



April 8, 2020

To: Finance and Administration Committee

From: Darrell E. Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit

Subject: Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2019

Overview

The Internal Audit Department has completed an audit of investments for the period July 1 through December 31, 2019. Based on the audit, the Orange County Transportation Authority complied with its debt, investment, and reporting policies and procedures.

Recommendation

Receive and file Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2019, Internal Audit Report No. 20-509, as an information item.

Background

The Treasury Department (Treasury) is responsible for the management of the Orange County Transportation Authority's (OCTA's) Investment Portfolio (Portfolio). On December 31, 2019, the Portfolio's book value was approximately \$2.1 billion. The Portfolio consists of three managed portfolios: the liquid portfolio for immediate cash needs, 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 OCTA's Treasurer manages the liquid assets portfolio. OCTA also has investments in debt service reserve funds for various outstanding debt obligations.

The Investment Policy (Policy) sets forth guidelines for all OCTA investments to ensure conformance with the California Government Code. The Policy outlines permitted investments, as well as diversification guidelines. The diversification limits ensure the Portfolio is not unduly concentrated in securities

of one type, industry, or entity, thereby assuring adequate portfolio liquidity should one sector or company experience difficulties.

Discussion

OCTA's investment activities are reviewed on a semi-annual basis by the Internal Audit Department. The objective of the audit was to determine if OCTA complied with its debt, investment, and reporting policies and procedures for the period July 1 through December 31, 2019.

Summary

Based on the audit, OCTA complied with its debt, investment, and reporting policies and procedures.

Attachment

- A. Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2019, Internal Audit Report No. 20-509

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ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



Investments: Compliance, Controls, and Reporting July 1 through December 31, 2019

Internal Audit Report No. 20-509 March 24, 2020



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**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Investments: Compliance, Controls, and Reporting
July 1 through December 31, 2019
March 24, 2020**

Table of Contents

Conclusion	1
Background	1
Objectives, Scope, and Methodology	2

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Investments: Compliance, Controls, and Reporting
July 1 through December 31, 2019
March 24, 2020**

Conclusion

The Internal Audit Department (Internal Audit) has completed an audit of investments for the period July 1 through December 31, 2019. Based on the audit, the Orange County Transportation Authority (OCTA) complied with its debt, investment, and reporting policies and procedures.

Background

Portfolio Management

The Treasury Department (Treasury) is responsible for the management of OCTA's Investment Portfolio (Portfolio). To accomplish this, Treasury uses the Clearwater treasury software system to monitor investments and investment manager performance.

On December 31, 2019, the Portfolio's book value was approximately \$2.1 billion. The Portfolio consists of three managed portfolios: the liquid portfolio for immediate cash needs, 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 OCTA's Treasurer manages the liquid assets portfolio. OCTA also has investments in debt service reserve funds for various outstanding debt obligations. OCTA's Accounting Department (Accounting) is responsible for recording all debt and investment transactions, and for reconciling all bank and custodial accounts monthly.

Investment Policy

The Investment Policy (Policy) sets forth guidelines for all OCTA investments to ensure conformance with the California Government Code (CGC). The Policy outlines permitted investments as well as diversification guidelines. The diversification limits ensure the portfolio is not unduly concentrated in securities of one type, industry, or entity, thereby assuring adequate portfolio liquidity should one sector or company experience difficulties.

OCTA has provided the investment managers with a copy of the Policy and requires investment managers to invest their portfolios in accordance with the provisions of the Policy.

ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Investments: Compliance, Controls, and Reporting
July 1 through December 31, 2019
March 24, 2020

Objectives, Scope, and Methodology

The primary objective was to determine if OCTA complied with its debt, investment, and reporting policies and procedures.

Audit objectives included determining if:

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

According to Generally Accepted Government Auditing Standards (GAGAS), internal control is the system of processes that an entity's oversight body, management, and other personnel implement to provide reasonable assurance that the organization will achieve its operational, reporting, and compliance objectives. The five components are control environment, risk assessment, control activities, information and communication, and monitoring.¹ The components and principles that were evaluated as part of this audit are:

- Control Environment
 - OCTA demonstrates a commitment to integrity and ethical values.
 - Management establishes, with Board of Director (Board) oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
 - OCTA demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
- Risk Assessment
 - OCTA specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
 - OCTA identifies and assesses changes that could significantly impact the system of internal control.
- Control Activities
 - OCTA selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
 - OCTA selects and develops general control activities over technology to support the achievement of objectives.
- Information and Communication
 - OCTA obtains, or generates and uses relevant, quality information to support the functioning of other components of internal control.

¹ See U.S. Government Accountability Office publication, "Standards for Internal Control in the Federal Government," available at <http://www.gao.gov/products/GAO-14-704G>, for more information.

ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Investments: Compliance, Controls, and Reporting
July 1 through December 31, 2019
March 24, 2020

- Monitoring
 - OCTA evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the Board, as appropriate.

The scope included investment transactions and investment-related controls for the period July 1 through December 31, 2019.

The methodology consisted of obtaining the most current Policy and Debt and Investment Management Manual, reviewing any personnel changes and corresponding updates to bank authorization signature cards, reviewing a judgmental sample of daily cash worksheets prepared by Accounting and Treasury staff, testing a judgmental sample of investments for compliance with the Policy, tracing a haphazard sample of investments from the bank statements to Clearwater, testing a judgmental sample of wire transfers for accuracy and proper authorization, and verifying the accuracy of the quarterly investment and debts reports provided to OCTA's Board. For daily cash report testing, repo-sweep testing, and wire transfer testing, Internal Audit judgmentally selected one transaction per month during the scope period. For Treasury software and computer data testing, Internal Audit haphazardly selected five securities per investment manager per quarter, resulting in a sample of 40 securities, and traced the securities from the statements to the Clearwater Daily Holding Reports. For quarterly report transaction testing, Internal Audit judgmentally selected 40 investments per quarter for coverage over different types of securities. Since the samples are non-statistical, any conclusions are limited to the sample items tested. The methodology also included Treasury's monitoring of the investment managers' compliance with the Policy, including obtaining acknowledgement of receipt of OCTA's Policy, and obtaining written descriptions of the compliance and control environment of the custodian.

We conducted this performance audit in accordance with GAGAS. 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.