



April 26, 2017

To: Finance and Administration Committee

From: Darrell Johnson, Chief Executive Officer
Janet Sutter, Executive Director
Internal Audit

Subject: Investment Management Service Contracts, Internal Audit Report No. 17-504

Overview

The Internal Audit Department has completed an audit of Investment Management Service Contracts. Based on the audit, contract compliance and invoice review controls are generally adequate; however, several concerns were identified related to the procurement of treasury management software. Also, a recommendation was made to update agreements with investment managers.

Recommendation

Direct staff to implement two recommendations provided in Investment Management Service Contracts, Internal Audit Report No. 17-504.

Background

The Treasury/Public Finance Department (Treasury) is responsible for management of the Orange County Transportation Authority's (OCTA's) investment portfolio. On December 31, 2016, the investment portfolio's book value was approximately \$1.48 billion.

In April 2012, Treasury staff entered into an agreement with Clearwater Analytics, a web-based investment portfolio accounting and reporting tool for the purpose of automating the process of monitoring, reconciling, and reporting of the investment portfolio.

OCTA procurement policy and procedures (policies), approved by the Board of Directors (Board), include procurement approval thresholds, guidelines for issuance of requests for proposal (RFP), criteria for evaluating proposals, and rules for the conduct of procurement activities. Among these is a requirement to obtain Board approval for any contract exceeding \$250,000, or any amendment

exceeding 15 percent of contract value, or \$250,000, whichever is less. Guidelines require Contracts Administration and Materials Management (CAMP) administrators to include a cost and price form for bidders to complete as part of their proposal. Changes to the scope of work after issuance of an RFP are typically addressed as addendums to the RFP. Policies state that all contact with proposers during the solicitation, evaluation, negotiation, and award phases must be limited only to CAMP staff. Finally, CAMP generally uses standard contract templates that have been reviewed with legal counsel and risk management to ensure inclusion of appropriate clauses and insurance coverage requirements.

Discussion

The procurement process used to acquire treasury management software in 2011, did not comply with all policies. Further, staff issued the original contract and the first amendment to the contract just under the thresholds that would require Board approval. In addition, the Internal Audit Department (Internal Audit) noted several irregularities related to the initial procurement.

Specifically, the original procurement solicited proposals for a six-month term, with a budget of \$70,000. Staff eventually issued a five-year, \$250,000 contract to one of the proposing firms without amending or reissuing the RFP. Also, the selected firm submitted a proposal that was not in the format dictated by the RFP. Rather than finding the proposal non-responsive, staff developed an estimate of the annual cost for purposes of price comparison. A corresponding calculation and methodology used to arrive at the price estimate was not documented; however, it resulted in the selected firm receiving the highest score under the cost criterion. Finally, documentation on file reflects that the project manager engaged in direct negotiations with the selected firm.

During these direct negotiations, the project manager negotiated a lower contract cost over a five-year term in exchange for allowing the firm to use the OCTA logo for marketing purposes and to allow a case study to be completed within the first year of the contract. Currently, the vendor website includes a testimonial by the project manager.

Documentation on file reflects staff's estimate of the five-year total cost of the contract to be \$296,000, with notes outlining a four-year contract for \$250,000, and a one-year amendment of 15 percent; however, the contract was ultimately issued for \$250,000 for five years. In March 2016, the fourth year of the contract, staff issued an amendment to increase the contract value by 15 percent. This amendment proved to be insufficient, and two months later a second amendment was requested to increase the total maximum obligation to \$409,500. The second amendment was presented to the Board for approval, as required.

Internal Audit recommended management ensure compliance with procedures and adequate documentation be prepared and maintained to support methodologies for cost estimates and decisions made regarding acceptance of proposal deviations and reasons for changes to RFP scope that do not result in an amended or reissued RFP. In addition, Internal Audit noted that the value of cost estimates should translate to contract value. Finally, Internal Audit recommended management consider developing a policy with guidelines for the use of OCTA's logo by vendors, staff-provided testimonials, or staff participation in vendor case studies for marketing purposes. Management agreed and indicated that requirements will be re-enforced with staff, and justification for decisions, along with the method for calculating final pricing, will be documented and on file. Management also agreed to consider developing a policy with guidelines for the use of OCTA's logo by vendors, staff-provided testimonials, or staff participation in studies for marketing purposes.

In addition, Internal Audit found that evergreen contracts with State Street Global Advisors, Western Asset Management Company, and J.P. Morgan do not include standard provisions such as insurance requirements, a right to audit clause, and identification of key personnel. Internal Audit recommended management review and update the agreements to include appropriate and applicable contract clauses. Management agreed and indicated that the agreements will be updated.

Summary

Internal Audit has completed an audit of Investment Management Service Contracts.

Attachment

- A. Investment Management Service Contracts, Internal Audit Report No. 17-504

Prepared by:



Gabriel Tang
Principal Internal Auditor
714-560-5746

Approved by:



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