

**ORANGE COUNTY TREASURER  
SENATE BILL 866, ARTICLE 6 COMPLIANCE  
REPORT ON AUDIT  
FOR THE YEAR ENDED DECEMBER 31, 1998**

**Issued: December 9, 1999**

Audit Number 9929

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Staff Auditors:	Pamela L. Parisien Young Kim



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**COUNTY OF ORANGE  
INTERNAL AUDIT DEPARTMENT**

**ORANGE COUNTY TREASURER**  
**SENATE BILL 866, ARTICLE 6 COMPLIANCE**  
**REPORT ON AUDIT**  
**FOR THE YEAR ENDED DECEMBER 31, 1998**

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## **INTERNAL AUDIT DEPARTMENT**

File No. 9929

December 9, 1999

County of Orange  
Treasury Oversight Committee  
12 Civic Center Plaza, Room G-76  
Santa Ana, CA 92701-4521

### INTERNAL AUDITORS' REPORT

We have examined the assertions of the Orange County Treasurer, included in the representation letter dated September 28, 1999, regarding compliance with California Government Code of Regulations Senate Bill 866, Article 6 and related provisions of the Orange County Treasurer Investment Policy Statement, as set forth in the accompanying schedule for the year ended December 31, 1998. The Treasurer is responsible for compliance with those requirements. Our responsibility is to express an opinion on the Treasurer's assertions about the compliance based on our examination.

Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about the Treasurer's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on the Treasurer's compliance with specified requirements.

In our opinion, the Treasurer's assertions about compliance with the aforementioned investment compliance requirements for the year ended December 31, 1998, are fairly stated, in all material respects.

This report is intended solely for the information and use of the County Treasury Oversight Committee and should not be used for any other purpose. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

[Original signed letter is on file with the Clerk of the Board]

Peter Hughes  
Director

**COUNTY OF ORANGE**  
**SUMMARY OF INVESTMENT COMPLIANCE REQUIREMENTS**  
**SCHEDULE I**  
**For Year-Ended 12/31/98**

The investment compliance requirements presented in the California Government Code of Regulations Senate Bill 866, Article 6 Section 27130 through 27137, and related provisions of the Orange County Treasurer Investment Policy Statement are as follows:

**Senate Bill 866, Article 6**

1. The Legislature finds and declares that local agencies, including school districts, should participate in reviewing the policies that guide the investment of those funds. (Section 27130)
2. The Board of Supervisors in each county shall, if the county is investing surplus funds, establish a county treasury oversight committee that consists of from three to eleven members. (Section 27131)
3. The county treasury oversight committee shall consist of members appointed from the following: county treasurer; county auditor, auditor-controller, or finance director; representative appointed by the county board of supervisors; county superintendent of schools or designee; representative selected by a majority of the presiding officers of the governing bodies of the school or community college districts; a representative selected by a majority of the presiding officers of the legislative bodies of the special districts; up to five other members of the public who either have expertise or academic background in finance or are economically diverse and bipartisan in political registration. (Section 27132)
4. Committee members may not be employed by an entity that has contributed to the campaign of a candidate for the office of local treasurer, or contributed to the campaign of a candidate to be a member of a legislative body of any local agency that has deposited funds in the county treasury, in the previous three years or during the period that the employee is a member of the committee. (Section 27132.1)
5. Committee members may not directly or indirectly raise money for a candidate for local treasurer or a member of the governing board of any local agency that has deposited funds in the county treasury while a member of the committee. (Section 27132.2)
6. Committee members may not secure employment with bond underwriters, bond counsel, security brokerages or dealers, or with financial services firms during the period that the person is a member of the committee or for three years after leaving the committee. (Section 27132.3)
7. Committee meetings shall be open to the public and subject to the Ralph M. Brown Act. (Section 27132.4)
8. The county treasurer shall annually prepare an investment policy that will be reviewed and monitored by the county treasury oversight committee. The investment policy shall include the following: authorized investments; maximum security term; brokers and dealers selection; limits on the receipt of gifts; investment report; cost calculation and apportionment policy; deposit terms and conditions; and funds withdrawal criteria. (Section 27133)

**COUNTY OF ORANGE**  
**SUMMARY OF INVESTMENT COMPLIANCE REQUIREMENTS**  
**SCHEDULE I (Continued)**  
**For Year-Ended 12/31/98**

9. The county treasury oversight committee shall cause an annual audit to be conducted to determine the county treasury's compliance with the investment compliance requirements presented in the California Government Code of Regulations, Senate Bill 866, Article 6, Sections 27130 through 27137. (Section 27134)
10. The costs of complying with this article shall be county charges and may be included with those charges enumerated under Section 27013. (Section 27135)
11. The county treasurer shall evaluate each proposed withdrawal for its consistency with the criteria adopted pursuant to Section 27133. Prior to approving a withdrawal, the county treasurer shall find that the proposed withdrawal will not adversely affect the interests of the other depositors in the county treasury pool. (Section 27136)
12. The county treasury oversight committee shall not direct individual investment decisions, select individual investment advisors, brokers, or dealers, or impinge on the day-to-day operations of the county treasury. (Section 27137)

**Orange County Treasurer Investment Policy Statement (IPS)**

13. Investments maintained in the portfolios shall be consistent with those authorized per Government Code Sections 53601 et seq., 53631.5, and 53635, as stated in IPS Sections IV and V.
14. Investments maintained in the portfolios shall comply with investment criteria as stated in IPS Sections IV, V and VI, including rating, term limit, and diversification requirements.
15. Treasurer, investment personnel, and Treasury Oversight Committee members shall annually complete the Statement of Economic Interests Disclosure (State of California Form 700) and must comply with the Orange County Gift Ban Ordinance which prohibits the receipt of specified gifts, as stated in IPS Section VII.
16. All investment transactions must be executed through brokers/dealers and financial institutions that meet the selection criteria specified in IPS Section VIII and are placed on the List of Qualified Institutions.
17. The Treasurer shall submit monthly, quarterly and annual reports in compliance with Government Code Sections 53607, 53646, and 27134, as stated in IPS Section IX.
18. All security transactions entered into by the Treasurer shall be conducted on a delivery-versus payment basis and securities shall be held by a third party custodian, as stated in IPS Section X.
19. Repurchase agreements are required to be collateralized by securities authorized under Government Code Section 53601 at a minimum of 102% of market value of the principal and accrued interest and shall be adjusted no less frequently that weekly, as stated in IPS Section XI.

**COUNTY OF ORANGE**  
**SUMMARY OF INVESTMENT COMPLIANCE REQUIREMENTS**  
**SCHEDULE I (Continued)**  
**For Year-Ended 12/31/98**

20. The Treasurer will charge all pool participants for administrative and overhead costs of investing, depositing, banking, auditing, reporting, or otherwise handling or managing the funds as authorized by Government Code Section 27013, as stated in IPS Section XIV.
21. Local agencies that voluntarily deposit monies with the Treasurer must provide to the Treasurer a resolution adopted by its governing board stating that excess funds are available for investing, in compliance with requirements stated in IPS Section XV.
22. Withdrawal of participant funds shall require prior written approval from the Treasurer. Prior to approving the withdrawal request, the Treasurer shall make a finding of the effect of the withdrawal on the stability and predictability of the investments, as stated in IPS Section XVI.



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**Director**

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## **INTERNAL AUDIT DEPARTMENT**

File No. 9929

December 9, 1999

County of Orange  
Treasury Oversight Committee  
12 Civic Center Plaza, Room G-76  
Santa Ana, CA 92701-4521

### MANAGEMENT LETTER

We have examined the assertions of the Orange County Treasurer regarding compliance with California Government Code of Regulations Senate Bill 866, Article 6 and related provisions of the Orange County Treasurer Investment Policy Statement for the year ended December 31, 1998, and have issued our report thereon dated December 9, 1999.

In planning and performing our examination, we considered the Treasurer's internal control framework in order to determine our examination procedures for the purpose of expressing an opinion on the Treasurer's assertions about the compliance and not to provide assurance on the internal control framework. Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about the Treasurer's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

The Treasurer is responsible for establishing and maintaining an internal control framework over compliance. In fulfilling this responsibility, judgments by management are required to assess the expected benefits and related costs of internal control framework policies and procedures. The objectives of an internal control framework over compliance are to provide management with reasonable, but not absolute, assurance that compliance is achieved with established criteria and management's policies.

Because of inherent limitations in any internal control framework over compliance, intentional or unintentional noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the framework to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Treasury Oversight Committee  
December 9, 1999

Our examination, made for the limited purpose described above, would not necessarily disclose all material weaknesses in the Treasurer's compliance with applicable statutory requirements and County policies. However, our examination did disclose certain conditions, which are not considered by us to be material weaknesses, but for which we believe corrective action by management is practicable in the circumstances. The weaknesses we observed are discussed in the Findings, Recommendations, and Responses section of this report and should be corrected to strengthen the control framework and enhance assurance that internal control procedures are adequate to achieve compliance with stated requirements. The absence of complimentary comments in the following recommendations does not mean that such comments could not be made but rather that we have limited our recommendations to those items upon which management may want to take action.

This report was discussed with representatives of the Treasury management; their responses have been incorporated in the report. This report is intended solely for the use of the County Treasury Oversight Committee (TOC) and Treasury management and should not be used for any other purpose. However, this report is a matter of public record and its distribution is not limited.

We appreciate the cooperation and assistance extended to us by the personnel of the Treasury during our examination.

Sincerely,

Peter Hughes  
Director  
Internal Audit Department



## **FINDINGS, RECOMMENDATIONS, AND RESPONSES**

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### **I. Scope of Investment Policy Statement**

Government Code Section 27133, part of Senate Bill (SB) 866 Article 6, requires the Treasurer's investment policy statement to include a list of securities in which the Treasury may invest, according to law. The Orange County Treasurer's Investment Policy Statement (IPS) in effect during the audit period did not cover specific, or non-pooled, investments held in the Treasury. We were informed that a revision is currently being drafted to the IPS that will include a paragraph or section detailing that non-pooled investments shall be invested according to the Government Code (GC) and/or other legal requirements.

#### **Recommendation No. 1**

**We recommend** Treasury management ensure the IPS covers all investments in which the Treasury may invest, including non-pooled investments, in compliance with GC Sec. 27133 of SB 866.

#### **Treasury Management Response:**

Concur. The Treasurer-Tax Collector has included language concerning specific, or non-pooled investments, in the Investment Policy Statement revisions for the year 2000.

### **II. Investment Earnings and Fee Charges**

Investment earnings and administrative fee charges were not allocated to pool participants on a monthly basis, as required by IPS Section XIV - Compensation Agreement. The entries to record the allocation on the County's books are processed by the Auditor-Controller (A-C). It is the A-C's policy to delay processing of the allocation entries until sufficient cash becomes available to allow for the cash distribution. During the audit period, it took an average of one to two months for sufficient cash to become available to process the allocations. The Treasurer is pursuing acceptable alternatives to delaying the monthly allocations. This issue was noted in our Management Letter dated July 8, 1998, and has been included in the monthly Treasurer's Management Report.

#### **Recommendation No. 2**

**We recommend** Treasury management continue to pursue an acceptable resolution to the allocation methodology and until then, revise the IPS to reflect the current apportionment procedure.

#### **Treasury Management Response:**

Concur. The Treasurer recently met with the Auditor-Controller, Chief Financial Officer and the Director of Internal Audit to review a draft of a white paper on interest apportionment. The draft will be finalized and submitted to County Counsel by December 31, 1999. The Treasurer will include his proposed revisions to the IPS in the white paper and will submit a revised IPS to the Board after County Counsel has opined on this matter.

### III. Investment Inventory Database

The investment inventory records could contain errors. The inventory of all Treasury investments is maintained on the SunGard Securities Systems database. Investment information is entered into the database from a trade ticket prepared by a Treasurer investment officer. The investment officer compares the trade ticket to a confirmation faxed by the broker. A person independent of investing and data entry compares the database information to the trade ticket, not to the broker confirmation. Therefore, if an error were made in the trade ticket, the error could go undetected. In addition, an independent person does not verify the investment type code input during data entry.

The information contained in the database is used by the Treasury to monitor compliance with SB866 and IPS requirements. Therefore, accuracy of the database information is important for monitoring compliance with those requirements. Our examination did not identify any significant discrepancies in database information. However, one discrepancy caused by a trade ticket error was noted during the June 1999 quarterly treasury audit. Consequently, the Treasurer had to reperform time-consuming compliance monitoring for the days affected, which resulted in the identification of several compliance deficiencies.

A comparison made by an independent person of investment information contained in the database to a broker confirmation would help ensure the accuracy of the database.

#### **Recommendation No. 3**

**We recommend** a person independent of the investing and data entry function perform a comparison of database information to the broker confirmation.

#### **Treasury Management Response:**

Concur. We will expand our internal controls in this area to include a comparison, by an independent person, of broker confirmations to the investment information entered in the database. In addition, the investment type coding will be included in this review. We will implement this expanded review by January 3, 2000.

#### **Recommendation No. 4**

**We further recommend** investment type coding be verified by a person independent of the investing and data entry functions.

#### **Treasury Management Response:**

See response to recommendation No. 3 above.

#### IV. Written Policies and Procedures

Policies and procedures provide guidance for the performance of duties and functions, establish accountability, and help ensure consistent application of internal controls. Policies and procedures for compliance activities with certain SB866 and IPS requirements have not been finalized, including:

- Annual review of qualified institutions (IPS Section VIII, GC 27133)
- Conflict of interest/ethics (IPS Section VII, GC 27132 & GC 27137)
- Processing/evaluating withdrawal requests (IPS XVI, GC 27133(h) & GC 27136)
- Annual review of administrative and overhead fees (IPS XIV, GC 27013 & GC 27135)
- Financial Reporting (IPS XIX, GC 53646 & GC 53686)

#### **Recommendation No. 5**

**We recommend** Treasury management finalize written policies and procedures for compliance activities with SB866 and IPS requirements and distribute them to appropriate personnel for implementation.

#### **Treasury Management Response:**

Concur. Treasury management will finalize written policies and procedures for compliance activities with SB866 and IPS requirements and distribute them to appropriate personnel by January 31, 2000.

**APPENDIX**  
**TREASURY MANAGEMENT RESPONSE**

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COUNTY OF ORANGE  
**OFFICE OF THE TREASURER-TAX COLLECTOR**

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IN REPLY PLEASE REFER TO:

December 8, 1999

Peter Hughes, Director  
Internal Audit Department  
County of Orange  
400 Civic Center Drive West  
Building 12, Room 232  
Santa Ana, CA 92701-4521

Dear Peter:

Pursuant to Audit Oversight Committee Administrative Procedure No. 1, we have prepared our response to the draft results of your SB866 Compliance Examination for the year ended December 31, 1998. Our response is referenced by the recommendation numbers used in your report.

Scope of Investment Policy Statement

Recommendation No. 1:

Concur. The Treasurer-Tax Collector has included language concerning specific, or non-pooled investments, in the *Investment Policy Statement revisions for the year 2000*.

Investment Earnings and Fee Charges

Recommendation No. 2:

Concur. The Treasurer recently met with the Auditor-Controller, Chief Financial Officer and the Director of Internal Audit to review a draft of a white paper on interest apportionment. The draft will be finalized and submitted to County Counsel by December 31, 1999. The Treasurer will include his proposed revisions to the IPS in the white paper and will submit a revised IPS to the Board after County Counsel has opined on this matter.

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December 8, 1999

Peter Hughes, Interim Director  
Page 2

Investment Inventory Database  
Recommendation Nos. 3 and 4

Concur. We will expand our internal controls in this area to include a comparison, by an independent person, of broker confirmations to the investment information entered in the database. In addition, the investment type coding will be included in this review. We will implement this expanded review by January 3, 2000.

Treasury Oversight Committee  
Recommendation No. 5

Concur. Treasury management will finalize written policies and procedures for compliance activities with SB866 and IPS requirements and distribute them to appropriate personnel by January 31, 2000.

Thank you for the diligent and professional efforts expended by Internal Audit personnel on this audit. I am confident that the scope of your work in addition to the quarterly review of our compliance by Fitch IBCA, Inc. provides the necessary elements to fulfill the annual audit requirement of the Treasury Oversight Committee as set forth in California Government Code Section 27134 as enacted by SB866.

Very truly yours,



John M. W. Moorlach, C.P.A., CFP  
Treasurer-Tax Collector