



September 10, 2014

To: Finance and Administration Committee

From: Darrell Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit

Subject: Investments: Compliance, Controls, and Reporting Review,
January 1 through June 30, 2014

Overview

The Internal Audit Department has completed an investments review for the period January 1 through June 30, 2014. Based on the review, the Orange County Transportation Authority complied with its debt, investment, and reporting policies and procedures, except for one instance related to reporting that has since been addressed through an update to the Investment Policy. The Internal Audit Department made one recommendation that Treasury/Public Finance Department staff follow the Investment Policy in effect at the time of transactions.

Recommendation

Direct staff to implement the recommendation provided in Investments: Compliance, Controls, and Reporting Review, January 1 through June 30, 2014, Internal Audit Report No. 15-503.

Background

The Treasury/Public Finance Department (Treasury) is responsible for management of the Orange County Transportation Authority's (OCTA) investment portfolio. On June 30, 2014, the investment portfolio's book value was approximately \$1.22 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 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.

OCTA's independent auditor, Vavrinek, Trine, Day & Co., LLP (VTD), will perform agreed-upon procedures with respect to the Treasury function for the year ended June 30, 2014. As a result, the Internal Audit Department (Internal Audit) limited the scope of this review to procedures that will not be performed by VTD during the course of their agreed-upon procedures review.

Discussion

On June 2, 2014, Logan Circle Partners, L.P. and Cutwater Asset Management, investment managers of the bond proceeds portfolio, held a higher money market balance than allowed by the Investment Policy (Policy) for a one-day period. Treasury did not report this incident as part of the Second Quarter 2014 Debt and Investment Report as required by the Policy. Although the Policy was updated the following month to allow bond proceeds to be invested in short term investments without regard to diversification limits, Treasury staff should have treated this as a compliance issue under the Policy in effect at the time.

Internal Audit recommended that Treasury staff follow the Policy in effect at the time of transactions, and management agreed.

Summary

Based on the review, OCTA complied with its debt, investment, and reporting policies and procedures, except for one instance related to reporting.

Attachment

- A. Investments: Compliance, Controls, and Reporting Review, January 1 through June 30, 2014 Internal Audit Report No. 15-502

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ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



Investments: Compliance, Controls, and Reporting January 1 through June 30, 2014

Internal Audit Report No. 15-502

August 28, 2014



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Serena Ng, CPA, Principal Internal Auditor
Gabriel Tang, CPA, Principal Internal Auditor

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT**

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Conclusion

The Internal Audit Department (Internal Audit) has completed an investments review for the period January 1, 2014 through June 30, 2014. Based on the review, the Orange County Transportation Authority (OCTA) complied with its debt, investment, and reporting policies and procedures, except for one instance related to reporting that has since been addressed through an update to the Investment Policy (Policy). Internal Audit made one recommendation that Treasury/Public Finance Department (Treasury) staff follow the Policy in effect at the time of transactions.

Background

Portfolio Management

Treasury is responsible for the management of OCTA's investment portfolio. On June 30, 2014, the investment portfolio's book value was approximately \$1.22 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 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.

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Objectives, Scope and Methodology

The primary objective of the review was to determine if OCTA complied with its debt, investment, and reporting 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.

OCTA's independent auditor, Vavrinek, Trine, Day & Co., LLP (VTD), will perform agreed-upon procedures with respect to the Treasury function for the year ended June 30, 2014. Internal Audit limited the scope of this review to procedures that will not be performed by VTD during the course of their agreed-upon procedures.

The methodology consisted of reviewing a judgmental sample of daily cash worksheets prepared by the Accounting Department and the Treasury, verifying a judgmental sample of wire transfers to source documents, 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 January 1 through June 30, 2014.

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

On June 2, 2014, Logan Circle and Cutwater, investment managers of the bond proceeds portfolio, held a higher money market balance than allowed by the Policy for a one-day period. The Treasury did not report this incident as part of the Second Quarter 2014 Debt and Investment Report, as required by the Policy. Although the Policy was updated the following month to allow bond proceeds to be invested in short term investments without regard to diversification limits, staff should have treated this as a compliance issue under the Policy in effect at the time.

Recommendation 1:

Internal Audit recommends that Treasury staff follow the Policy in effect at the time of transactions.

Management Response:

Management will follow the provisions of the Investment Policy in effect. In this situation, staff did not consider the higher money market balance a compliance issue since instructions were provided to the bond proceeds portfolio managers by OCTA's Treasurer to remain liquid and therefore did not disclose the incident in the quarterly report. As indicated in the audit finding, management has revised the Policy to include language regarding the drawdown of portfolio funds requested by the Treasurer. The revised Policy was approved by the Board of Directors in July 2014, and affects investments made on and after July 14, 2014.