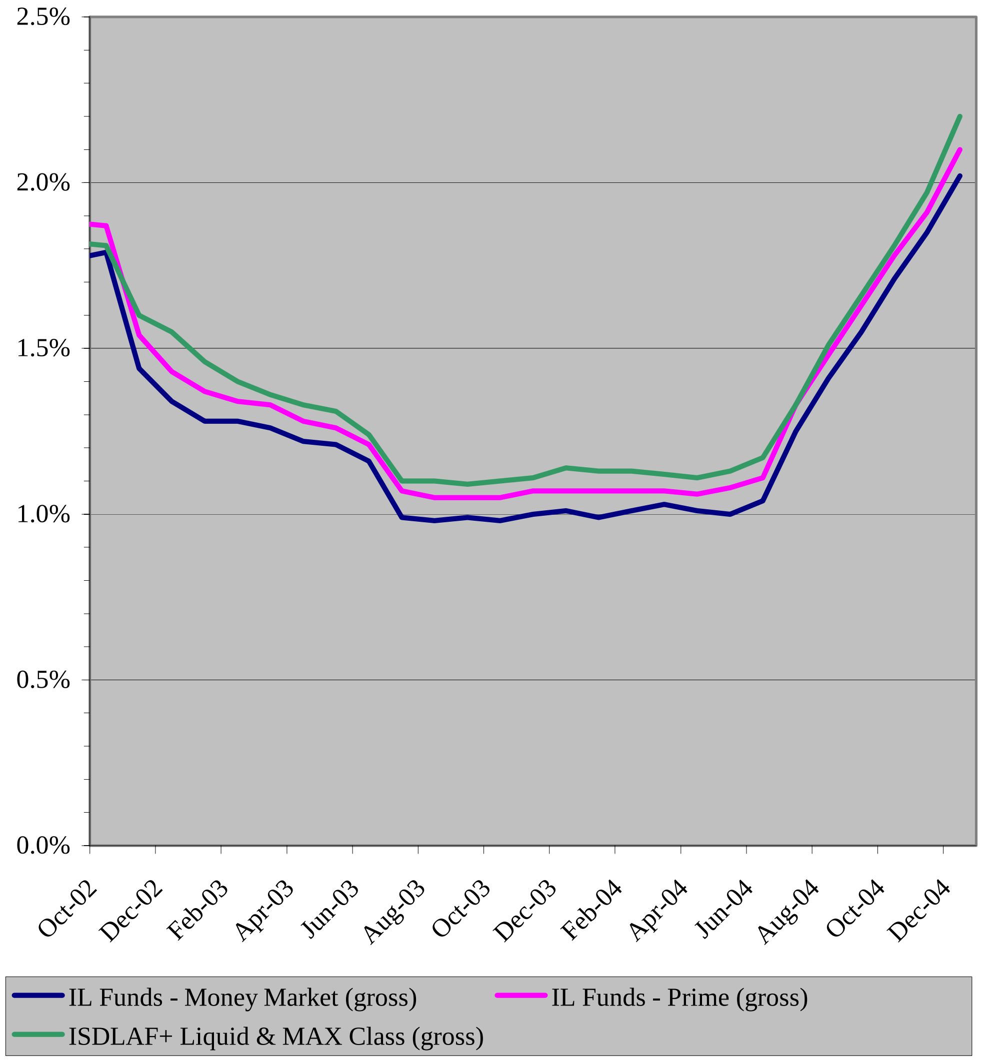
Illinois Treasurer's Illinois Funds

The ISDLAF+ performed slightly better than the Illinois Treasurer's Office Illinois Funds in the gross rate comparison; the Illinois Funds performed better in the net rate comparison.

In addition to the Fund's Investment Advisory Agreement, which calls for comparison of the ISDLAF+ to the Illinois Funds, a Fund official noted that the Board requests that the Fund be compared with the Illinois Treasurer's Office Illinois Funds. The ISDLAF+ uses the **gross** rate of return when comparing its Fund's performance to the performance of the Illinois Funds. The **gross** rate of return is the return on investments before expenses are deducted. The **net** rate of return is the return that investors realize on monies invested. The **net** return comparison takes into account expenses when calculating the average annualized monthly return.

When compared to the Illinois Treasurer's Office Illinois Funds, the ISDLAF+ performed slightly better than the Illinois Funds in the **gross** rate comparison (i.e. before expenses are deducted); however, the Illinois Funds performed better than the ISDLAF+ in the **net** rate comparison (after expenses). Digest Exhibit 4 shows a monthly average annualized **gross** return comparison between the ISDLAF+ and the Illinois Treasurer's Office Illinois Funds Money Market Fund and Prime Fund. Digest Exhibit 5 shows a comparison of the monthly average annualized **net** return for each class of the ISDLAF+ and Illinois Treasurer's Office Illinois Funds.

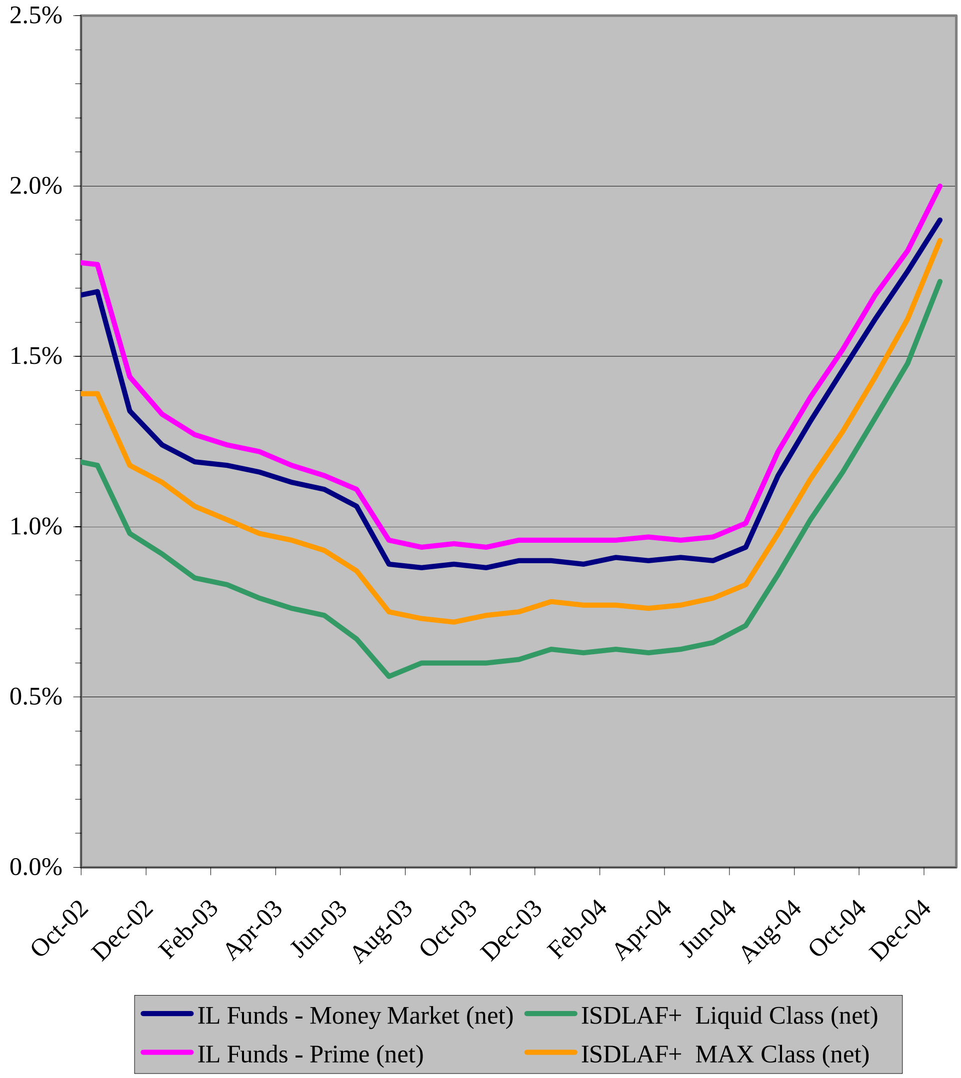
Digest Exhibit 4
COMPARISON OF ISDLAF+ AND ILLINOIS FUNDS
MONTHLY ANNUALIZED GROSS RETURN
October 2002 through December 2004



Note: Gross returns for each ISDLAF+ class (Liquid and MAX) are not available because the Fund is a single series (with multiple classes).

Source: ISDLAF+ and the Illinois Treasurer's Office.

Digest Exhibit 5
COMPARISON OF ISDLAF+ AND ILLINOIS FUNDS
MONTHLY ANNUALIZED NET RETURN
October 2002 through December 2004



Source: ISDLAF+ and the Illinois Treasurer's Office.

Performance Reporting to Participants

Reports related to Fund performance are prepared and provided to the Trustees at each quarterly meeting. These reports contain average yield and return comparisons as well as a performance evaluation of the Multi-Class Series of the Fund. Although the Fund's Administrator prepares comparisons and provides them to Trustees at quarterly meetings, the ISDLAF+ annual report distributed to Fund participants does not contain a performance comparison.

The ISDLAF+ annual report distributed to Fund participants does not contain a performance comparison.

We recommended that the Illinois School District Liquid Asset Fund Plus should include performance comparisons in the ISDLAF+ annual report distributed to Fund participants. (pages 25-37)

MANAGEMENT CONTROLS

The ISDLAF+ has established a system of management controls for the monies invested by participants in the pooled funds of the Multi-Class Series. These include written investment policies, quarterly reporting to the Board of Trustees, weekly compliance reporting to the audit committee, and regular performance comparisons.

Digest Exhibit 6
SUMMARY OF RECOMMENDED MANAGEMENT CONTROLS FOR GOVERNMENT INVESTMENT POOLS

Recommended Control	**Adopted by ISDLAF+ in:**
Full disclosure of pool objectives and policies	Declaration of Trust (as amended January 14, 1999) and Information Statement (October 1, 2002).
Adoption of formal and clear investment objectives	Declaration of Trust Article IV and the Information Statement.
Written and approved investment policies	Declaration of Trust and the Information Statement.
System of internal controls documented in an investment procedures manual that is reviewed and updated annually	Subadvisor (Federated) manual dated May 2004.
Investment Reports prepared at least quarterly	Reports are prepared for Trustees on a quarterly basis. Compliance reports prepared for the audit committee on a weekly basis.
Investment policies formally approved and adopted by the governing body and reviewed annually	Investment policies are contained in the Declaration of Trust and the Information Statement (see above). Although these policies as a matter of practice are not reviewed annually, the Trustees review authorized investments on a quarterly basis.
Series of benchmarks established against which portfolio performance should be compared on a regular basis	Information Statement contains a list of comparisons that may be used. The agreement with the Fund's Investment Advisor contains required comparisons.
Weighted Average Maturity (WAM) of less than 90 days	Information Statement investment policies require a WAM of 60 days or less.

Source: OAG analysis of recommended controls and ISDLAF+ policies.

Digest Exhibit 6 summarizes the recommended management controls for government investment pools and the document or method by which the ISDLAF+ had implemented the control. When Standard and Poor's reviews pools for rating purposes, it closely considers the internal controls, including pricing policies, net asset value deviation procedures, depth of staff, stress testing capabilities, asset flow monitoring, trade ticket verification, systems backups and disaster recovery.

Banker's Acceptances

It is unclear whether the Public Funds Investment Act specifically authorizes investment in banker's acceptances.

It is unclear whether the Public Funds Investment Act specifically authorizes investment in banker's acceptances. Banker's acceptances are short-term credit instruments most commonly used by persons or firms engaged in international trade. In general, banker's acceptances are time drafts drawn on and accepted by a bank.

According to ISDLAF+ officials, a bank may hold the banker's acceptance in its portfolio or it may sell the banker's acceptance in the secondary market, usually at the rate of other money market instruments. Banker's acceptances that are sold in the secondary market are sold just like any other security, by order ticket. Banker's acceptances can be purchased in the secondary market from either the issuing bank or a dealer who has purchased the banker's acceptance from the bank.

In 1997 the Attorney General issued an Informal Opinion (I-97-022; August 25, 1997) that concluded that school districts are not authorized to invest their funds in banker's acceptances either directly or through investments in money market mutual funds. The general basis for the conclusion was that the Public Funds Investment Act does not specifically list banker's acceptances as an appropriate investment. The Informal Opinion lists at least six other unrelated acts related to investing public funds that specifically list banker's acceptances as an allowable investment.

The ISDLAF+ responded that the authority to invest in banker's acceptances is contained in Section 2(a)(3) of the Public Funds Investment Act (30 ILCS 235/2) in which it authorizes the investment of school district funds "***in interest-bearing savings accounts, interest-bearing certificates of deposit or interest-bearing time deposits <u>or any other investments constituting direct obligations of any bank as defined in the Illinois Banking Act</u>***" (emphasis added).

A review of the 2002 through 2004 annual reports shows that the ISDLAF+ Multi-Class Series portfolio had little or no outstanding investments in banker's acceptances for these years. The Fund held no outstanding banker's acceptances as of September 30, 2002 and 2003. For 2004, the Fund held approximately $5.34 million in banker's acceptances and $1.4 million in bank notes or about one percent of the entire investment portfolio.

We reviewed the investment policies of other local government investment pools (LGIPs) and found that it is not uncommon for LGIPs to invest in banker's acceptances. Our review of school district liquid asset funds in other states also found that several of the funds' policies specifically allow for banker's acceptances as investments of the fund.

We included a Matter for Consideration that the General Assembly may wish to consider defining the term "direct obligations of any bank" in the Illinois Public Funds Investment Act. (pages 39-48)

RECOMMENDATIONS

The audit contains two recommendations to the ISDLAF+ and a Matter for Consideration by the Illinois General Assembly. The ISDLAF+ generally agreed to implement the two recommendations.

WILLIAM G. HOLLAND
Auditor General

WGH:MP
May 2005

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GLOSSARY OF TERMS

AAAm rating – a rating given by Standard & Poor's based on an analysis of a fund's credit quality, market price exposure, and management. The rating signifies excellent safety of invested principal and a superior capacity to maintain principal value and limit exposure to loss.

Banker's Acceptance – a time draft drawn on and accepted by a bank, and commonly used in international transactions. A banker's acceptance is a primary and unconditional liability of the accepting bank obligating the bank to pay the holder on maturity.

Benchmark – a standard against which the performance of something can be measured.

ISDLAF+ – the Illinois School District Liquid Asset Fund Plus. Also referred to as the Fund.

Letter of Credit (LOC) – a letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount.

SAS 70 – Statement on Auditing Standards 70 (SAS 70) is an internationally recognized auditing standard developed by the American Institute of Certified Public Accountants. SAS 70 represents that a service organization has been through an in-depth audit of its control activities, which generally include controls over information technology and related processes. SAS 70 examinations signify that a service organization has had its control objectives and control activities examined by an independent accounting and auditing firm.

Section 2a7-like – a term used to describe a fund or pool that is not registered with the Securities and Exchange Commission (SEC) as an investment company, but nevertheless operates in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. Rule 2a7 allows money market funds to use amortized cost to value their net assets.

Weighted Average Maturity – the average maturity of all the securities that comprise a portfolio.

Chapter One

INTRODUCTION AND BACKGROUND

REPORT CONCLUSIONS

The Illinois School District Liquid Asset Fund Plus (ISDLAF+ or the Fund) is an Illinois common law trust that was created in 1984 pursuant to provisions of the Illinois School Code. The Fund offers shares in a manner similar to a money market mutual fund in which participants can choose from two different classes of shares. As of September 2004, the ISDLAF+ pooled funds totaled approximately $586 million.

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Prior to July 2004, neither Trustees nor service providers for the ISDLAF+ were required to file conflict of interest statements or disclosure forms with the Fund. In July 2004, the ISDLAF+ Board of Trustees approved a motion requiring each voting Trustee to annually submit to the Secretary, with a copy to the Fund counsel, copies of their economic interest disclosure forms that are filed annually with their respective county clerks. The motion also required Trustees to complete a Conflict of Interest Disclosure Statement. As of April 15, 2005, the Fund provided auditors with the Fund's Conflict of Interest Disclosure Statements for all ten of the current voting Trustees and copies of the Statements of Economic Interest filed with the respective county clerks for nine of the ten Trustees. However, the motion did not provide guidance regarding the types of relationships considered potential conflicts and the reporting process. Furthermore, service providers and contractors with the Fund are not required to file a disclosure with the ISDLAF+ Board.

The Illinois State Treasurer's Office and four liquid asset funds in other states were contacted to determine whether they had relevant conflict of interest reporting policies and procedures. The Treasurer requires all employees to disclose all matters that could reasonably be expected to interfere with the employee's duties, as well as requires certain employees to file a Statement of Economic Interest with the Secretary of State (similar to the Statement of Economic Interest the ISDLAF+ Trustees file with their respective county clerks and now with the Secretary of the Board). One of the four other states' funds contacted had also established specific policies defining what types of relationships constitute a conflict of interest.

The ISDLAF+ Multi-Class Series performance for the period October 2002 through December 2004 was comparable to other money market types of funds investing public funds. We compared 7-day annualized average yields for the ISDLAF+ with school district liquid asset funds in several other states. We also compared the ISDLAF+ with money market and governmental pool indices and the 4-week Treasury bill.

The ISDLAF+ Multi-Class Series consists of a Liquid Class, which offers daily liquidity and a MAX Class, which generally requires a minimum deposit of 14 days. Over the past two years, ISDLAF+'s Liquid Class had a slightly lower net return than two of the three indices presented; however, it had a higher net return than that of two of the three other states' liquid asset funds presented. The ISDLAF+ MAX Class performance was comparable to the Standard and Poor's (S & P) indices and the 4-week T-bill and better than the iMoneyNet index. The MAX Class has been yielding approximately the same return as that of two of the three other states' liquid asset funds presented. When compared to the Illinois Treasurer's Office Illinois Funds, the ISDLAF+ performed slightly better than the Illinois Funds in the **gross** rate comparison (i.e. before expenses are deducted); however, the Illinois Funds performed better than the ISDLAF+ in the **net** rate comparison (i.e. after expenses).

Reports related to Fund performance are prepared and provided to the Trustees at each quarterly meeting. These reports contain average yield and return comparisons as well as a performance evaluation of the Multi-Class Series of the Fund. Although the Fund's Administrator prepares comparisons and provides them to Trustees at quarterly meetings, the ISDLAF+ annual reports distributed to Fund participants do not contain a performance comparison.

The ISDLAF+ has established a system of management controls for the monies invested by participants in the pooled funds of the Multi-Class Series. These include written investment policies, quarterly reporting to the Board of Trustees, weekly compliance reporting to the audit committee, and regular performance comparisons.

It is unclear whether the Public Funds Investment Act specifically authorizes investment in banker's acceptances. Although the Act includes a provision for the investment of funds in other investments constituting direct obligations of any bank, it does not define what these include. The Fund does invest in banker's acceptances, which an informal Attorney General opinion in 1997 determined were not permissible investments under the Public Funds Investment Act. We have included a Matter for Consideration for the Illinois General Assembly to consider defining the term "direct obligations of any bank" in the Public Funds Investment Act.

INTRODUCTION

On April 22, 2004, Senate Resolution Number 171 was adopted directing the Auditor General to conduct a management audit of the Illinois School District Liquid Asset Fund Plus (See Appendix A). The resolution asks the Auditor General to determine:

- Whether the Fund's provisions regarding conflicts of interest are sufficient and comparable to other pools investing public moneys;

- Whether the Fund's performance is comparable to other pools investing public moneys; and
- Whether controls are in place to adequately protect public moneys invested in the Fund.

BACKGROUND

Illinois law allows township and school treasurers, community college districts, and educational service regions to join together in investing funds. Section 8-7 of the School Code permits township and school treasurers to join with other school districts, community colleges, and educational service regions for the purpose of investing funds (105 ILCS 5/8-7). A similar provision is included in the Public Community College Act, which permits community colleges to do the same (110 ILCS 805/3-47).

> "Township and school treasurers are authorized to enter into agreements of any definite or indefinite term regarding the deposit, redeposit, investment, reinvestment or withdrawal of school funds, including, without limitation, agreements with other township and school treasurers, agreements with community college districts authorized by Section 3-47 of the Public Community College Act and agreements with educational service regions…"
> *Illinois School Code* (*105 ILCS 5/8-7)*

The Illinois School District Liquid Asset Fund Plus (ISDLAF+) is an Illinois common law trust that was organized for the purpose of combining available investment funds so as to enhance the investment opportunities available to school districts and to increase the investment earnings accruing to the benefit of the respective school districts. A Declaration of Trust that governs the operations of the ISDLAF+ was adopted by the Fund's Board of Trustees and legally filed. The Fund was created March 26, 1984, with four initial participants. In addition, the Trustees have formally adopted an Information Statement that also governs the ISDLAF+ operations and includes management and investment policies.

The Fund offers shares in a manner similar to a money market mutual fund. Participants can choose from two different classes of shares with the pooled funds of the Multi-Class Series. These include the Liquid Class and the MAX Class. The Liquid Class is a money market type of investment that offers daily liquidity and check-writing privileges. The MAX Class generally requires that a participant hold the shares for a minimum of 14 days. The MAX Class does not provide, and is therefore not charged expenses of the Custodian related to, check-writing privileges like the Liquid Class. However, if MAX Class shares are redeemed early, the participant may be charged a penalty equal to 7 days interest at the current daily rate on the value of the redemption.

Exhibit 1-1 shows an overview of the types of participants and funds invested in the Multi-Class Series of the Fund. The Fund has approximately 400 participants including township treasurers, school districts, and community colleges. As of September 30, 2004, the Fund's Multi-Class Series had total assets and investments of $586 million. As is shown in Exhibit 1-1, the majority of participants in the ISDLAF+ are school districts.

Exhibit 1-1
OVERVIEW OF ISDLAF+ PARTICIPANTS
As of September 30, 2004

Type	**Number**	**Amount In Fund**	**Percent of Funds**
School Districts	340	$499,285,766	85.2%
Community Colleges	15	$21,199,222	3.6%
Township Treasurers	16	$49,198,387	8.4%
Other	26	$16,475,631	2.8%
Total	**397**	**$586,159,005**	**100%**

Notes: Total funds do not match annual reports primarily due to daily account activity. Total may not add due to rounding.

Source: PMA analysis of ISDLAF+ Daily Account Balances as of 9/30/04.

Fixed Rate Investment Program

The Fund's offerings have expanded over the years to include a comprehensive menu of investment options, full service banking, cash flow management, and financial planning. In addition to the approximately $586 million invested in the Multi-Class Series of the pooled funds as of September 2004, there was an additional $3.2 billion dollars that is made up of individual investments made by participants. These investments are referred to as the Fixed Rate Investment Program (FRI) and are individual investments that participants make that are separate and apart from those of the pooled funds of the Multi-Class Series. ISDLAF+ participants can purchase individual fixed income instruments using monies from their Fund accounts. The instruments are of varying maturities, including those with maturities of more than one year, issued by a variety of issuers. These investments include certificates of deposit of banks and thrift institutions ("CDs"), commercial paper, and banker's acceptances. Investors purchasing investments through the Fixed Rate Investment Program pay a mark-up from .15% up to .35% to the Fund Administrator, depending upon the type of investment purchased.

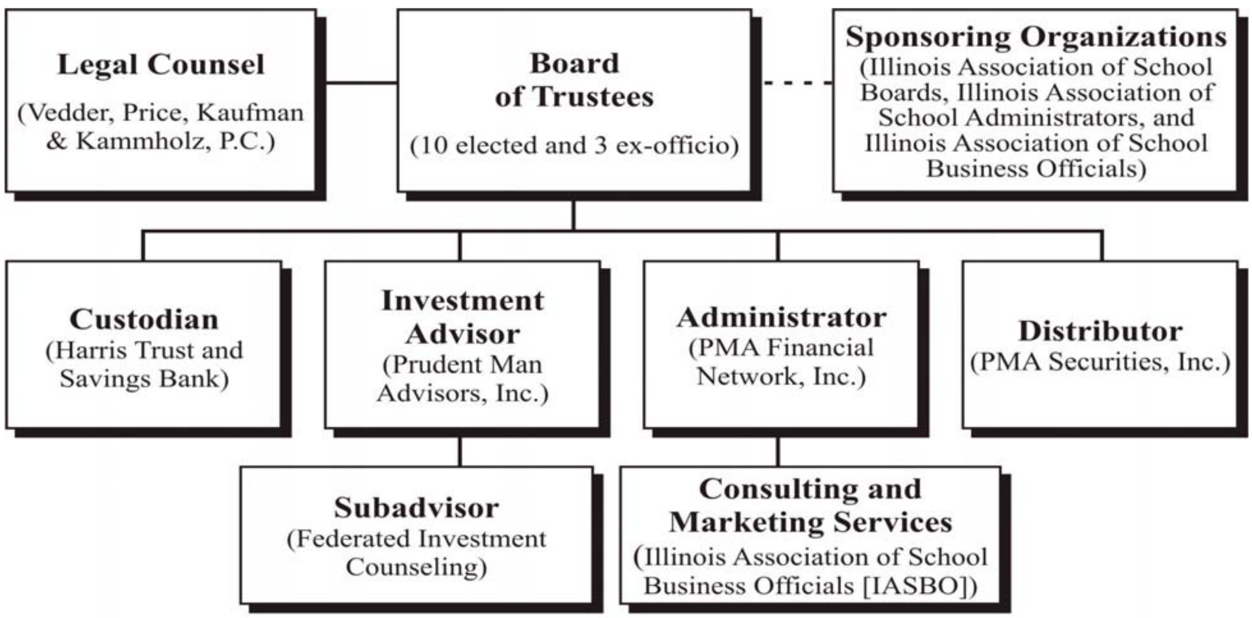
ISDLAF+ MANAGEMENT AND ORGANIZATION

The affairs and operations of the ISDLAF+ are governed and controlled by a Board of Trustees. Service providers hired by the Board perform all the day-to-day functions of the Fund. The Board-hired service providers include an Investment Advisor, Administrator, Distributor, and Custodian. There is also a Subadvisor and a subcontractor for consulting and marketing. Several of these services are provided by related entities. Although the organization of school district liquid asset funds in other states varies, it is not uncommon for these types of funds to have the same service provider as the administrator and advisor of the fund like the ISDLAF+. Exhibit 1-2 is an overview of the organization and management of the Fund followed by a discussion of the responsibilities of the different entities involved in operating and managing the Fund. The expenses for each service provider are set by contract and are explained in the Fund's Information Statement.

Board of Trustees

The Board of Trustees (Board) oversees the actions of the Investment Advisor, the Administrator, the Custodian, the Sponsors, and the Distributor, and decides general policies of the Fund. The ISDLAF+ Declaration of Trust establishes a Board of Trustees. The current Board is comprised of 13 trustees, 10 of whom are elected and three who serve in an ex-officio capacity. The elected Trustees are divided into three classes arranged so that the term of one class expires each year. At each annual meeting of investors, Trustees of the class whose term then expires are elected to serve for a term of three years. Trustees can be elected to any number of successive terms. The Fund's Declaration of Trust requires that the elected Trustees be individuals who are treasurers, school board members, superintendents or business officials of a school entity that is an investor of the Fund or the regional superintendent of an educational service region that is an investor. As of the end of the Fund's fiscal year (September 30, 2004) there was one vacancy on the Board (Appendix B includes a list of the 2004 ISDLAF+ Trustees).

Exhibit 1-2
ORGANIZATION AND MANAGEMENT STRUCTURE
Of The Illinois School District Liquid Asset Fund Plus



Source: OAG analysis of ISDLAF+ information.

The ex-officio members of the Board of Trustees are the executive directors of the three sponsoring organizations, the Illinois Association of School Boards (IASB), the Illinois Association of School Administrators (IASA), and the Illinois Association of School Business Officials (IASBO). All trustees serve without compensation, but are reimbursed for reasonable travel and other out-of-pocket expenses incurred in connection with their duties as trustees.

Administrator

The Fund's Administrator supervises all aspects of the Multi-Class Series operations, other than those delegated to the Investment Advisor, the Subadvisor, the Custodian, and the Distributor. The Administrator prepares all required tax returns for the Multi-Class Series of the Fund and prepares reports for investors.

PMA Financial Network, Inc. (PMA) provides administrative services to the Fund and functions as the Fund's Administrator. The Administrator services all investor accounts in the Fund; determines and allocates income of the Fund; provides administrative personnel and facilities to the Fund; determines the net asset value of the Liquid Class and MAX Class on a daily basis; and performs related administrative services for the Fund. PMA has been the Fund's Administrator since October 2002. Prior to October 2002, Cadre Financial Services Inc. was the Fund's Administrator. PMA was selected to manage the Fund through a Request for Proposal (RFP) process. PMA also contracts with and provides services to a similar fund in Wisconsin.

Investment Advisor

The Investment Advisor's primary responsibility is to formulate a continuing investment program and to oversee all decisions regarding the purchase and sale of securities for the Multi-Class Series. The Fund's Investment Advisor is Prudent Man Advisors, Inc., a corporation organized under the laws of the State of Illinois and an investment advisor registered with the Securities and Exchange Commission. Prudent Man Advisors, Inc. is an affiliate of PMA Financial Network, Inc., the Fund's Administrator, and PMA Securities, Inc., a broker-dealer that serves as the Fund's Distributor.

With the approval of the Board of Trustees, the Investment Advisor hired a Subadvisor to manage the assets of the Multi-Class Series. The Fund's Subadvisor is Federated Investment Counseling located in Pittsburgh, Pennsylvania. Federated is one of the largest institutional money market fund managers with total managed assets of $177.6 billion (over $26 billion in equity assets) as of September 30, 2004.

Distributor

PMA Securities, Inc. is the Distributor for shares of the Multi-Class Series and also makes available to Fund investors U.S. government securities as part of the Fixed Rate Investment Program. The Distributor engages in distribution efforts; assists investors in completing and submitting registration forms; assists in preparing and distributing information about the Fund and its investment services; and advises the Trustees regarding methods of seeking and obtaining additional investors for the Fund. PMA has subcontracted with the Illinois Association of School Business Officials (IASBO) as a marketing consultant to perform some of the duties of the Distributor. IASBO also maintains a website for the Fund.

Custodian

Harris Trust and Savings Bank maintains custody of all securities and cash assets of the Fund and acts as a safekeeping agent for the investment portfolio of the Multi-Class Series. It also serves as the depository in connection with direct investments and redemptions.

Sponsors

The Illinois Association of School Boards, the Illinois Association of School Administrators, and the Illinois Association of School Business Officials serve as Sponsors of the Fund pursuant to the royalty and sponsorship agreements with the Fund. The Sponsors receive fees in exchange for their sponsorship of the Fund but do not control the operations of the Fund. The Fund pays the Sponsors royalty fees at an annual rate equal to .00625 percent of the average daily net assets for the Illinois Association of School Administrators and Illinois Association of School Business Officials and .0125 percent for the Illinois Association of School Boards.

Based on the rates above, the Sponsors received a total of $122,502 and $143,048 for fiscal years 2003 and 2004 respectively for these fees from the Fund. The current royalty agreements, however, call for the three sponsors to receive a minimum total of $250,000 (IASB receives $125,000 and IASA and IASBO each receive $62,500). The difference between the fees received from the Fund and the minimum required in the royalty agreements is made up out-of-pocket by the Fund Administrator.

INVESTMENTS AND SERVICES

When the ISDLAF+ began in 1984, it offered only a pooled money market product for participants. The Fund now offers other financial resource management programs including individual investment options, full service banking, cash-flow management, bond proceeds management, financial planning, and a short-term borrowing program. Participants can invest monies in the Multi-Class Series pooled investments and/or participants can choose to invest their monies in individual investments that are outside of the pooled funds in the Fixed Rate Investment Program.

The Multi-Class Series

In 1999, the participants in the Fund approved an amendment to the Fund’s Declaration of Trust that permitted the Fund’s Trustees to authorize the termination and consolidation of the Fund’s two existing series of shares (the Liquid Series and the MAX Series) and create a single portfolio. The core program of the Fund is the Multi-Class Series. The Multi-Class Series is a AAAm rated pooled investment that is managed by the Fund’s Subadvisor (Federated). The Fund currently offers shares of the Multi-Class Series, which consists of the Liquid Class and the MAX Class. The Liquid Class is a money market type of investment that offers daily liquidity. The MAX Class generally requires that a participant hold the shares for a minimum of 14 days. The MAX Class does not provide, and is therefore not charged expenses of the Custodian related to, check-writing privileges like the Liquid Class. However, if MAX Class shares are redeemed early, the participant may be charged a penalty equal to 7 days interest at the current daily rate on the value of the redemption. There is no minimum account balance requirement for either class. The total net assets of the Multi-Class Series, as reported in the Fund’s Annual Report, totaled $585,667,597 as of September 2004.

Exhibit 1-3
ISDLAF+ INVESTMENT OPTIONS

Type of Investment	Description	Examples
U.S. Government Obligations	• Issued or guaranteed by the U.S. government or one of its agencies • Investments are backed by full faith and credit of U.S. or backed solely by the issuing or guaranteeing agency itself	• Federal Home Loan Mortgage Corporation • Federal National Mortgage Association • Federal Home Loan Bank System
Floating-Rate and Variable-Rate Obligations	• Interest rates may be adjusted at specified intervals if a specific benchmark rate or index changes • May be beneficial when interest rates are rising because of additional return	• American Express Credit Corporation • Merrill Lynch & Co., Inc. • Highview Baptist Church, Inc. (Series 2002), (Bank One N.A. (Chicago) LOC)
Commercial Paper	• Short-term obligations of corporations • Company's assets must exceed $500 million • Paper must be rated in one of the three highest rating categories by at least two of the major rating organizations	• General Electric Capital Corporation • Fairway Finance Company LLC • Edison Asset Securitization LLC
Demand Instruments	• Corporate debt securities that the issuer must repay upon demand or that a third party must repurchase at face value upon demand	• Decoster (Series 2003-A) • KRH Wieland LLC and Kinsey Realty Holdings LLC, (Series 2003)
Bank Obligations	• Interest-bearing certificates of deposit or time deposits • Other direct obligations of a bank, including Banker's Acceptances[1]	• Citibank N.A., New York, Certificate of Deposit • Regions Bank, Alabama, Certificate of Deposit
Repurchase Agreements	• A party agrees to sell a U.S. government security to the Fund then repurchase it at an agreed-upon price at a stated time • Creates a fixed return for the Fund • Fully collateralized at 102% with U.S. government securities	• Repurchase agreement with Bank of Montreal, dated 9/30/2004 due 10/1/2004 at 1.860%, collateralized by U.S. Government Agency Obligations with maturities to 6/12/2013

Note: [1] Banker's Acceptances are discussed further in Chapter Four of this report on pages 47-48.

Source: ISDLAF+ 2004 Annual Report and October 1, 2002 Information Statement.

The Multi-Class Series pays fees to the Administrator, the Investment Advisor, the Distributor, the Sponsors, and the Custodian. These fees are for investment advice, administration, marketing, royalties related to sponsorship, cash management services, and other expenses, such as out-of pocket expenses incurred by Trustees and officers, insurance for the Trustees, fees of the Custodian, audit fees and legal fees.

Exhibit 1-3 shows a general overview of the types of investment options for the Multi-Class Series and gives common examples of these investments.

Other Programs and Services Offered to Fund Participants

In addition to the investments and services offered by the Multi-Class Series and the Fixed Rate Investment Program, the Fund Administrator offers other programs and services for cash flow management, financial planning, bond proceeds management, and a recently instituted short-term borrowing program (August 2004).

Cash Flow Management Program

The cash flow management program is designed to help schools better manage their financial resources. The program utilizes historical data to generate an investment plan that adequately covers liabilities, pushes investments as far out on the yield curve as possible to take advantage of higher rates, and identifies reserves that can be invested long-term.

Financial Planning Program

The financial planning program is a tool offered to participants that allows for assumptions in order to project the participant's financial position. Historical financial data is combined with current budget data and projections for revenues and expenses of the participant in order to develop a financial plan. The plan takes into account the last five years' financial history, tax levy information, student enrollment, student/teacher ratio, new property growth, debt retirement schedules, Consumer Price Index, and tax-cap limitations.

Bond Proceeds Management Program

The bond proceeds management program is a service that helps participants establish a reliable and sufficient flow of funds while optimizing investment earnings and adequately covering expenses. The participant is provided monthly reports with interest projections, arbitrage spend-down status, potential arbitrage payments, and portfolio reporting. The bond proceeds management program also assists participants in preparing arbitrage reports for the purpose of Internal Revenue Service reporting. The program also helps participants with district and State statute compliance issues.

ISDLAF+ FINANCIAL OVERVIEW

Exhibit 1-4 presents the total net assets, investment income, and expenses of the ISDLAF+ Multi-Class Series as of the end of each fiscal year for 2002-2004. The total net assets for the Fund have ranged from approximately $410 million in fiscal year 2002 to almost $640 million in fiscal year 2003.

The Fund invests in high-quality, short-term debt instruments guaranteed by the full faith and credit of the United States, certain U.S. government agency obligations, commercial paper, bank obligations, and other obligations permitted by Illinois law, particularly the Public Funds Investment Act (30 ILCS 235).

Exhibit 1-4
ISDLAF+ ASSETS, INVESTMENT INCOME, AND EXPENSES
Fiscal Years 2002-2004
(as of September 30)

	FY 2002	FY 2003	FY 2004
Total Net Assets[1]	$409,645,436	$639,071,952	$585,667,597
Investment Income	$10,056,519	$6,599,448	$6,988,304
Expenses	$2,016,055	$2,375,099	$2,422,759

Note: [1]Total Net Assets includes “other assets in excess of liabilities” which were $135,860 for FY 2002, $171,771 for FY 2003, and $89,671 for FY 2004.

Source: OAG analysis of ISDLAF+ annual reports.

Each annual report provides a list of the debt instruments (and their values) the ISDLAF+ is invested in as of the end of the fiscal year (September 30). According to the Fund’s 2004 Annual Report, all investments are classified as insured or registered, or securities held by the Fund or its agent in the Fund’s name. Exhibit 1-5 provides a breakdown of the Fund’s investments at the end of the last three fiscal years. According to ISDLAF+ officials, the change in allocations between 2002 and 2003 occurred because of the difference in administration. PMA took over the management of the ISDLAF+ beginning in fiscal year 2003. Prior to this, Cadre Financial Services Inc. was the Administrator.

Exhibit 1-5
APPROXIMATE MARKET VALUES AND INVESTMENT ALLOCATIONS
Fiscal Years 2002-2004
(as of September 30)

	2002	**% of Total Net Assets**	**2003**	**% of Total Net Assets**	**2004**	**% of Total Net Assets**
Certificates of Deposit	-	-	$54,800,092	8.6%	$113,000,000	19.3%
Commercial Paper	$58,132,576	14.2%	$200,099,805	31.3%	$157,013,035	26.8%
U.S. Government Agency Obligations	$205,120,415	50.1%	$67,530,412	10.6%	$65,758,840	11.2%
Notes – Variable	-	-	$117,537,872	18.4%	$176,767,208	30.2%
Repurchase Agreements	$85,415,000	20.9%	$198,932,000	31.1%	$66,300,000	11.3%
Federal National Mortgage Association	$60,841,585	14.9%	[1]	-	[1]	-
Bankers Acceptances and Bank Notes	-	-	-	-	$6,738,843	1.2%
Total Investments	**$409,509,576**		**$638,900,181**		**$585,577,926**	
Other Assets in Excess of Liabilities	$135,860	.0%	$171,771	.0%	$89,671	.0%
Total Net Assets	**$409,645,436**	[2]**100%**	**$639,071,952**	**100%**	**$585,667,597**	**100%**

Notes: [1] Included in U.S. Government Agency Obligations.
[2] Totals may not add due to rounding.

Source: ISDLAF+ annual reports.

Expenses and Fees

The expenses and fees paid by the Fund are primarily those related to administration and other services performed by the Fund's contractors. These fees include Investment Advisory fees, Administration fees, Marketing fees, and Sponsorship fees. The Fund also pays other expenses associated with out-of-pocket expenses incurred by its Trustees and officers, fees charged by the Custodian (Harris Trust and Savings Bank), audit fees, and legal fees.

Exhibit 1-6 is a summary of ISDLAF+ expenses over the past three years. Most expenses are based on the average net assets of the Fund. According to information received from the ISDLAF+ Administrator, the average daily fund balance increased from $467 million in fiscal year 2002 to more than $572 million in fiscal year 2004. Fund officials noted that the liability insurance expense nearly doubled from fiscal year 2002 to fiscal year 2003 because the Fund doubled its liability coverage from $1 million to $2 million. The basis of ISDLAF+ expenses is presented in Appendix C.

Exhibit 1-6
ISDLAF+ EXPENSES
Fiscal Years 2002-2004
(as of September 30)

Fiscal Year	**FY 2002**	**FY 2003**	**FY 2004**
Administrator	***Cadre***	***PMA***	***PMA***
Administration fees	$615,505	$686,012	$801,067
Investment advisory fees	465,119	490,009	514,972
Marketing fees	233,546	343,007	400,534
Sponsorship fees		122,502	143,048
Consulting fees	191,545	0	0
Custodian and cash management fees – Liquid Class	329,313	520,324	402,067
Custodian and cash management fees – MAX Class	44,410	32,053	20,300
Legal fees	77,637	93,248	54,510
Audit fees	23,500	39,774	35,437
Trustees' expenses	23,355	24,501	28,610
Liability insurance expense	12,125	23,669	22,214
Total Expenses	**$2,016,055**	**$2,375,099**	**$2,422,759**
Average Daily Fund Balance	**$467,104,719**	**$490,087,631**	**$572,495,020**

Source: ISDLAF+ annual reports and ISDLAF+ Administrator.

SCOPE AND METHODOLOGY

This audit was conducted in accordance with generally accepted government auditing standards and the audit standards promulgated by the Office of the Auditor General at 74 Ill. Adm. Code 420.310.

The audit's objectives are contained in Senate Resolution 171 (see Appendix A), which asks the Auditor General to determine:

- Whether the Fund's provisions regarding conflicts of interest are sufficient and comparable to other pools investing public moneys;
- Whether the Fund's performance is comparable to other pools investing public moneys; and
- Whether controls are in place to adequately protect public moneys invested in the Fund.

We reviewed applicable laws governing the investment of public funds and the disclosure of conflicts of interest. We reviewed compliance with those laws to the extent necessary to meet the audit's objectives. Any instances of non-compliance we identified are noted in this report.

We also reviewed management controls and assessed risk relating to the audit's objectives. We reviewed the last two financial audits of the ISDLAF+, including the working papers. We also reviewed audits and SAS 70 reviews conducted of the ISDLAF+ Administrator and Advisor and the ISDLAF+ Subadvisor. A risk assessment was conducted to identify areas that needed closer examination based on the data that was collected during the audit. Any significant weaknesses in those controls are included in this report.

We met with the Fund's legal counsel and other contractors to review their roles and responsibilities related to the Fund's operations. We conducted an on-site field visit and walkthrough of the Administrator's office in Warrenville, Illinois to review its operations and administration. We also met with the executive directors of the three sponsoring organizations of the ISDLAF+ to review their roles in operations and administration of the Fund. Although we mailed a letter to all members of the Fund's Board of Trustees as of November 2004 extending an opportunity to meet with us, the six trustees that responded to the letter stated that they did not feel it was necessary to meet with us to discuss ISDLAF+ operations but if we had specific questions beyond the information we were provided we could contact them.

We met with officials of the Illinois Treasurer's Office to collect performance information and discuss the Illinois Funds' conflict of interest provisions. Four school district liquid asset funds in other states were also contacted to determine whether they had developed specific policies related to conflicts of interest.

The scope of this audit focused on the pooled funds administered by the ISDLAF+, as the audit resolution's determinations specifically directed. This includes the Multi-Class Series (Liquid Class and MAX Class) funds. A detailed review of other services offered by the Fund's Administrator, including the fixed rate investment program, cash flow management program, financial planning program, and bond proceeds management program was beyond the scope of this review.

We also note that, although we were provided copies of meeting minutes of the Board of Trustees for the ISDLAF+, the Fund's legal counsel redacted some discussions in the minutes because they contained information that was subject to attorney client privilege. Although the Fund's legal counsel stated that she was not aware of any other relationships or conflicts that had been disclosed in other redacted sections of Board meeting minutes, we were not able to independently corroborate this assertion.

REPORT ORGANIZATION

The remainder of this report is organized into the following chapters:

- **Chapter Two** reviews conflict of interest provisions;
- **Chapter Three** examines the ISDLAF+ performance compared to benchmarks and other similar funds; and
- **Chapter Four** discusses ISDLAF+ management controls.

Chapter Two

CONFLICTS OF INTEREST

CHAPTER CONCLUSIONS

The Declaration of Trust contains provisions that discuss the Fund and certain affiliates and their interests. The provisions contained in the Declaration of Trust generally allow for Trustees to have business interests similar to those of the Fund or to be interested in a transaction, provided the interest is disclosed and the action authorized by a majority vote of unaffiliated Trustees or a majority of participants. The Declaration of Trust contains a clause that allows the By-Laws of the Fund to contain more restrictive conflict of interest provisions. However, the By-Laws do not contain more restrictive provisions.

Prior to July 2004, neither Trustees nor service providers for the ISDLAF+ were required to file conflict of interest statements or disclosure forms with the Fund. In July 2004, the ISDLAF+ Board of Trustees approved a motion requiring each voting Trustee to annually submit to the Secretary, with a copy to the Fund counsel, copies of their economic interest disclosure forms that are filed annually with their respective county clerks. The motion also required Trustees to complete a Conflict of Interest Disclosure Statement. As of April 15, 2005, the Fund provided auditors with the Fund’s Conflict of Interest Disclosure Statements for all ten of the current voting Trustees and copies of the Statements of Economic Interest filed with the respective county clerks for nine of the ten Trustees. However, the motion did not provide guidance regarding the types of relationships considered potential conflicts and the reporting process. Furthermore, service providers and contractors with the Fund are not required to file a disclosure with the ISDLAF+ Board.

The Illinois State Treasurer’s Office and four liquid asset funds in other states were contacted to determine whether they had relevant conflict of interest reporting policies and procedures. The Treasurer requires all employees to disclose all matters that could reasonably be expected to interfere with the employee’s duties, as well as requires certain employees to file a Statement of Economic Interests with the Secretary of State (similar to the Statement of Economic Interest the ISDLAF+ Trustees file with their respective county clerks and now with the Secretary of the Board). One of the four other states’ funds contacted had also established specific policies defining what types of relationships constitute a conflict of interest.

CONFLICTS OF INTEREST

Senate Resolution No. 171 asked the Auditor General to determine whether the Fund’s provisions regarding conflicts of interest are sufficient and comparable to other pools investing public moneys. The statutory provisions contained in the Public Funds Investment Act (30 ILCS 235) and those in the Fund’s Declaration of Trust are not specific regarding conflicts of interest for the ISDLAF+. The Public Funds Investment Act only refers to pecuniary interests of treasurers or financial officers of public agencies.

Public Funds Investment Act Provisions

The Public Funds Investment Act (30 ILCS 235 *et seq*.), which sets the parameters of the types of investments that public agencies can make, also contains provisions related to conflicts of interest. According to ISDLAF+ officials, the Act's conflict of interest provisions do not apply directly to the Fund, since the Fund is not a public agency but, rather, may be viewed as an instrumentality of the school and community college districts. However, the provisions of the Act would apply to any of the Trustees who are treasurers or financial officers of a school district in their capacity as such. The Act requires that:

> *(d) Except for pecuniary interests permitted under subsection (f) of Section 3-14-4 of the Illinois Municipal Code or under Section 3.2 of the Public Officer Prohibited Practices Act, no person acting as treasurer or financial officer or who is employed in any similar capacity by or for a public agency may do any of the following:*
>
> > *(1) have any interest, directly or indirectly, in any investments in which the agency is authorized to invest.*
> >
> > *(2) have any interest, directly or indirectly, in the sellers, sponsors, or managers of those investments.*
> >
> > *(3) receive, in any manner, compensation of any kind from any investments in which the agency is authorized to invest.*

The Public Funds Investment Act also requires that there must be a written investment policy adopted by the public agency, which includes, among others, a policy regarding ethics and conflicts of interest (30 ILCS 235/2.5 (a)(12)).

The section of the Public Officer Prohibited Activities Act cited above (50 ILCS 105/3.2) is related to pecuniary interests allowed in contracts of deposit and financial service with local banks and savings and loan associations. It states that:

> *Nothing contained in this Act… shall preclude a contract of deposit of monies, loans, or other financial services by a unit of local government, school district, community college district, State university, or a police or firefighter's pension fund… with a local bank or local savings and loan association, regardless of whether a member or members of the governing body of the unit… are interested in the bank or savings and loan association as a director, an officer, employee, or holder of less than 7 ½% of the total ownership interest. A member or members holding such an interest in such a contract shall not be deemed to be holding a prohibited interest for purposes of this Act. The interested member or members of the governing body must publicly state the nature and extent of their interest during deliberations concerning the proposed award of such a contract, but shall not participate in any further deliberations concerning the proposed award. The interested member or members shall not vote on such a proposed award. Any member or members abstaining from participation in deliberations and voting under this Section may be considered present for purposes of establishing a quorum. Award of such a contract shall require approval by a majority vote of those members presently holding office. Consideration and award of any such contract in which a member or members are interested may only be made at a regularly scheduled public meeting of the governing body of the unit or district.*

Declaration of Trust Provisions

We reviewed the current ISDLAF+ Declaration of Trust (January 1999) and determined that it contained provisions that allow for almost any type of relationship to exist between a Trustee of the Fund and an outside business or investment without the relationship being deemed a conflict, provided the relationship was disclosed (see Exhibit 2-1).

The provisions contained in the Declaration of Trust generally allow that:

- A transaction to which the Fund is a party is valid even though one or more Trustees is interested in the transaction, provided the interest is disclosed and the unaffiliated Trustees vote by a majority to authorize the transaction.
- Trustees may have business interests similar to those of the Fund.
- Trustees may have an interest in a service provider to the Fund, and receive compensation from the service provider as well as compensation as a Trustee of the Fund.

Conflict of Interest Statements

Prior to July 2004, neither Trustees nor service providers for the ISDLAF+ were required to file conflict of interest statements or forms with the Fund. We requested the conflict of interest statements filed by members of the Board of Trustees for 2002-2004. Fund officials responded, “There are no documents responsive to this request.” According to Fund officials, the only conflict of interest forms that would be on file for Trustees would be related to the jobs that they hold outside of the Fund such as being a superintendent, treasurer, or school board member. These are filed with the local county clerk’s office, but are not submitted to the Fund. Contractors and service providers are not required to file a statement with anyone.

At the July 2003 quarterly meeting, the Trustees agreed that it would be appropriate to consider adopting a conflict of interest policy at the next Board meeting. One year later, at the July 2004 quarterly Trustees meeting, the Board of Trustees approved a motion requiring each voting Trustee to annually submit to the Secretary the Fund’s Conflict of Interest Disclosure Statement. The Fund’s Conflict of Interest Disclosure Statement that the Trustees sign states that they will voluntarily disclose any conflicts that arise and asks the Trustees to disclose any personal or professional circumstances that place them in the position of having a private interest which is in conflict with any interest of the Fund or with their obligations to the Fund. The motion also required Trustees to submit copies of their Statement of Economic Interests Disclosure forms that are filed annually with their respective county clerks. As of April 15, 2005, the Fund provided auditors with the Fund’s Conflict of Interest Disclosure Statements for all ten of the current voting Trustees and copies of the Statements of Economic Interest filed with the respective county clerks for nine of the ten Trustees.

Exhibit 2-1

ISDLAF+'S DECLARATION OF TRUST CONFLICT OF INTEREST PROVISIONS

In Section 2.14 of the Declaration of Trust entitled ***Concerning the Fund and Certain Affiliates***[1] it states that:

(a) The Fund may enter into transactions with any Affiliate of the Fund or of the Adviser, the Administrator, the Custodian or an Affiliate of any **Trustee***, officer, director, employee or* **agent** *of the fund or of the Adviser, the Administrator, or the Custodian if (i) each such transaction (or type of transaction) has, after disclosure of such affiliation, been approved or ratified by the affirmative vote of a majority of the Trustees, including a majority of the Trustees who are not Affiliates of any Person (other than the Fund) who is a party to the transaction or transactions with the Fund and (ii) such transaction (or type of transaction) is, in the opinion of the Trustees, on terms fair and reasonable to the Fund and the Participants and at least as favorable to them as similar arrangements for comparable transactions (of which the Trustees have knowledge) with organizations unaffiliated with the Fund or with the Person who is a party to the transaction or transactions with the Fund.*

(b) Except as otherwise provided in this Declaration of Trust or in the Laws of the State of Illinois, in the absence of fraud, a contract, act or other transaction, between the Fund and any other Person, or in which the Fund is interested, is valid and **no Trustee***, officer, employee or* **agent** *of the Fund* **has any liability** *as a result of entering into any such contract, act or transaction* **even though** *(i) one or more of the Trustees, officers, employees or* **agent***s of such other Person, or (ii)* **one or more of the Trustees***, officers, employees, or* **agent***s of the Fund individually or jointly with others***, is a party or are parties to or directly interested in***,* **or affiliated with, such contract, act or transaction, provided that (i) such interest or affiliation is disclosed to the Trustees and the Trustees authorize such contract***, act or other transaction* **by a vote of a majority of the unaffiliated Trustees***, or (ii) such interest or affiliation is disclosed to the Participants, and such contract, act or transaction is approved by a majority of the Participants.*

(c) **Any Trustee** *or officer, employee, or* **agent** *of the Fund* **may***, in his personal capacity, or in a capacity as trustee, officer, director, stockholder, partner, member,* **agent***, adviser, or employee of any Person***, have business interests** *and engage in business activities in addition to those relating to the Fund, which interests and activities may be* **similar to those of the Fund** *and include the acquisition, syndication, holding, management, operation or disposition of securities, investments and funds, for his own account or for the account of such Person. Each Trustee, officer, employee and* **agent** *of the Fund shall be free of any obligation to present to the Fund any investment opportunity which comes to him in any capacity other than solely as Trustee, officer, employee or* **agent** *of the Fund, even if such opportunity is of a character which if presented to the Fund, could be taken by the Fund.*

*(d) …***any Trustee** *or officer, employee or* **agent** *of the Fund* **may be interested** *as trustee, officer, director, stockholder, partner, member,* **agent***, adviser or employee of, or otherwise have a direct or indirect interest in, any Person who may be engaged to render advice or services to the Fund,* **and may receive compensation** *from such Person as well as compensation as Trustee, officer, employee or* **agent** *of the Fund or otherwise hereunder.* **None of the activities and interests referred to in this paragraph (d) shall be deemed to conflict with his duties and powers as Trustee, officer, employee or agent of the Fund.**

(e) To the extent that any other provision of this Declaration of Trust conflicts with, or is otherwise contrary to the provisions of, this Section 2.14, the provisions of this Section 2.14 shall be deemed controlling.

(f) …Trustees <u>**shall not**</u> *have the power to engage in any transaction with any Affiliate that would be inconsistent with the Laws of the State of Illinois concerning public ethics and conflicts of interest, and the By-Laws of the Fund may contain provisions more restrictive than those set forth in this section 2.14.* ***(Emphasis added)***

[1] "Affiliate" shall mean, with respect to any Person, another Person directly or indirectly controlling, controlled by or under common control with such Person, or any officer, director, partner or employee of such Person.

Source: ISDLAF+ Declaration of Trust as amended and restated as of January 14, 1999.

The Statement of Economic Interest filed by local officials with their respective county clerks asks Trustees to list:

- The name and instrument of ownership in any entity doing business in the State, in which the ownership held is in excess of $5,000 or from which dividends exceeded $1,200 during the previous year.
- The name, address, and type of practice of any professional organization in which the person making the statement was an officer, director, associate, partner, or proprietor or served in any advisory capacity, from which income in excess of $1,200 was derived during the preceding calendar year.
- The nature of professional services rendered (other than to the unit or units of local government in relation to which the person is required to file) to each entity from which income exceeding $5,000 was received for professional services rendered during the preceding year.
- The identity of any capital asset from which a capital gain of $5,000 or more was realized during the preceding year.
- The name of any entity and the nature of the governmental action required by any entity which has applied to a unit of local government in relation to which the person must file for any license franchise or permit for annexation, zoning or rezoning of real estate during the preceding calendar year if the ownership interest of the person filing is in excess of $5,000 fair market value at the time of filing or if income or dividends in excess of $1,200 were received during the preceding year.
- The name of any entity doing business with a unit of local government in relation to which the person is required to file from which income in excess of $1,200 was derived during the preceding year other than for professional services and the title or description of any position held in that entity.
- The name of any unit of government which employed the person making the statement during the preceding calendar year other than the unit or units of government in relation to which the person is required to file.
- The name of any entity from which a gift or gifts, or honorarium or honoraria, valued singly or in the aggregate in excess of $500, was received during the preceding year.

During the audit we collected the Statements of Economic Interest for the 2004 Board of Trustees from the respective county clerks to identify possible conflicts of interest with the Fund or its service providers (see Appendix B). During the audit we also reviewed contracts with service providers, meeting minutes, website information related to annual meetings held by sponsors, and compared the ISDLAF+ Trustees to the boards of the sponsoring organizations. We identified several relationships that may have been reported if Trustees and service providers had filed disclosures with the ISDLAF+ Board. Examples of these relationships include:

- One of the Fund's Trustees serves on the Board of Illinois Association of School Business Officials (IASBO). IASBO has a contract with the Fund Administrator (PMA) to provide marketing services for the Fund. This Trustee is the current ISDLAF+ Board Treasurer and is also one of two voting Trustees that sit on the ISDLAF+ Board's Audit Committee.
- One IASBO employee is affiliated with PMA to maintain his Series 7 license to represent and market the ISDLAF+. Although he does not receive payments from PMA, his license is contingent upon his relationship with it.

- A trustee on one of the sponsoring organization's boards (IASA) is a PMA employee.
- One ISDLAF+ Trustee owns a financial consulting company that conducts business with school districts, which may be in direct competition with the services provided by the Fund.
- The Fund's Administrator co-sponsored meals at a sponsoring organization's annual conference in 2004.

We reviewed the quarterly meeting minutes for the three-year period October 2001 through October 2004 and found only one instance in which Trustees disclosed a relationship prior to a vote. This was the vote to terminate the previous Administrator. At the June 2002 quarterly meeting of the Board of Trustees, several Trustees disclosed for the record that either they or a spouse had served on IASBO's Board. The disclosure was made prior to the vote to notify the previous Administrator (Cadre Financial Services Inc.) that the Fund was terminating its contracts and awarding them to another bidder (PMA). The bid from the previous Administrator had not asked IASBO to again participate in the marketing of the Fund. The new Administrator's bid included IASBO as the marketing consultant. The contract between the Fund and PMA calls for PMA Securities, Inc. to receive .07 percent of the average daily net assets for acting as the Distributor. The subcontract between PMA and IASBO gives approximately half of this amount (.035 percent for the first $500 million) to IASBO. For 2004, the Fund expended approximately $400,000 for marketing.

Because the discussions in the Attorney's Report section for each of the quarterly meeting minutes were blacked out by the ISDLAF+'s legal counsel pursuant to attorney client privilege, we could not determine if there may have been other instances in which a relationship was disclosed. We inquired as to any other conflicts that may have been disclosed in the Attorney's Report sections of the Board of Trustees meeting minutes. Officials responded that they were not aware of any other relationships or conflicts that had been disclosed in the redacted sections of Board meeting minutes.

OTHER FUNDS' CONFLICTS OF INTEREST REQUIREMENTS

SR 171 asked the Auditor General to determine whether the Fund's provisions regarding conflicts of interest are sufficient and comparable to other pools investing public money. We reviewed the conflict of interest provisions for school district liquid asset funds in other states and compared them to those of the ISDLAF+. We also reviewed the conflict of interest policies for the Illinois Treasurer's Office Illinois Funds.

Other Government Investment Pools and School District Liquid Asset Funds

Many of the other government investment pools and school district liquid asset funds that we reviewed had similar provisions regarding conflicts of interest as were found in the ISDLAF+'s Declaration of Trust. These provisions were usually included in the fund or pool's declaration of trust and were under a section titled "Concerning the Fund and Certain Affiliates." Several funds and pools had provisions that allowed for more specific policies. The provision stated that:

(a) The Trustees may (but need not), in their discretion, from time to time, adopt standards with respect to conflicts of interest and similar matters to govern (i) Trustees, officers, directors, employees and agents of the Trust and their Affiliates and (ii) such other Persons and their Affiliates as the Trustees may deem appropriate.

The ISDLAF+ Declaration of Trust provision, which calls for Trustees to disclose their interests, is not included in three of the four other states' school district liquid asset fund declarations of trusts that we reviewed (see paragraph b of Exhibit 2-1).

The ISDLAF+ Declaration of Trust provides under Section 2.14(f) that the Fund By-Laws may contain provisions that are more restrictive than those set forth in this section. However, the By-Laws do not contain more restrictive provisions.

Four similar funds in other states were contacted to ask if they had developed specific policies related to conflicts of interest. One of the funds, which had the same disclosure provisions as the ISDLAF+ in its declaration of trust, responded that it had developed more specific policies. These policies included specific types of relationships that were considered conflicts of interest such as:

- Having a direct financial interest (5% or greater) in any contractor organization or banking or savings institution approved for investment by the fund.
- Being an employee, director or officer of any contractor organization or bank or savings institution approved for investment by the fund.
- Having an indirect financial interest in or receiving a direct pecuniary fee or commission or having an immediate family member who is an employee, director or officer of any contractor organization or banking or savings institution approved for investment by the fund.
- Having low or zero interest loans from contractor organizations or banking or savings institutions approved for investment by the fund.
- Being involved in legal actions, current or pending, involving bankruptcy or business failures with contractor organizations or banks or savings institutions approved for investment by the fund.
- Being an employee, director or officer of or having other contractual relationships with any regional, state, or national funds similar to the fund.

Illinois Treasurer's Office Illinois Funds Requirements

The Treasurer's Employee Handbook requires employees of the Illinois Treasurer's Office to disclose to the Office all matters that could reasonably be expected to interfere with the employee's duty to the Treasurer's Office, or with the employee's ability to render unbiased and objective advice, or create the appearance of impropriety in the Treasurer's Office. Employees must also complete and file forms related to conflicts of interest including:

- All employees are required to annually complete the Code of Ethical Conduct Investments and Loans Disclosure Form; and
- Specific employees are required to complete the Secretary of State's Statement of Economic Interests.

The Code of Ethical Conduct Investments and Loans Disclosure Form asks employees to disclose all investments and loans with entities doing business with the Treasurer's Office. It also asks employees to list any material beneficial ownership of investments that might affect their ability to render objective advice or decisions.

The Statement of Economic Interests filed with the Secretary of State by some employees of the Illinois Funds asks them to list information including:

- The name and instrument of ownership in any entity doing business in the State, in which the ownership held is in excess of $5,000 or from which dividends exceeded $1,200 during the previous year.
- The name, address, and type of practice of any professional organization in which the person making the statement was an officer, director, associate, partner, or proprietor or served in any advisory capacity, from which income in excess of $1,200 was derived during the preceding calendar year.
- The nature of professional services rendered (other than to the State of Illinois) to each entity from which income exceeding $5,000 was received for professional services rendered during the preceding year.
- The identity of any capital asset from which a capital gain of $5,000 or more was realized during the preceding year.
- The identity of any compensated lobbyist with whom the person making the statement maintains a close economic association.
- The name of any entity doing business in the State of Illinois from which income in excess of $1,200 was derived during the preceding calendar year other than for professional services and the title or description of any position held in that entity.
- The name of any unit of government which employed the person making the statement during the preceding year other than the unit or units of government in relation to which the person is required to file.
- The name of any entity from which a gift or gifts, or honorarium or honoraria, valued singly or in the aggregate in excess of $500, was received during the preceding year.

In July 2004, the ISDLAF+ Board of Trustees approved a motion requiring "each voting Trustee to annually submit to the Secretary, with a copy to Fund counsel, their economic interest disclosure form, attached to the Fund's Conflict of Interest Disclosure Statement." This new reporting represents an improvement over prior years. However, the motion does not define what types of conflicts should be reported. Other similar entities have established more detailed policies that delineate the process and define the types of relationships that constitute a conflict of interest. Conflict of interest policies and procedures would help ensure proper disclosure of potential conflicts, which serves to protect the Fund.

Such policies would provide needed guidance to Trustees regarding the types of relationships that should be disclosed and delineate the reporting process. Given the competitive nature of the financial services being provided to the ISDLAF+, service providers and contractors with the Fund should also be required to file a conflict or economic interest disclosure with the ISDLAF+ Board.

CONFLICTS OF INTEREST POLICIES AND PROCEDURES	
RECOMMENDATION 1	*The Illinois School District Liquid Asset Fund Plus should establish specific written policies and procedures regarding conflicts of interest including the types of relationships that should be disclosed as well as the process of reporting conflicts. Such policies and procedures should include not only Fund officials but also service providers and other contractors.*
ISDLAF+ RESPONSE	We are pleased that the Report recognizes the efforts ISDLAF+ has made, beyond the provisions of the Declaration of Trust, to require disclosure by the voting Trustees through the filing with the Fund of their Statements of Economic Interests, which they are required to file with their respective county clerks. As the Report points out, these disclosures and the process for making them are similar to what is required of certain employees of the Illinois Funds. The Report also demonstrates that the Fund's conflicts of interest policies and procedures are more detailed than at least two of the four comparable state funds surveyed by the Auditor General. Nonetheless, pursuant to the Report and the recommendation, which we found to be very helpful, and because we believe it is important to continuously refine our processes so that Fund investors will continue to have confidence in the Fund, ISDLAF+ will continue to strive for even more specificity and improvement in its policies and procedures regarding conflicts of interest as applied to the Trustees of the Fund and service providers and other contractors.

Chapter Three

FUND PERFORMANCE

CHAPTER CONCLUSIONS

The ISDLAF+ Multi-Class Series performance for the period October 2002 through December 2004 was comparable to other money market types of funds investing public funds. We compared 7-day annualized average yields for the ISDLAF+ with school district liquid asset funds in several other states. We also compared the ISDLAF+ with money market and governmental pool indices and the 4-week Treasury bill.

The ISDLAF+ Multi-Class Series consists of a Liquid Class, which offers daily liquidity and a MAX Class, which generally requires a minimum deposit of 14 days. Over the past two years, the ISDLAF+'s Liquid Class had a slightly lower net return than two of the three indices presented; however, it had a higher net return than that of two of the three other states' liquid asset funds presented. The ISDLAF+ MAX Class performance was comparable to the Standard and Poor's (S & P) indices and the 4-week T-bill and better than the iMoneyNet index. The MAX Class has been yielding approximately the same return as that of two of the three other states' liquid asset funds presented. When compared to the Illinois Treasurer's Office Illinois Funds, the ISDLAF+ performed slightly better than the Illinois Funds in the **gross** rate comparison (i.e. before expenses are deducted); however, the Illinois Funds performed better than the ISDLAF+ in the **net** rate comparison (after expenses).

Reports related to Fund performance are prepared and provided to the Trustees at each quarterly meeting. These reports contain average yield and return comparisons as well as a performance evaluation of the Multi-Class Series of the Fund. Although the Fund's Administrator prepares comparisons and provides them to Trustees at quarterly meetings, the ISDLAF+ annual reports distributed to Fund participants do not contain a performance comparison.

FUND PERFORMANCE

Senate Resolution No. 171 asked the Auditor General to determine whether the Fund's performance is comparable to other pools investing public moneys. Although the ISDLAF+ does not have a formal written set of benchmarks, general performance measures are listed in the Information Statement and two specific comparisons are required in the Fund's Investment Advisory Agreement. The Information Statement contains a performance information section, which states that:

> *…comparative performance information about a Class of the Multi-Class Series may be used from time to time in advertisements, sales literature and investor reports. This information may include data, ratings and rankings from Lipper Inc., iMoneyNet, Inc., The Bank Rate Monitor, Morningstar and other industry publications, business periodicals and services. Comparisons to recognized market indices and to the returns*

on specific money market securities or types of securities or investments also may be used.

Exhibit 3-1
2004 FUND PERFORMANCE COMPARISONS
(as of September 2004)

COMPARABLE FUNDS	**LIQUID CLASS**			**MAX CLASS**		
		30-day Net Yield	**Net Portfolio Assets (millions)**		**30-day Net Yield**	**Net Portfolio Assets (millions)**
ISDLAF+	**Liquid Class**	**1.16%**	**$298**	**MAX Class**	**1.28%**	**$288**
MSDLAF (Minnesota)	Liquid Series	0.81%	$138	MAX Series	1.24%	$403
MILAF+ (Michigan)	Liquid Series	0.96%	$201	MAX Series	1.28%	$525
PSDLAF (Pennsylvania)	Liquid Series	1.13%	$203	MAX Series	1.34%	$364
NSDLAF+ [1] (Nebraska)		1.18%	$166		1.18%	$166
Illinois Funds[3] (IL State Treasurer)	Money Market Fund	1.42%	$4,235[2]	Prime Fund	1.49%	$779
INDICES						
S&P Rated Government Investment Pool (GIP) Indices	All	1.34%		General Purpose Taxable	1.35%	
iMoneyNet – Taxable All		1.02%			1.02%	
OTHER BENCHMARKS						
4-week Treasury bill		1.52%			1.52%	

[1] NSDLAF+ (Nebraska) has only one class of shares.
[2] Assets related to school districts and township treasurers approximate $765 million. (Illinois Funds is available to all State and local government agencies, including school districts, villages, and universities.)
[3]For consistency purposes, information presented in Exhibit 3-1 comes from S&P fund profiles. In its review of the draft report, the Treasurer's Office provided slightly different yields for the Money Market Fund and the Prime Fund, 1.46% and 1.52% respectively.

Source: Standard and Poor's (S&P) fund profiles, federal reserve website, and PMA.

There are two required performance comparisons in the ISDLAF+ agreement with the Fund's Investment Advisor. The two required quarterly comparisons in the agreement are the Taxable Money Market Fund Index reported in iMoneyNet's Money Fund Report and the Illinois Treasurer's Office Illinois Funds.

There are several variables that may have an effect on fund comparisons. These include the size and composition of the portfolio, the weighted average maturity (WAM), investment strategy, investment restrictions, services offered, and the fees and expenses charged to participants. These variables may have an effect on a fund's yield. For example, the ISDLAF+ portfolio's WAM is managed at 60 days or less. A portfolio that allows a higher WAM has the potential to earn a higher yield. Similarly, more lax restrictions and strategies allow investing in more risky investments, which also have the potential to earn a higher yield. An ISDLAF+ official noted that funds rated by Standard and Poor's (S&P) allow for a better comparison because non-rated funds can have more liberal or aggressive investment policies.

During the audit we collected data from S&P as of September 2004 for comparable funds including the composition of each investment portfolio, 7-day net yield, 30-day net yield, assets, and weighted average maturity (see Appendix D). All funds being used for comparison are evaluated by S&P and have the highest money market fund rating possible (AAAm).

ISDLAF+ officials said they measure performance by the rate of return and value of services they offer. These services include financial planning/cash flow analysis and bond proceeds management. Services can add an intangible value, especially for Fund participants with little investing or financial planning knowledge.

ISDLAF+ PERFORMANCE COMPARISONS

The ISDLAF+ agreement with the Fund's Investment Advisor calls for comparison of the ISDLAF+ to the Illinois Treasurer's Office Illinois Funds and an iMoneyNet Index. The Board of Trustees quarterly packets contain comparisons conducted on a monthly and annual basis between the ISDLAF+, an iMoneyNet index, the Illinois Funds, and a 60-day Treasury bill (T-bill). Exhibit 3-1 is a general comparison of 30-day yields as of September 2004 for the ISDLAF+, the Illinois Treasurer's Office Illinois Funds, other school district liquid asset funds, indices, and other investment options. The 30-day yield represents the annualized return for the previous 30 days, net of expenses.

INDICES
- iMoneyNet-Taxable All
- S&P Rated Government Investment Pool Index/All
- S&P Rated Government Investment Pool/General Purpose Taxable

OTHER FUNDS
- Illinois Treasurer's Illinois Funds
- Michigan Liquid Asset Fund Plus
- Minnesota School District Liquid Asset Fund
- Nebraska School District Liquid Asset Fund Plus
- Pennsylvania School District Liquid Asset Fund

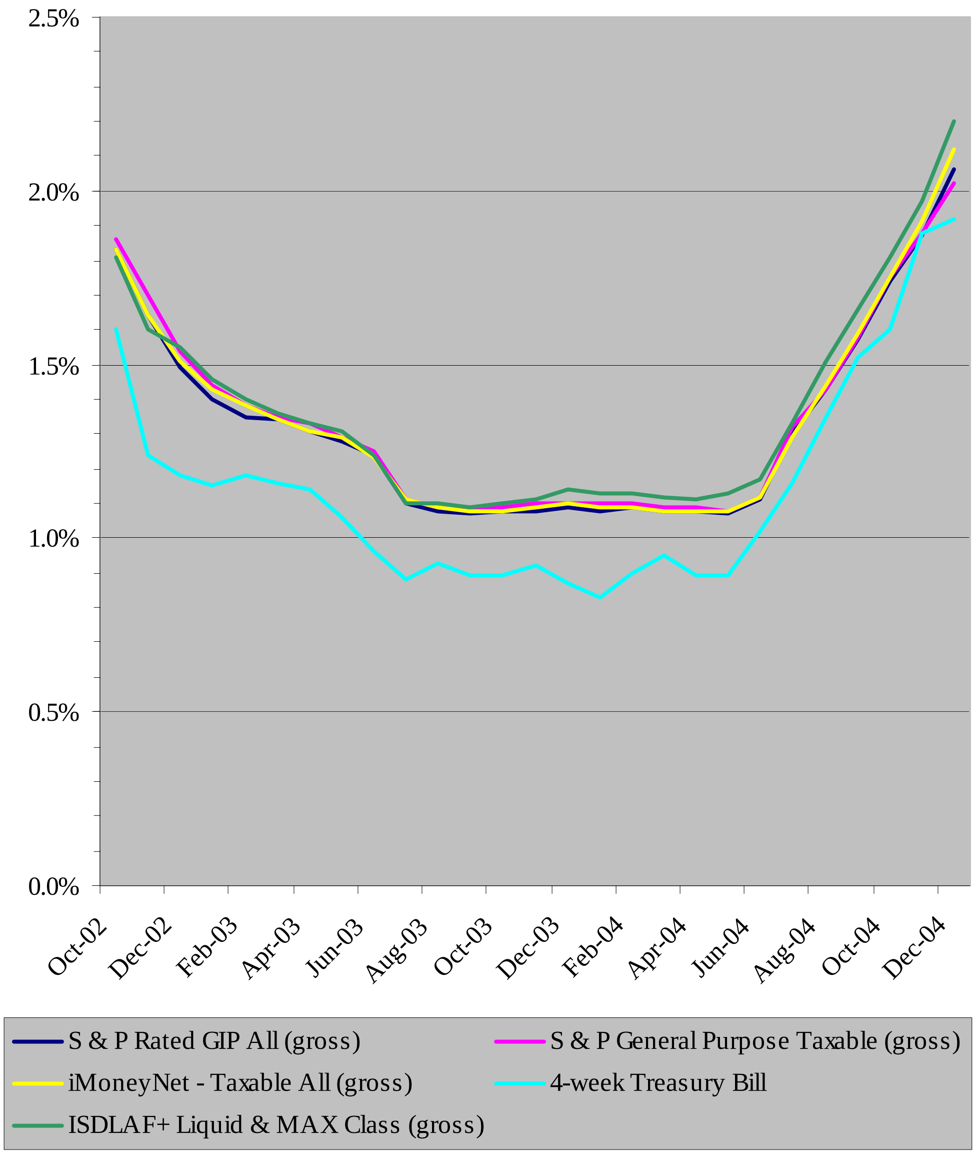
OTHER BENCHMARKS
- Treasury bills

Indices

An index is an average representing a particular market or a portion of it. According to Standard and Poor's (S&P), managers and oversight boards often find it difficult to benchmark the relative performance of their funds. However, fund managers and boards can benefit from indices because they can compare their funds with a standard for similarly managed funds. Indices provide a standard by which to evaluate whether a fund is being managed effectively as well as a measure with which to gauge the safety and relative performance of a fund. Also, a fund with a yield out of line with the index could signal higher risks to public investors.

We compared the ISDLAF+ with three indices, the iMoneyNet-Taxable All Index, the S&P Rated Government Investment Pool Index/All and the S&P Rated Government Investment Pool Index/General Purpose Taxable. The iMoneyNet-Taxable All Index is comprised of more than 1,200 registered money market funds. The S&P Rated GIP Index/All includes 46 public investment pools each with a rating of 'AAAm' or 'AAm'. The S&P Rated GIP Index/General Purpose Taxable includes 25 public investment pools. Both of the S&P indices include the ISDLAF+ and school district liquid asset funds in other states.

Exhibit 3-2
COMPARISON OF ISDLAF+ MONTHLY ANNUALIZED GROSS RETURN WITH SELECTED INDICES AND BENCHMARKS
October 2002 through December 2004



Note: Gross returns for each ISDLAF+ class (Liquid and MAX) are not available because the Fund is a single series (with multiple classes).
Source: OAG analysis of average monthly returns of the ISDLAF+ and selected indices.

The S&P Rated Government Investment Pool (GIP) Indices provide performance indicators of rated GIPs that maintain a stable net asset value (NAV) of $1.00 per share. The S&P Rated GIP Index/General Purpose Taxable was developed to provide increased measures of performance information that is more reflective of specific investment practices. This index consists of pools that invest in an array of securities other than just U.S. government and treasury securities (S&P Rated GIP Index/Government), which may include commercial paper, corporate notes, banker's acceptances, and certificates of deposit.

Exhibits 3-2 and 3-3 show the ISDLAF+ compared to these indices. Exhibit 3-2 shows the average annualized monthly gross return for the ISDLAF+ compared to three indices and the 4-week T-bill. Exhibit 3-2 shows that there was little difference among the ISDLAF+ gross return and the indices. Exhibit 3-3 is the same comparison, except the returns are net of expenses, so returns were lower. The ISDLAF+ Liquid Class had a lower net return than two of the three indices presented; however, the ISDLAF+ MAX Class net return was comparable to the S&P indices, as well as the 4-week T-bill.

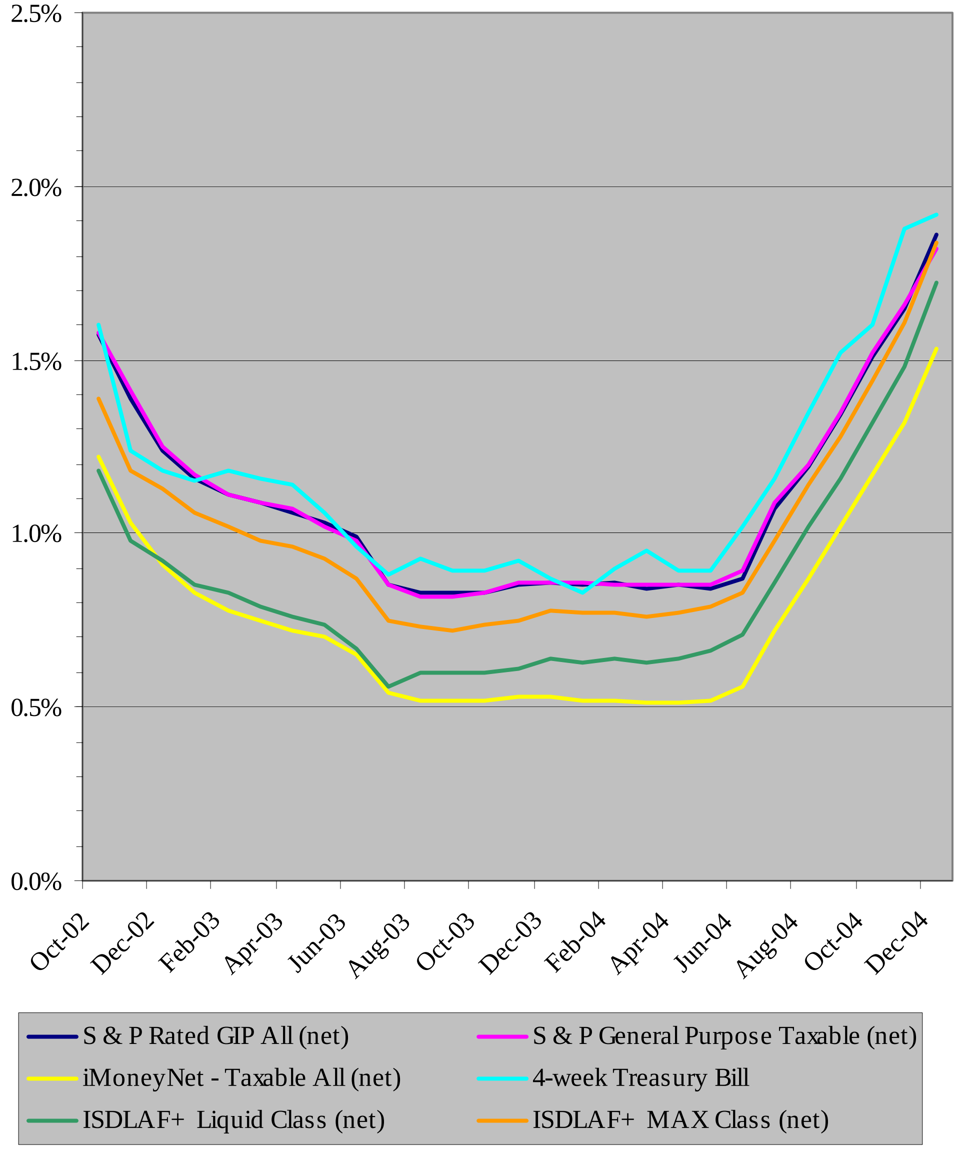
Other Investment Options

There are other investment options that are not the same as a liquid asset fund, but they are used for benchmark comparisons because they are options investors have, depending upon liquidity needs. T-bills are an example. Exhibits 3-1, 3-2, and 3-3 include a comparison to the 4-week T-bill in relation to the ISDLAF+ and other indices.

Exhibit 3-3

COMPARISON OF ISDLAF+ MONTHLY ANNUALIZED NET RETURN WITH SELECTED INDICES AND BENCHMARKS

October 2002 through December 2004



Source: OAG analysis of average monthly returns of the ISDLAF+ and selected indices.

Other States' School District Liquid Asset Funds

We collected available yield data for other states' school district liquid asset funds for the period of October 2002 to December 2004. Exhibits 3-4, 3-5, and 3-6 show the 7-day yield comparisons for the Liquid and MAX Classes, respectively, among school district liquid asset funds in other states.

Exhibit 3-4
AVERAGE OF 7-DAY YIELD FOR ISDLAF+ AND FUNDS IN OTHER STATES
October 2002 through December 2004

	ISDLAF+	Minnesota	Michigan	Nebraska
Liquid Class	0.84%	0.60%	0.67%	0.90%
MAX Class	0.99%	0.99%	1.02%	0.90%

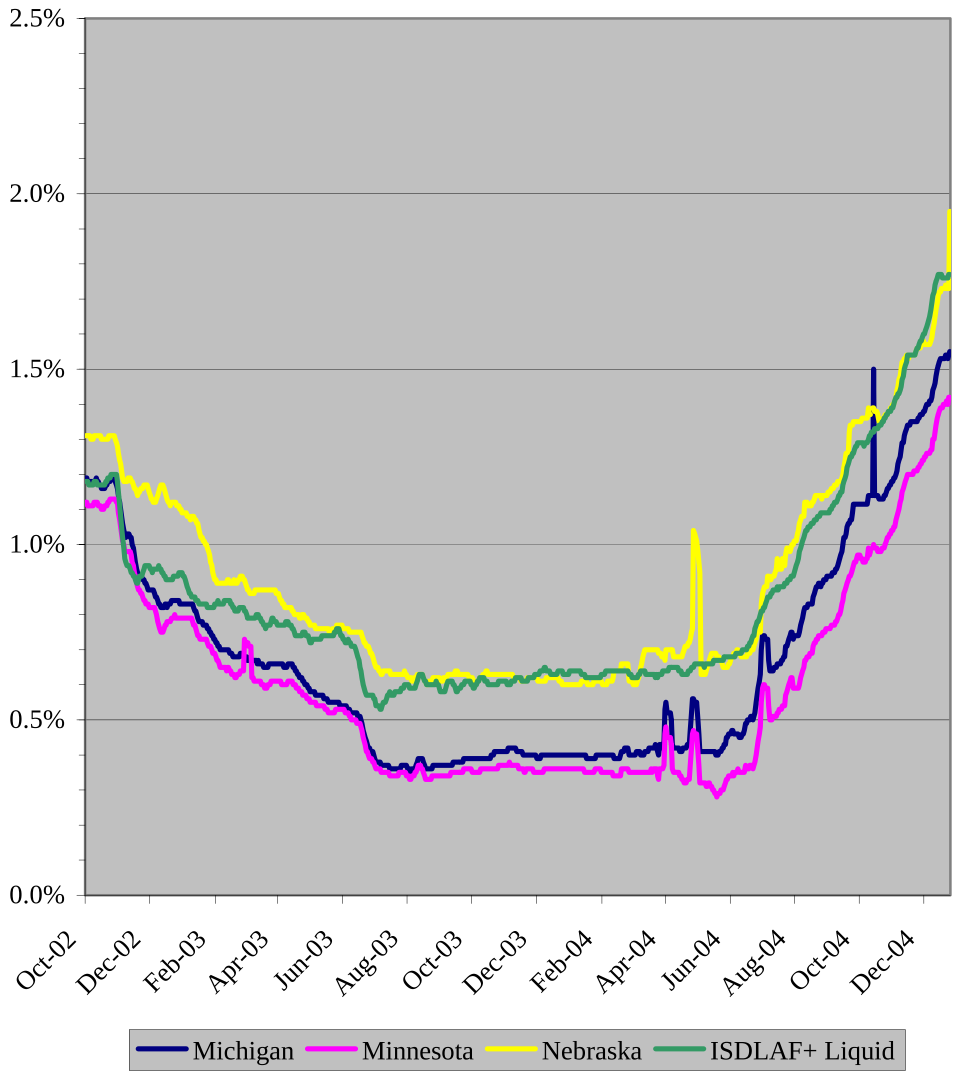
Note: Nebraska's school district liquid asset fund has only one class of shares.
Source: OAG analysis of daily 7-day yields.

Over the past two years, ISDLAF+'s Liquid Class performance was better than two of the three funds that are presented in Exhibit 3-5. Nebraska's school district liquid asset fund has only one class of shares. This is why it had a higher return in the Liquid Class comparison, but the lowest return on average when compared to MAX Class returns. The ISDLAF+'s MAX Class has been yielding approximately the same return as that of the other two funds with both a Liquid and MAX class.

Exhibit 3-5

COMPARISON OF ISDLAF+ LIQUID CLASS DAILY 7-DAY YIELD WITH OTHER STATES

October 2002 through December 2004



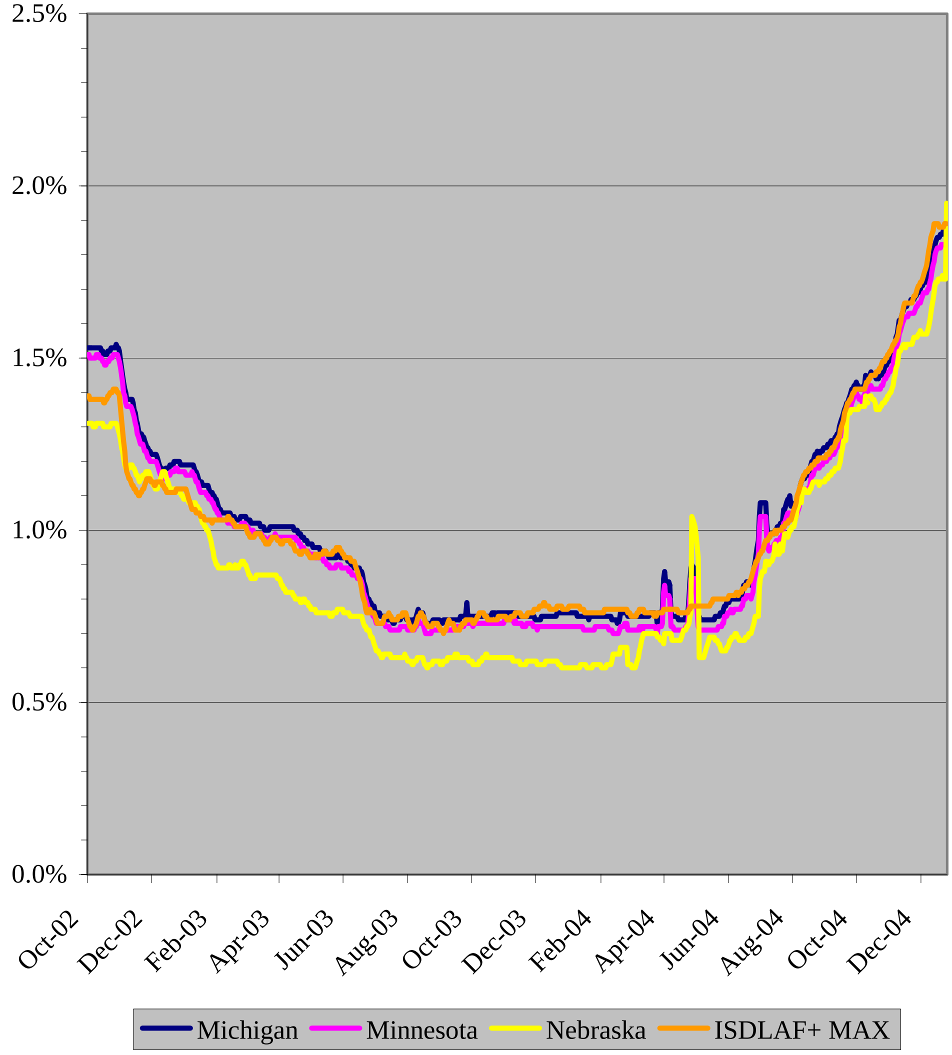
Note: Nebraska's school district liquid asset fund has only one class of shares.

Source: OAG analysis of 7-day yield data collected from other funds' websites.

Exhibit 3-6

COMPARISON OF ISDLAF+ MAX CLASS DAILY 7-DAY YIELD WITH OTHER STATES

October 2002 through December 2004



Note: Nebraska's school district liquid asset fund has only one class of shares.
Source: OAG analysis of 7-day yield data collected from other funds' websites.

Illinois Treasurer's Illinois Funds

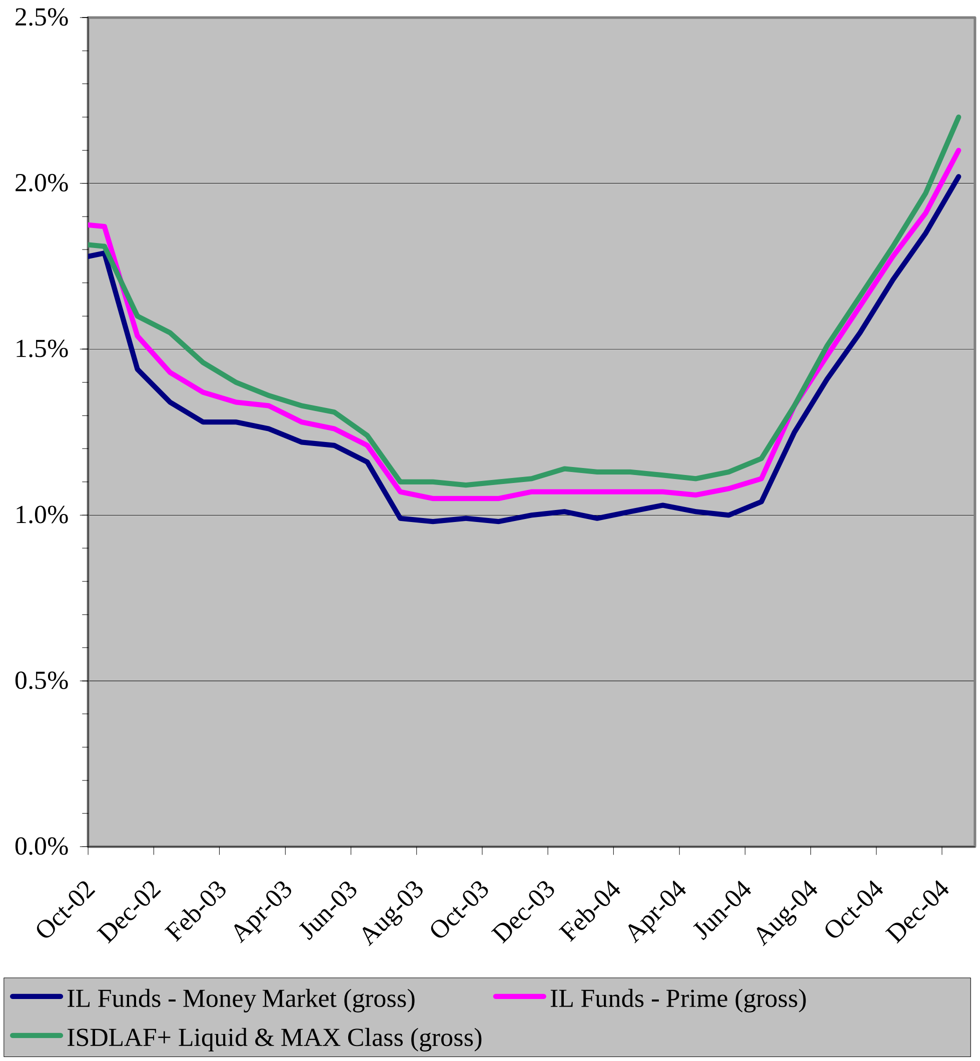
In addition to the Fund's Investment Advisory Agreement, which calls for comparison of the ISDLAF+ to the Illinois Funds, a Fund official noted that the Board requests that the Fund be compared with the Illinois Treasurer's Office Illinois Funds. The ISDLAF+ uses the **gross** rate of return when comparing its Fund's performance to the performance of the Illinois Funds. The gross rate of return is the return on investments before expenses are deducted. Exhibit 3-7 shows a monthly average annualized **gross** return comparison between the ISDLAF+ and the Illinois Treasurer's Office Illinois Funds Money Market Fund and Prime Fund.

Exhibit 3-8 shows a comparison of the monthly average annualized **net** return for each class of the ISDLAF+ and Illinois Treasurer's Office Illinois Funds. The net rate of return is the return that investors realize on moneys invested. The net return comparison takes into account expenses when calculating the average annualized monthly return. Although the ISDLAF+ performed slightly better than the Illinois Treasurer's Office Illinois Funds in the gross rate comparison, the Illinois Funds performed better in the net rate comparison.

Exhibit 3-7

COMPARISON OF ISDLAF+ AND ILLINOIS FUNDS
MONTHLY ANNUALIZED GROSS RETURN

October 2002 through December 2004

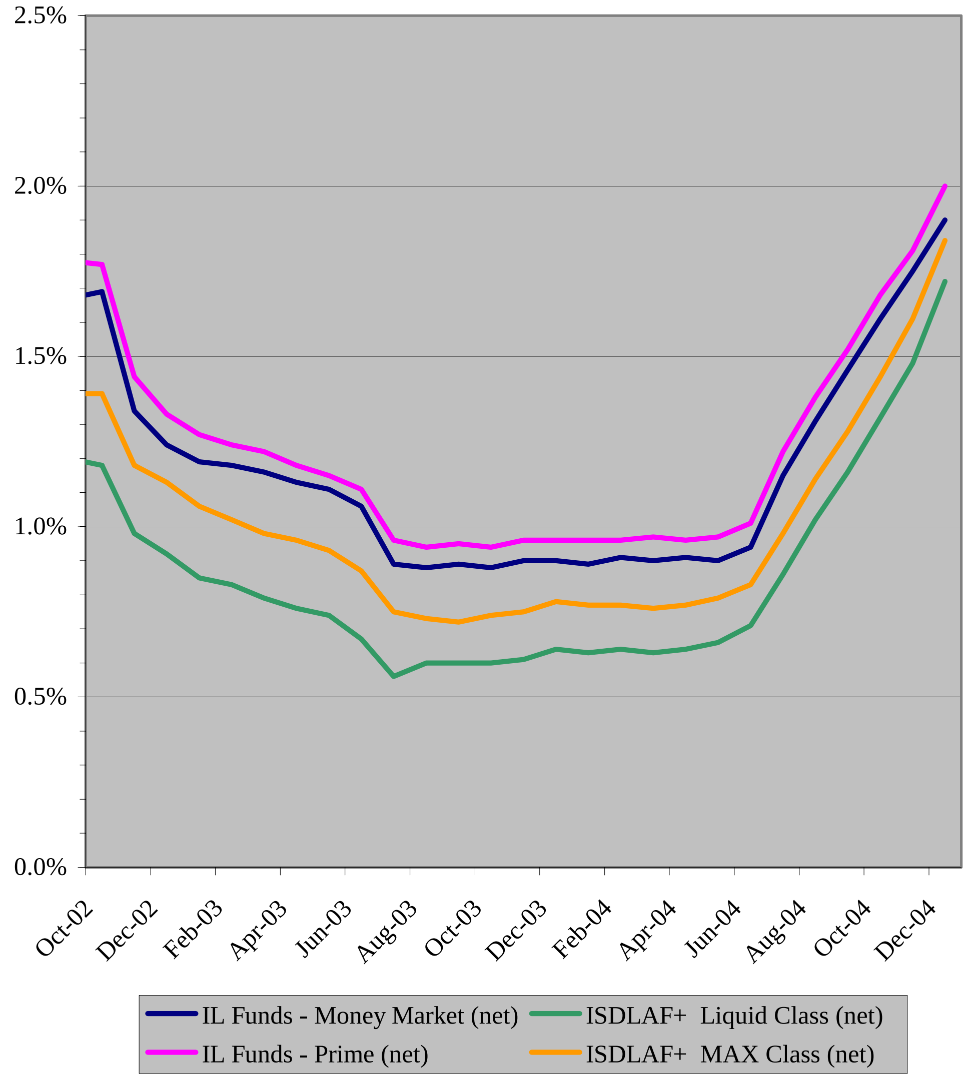


Note: Gross returns for each ISDLAF+ class (Liquid and MAX) are not available because the Fund is a single series (with multiple classes).
Source: ISDLAF+ and the Illinois Treasurer's Office.

Exhibit 3-8

COMPARISON OF ISDLAF+ AND ILLINOIS FUNDS
MONTHLY ANNUALIZED NET RETURN

October 2002 through December 2004



Source: ISDLAF+ and the Illinois Treasurer's Office.

PERFORMANCE REPORTING TO PARTICIPANTS

Quarterly reports prepared by the Fund's Administrator and provided to Trustees show average yield and return comparisons, as well as a performance evaluation. The average yield and return comparison compares the monthly net and gross yields of the iMoneyNet - Taxable All index to those of the MAX and Liquid classes of the ISDLAF+. The performance evaluation shows several other comparisons including the Illinois Treasurer's Office Illinois Funds, 60-Day Treasury bill, and the federal funds rate.

ISDLAF+ annual reports, which are distributed to all participants and are available on the ISDLAF+ website, include a breakdown of total investment return by class. While the annual reports do provide total investment return, they do not discuss performance benchmarks and do not include comparisons of the ISDLAF+'s performance. Comparisons are important in order to keep ISDLAF+ participants informed of the Fund's performance and how the Fund's performance measures up to other comparable investment options.

ANNUAL REPORT	
RECOMMENDATION 2	*The Illinois School District Liquid Asset Fund Plus should include performance comparisons in the ISDLAF+ Annual Report distributed to Fund participants.*
ISDLAF+ RESPONSE	The Report rightly points out that "there are several variables that may have an effect on fund comparisons," and any comparison of fund performance would need to disclose those factors. The Fund also believes that any comparison of other funds' performance to that of the Multi-Class Series is incomplete without noting the additional services provided to Fund Participants. In this context, the Fund will consider including performance comparisons in its annual report, to the extent consistent with applicable law.

Chapter Four

MANAGEMENT CONTROLS

CHAPTER CONCLUSIONS

The ISDLAF+ has established a system of management controls for the monies invested by participants in the pooled funds of the Multi-Class Series. These include written investment policies, quarterly reporting to the Board of Trustees, weekly compliance reporting to the audit committee, and regular performance comparisons.

It is unclear whether the Public Funds Investment Act specifically authorizes investment in banker's acceptances. Although the Act includes a provision for the investment of funds in other investments constituting direct obligations of any bank, it does not define what these include. The Fund does invest in banker's acceptances, which an informal Attorney General opinion in 1997 determined were not permissible investments under the Public Funds Investment Act. We have included a Matter for Consideration for the Illinois General Assembly to consider defining the term "direct obligations of any bank" in the Public Funds Investment Act.

MANAGEMENT CONTROLS AND RISK

We reviewed management controls to determine if they were adequate to protect the interests of investors in the Multi-Class Series of the ISDLAF+. Our review included statutes, policies and procedures, the Fund's Declaration of Trust and Information Statement, financial reports and other information gathered from the Fund's service providers. We met with representatives of the Fund to discuss provisions related to conflicts of interest, fund performance and measurement, and controls that are in place to safeguard the public moneys held in the Fund. We also reviewed the last two financial audits and an agreed-upon procedures review conducted of the ISDLAF+, including the working papers, audits of the Fund's Investment Advisor, and SAS #70 reviews conducted of the Fund's Subadvisor. The audits of the ISDLAF+ that we reviewed for fiscal years 2003 and 2004 did not identify any areas of non-compliance with respect to the Fund's investment objectives and policies or note problems regarding the Fund's system of internal controls.

GOVERNMENT INVESTMENT POOLS & MANAGEMENT CONTROLS

The primary objective of Government Investment Pools (GIPs) is the prudent management of public funds on behalf of state and local governments. These pools offer cost-effective pooled investment vehicles in which public entities pool their idle cash and operating funds while earning a competitive rate of return and providing safety and liquidity.

The National Association of State Treasurers (NAST), the Government Finance Officer's Association (GFOA), the Association of Public Treasurers of U.S. & Canada (APT US&C), and the Government Accounting Standards Board (GASB) have developed recommended guidelines for GIPs. The investment practices and guidelines generally call for:

- Full disclosure of pool objectives and policies
- The adoption of formal and clear investment objectives
- Written and approved investment policies

Proper controls begin with established investment policies and suitable oversight. Advisory boards add a much-needed level of oversight and help ensure that policies are adhered to and are consistent with a pool's objectives. To provide an additional level of oversight, states and public investor associations have requested and received Standard and Poor's (S&P) ratings on GIPs.

Recommended Controls

In 1989, the NAST released guidelines for local government investment pools. The GFOA has formally endorsed these guidelines and has created its own sample investment policy. According to these policies, the general objectives of investment policies should be safety, liquidity, and yield, in that order.

GFOA adopted the NAST's guidelines in 1996. According to the GFOA there should be a system of controls in place to prevent loss of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the entity. The details of the internal controls system should be documented in an investment procedures manual and should be reviewed and updated annually.

Investment reports should be prepared at least quarterly, including a management summary that provides an analysis of the status of the current investment portfolio and the individual transactions executed over the last quarter. The reports should be prepared in a manner which allows the entity to ascertain whether investment activities during the reporting period have conformed to the investment policy. GFOA also recommends that:

- **Investment policies** should be formally approved and adopted by the governing body of the entity and reviewed annually.
- A series of appropriate **benchmarks should be established** against which portfolio performance should be compared on a regular basis.

S&P has reviewed stable net asset value (NAV) or money market GIPs that maintain weighted average maturities (WAM) from 60 days to 360 days. S&P believes that to provide adequate capacity to maintain principal value and limit exposure to loss, a pool's WAM should be 90 days or less. Standard and Poor's also believes that when the investment objective of a GIP is to provide participants with a stable NAV, individual securities' final maturities (excluding floating-rate notes) should not exceed one year. The ISDLAF+'s Information Statement requires that the WAM be 60 days or less.

Exhibit 4-1 summarizes the recommended management controls for government investment pools and the document or method by which the ISDLAF+ had implemented the control. When Standard and Poor's reviews pools for rating purposes, it closely considers the internal controls, including pricing policies, NAV deviation procedures, depth of staff, stress testing capabilities, asset flow monitoring, trade ticket verification, systems backups and disaster recovery.

Exhibit 4-1
SUMMARY OF RECOMMENDED MANAGEMENT CONTROLS FOR GOVERNMENT INVESTMENT POOLS

Recommended Control	**Adopted by ISDLAF+ in:**
Full disclosure of pool objectives and policies	Declaration of Trust (as amended January 14, 1999) and Information Statement (October 1, 2002).
Adoption of formal and clear investment objectives	Declaration of Trust Article IV and the Information Statement.
Written and approved investment policies	Declaration of Trust and the Information Statement.
System of internal controls documented in an investment procedures manual that is reviewed and updated annually	Subadvisor (Federated) manual dated May 2004.
Investment Reports prepared at least quarterly	Reports are prepared for Trustees on a quarterly basis. Compliance reports prepared for the audit committee on a weekly basis.
Investment policies formally approved and adopted by the governing body and reviewed annually	Investment policies are contained in the Declaration of Trust and the Information Statement (see above). Although these policies as a matter of practice are not reviewed annually, the Trustees review authorized investments on a quarterly basis.
Series of benchmarks established against which portfolio performance should be compared on a regular basis	Information Statement contains a list of comparisons that may be used. The agreement with the Fund's Investment Advisor contains required comparisons.
Weighted Average Maturity (WAM) of less than 90 days	Information Statement investment policies require a WAM of 60 days or less.

Source: OAG analysis of recommended controls and ISDLAF+ policies.

Other Risks and Controls

The primary objectives of any government investment pool are safety, liquidity, and yield. The ISDLAF+ has established controls to mitigate risks related to the Fund's investments and compliance with statutory requirements. There are risks associated with investing, even in safer short-term investments. The Fund has controls in place to minimize credit risk, market risk, and interest rate risk.

Credit Risk is the risk of loss due to failure of the security issuer or backer. Recommended controls include:

- Limiting investments to certain types of securities;
- Pre-qualifying financial institutions, brokers, dealers, intermediaries, and advisors with which the entity will do business; and
- Diversifying.

The Fund's investment policies limit the types of investments that can be made. In addition, the Fund's Administrator (PMA) has a system in place that evaluates and rates banks (on a scale of 1 through 5) on an ongoing basis. The ISDLAF+ policy is to only invest in banks with a rating of at least 3 (4s and 5s are not allowable). The Fund's investment policies also place restrictions on investments, such as:

- Corporation and banks must have assets exceeding $500 million; and
- No more than 33 1/3 percent of the Fund's assets can be invested in commercial paper.

Interest Rate Risk is the risk that market value of securities will fall due to changes in market interest rates. Recommended controls include:

- Structuring investment portfolio so that securities mature to meet cash requirements for ongoing operations in order to avoid the need to sell securities on the open market prior to maturity; and
- Investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools and limiting the average maturity of the portfolio.

Market Risk is the risk that changes in interest rates will lower the value of an investment if it is sold before maturity.

PMA has developed a cash flow analysis program that helps Fund participants match their investments to cash needs by laddering investments. By matching investments to cash needs, the chances of having to sell investments prior to maturity is lessened. To mitigate interest rate risk the ISDLAF+ has limited the WAM to 60 days or less.

OVERSIGHT AND MONITORING OF ISDLAF+

The Fund has several levels of oversight and monitoring in place including the Board and the Board's Audit Committee, external auditors, and reviews that are performed internally by the service providers.

Board of Trustees

The Fund is governed by a 13-member Board of Trustees (10 elected and 3 ex-officio) that decides general policies and oversees the actions of the Investment Advisor, the Administrator, the Custodian, the Sponsors and the Distributor. The Trustees meet quarterly and are provided with an Administration, Investment Advisory, and Marketing and Sales Report. The Investment Advisory section is prepared by the Fund's Subadvisor (Federated). The packet includes information regarding average yield and return comparisons, portfolio composition, approved lists of investments, financial reports (e.g. daily account balances and cash disbursements), a quarterly compliance letter and review, and a performance evaluation by month. The packet also contains an overview of the quarter's marketing efforts.

Annually, the Board packet contains a performance evaluation of marketing efforts that compares goals and objectives to actual performance. Representatives of the service providers also attend the quarterly Board meetings and present information to the Board.

Audit Committee

The Board of Trustees formally adopted an audit committee charter in January 2002. The Audit committee meets quarterly and receives weekly reports from the Fund Administrator. The weekly reports monitor compliance with applicable investment statutes, provisions of the Fund's Declaration of Trust and Information Statement concerning permitted investments, and contain a mark-to-market of the portfolio and the weighted average maturity. The Administrator (PMA) conducts the compliance reviews. The audit committee also reviews the audit plans and audits conducted of the ISDLAF+ by PriceWaterhouseCoopers annually.

Monitoring of Investments

The ISDLAF+ Subadvisor, Federated Investment Counseling, manages the investments of the Fund's Multi-Class Series. We gathered information related to controls that are in place at Federated to ensure funds are being invested appropriately. We reviewed the most recent "Report on Controls Placed in Operation and Tests of Operating Effectiveness" (SAS 70) for the period September 1, 2003, through June 30, 2004. The report was prepared to provide information on the company's internal control activities and in accordance with the requirements of SAS 70 (Reports on the Processing of Transactions by Service Organizations). The report concluded that "the controls, as described, are suitably designed to provide reasonable assurance that the specified control objectives would be achieved."

Federated maintains an internal system called Fed Ports, which allows the portfolio managers to input investment restrictions into the system so that any security that would violate the system restrictions would not be executed. According to the ISDLAF+ Investment Advisor, the investment restrictions have been input into this system to ensure that the investment are compliant with the Public Funds Investment Act and the additional restrictions of maintaining a AAAm rating from Standard and Poor's.

The Fund's Investment Advisor (PMA) has an employee that serves as a compliance officer to monitor the investments of the Fund and the weighted average maturity of the portfolio. PMA conducts daily, monthly, and quarterly reviews of the investments in the Fund to ensure compliance with the Public Funds Investment Act and S&P requirements. These reviews are provided to the ISDLAF+ audit committee on a weekly basis and the Trustees on a quarterly basis. PMA also monitors daily account activity, including a reconciliation function whereby PMA's accounting section employees reconcile account information on the PMA system with the custodian's system. Exception reports are run each day during the reconciliation and problems identified in these reports are followed up on. PMA also follows up on inquiries from Fund participants as part of the reconciliation process each day with the custodian.

INVESTMENT RESTRICTIONS AND POLICIES

Public agencies are restricted regarding the types of investments that can be made with monies. These investment restrictions and policies are delineated in the Public Funds Investment Act (30 ILCS 235), the Fund's Declaration of Trust, and the Fund's Information Statement. The ISDLAF+ Declaration of Trust contains a section regarding investment requirements that mirror the requirements contained in the Public Funds Investment Act. The ISDLAF+ Information Statement establishes more specific fundamental policies/restrictions.

The Illinois School Code requires that joint investments can only be made in investments authorized by law for the investment of school funds or, in the case of community colleges and educational service regions, investments allowed for community college funds and educational service region funds. The laws also require that monies combined for the purpose of investment be accounted for separately in all respects, and the earnings from such investments shall be separately and individually computed, recorded, and credited to the fund or entity for which the investment was acquired (105 ILCS 5/8-7).

Public Funds Investment Act

Legally authorized investments that the Fund can make are subject to and delineated in the Public Funds Investment Act (30 ILCS 235/2). These include bonds, certificates of deposit, short-term corporate obligations, and money market mutual funds. In addition to those investments, the Public Funds Investment Act allows public agencies to invest in the Public Treasurer's Investment Pool and repurchase agreements under certain circumstances. The Public Funds Investment Act also requires that investments may be made only in banks and financial institutions which are insured by the Federal Deposit Insurance Corporation (FDIC).

Section 2 of the Public Funds Investment Act contains a list of authorized investments that can be made with public agency funds including those of school districts (see Exhibit 4-2). These include investments such as bonds, certificates of deposit, treasury bills, and money market mutual funds. The Act also includes restrictions upon certain types of allowable investments. For instance:

- Investments may be made only in banks that are insured by the FDIC;
- Investments in money market mutual funds must follow the other investment requirements of the section and the money market funds must be registered under the Investment Company Act of 1940; and
- Repurchase agreements are only allowable if they are government securities and have maturities of less than 330 days.

Section 2 also allows public funds to be invested in short-term obligations of corporations. However, the corporation must be organized in the United States and have assets exceeding $500 million. The corporate obligations must also be rated at the time of purchase at one of the three highest classifications established by at least two standard rating services, mature not later than 180 days from the date of purchase, and must not exceed 10 percent of the corporation's outstanding obligations. The Act also requires that no more than one-third of the public agency's funds may be invested in short-term obligations of corporations.

Exhibit 4-2
ILLINOIS PUBLIC FUNDS INVESTMENT ACT (30 ILCS 235)
AUTHORIZED INVESTMENTS

Sec. 2. Authorized investments.

(a) Any public agency may invest any public funds as follows:
(1) in bonds, notes, certificates of indebtedness, treasury bills or other securities now or hereafter issued, which are guaranteed by the full faith and credit of the United States of America as to principal and interest;

(2) in bonds, notes, debentures, or other similar obligations of the United States of America or its agencies;

(3) in interest-bearing savings accounts, interest-bearing certificates of deposit or interest-bearing time deposits or any other investments constituting direct obligations of any bank as defined by the Illinois Banking Act;

(4) in short term obligations of corporations organized in the United States with assets exceeding $500,000,000 if (i) such obligations are rated at the time of purchase at one of the 3 highest classifications established by at least 2 standard rating services and which mature not later than 180 days from the date of purchase, (ii) such purchases do not exceed 10% of the corporation's outstanding obligations and (iii) no more than one-third of the public agency's funds may be invested in short term obligations of corporations; or

(5) in money market mutual funds registered under the Investment Company Act of 1940, provided that the portfolio of any such money market mutual fund is limited to obligations described in paragraph (1) or (2) of this subsection and to agreements to repurchase such obligations.

Source: Illinois Public Funds Investment Act (30 ILCS 235).

Declaration of Trust

The Fund's Declaration of Trust Section 2.2 lists the permitted investments. These are generally the same as those in the Public Funds Investment Act. Article IV covers the investment policies and objectives of the Fund. Article IV of the Declaration of Trust prohibits the Fund from:

- Purchasing any permitted investments which have a maturity date more than one year from the date of the purchase;
- Purchasing any permitted investment if the effect of the purchase would be to make the average dollar weighted maturity of the Fund's investment portfolio greater than the period designated by the Trustees with respect to the Series (60 days);
- Borrowing money or incurring indebtedness to purchase investments, except as a temporary measure to facilitate withdrawal requests or to provide for the purchase of

portfolio securities pending receipt by the Custodian of collected funds from a participant; and

- Making loans.

Information Statement

Although the Declaration of Trust contains a section regarding investment requirements, it is simply a summary of the requirements contained in the Public Funds Investment Act. The Fund's Information Statement establishes six specific fundamental policies/restrictions. The Fund may not:

1) Make investments other than those permitted by the Illinois Public Funds Investment Act (30 ILCS 235 contains a lengthy section regarding allowable investments);
2) Invest in a security that matures more than one year after purchase, unless a recognized securities firm (on the U.S. Treasury list of Primary Government Securities Dealers) or a bank having more than $500 million in assets irrevocably agrees to purchase the security from the Fund within one year;
3) Make an investment that would cause the weighted average maturity (60 days) of a particular Series to be greater than that designated by the Fund's Board of Trustees;
4) Borrow money or incur indebtedness, except as a temporary measure to meet unexpected withdrawal requests from investors;
5) Make loans; and
6) Hold or provide for the custody of any Fund property in a manner not permitted by law or by any institution or person not authorized by law.

The ISDLAF+'s Information Statement contains more details regarding the types of specific authorized investments of the Fund. Specific investments listed in the Information Statement include U.S. government obligations, floating-rate and variable-rate obligations, commercial papers, demand instruments, bank obligations (including banker's acceptances), and repurchase agreements. The ISDLAF+'s Information Statement also requires 102 percent collateralization for investments in repurchase agreements.

REVIEW OF INVESTMENTS

During the audit we reviewed investments of the ISDLAF+ Multi-Class Series as of September 2004 to determine if the investments were in compliance with applicable laws and the investment policies of the ISDLAF+. We also obtained copies of the offerings and reviewed the terms of the investment instruments including several variable rate instruments, an example of commercial paper, and a banker's acceptance.

Each of the variable rate investments that we reviewed was backed by an irrevocable letter of credit from a bank. The variable rate investments with longer maturities and rate resets included demand features which allowed for put back plus accrued interest on seven days notice. Because these investments can be put back on seven days notice, these securities always have seven days to maturity when calculating the weighted average maturity for all investments in the Fund.

Banker's Acceptances

Banker's acceptances are short-term credit instruments most commonly used by persons or firms engaged in international trade. They are comparable to short-term government securities (for example, Treasury bills) and may be sold on the open market at a discount. In general, banker's acceptances are time drafts drawn on and accepted by a bank. Before acceptance, the draft is not an obligation of the bank: it is merely an order by the drawer to the bank to pay a specified sum of money on a specified date to a named person or to the bearer of the draft. Upon acceptance, which occurs when an authorized bank employee stamps the draft "accepted" and signs it, the draft becomes a primary and unconditional liability of the bank. Banker's acceptances are "two-name" paper; that is, two parties, the accepting bank and the drawer, are obligated to pay the holder at maturity.

According to ISDLAF+ officials, a bank may hold the banker's acceptance in its portfolio or it may sell the banker's acceptance in the secondary market, usually at the rate of other money market instruments. Banker's acceptances that are sold in the secondary market are sold just like any other security, by order ticket. Banker's acceptances can be purchased in the secondary market from either the issuing bank or a dealer who has purchased the banker's acceptance from the bank.

Senate Resolution No. 171 specifically mentions that the Treasurer of the State of Illinois had ongoing questions concerning the Fund's investment in banker's acceptances, which was determined to be an inappropriate investment by the Illinois Attorney General. We met with the Treasurer's Office and reviewed the Informal Opinion rendered by the Illinois Attorney General's Office (I-97-022; August 25, 1997).

The Attorney General's 1997 Informal Opinion concluded that school districts are not authorized to invest their funds in banker's acceptances either directly or through investments in money market mutual funds. The general basis for the conclusion was that the Public Funds Investment Act does not specifically list banker's acceptances as an appropriate investment. The Informal Opinion lists at least six other unrelated acts related to investing public funds that specifically list banker's acceptances as an allowable investment.

The ISDLAF+ argued that the authority to invest in banker's acceptances is contained in Section 2(a)(3) of the Public Funds Investment Act (30 ILCS 235/2) in which it authorizes the investment of school district funds "***in interest-bearing savings accounts, interest-bearing certificates of deposit or interest-bearing time deposits <u>or any other investments constituting direct obligations of any bank as defined in the Illinois Banking Act</u>***" (emphasis added).

In 1998, the Treasurer requested that the Attorney General look into this matter and pursue any necessary action to assure that Illinois school districts are investing their funds in legally authorized investment vehicles. The Attorney General responded that it does not have the oversight responsibility for the investment policies of school districts or other local public entities.

A review of the 2002 through 2004 annual reports shows that the ISDLAF+ Multi-Class Series portfolio had little or no outstanding investments in banker's acceptances for these years. The Fund held no outstanding banker's acceptances as of September 30, 2002 and 2003. For 2004, the Fund held approximately $5.34 million in banker's acceptances and $1.4 million in bank notes or about one percent of the entire investment portfolio. According to the ISDLAF+ Investment Advisor, the banker's acceptance we reviewed with Wachovia Bank N.A. is a continuously offered security that was purchased from the secondary market and did not have a unique offering memorandum.

We reviewed the investment policies of other local government investment pools (LGIPs) and found that it is not uncommon for LGIPs to invest in banker's acceptances. Our review of school district liquid asset funds in other states also found that several of the funds' policies specifically allow for banker's acceptances as investments of the fund.

MATTER FOR CONSIDERATION BY THE GENERAL ASSEMBLY
The General Assembly may wish to consider defining the term "direct obligations of any bank" in the Illinois Public Funds Investment Act.
ISDLAF+ Comment: The Fund believes that the Public Funds Investment Act (the "Act") gives clear authority for public agencies to invest in "any …obligations constituting direct obligations of any bank …,"including bankers' acceptances. When the Fund became aware of the Attorney General's informal opinion construing the Act to prohibit school districts from investing in bankers' acceptances, the Fund submitted a lengthy legal analysis to the Attorney General contending otherwise. The Fund continues to believe that there are no legal or public policy reasons for prohibiting public agencies from investing in bankers' acceptances. These instruments offer less risk than other permitted investments such as commercial paper or certain types of Ginnie Maes or Freddie Macs. Accordingly, even though the Fund believes that the present statutory language clearly authorizes investments in bankers' acceptances by the Fund, if the Legislature feels clarifying language is necessary, that goal can be achieved by adding the specific words "bankers' acceptances" to the statutory list of permissible investments.

APPENDICES

APPENDIX A

Senate Resolution Number 171

Adopted April 22, 2004

STATE OF ILLINOIS
NINETY-THIRD GENERAL ASSEMBLY
SENATE

Senate Resolution No. 171

Offered by Senator Jeffrey M. Schoenberg

WHEREAS, Section 8-7 of the School Code authorizes township and school treasurers to "enter into agreements...regarding the deposit, redeposit, investment, reinvestment or withdrawal of school funds, including, without limitation, agreements with other township and school treasurers"; and

WHEREAS, Section 3-47 of the Public Community College Act authorizes community college districts to "enter into agreements...regarding the deposit, redeposit, investment, reinvestment or withdrawal of community college funds, including, without limitation, agreements with...township and school treasurers authorized by Section 8-7 of the School Code"; and

WHEREAS, Under the authority provided by those statutes, the Illinois School District Liquid Asset Fund Plus, a common law trust, was created; and

WHEREAS, Hundreds of Illinois school districts invest public moneys in the Fund; and

WHEREAS, Section 2.14(d) of the Fund's Declaration of Trust states, "any Trustee or officer, employee or agent of the Fund may be interested...or otherwise have a direct or indirect interest in, any Person who may be engaged to render advice or services to the Fund"; and

WHEREAS, A recent news report involving the Worth Township School Treasurer, a former Trustee of the Fund, questions certain activities involving the Fund; and

WHEREAS, In 1997 the State Treasurer had ongoing questions concerning the Fund's investment in banker's acceptances, which *was determined to be an inappropriate investment by the State's Attorney General at that time; therefore, be it*

RESOLVED, BY THE SENATE OF THE NINETY-THIRD GENERAL ASSEMBLY OF THE STATE OF ILLINOIS, that we ask the Auditor General to conduct a management audit of the Illinois School District Liquid Asset Fund Plus; and be it further

RESOLVED, That the audit include without limitation (i) whether the Fund's provisions regarding conflicts of interest are sufficient and comparable to other pools investing public moneys, (ii) whether the Fund's performance is comparable to other pools investing public moneys, and (iii) whether controls are in place to adequately protect public moneys invested in the Fund; and be it further

RESOLVED, That the Fund, its Trustees, officers, and employees, its agents and contractors, and any other entity or person that may have information relevant to this audit cooperate fully and promptly with the Office of the Auditor General in the conduct of this audit; and be it further

RESOLVED, That the Auditor General commence this audit as soon as possible and distribute the report upon completion in accordance with Section 3-14 of the Illinois State Auditing Act; and be it further

RESOLVED, That a suitable copy of this resolution be delivered to the Auditor General.

Adopted by the Senate, April 22, 2004.

Linda Hawker — Secretary of the Senate

Emil Jones Jr. — President of the Senate

APPENDIX B
ISDLAF+ Board of Trustees for 2004

APPENDIX B
ISDLAF+ Board of Trustees for 2004

Name	Position(s) with ISDLAF+ Board	Year First Elected Trustee	Principal Occupation	Other Boards or Companies	Nature of Any "Professional Services" Rendered
Robert G. Grossi	Chairperson	1995	Treasurer Bloom Township Schools	Proprietor, Crystal Financial Consultants, Inc.	Financial Advisory services to various school districts and municipalities.
Gregg L. Worrell	Vice Chairperson	1999	Assistant Superintendent Valley View CUSD #365-U	N/A	N/A
Mohsin Dada	Treasurer	2001	Assistant Superintendent Schaumburg SD 54	Board Member of Illinois Association of School Business Officials	Cost Reduction Consulting services to Evanston Township High School
Ronald E. Everett	Assistant Treasurer/ Ex-officio Trustee	N/A Ex-officio	Executive Director Illinois Association of School Business Officials	N/A	N/A
Michael D. Johnson	Secretary/ Ex-officio Trustee	N/A Ex-officio	Executive Director Illinois Association of School Boards	N/A	N/A
Gary Allison	Trustee	2003	Superintendent Jacksonville SD 117	N/A	N/A
Jack K. Barshinger	Trustee	2003	Superintendent Glen Ellyn SD 41	N/A	Winfield School District 34
James S. Hintz	Trustee	1992	Asst. Superintendent Adlai E. Stevenson HSD 125	N/A	N/A
Joseph J. McDonnell	Trustee	2003	School Treasurer Bremen Township Schools	N/A	N/A
Louis Ryseff	Trustee	2001	Board Member Belleville Township HSD 201	President, Business Service Technologies, Inc. D/B/A Brite Way Cleaners	N/A
Walter H. Warfield	Ex-officio Trustee	N/A Ex-officio	Executive Director Illinois Association of School Administrators	N/A	N/A
Robert D. Widmer	Trustee	2003	Vice President Heartland Community College	N/A	N/A

Source: OAG analysis of Statements of Economic Interests.

APPENDIX C
Expense Basis for the
ISDLAF+ Multi-Class Series

APPENDIX C

Expense Basis for the ISDLAF+ Multi-Class Series

(as a percent of average daily net assets)

Administrator	0.14% up to $750 million 0.13% $750 million to $1billion 0.12% over $1billion
Investment Advisor/Subadvisor	*Effective October 1, 2004* 0.08% up to $750 million 0.07% $750 million to $1billion 0.06% over $1billion *Previous to October 1, 2004* 0.10% up to $750 million 0.09% $750 million to $1billion 0.08% over $1billion
Custodian	Fees for Cash Management services (Various fees specified in the custodial agreement)
Distributor (Marketing)	0.07%
Sponsors	0.0125% - Illinois Association of School Boards 0.00625% - Illinois Association of School Administrators 0.00625% - Illinois Association of School Business Officials
Other	0.005% accrued for Trustee expenses

Source: ISDLAF+ Information Statement (October 1, 2002).

APPENDIX D
Comparison of ISDLAF+ and Other States' Liquid Asset Funds

APPENDIX D
Comparison of ISDLAF+ and Other States' Liquid Asset Funds
As of September 2004

LIQUID CLASS

	ISDLAF+	**MILAF + Michigan**	**MSDLAF Minnesota**	**NSDLAF+ Nebraska**	**PSDLAF Pennsylvania**
7-day Yield	1.26%	1.06%	0.90%	1.26%	1.19%
30-day Yield	1.16%	0.96%	0.81%	1.18%	1.13%
Net Portfolio Assets (millions)	$298	$201	$138	$166	$203
Net Asset Value (Per Share)	$1.00	$1.00	$1.00	$1.00	$1.00
Weighted Average Maturity (Days)	48	57	57	57	53
FUND COMPOSITIONS					
Treasury Notes					
Repurchase Agreements (REPO)	11.3%	12.0%	12.0%		13.8%
Money Market funds					
Agency & Government	11.2%	55.0%	55.0%	100.0%	81.8%
Bank Deposits	20.5%				4.4%
Commercial Paper	26.8%	33.0%	33.0%		
Corporate	30.2%				

ISDLAF+ - Illinois School District Liquid Asset Fund Plus
MILAF+ - Michigan Liquid Asset Fund Plus
MSDLAF - Minnesota School District Liquid Asset Fund
NSDLAF+ - Nebraska School District Liquid Asset Fund Plus
PSDLAF - Pennsylvania School District Liquid Asset Fund

Note: The Nebraska School District Liquid Asset Fund Plus has only one class of shares.

Source: Standard and Poor's Government Investment Pool profiles.

APPENDIX D
Comparison of ISDLAF+ and Other States' Liquid Asset Funds
As of September 2004

MAX CLASS

	ISDLAF+	MILAF + Michigan	MSDLAF Minnesota	NSDLAF+ Nebraska	PSDLAF Pennsylvania
7-day Yield	1.38%	1.36%	1.33%	1.26%	1.39%
30-day Yield	1.28%	1.28%	1.24%	1.18%	1.34%
Net Portfolio Assets (millions)	$288	$525	$403	$166	$364
Net Asset Value (Per Share)	$1.00	$1.00	$1.00	$1.00	$1.00
Weighted Average Maturity (Days)	48	57	57	57	53

FUND COMPOSITIONS

	ISDLAF+	MILAF + Michigan	MSDLAF Minnesota	NSDLAF+ Nebraska	PSDLAF Pennsylvania
Treasury Notes					
Repurchase Agreements (REPO)	11.3%	12.0%	12.0%		13.8%
Money Market funds					
Agency & Government	11.2%	55.0%	55.0%	100.0%	81.8%
Bank Deposits	20.5%				4.4%
Commercial Paper	26.8%	33.0%	33.0%		
Corporate	30.2%				

ISDLAF+ - Illinois School District Liquid Asset Fund Plus
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NSDLAF+ - Nebraska School District Liquid Asset Fund Plus
PSDLAF - Pennsylvania School District Liquid Asset Fund

Note: The Nebraska School District Liquid Asset Fund Plus has only one class of shares.

Source: Standard and Poor's Government Investment Pool profiles.

APPENDIX E
ISDLAF+ Responses

ILLINOIS SCHOOL DISTRICT

LIQUID ASSET FUND PLUS

May 2, 2005

The Honorable William G. Holland
Auditor General of the State of Illinois
Iles Park Plaza
740 East Ash Street
Springfield, Illinois 62703-3154

Re: Management Audit of Illinois School District Liquid Asset Fund Plus (the "Fund" or "ISDLAF+")

Dear Mr. Holland:

We would like to express our appreciation to the staff of the Auditor General. Our goal throughout this management audit was to communicate clearly and demonstrate the high level of professionalism and integrity in which the Fund is managed. Certainly, the staff of the Auditor General operated in a like manner. Additionally, we appreciated their effort to dig deep and truly understand the ways in which the Fund endeavors to protect public monies and provide Illinois schools with a comprehensive and competitive package of products and services.

We are pleased that the results of this thorough and comprehensive management audit have documented the magnitude of the controls and procedures that the Fund has implemented in order to protect school assets. Additionally, we are pleased that the report has recognized the Fund's competitive performance and value-added services.

The Board of Trustees is proud that Standard & Poor's rates the Fund AAAm, the highest rating available in the industry. This top rating reflects the prudence with which the Fund is managed and is consistent with the Fund's stated goals of safety of principal, liquidity and competitive yield.

Consistent with its conscientious service to school districts throughout Illinois, ISDLAF+ was pleased to cooperate with the Illinois Auditor General in assisting it in fulfilling its statutory obligation to respond to Senate Resolution Number 171, adopted on April 22, 2004, and we thank the Auditor General's office for its efforts. We look upon the Auditor General's inquiry and its Report as meaningful opportunities to gain helpful information to assist us to improve, where warranted, and to evaluate our processes to assure that we have made and will continue to make appropriate progress in the areas covered by the Report.

Please consider the following the Fund's written responses to the management audit of the Fund.

Recommendation 1: The Illinois School District Liquid Asset Fund Plus should establish specific written policies and procedures regarding conflicts of interest including the types of relationships that should be disclosed as well as the process of reporting conflicts. Such policies and procedures should include not only Fund officials but also service providers and other contractors.

ISDLAF+ Response 1: We are pleased that the Report recognizes the efforts ISDLAF+ has made, beyond the provisions of the Declaration of Trust, to require disclosure by the voting Trustees through the filing with the Fund of their Statements of Economic Interests, which they are required to file with their respective county clerks. As the Report points out, these disclosures and the process for making them are similar to what is required of certain employees of the Illinois Funds. The Report also demonstrates that the Fund's conflicts of interest policies and procedures are more detailed than at least two of the four comparable state funds surveyed by the Auditor General. Nonetheless, pursuant to the Report and the recommendation, which we found to be very helpful, and because we believe it is important to continuously refine our processes so that Fund investors will continue to have confidence in the Fund, ISDLAF+ will continue to strive for even more specificity and improvement in its policies and procedures regarding conflicts of interest as applied to the Trustees of the Fund and service providers and other contractors.

Recommendation 2: The Illinois School District Liquid Asset Fund Plus should include performance comparisons in the ISDLAF+ Annual Report distributed to Fund participants.

ISDLAF+ Response 2: The Report rightly points out that "there are several variables that may have an effect on fund comparisons," and any comparison of fund performance would need to disclose those factors. The Fund also believes that any comparison of other funds' performance to that of the Multi-Class Series is incomplete without noting the additional services provided to Fund Participants. In this context, the Fund will consider including performance comparisons in its annual report, to the extent consistent with applicable law.

Matter for Consideration by the General Assembly: The General Assembly may wish to consider defining the term "direct obligations of any bank" in the Illinois Public Funds Investment Act.

ISDLAF+ Comment: The Fund believes that the Public Funds Investment Act (the "Act") gives clear authority for public agencies to invest in "any … obligations constituting direct obligations of any bank …," including bankers' acceptances. When the Fund became aware of the Attorney General's informal opinion construing the Act to prohibit school districts from investing in bankers' acceptances, the Fund submitted a lengthy legal analysis to the Attorney General contending otherwise. The Fund continues to believe that there are no legal or public policy reasons for prohibiting public agencies from investing in bankers' acceptances. These instruments offer less risk than other permitted investments such as commercial paper or certain types of Ginnie Maes or Freddie Macs. Accordingly, even though the Fund believes that the present statutory language clearly authorizes investments in bankers' acceptances by the Fund, if the Legislature feels clarifying language is necessary, that goal can be achieved by adding the specific words "bankers' acceptances" to the statutory list of permissible investments.

* * *

Thank you for all of the efforts and hard work of your office.

Very truly yours,

Robert G. Grossi

cc: Michael S. Paoni
Audit Manager