



May 22, 2019

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, 2018

Overview

The Internal Audit Department has completed an audit of investments for the period July 1 through December 31, 2018. Based on the audit, the Orange County Transportation Authority complied with its debt and investment policies; however, a few errors were identified in the fourth quarter investment and debt report, and a recommendation was made to enhance monitoring of asset-backed securities' diversification limits.

Recommendation

Direct staff to implement two recommendations provided in Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2018, Internal Audit Report No. 19-507.

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, 2018, the Portfolio's book value was approximately \$1.7 billion. The Portfolio consists of two managed portfolios: liquid assets for OCTA's daily operations and a short-term portfolio for future budgeted expenditures. External investment managers administer the short term portfolio, and OCTA's Treasurer manages the liquid assets portfolio.

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 (Internal Audit). 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, 2018.

In reviewing the 2018 Fourth Quarter Investment and Debt Report (Report), Internal Audit found that the book value reported for the short-term portfolio was \$162,768 higher than the balances per the custodial bank statements. Starting in the fourth quarter 2018, staff had begun using Clearwater system balances to complete the Report, rather than the custodial bank statements. Differences between how Clearwater and the custodial bank value Treasury Inflation-Protected Securities investments attributed to the difference. Also contributing to the difference, Clearwater had posted a factor update to the value of one mortgage-backed security in late December, whereas the investment manager did not post the same factor update and notify the custodial bank until after January. The Accounting Department records securities based on the custodial bank statements; as such, the Report does not reflect amounts booked in the financial accounting system. In addition, the balance of bank deposits was overstated by \$17,996 on the Report when staff erroneously used the cash balance from the prior business day. Internal Audit recommended that additional training be provided on the preparation of investment worksheets and Reports. Also, Internal Audit recommended that Treasury use custodial statements as the basis for preparing the Reports or, if Clearwater book values are used for reporting, that reconciliations be performed and documented. Management responded that additional training has been provided and that, in the future, if Clearwater balances are used to prepare Reports, a reconciliation will be performed and documented.

In addition, Treasury did not monitor the ten percent threshold for asset-backed securities during the audit period. According to the Policy, asset-backed securities, excluding mortgages, may not exceed ten percent. In addition, several daily holding reports used to monitor investment manager compliance with investment thresholds did not evidence secondary review as required. Internal Audit recommended management implement controls to monitor the ten percent threshold for asset-backed securities and ensure secondary review of daily holding reports. Management agreed and indicated that monitoring controls are in place and secondary reviews are being performed as required.

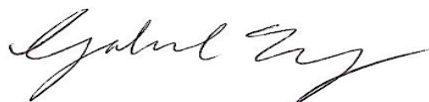
Summary

Internal Audit has completed an audit of investments for the period July 1 through December 31, 2018, and has offered two recommendations for improvement.

Attachment

- A. Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2018 Internal Audit Report No. 19-507

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