



May 12, 2021

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, 2020, Internal Audit Report No. 21-509

Overview

The Internal Audit Department has completed an audit of investments for the period July 1 through December 31, 2020. Based on the audit, the Orange County Transportation Authority complied with its debt, investment, and reporting policies and procedures; however, the Internal Audit Department is recommending management consider incorporating assertions previously provided in quarterly reports to the Board of Directors that were eliminated in favor of providing monthly reports to the Board of Directors.

Recommendation

Direct staff to implement a recommendation provided in Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2020, Internal Audit Report No. 21-509.

Background

The Treasury Department (Treasury) is responsible for the management of the Orange County Transportation Authority's (OCTA) Investment Portfolio (Portfolio). On December 31, 2020, the Portfolio's book value was approximately \$2.0 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. OCTA's Treasurer manages the liquid and bond proceeds portfolios, and four external investment managers administer the short-term 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

After March 2020, Treasury eliminated the practice of providing Quarterly Investment and Debt (quarterly) reports to the Board of Directors (Board). In lieu of the quarterly reports, Treasury added additional information to the monthly Investment and Debt (monthly) reports, previously provided only to the Finance and Administration Committee, which are now presented to the Board as well. The quarterly reports previously included an assertion by the OCTA Treasurer of compliance with the Policy and confirmation of the ability to meet expenditure requirements for the next six months, as suggested by both Section 53646 of the California Government Code and the California Debt and Investment Advisory Commission's Local Agency Investment Guidelines. These statements are not provided in the monthly reports. Internal Audit recommended that Treasury incorporate suggested assertions into monthly reports. Management agreed with the recommendation and will incorporate the assertions beginning with the next monthly report, which will be for the month of April 2021.

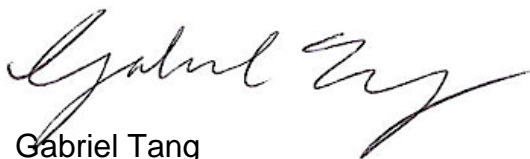
Summary

Internal Audit has completed an audit of investments for the period July 1 through December 31, 2020 and has offered one recommendation for improvement.

Attachment

- A. Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2020, Internal Audit Report No. 21-509

Prepared by:



Gabriel Tang
Principal Internal Auditor, Internal Audit
714-560-5746

Approved by:



Janet Sutter
Executive Director, Internal Audit
714-560-5591

ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



Investments: Compliance, Controls, and Reporting July 1 through December 31, 2020

Internal Audit Report No. 21-509 April 28, 2021



Performed by: Janet Sutter, CIA, Executive Director
 Serena Ng, CPA, Senior Manager
 Gabriel Tang, CPA, Principal Internal Auditor

Distributed to: Andrew Oftelie, Chief Financial Officer, Finance and Administration
 Sean Murdock, Robert Davis, Benjamin Torres, Maya Haddad

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Conclusion

The Internal Audit Department (Internal Audit) has completed an audit of investments for the period July 1 through December 31, 2020. Based on the audit, the Orange County Transportation Authority (OCTA) complied with its debt, investment, and reporting policies and procedures; however, Internal Audit is recommending management reconsider a change in reporting practices.

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, 2020, the Portfolio's book value was approximately \$2.0 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. OCTA's Treasurer manages the liquid and bond proceeds portfolios, and four external investment managers administer the short-term 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 (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. 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.

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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 the Code;
- 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 implements 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 the Finance and Administration (F&A) Committee and 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.

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- 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, 2020.

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 the 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 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.

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Audit Comment, Recommendation, and Management Response

Reporting Practices

After March 2020, Treasury eliminated the practice of providing Quarterly Investment and Debt (quarterly) reports to the Board. In lieu of the quarterly reports, Treasury added additional information to the monthly Investment and Debt (monthly) reports, previously provided only to the F&A Committee, which are now forwarded to the Board as well. Some information and assertions previously included in the quarterly reports to the Board have not been incorporated into the monthly reports.

While not a requirement, both Section 53646 of the Code and the California Debt and Investment Advisory Commission's Local Agency Investment Guidelines (LAIG) encourage treasurers to prepare a quarterly investment report to enable the legislative body to perform its fiduciary duty and provide full disclosure of the public entity's investment activities.

The quarterly reports previously included an assertion by the OCTA Treasurer of compliance with the Policy and confirmation of the ability to meet expenditure requirements for the next six months, as suggested by both the Code and the LAIG. These statements are not provided in the monthly reports.

Recommendation:

Internal Audit recommends that Treasury incorporate suggested assertions into monthly reports.

Management Response:

Management agrees with the recommendation and will incorporate the assertions beginning with the next monthly report, which will be for the month of April 2021.