



October 13, 2021

To: Finance and Administration Committee

From: Darrell E. Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit Department

Subject: Investments: Compliance, Controls, and Reporting, January 1 through June 30, 2021, Internal Audit Report No. 22-501

Overview

The Internal Audit Department has completed an audit of investments for the period January 1 through June 30, 2021. Based on the audit, the Orange County Transportation Authority complied with its debt, investment, and reporting policies and procedures; however, the Internal Audit Department did make one recommendation related to compliance monitoring.

Recommendation

Direct staff to implement a recommendation provided in Investments: Compliance, Controls, and Reporting, January 1 through June 30, 2021, Internal Audit Report No. 22-501.

Background

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

On June 30, 2021, the Portfolio's book value was approximately \$2 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

The Debt and Investment Management Manual requires staff to review Clearwater's Daily Holdings reports and compliance module on a weekly basis. During the period, the compliance module flagged a portfolio concentration issue; however, while staff marked the issue as resolved, there was no documentation explaining the reason. After discussion with the investment manager, it was determined that the flagged issue did not represent an actual violation but resulted from the compliance module incorrectly calculating portfolio percentages based on an understated total portfolio value. Additionally, Internal Audit noted that the compliance module does not recognize variable and floating rate securities as a separate investment type and presents all investments at the market value rather than at cost, unlike the Daily Holdings reports, that are customized to better monitor against OCTA Policy. Internal Audit recommended that staff consistently document resolution of all issues flagged in the compliance module and consider customizing the compliance module. Management agreed to document the resolution of all issues flagged in the compliance module. Going forward, the compliance module will present all investments at cost, but will not recognize variable and floating rate securities as a separate investment type as this is not an option currently offered by Clearwater.

Summary

Internal Audit has completed an audit of investments for the period January 1 through June 30, 2021 and has offered one recommendation for improvement.

Attachment

- A. Investments: Compliance, Controls, and Reporting, January 1 through June 30, 2021, Internal Audit Report No. 22-501

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ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



Investments: Compliance, Controls, and Reporting January 1 through June 30, 2021

Internal Audit Report No. 22-501 September 28, 2021



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Conclusion

The Internal Audit Department (Internal Audit) has completed an audit of investments for the period January 1 through June 30, 2021. Based on the audit, the Orange County Transportation Authority (OCTA) complied with its debt, investment, and reporting policies and procedures; however, Internal Audit did make one recommendation related to compliance monitoring.

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 June 30, 2021, 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 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 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 January 1 through June 30, 2021. OCTA's independent auditor, Crowe LLP (Crowe), will perform agreed-upon procedures with respect to the Treasury function for the year ended June 30, 2021. Internal Audit limited the scope of this audit to procedures that will not be performed by Crowe during the course of their agreed-upon procedures.

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 testing a haphazard sample of the monthly investment and debt programs reports provided to OCTA's Board. For daily cash report testing, repo-sweep testing, and wire transfer testing, Internal Audit judgmentally selected one transaction for each month in the scope period with activity. For monthly report transaction testing, Internal Audit judgmentally selected 40 investments 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 documentation related to 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

Compliance Monitoring

The Debt and Investment Management Manual (Manual) requires Treasury staff to review Clearwater's Daily Holdings reports and compliance module on a weekly basis. During the period, the compliance module flagged a portfolio concentration issue on four consecutive days. While Treasury staff marked the issue as resolved, there was no documentation by staff to explain the reason. After discussion with the investment manager, it was determined that the issue that was flagged did not represent an actual violation but resulted from the compliance module incorrectly calculating portfolio percentages based on an understated total portfolio value.

Additionally, Internal Audit noted that the compliance module does not recognize Variable and Floating Rate securities as a separate investment type and presents all investments at the market value rather than at cost, unlike the Daily Holdings reports, that are customized to better monitor against OCTA Policy.

Recommendation:

Internal Audit recommends that Treasury staff consistently document resolution of all issues flagged in the Clearwater compliance module, as required by the Manual. Additionally, Treasury staff should consider customizing the Clearwater compliance module to accurately monitor against OCTA Policy.

Management Response:

Staff agrees with the recommendation and will document the resolution of all issues flagged in the Clearwater compliance module.

Customizing the Clearwater compliance module to recognize Variable and Floating Rate securities as a separate investment type is not an option currently offered by Clearwater. For now, Treasury staff will continue to utilize the Daily Holdings reports in conjunction with the Clearwater compliance module to ensure compliance with OCTA's Policy. Additionally, going forward, the Clearwater compliance module will present all investments at cost rather than at market value.