



August 10, 2011

To: Finance and Administration Committee
From: Will Kempton, Chief Executive Officer
Subject: Investments: Compliance, Controls, and Accounting, July 1 through December 31, 2010

Overview

The Internal Audit Department has completed a review of investments for the period July 1, 2010 through December 31, 2010. Based on the review, it appears that the Orange County Transportation Authority complied with its debt, investment, and accounting policies and procedures except for investment diversification requirements outlined in the Orange County Transportation Authority's Investment Policy. The review found that investment holdings as of December 31, 2010, were not in compliance with the limit placed on investments in money market/mutual fund holdings, and this condition was not properly communicated in the Fourth Quarter Debt and Investment Report.

The Internal Audit Department recommended management review and revise the Orange County Transportation Authority's Investment Policy as applicable and ensure that any instances of non-compliance are properly communicated to the Orange County Transportation Authority's Board of Directors. The Internal Audit Department also offered a recommendation related to invoice review.

Recommendation

Direct staff to implement recommendations in the Investments: Compliance, Controls, and Accounting, July 1 through December 31, 2010, Internal Audit Report No. 11-508.

Background

The Treasury/Public Finance Department is responsible for management of the Orange County Transportation Authority's (OCTA) investment portfolio. On December 31, 2010, the investment portfolio's book value was approximately \$1.1 million. The portfolio consists of two managed portfolios: liquid assets for

OCTA's daily operations and the short-term portfolio for future budgeted expenditures. External investment managers administer the short-term portfolio, and OCTA's treasurer manages the liquid assets portfolio. OCTA also has funds invested in debt service reserve funds for various outstanding debt obligations. OCTA's Accounting Department is responsible for recording all debt and investment transactions and reconciling all bank and custodial accounts monthly.

Discussion

OCTA's investment activities are reviewed on a periodic basis by the Internal Audit Department (Internal Audit). The objective of this review is to determine if OCTA was in compliance with OCTA's debt, investment, and accounting policies and procedures for the review period of July 1, 2010 through December 31, 2010.

Internal Audit noted OCTA's investment holdings as of December 31, 2010, did not adhere to investment diversification requirements outlined in OCTA's investment policy. As of December 31, 2010, OCTA's money market/mutual fund holdings were approximately \$304.2 million, or 27.6 percent of its total investment portfolio. The majority of these holdings represented bond proceeds from the OCTA Measure M2 Sales Tax Revenue Bonds. Review of the fourth quarter Debt and Investment Report noted that the out of compliance condition was not properly communicated. Internal Audit recommended that management review and revise OCTA's Investment Policy (Policy) as applicable and ensure that any instances of non-compliance with the Policy are properly communicated to the OCTA Board of Directors. Management agreed to make appropriate revisions to the Policy.

Internal Audit also noted two invoices, under Agreement No. C-8-0883 for financial advisory services (Agreement), that included \$8,200 in fees billed for personnel not listed in the Agreement. Internal Audit recommended management amend the Agreement, as necessary, to include all authorized personnel. Management agreed to implement this recommendation.

Summary

Based on the review, it appears that OCTA complied with its debt, investment, and accounting policies and procedures except for investment diversification requirements outlined in OCTA's Investment Policy. Internal Audit offered two recommendations that management indicated would be implemented.

Attachment

- A. Investments: Compliance, Controls, and Accounting, July 1 through December 31, 2010

Approved by:



Janet Sutter
Executive Director, Internal Audit
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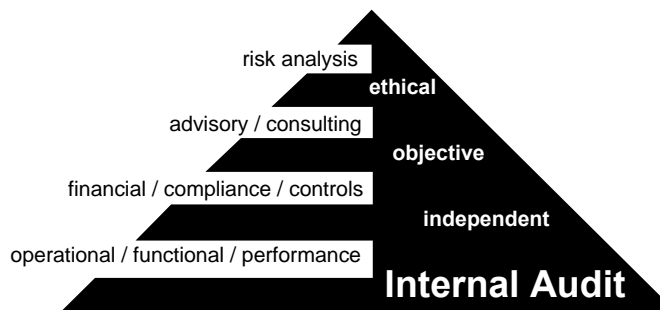
ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



Investments: Compliance, Controls, and Accounting July 1 through December 31, 2010

INTERNAL AUDIT REPORT NO. 11-508

July 28, 2011



Internal Audit Team:

Janet Sutter, CIA, Executive Director
Ricco Bonelli, CIA, Senior Internal Auditor

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Conclusion

The Internal Audit Department (Internal Audit) has completed a review of investments for the period July 1, 2010 through December 31, 2010. Based on the review, it appears that the Orange County Transportation Authority (OCTA) complied with its debt, investment, and accounting policies and procedures except for investment diversification requirements outlined in OCTA's Investment Policy (Policy). The review found that investment holdings as of December 31, 2010, were not in compliance with the limit placed on investments in money market/mutual fund holdings and this condition was not properly communicated in the fourth quarter Debt and Investment Report.

Internal Audit recommended management review and revise the Policy as applicable and ensure that any instances of non-compliance with the Policy are properly communicated to the OCTA Board of Directors. Internal Audit also offered a recommendation related to invoice review.

Background

The Treasury/Public Finance Department is responsible for management of OCTA's investment portfolio. On December 31, 2010, the investment portfolio's book value was approximately \$1.1 million. The portfolio consists of two managed portfolios: liquid assets for OCTA's daily operations, and the short term portfolio for future budgeted expenditures. External investment managers administer the short-term portfolio, and OCTA's Treasurer manages the liquid assets portfolio. OCTA also has funds invested in debt service reserve funds for various outstanding debt obligations. OCTA's Accounting Department is responsible for recording all debt and investment transactions and reconciling all bank and custodial accounts monthly.

Objectives, Scope and Methodology

The primary objective of the review was to determine if OCTA was in compliance with its debt, investment, and accounting policies and procedures.

Additional audit objectives included determining if:

- Internal controls over OCTA's investment activities were adequately designed;
- OCTA was in compliance with California Government Code;
- Investment transactions were adequately supported; and
- OCTA was in compliance with investment requirements of debt issuances.

The scope of the review included investment transactions and investment-related controls for the period July 1 through December 31, 2010.

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The methodology consisted of reviewing a judgmental sample of daily cash worksheets prepared by the Accounting Department and the Treasury/Public Finance Department, verifying judgmental samples of investment transactions and wire transfers to source documents, reviewing judgmental samples of bank reconciliations and daily investment holding reports, and reviewing the quarterly debt and investment reports provided to OCTA's Board of Directors.

This review was conducted in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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Audit Comments, Recommendations, and Management Responses

Adherence to OCTA Investment Policy

Internal Audit noted that OCTA's investment holdings as of December 31, 2010, did not adhere to investment diversification requirements outlined in the Policy. According to the Policy, investments in money market funds/mutual funds are limited to 20 percent of the investment portfolio, in accordance with California Government Code 53601. As of December 31, 2010, OCTA's money market/mutual fund holdings were approximately \$304.2 million, or 27.6 percent of its total investment portfolio.

The majority of the money market/mutual fund holdings represented bond proceeds from the OCTA Measure M2 Sales Tax Revenue Bonds. With respect to investment of bond proceeds, the California Government Code allows public agencies to follow the controlling provisions governing the issuance of the bonds; however, the Policy limits investment of bond proceeds to the maturity and diversification guidelines of the investment portfolio.

Finally, Internal Audit noted that the fourth quarter Debt and Investment Report indicated "As of December 31, 2010, OCTA's portfolio is in compliance with its investment policy." Although an attachment to the report reflected the out of compliance condition, this information was not properly communicated in the staff report.

Recommendation 1: Internal Audit recommends management review and revise the Policy as applicable and ensure that any instances of non-compliance with the Policy are properly communicated to the OCTA Board of Directors.

Management Response (Finance and Administration Division): During the review period, the investment holdings in money market funds/mutual funds totaled 27.6 percent. The majority of these funds were bond proceeds from OCTA's December 2010 debt issuance. The investment of bond proceeds is governed by the provisions contained in Government Code Section 5922(d). This Section allows OCTA to follow the controlling provisions of the bond indenture which does not include a maximum limitation for money market funds/mutual funds investments. Although OCTA's investment portfolio was in compliance with the California Government Code, it was not in compliance with the OCTA Investment Policy because the Policy restricts bond proceeds to the same provisions of non-bond proceeds investments. The fourth quarter Debt and Investment Report incorrectly indicated that the investment portfolio was in compliance with the OCTA Investment Policy. It should have stated it was in compliance with the California Government Code.

The bond proceeds portfolio was entirely invested in money market funds/mutual funds as of December 31, 2010, because OCTA was in the process of hiring external portfolio

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managers. Prior to the transfer of funds to the external managers, OCTA kept the funds liquid since those investment instruments yielded more competitive rates of return than other investment securities such as treasury or agency investments.

Limiting investment of bond proceeds to the maturity and diversification guidelines of the OCTA Investment Policy creates an issue during the startup of a bond proceeds portfolio. Funds need to be kept liquid during a short period of time while the ultimate investment strategy is put into place. Therefore, there may be times when OCTA's portfolio may not be in compliance with the Investment Policy under the current language. Staff will draft suitable language that addresses this issue. Therefore, management concurs with Internal Audit's recommendation and will seek authorization from the Board of Directors to amend the Investment Policy.

Invoicing for Personnel not Identified in Contract

A review of two invoices under Agreement No. C-8-0883 for financial advisory services (Agreement) noted \$8,200 in fees billed for personnel not listed in the Agreement.

Recommendation 2: Internal Audit recommends that management amend the Agreement, as necessary, to include all authorized personnel.

Management Response (Finance and Administration Division): Management concurs with Internal Audit's recommendation and will amend the Agreement to include the additional analyst personnel.