



*May 14, 2014*

**To:** Finance and Administration Committee

**From:** Darrell Johnson, Chief Executive Officer

Janet Sutter, Executive Director  
Internal Audit

**Subject:** Investments: Compliance, Controls, and Accounting Review,  
July 1 through December 31, 2013

### **Overview**

The Internal Audit Department has completed a review of investments for the period July 1 through December 31, 2013. Based on the review, the Orange County Transportation Authority complied with its debt, investment, and accounting policies and procedures; however, the Internal Audit Department made one recommendation to update the Orange County Transportation Authority Investment Policy to address situations where an investment manager's out of compliance condition is not treated as a violation.

### **Recommendation**

Direct staff to implement the recommendation provided in Investments: Compliance, Controls, and Accounting Review, July 1 through December 31, 2013, Internal Audit Report No. 14-513.

### **Background**

The Treasury/Public Finance Department is responsible for the management of the Orange County Transportation Authority's (OCTA) investment portfolio. On December 31, 2013, the investment portfolio's book value was approximately \$1.17 billion. The portfolio consists of three managed portfolios: liquid assets for OCTA's daily operations, a bond proceeds portfolio to meet Measure M2 transportation program needs, and the short term portfolio for future budgeted expenditures. External investment managers administer the short term portfolio and bond proceeds portfolio, and OCTA's Treasurer manages the liquid assets portfolio. OCTA also has funds invested in debt service reserves 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***

There is no requirement that identification of non-compliance with the OCTA Investment Policy be documented and, in one instance, an investment manager, Logan Circle, was not penalized for having higher than allowed balances in an investment instrument.

Logan Circle, an investment manager of the bond proceeds portfolio held a higher money market balance than allowed by the OCTA Investment Policy (Policy) for a 13-day period (December 12, 2013 through January 1, 2014). Staff was aware of the money market balance and stated that it resulted from an OCTA instruction to remain liquid in order to accommodate an upcoming drawdown. In this case, Treasury Department staff did not count the non-compliance as a violation subject to probation.

The Internal Audit Department (Internal Audit) recommended that management update the OCTA Investment Policy to address these situations. Management agreed and indicated that the Policy will be amended to address determination of compliance issues.

***Summary***

Based on the review, OCTA complied with its debt, investment, and accounting policies and procedures; however, Internal Audit made one recommendation to update the OCTA Investment Policy to address situations where an investment manager's out of compliance condition is not penalized due to instructions by OCTA.

***Attachment***

- A. Investments: Compliance, Controls, and Accounting Review, July 1 through December 31, 2013 Internal Audit Report No. 14-513

**Prepared by:**



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**Approved by:**



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# ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



## Investments: Compliance, Controls, and Accounting July 1 through December 31, 2013

### Internal Audit Report No. 14-513

April 14, 2014



**Internal Audit Team:** Janet Sutter, CIA, Executive Director  
Serena Ng, CPA, Principal Internal Auditor  
Gabriel Tang, CPA, Principal Internal Auditor

**ORANGE COUNTY TRANSPORTATION AUTHORITY  
INTERNAL AUDIT DEPARTMENT**

**Investments: Compliance, Controls, and Accounting  
July 1 through December 31, 2013  
April 14, 2014**

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**Conclusion**

The Internal Audit Department (Internal Audit) has completed a review of investments for the period July 1 through December 31, 2013. Based on the review, it appears that the Orange County Transportation Authority (OCTA) complied with its debt, investment, and accounting policies and procedures; however, Internal Audit made one recommendation to update the OCTA Investment Policy to address situations where an investment manager's out of compliance condition is not treated as such due to instructions by OCTA.

**Background**

The Treasury/Public Finance Department is responsible for the management of OCTA's investment portfolio. On December 31, 2013, the investment portfolio's book value was approximately \$1.17 billion. The portfolio consists of three managed portfolios: liquid assets for OCTA's daily operations, a bond proceeds portfolio to meet Measure M2 transportation program needs, and the short term portfolio for future budgeted expenditures. External investment managers administer the short-term portfolio and bond proceeds portfolio, and OCTA's Treasurer manages the liquid assets portfolio. OCTA also has funds invested in debt service reserve 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.

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**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 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.

The scope of the review included investment transactions and investment-related controls for the period July 1 through December 31, 2013.

We conducted this performance audit 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 Comment, Recommendation, and Management Response**

**Investment Manager Non-Compliance**

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There is no requirement that identification of non-compliance with the OCTA Investment Policy (Policy) be documented and, in one instance, an investment manager, Logan Circle, was not penalized for having higher than allowed balances in an investment instrument.

Logan Circle, an investment manager of the bond proceeds portfolio held a higher money market balance than allowed by the Policy for a 13-day period (December 12, 2013 through January 1, 2014). The Policy states that the money market balance may not exceed 20 percent of the portfolio value; however Logan Circle held as much as 36 percent (approximately \$12 million) of the portfolio in money market funds.

Staff was aware of the money market balance and stated that it resulted from an OCTA instruction to remain liquid in order to accommodate an upcoming drawdown. The same instruction was given to the second bond proceeds portfolio investment manager who was able to maintain the portfolio in compliance with the Policy. On December 23, 2013, a \$1.8 million drawdown from the Logan Circle account occurred. In this case, Treasury Department staff did not count the non-compliance as a violation subject to probation.

The Treasury Department reported the investment manager's higher than allowed money market balance to the Finance and Administration Committee as part of the Fourth Quarter 2013 Debt and Investment Report.

**Recommendation 1:**

Internal Audit recommends that management update the OCTA Investment Policy to address situations where an investment manager's non-compliance is not treated as a violation. Instances should be documented.

**Management Response:**

Management agrees that compliance with the Investment Policy is essential. In this case where the manager remained liquid, it was not considered a non-compliance event due to the upcoming drawdown in the bond proceeds portfolio and the instructions provided to the manager. In matters where there are fluctuations in cash flow, there will be instances where the maximum allocation may be temporarily



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exceeded due to the reduction in bond funds and drawdowns. In those situations, staff will notify the Board of Directors in the Debt and Investment report.

Management will update OCTA's Investment Policy to include additional language regarding the drawdown of portfolio funds and the determination of compliance issues.