

# Internal Audit Department

O R A N G E C O U N T Y  
6<sup>th</sup> Largest County in the USA

## REQUIRED ANNUAL EXAMINATION OF THE TREASURER'S INVESTMENT COMPLIANCE WITH GOVERNMENT CODE AND COUNTY INVESTMENT POLICIES

For the Year Ended  
December 31, 2013

### Critical Impact

Investments held at Fair Value by the  
Treasurer at December 31, 2013 were  
\$7.797 billion.

The purpose of this examination is to help provide assurance to the Board of Supervisors that the Treasurer has purchased only those high quality and safe investments allowed by the State of California and the County's Investment Policy as approved by the Board of Supervisors.

Our examination was conducted in accordance with the attestation standards established by the American Institute of Certified Public Accountants.

In our opinion, the Orange County Treasurer complied in all material respects with selected investment regulations of the California Government Code and the Orange County Treasurer Investment Policy Statement for the year ended December 31, 2013.

Our examination disclosed one (1) deficiency in internal control over compliance where subsequent corrective actions were put in place to prevent further non-compliance.

AUDIT NO: 1314  
REPORT DATE: SEPTEMBER 10, 2014

**Director:** Dr. Peter Hughes, MBA, CPA, CIA  
**Senior Audit Manager:** Alan Marcum, CPA, CIA  
**Audit Manager In-Charge:** Lisette Free, CPA, CFE  
**Audit Manager:** Michael Dean, CPA, CIA

### RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010, 2013



American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management



2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays



2008 Association of Local Government Auditors' Bronze Website Award



2005 Institute of Internal Auditors' Award for Recognition of Commitment to Professional Excellence, Quality, and Outreach



ORANGE COUNTY BOARD OF SUPERVISORS'  
**Internal Audit Department**

*GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010, 2013*

*Providing Facts and Perspectives Countywide*

**RISK BASED AUDITING**

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OC Internal Audit Department, visit our website: [www.ocgov.com/audit](http://www.ocgov.com/audit)



**OC Fraud Hotline (714) 834-3608**



## Transmittal Letter



**Audit No. 1314 September 10, 2014**

**TO:** Members, Treasury Oversight Committee

**FROM:** Dr. Peter Hughes, CPA, Director  
Internal Audit Department

**SUBJECT:** Required Annual Examination of the Treasurer's  
Investment Compliance with Government Code and  
County Investment Policies

At the direction of the Board of Supervisors, we have completed our fifth annual compliance attestation engagement of the County's Investment Pool since the Treasury Oversight Committee decided to contract with an outside auditing firm in 2004. This annual examination is required by California Government Code 27134. Our examination disclosed one (1) deficiency in internal control over compliance where subsequent corrective actions were put in place to prevent further non-compliance. Our report on the Annual Examination of the Treasurer's Investment Compliance for the year ended December 31, 2013 is attached for your review.

Each month I submit an **Audit Status Report** to the BOS where I detail any audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

Please feel free to call me should you wish to discuss any aspect of our audit report. Additionally, we will request your department complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

### ATTACHMENTS

Other recipients of this report are listed on the **Independent Accountant's Report** on page 2.

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Compliance with Government Code and  
County Investment Policies  
Audit No. 1314*

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## INDEPENDENT ACCOUNTANT'S REPORT

September 10, 2014

Audit No. 1314

William "Andy" Dunn, Chair, Public Member  
Treasury Oversight Committee  
625 North Ross Street, Building 11  
Santa Ana, California 92701

We have examined the Orange County Treasurer's compliance with California Government Code Sections 27130 through 27137 and related provisions of the Orange County Investment Policy Statement for the Money Market and the Extended Funds for the year ended December 31, 2013. In addition, we examined compliance with certain requirements contained within the Resolution for the Establishment of the Treasury Oversight Committee, Bylaws and Rules of Procedures of the Treasury Oversight Committee, and County policies and procedures. The Orange County Treasurer's management is responsible for compliance with those requirements. Our responsibility is to express an opinion on the Orange County Treasurer's compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about the Orange County 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 Orange County Treasurer's compliance with specified requirements.

Our examination includes consideration of internal control over compliance as a basis for designing our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of the Treasurer's internal control. Accordingly, we do not express an opinion on the effectiveness of the Treasurer's internal control.

A **deficiency in internal control** over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement on a timely basis. A **significant deficiency** in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. A **material weakness** in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the third paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

# Independent Accountant's Report



However, we identified one (1) deficiency in internal control over compliance that could be improved as shown in the accompanying schedule of Detailed Results, Findings, Recommendations and Management Responses.

In our opinion, the Orange County Treasurer complied, in all material respects, with the aforementioned requirements for the year ended December 31, 2013.

This report is intended solely for the information and use of the Orange County Treasurer-Tax Collector and County Treasury Oversight Committee and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

Respectfully Submitted,

A handwritten signature in blue ink that reads "Peter Hughes".

Dr. Peter Hughes, CPA, Director  
Internal Audit Department

## **Members, Treasury Oversight Committee Distribution:**

Hon. Dr. Al Mijares, County Superintendent, OC Department of Education  
Jan Grimes, Auditor-Controller  
Michael B. Giancola, County Executive Officer  
Laura Parisi, CPA, Public Member  
Gary Capata, CPA, Public Member

## **Distribution Pursuant to Audit Oversight Committee Procedure No. 1:**

Members, Board of Supervisors  
Members, Audit Oversight Committee  
Shari L. Freidenrich, Treasurer-Tax Collector  
Paul C. Gorman, Chief Assistant Treasurer-Tax Collector  
JC Squires, Financial Manager, Treasurer-Tax Collector  
Ginika Ezinwa, Accounting/Compliance Manager, Treasurer-Tax Collector  
Michael B. Giancola, County Executive Officer  
Mark Denny, Chief Operating Officer  
Frank Kim, Chief Financial Officer  
Foreperson, Grand Jury  
Susan Novak, Clerk of the Board of Supervisors  
Macias Gini & O'Connell LLP, County External Auditor



## COUNTY OF ORANGE SUMMARY OF INVESTMENT COMPLIANCE REQUIREMENTS For Year Ended December 31, 2013

The investment compliance requirements in California Government Code Sections 27130 through 27137 and related provisions of the Orange County Investment Policy Statement are as follows:

### California Government Code Sections 27130 through 27137

1. Section 27130  
The Legislature finds and declares that local agencies, including school districts, should participate in reviewing the policies that guide the investment of those funds.
2. Section 27131  
The Board of Supervisors in each county may, if the county is investing surplus funds, establish a county treasury oversight committee that consists of from three to eleven members.
3. Section 27132  
The county treasury oversight committee shall consist of members appointed from the following: county treasurer; county auditor, auditor-controller or finance director; a representative appointed by the county board of supervisors; the county superintendent of schools or designee; a 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 an academic background in finance and are economically diverse and bipartisan in political registration.
4. Section 27132.1  
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.
5. Section 27132.2  
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.
6. Section 27132.3  
Committee members may not secure employment with bond underwriters, bond counsel, security brokerages or dealers, or with financial services firms with whom the treasurer is doing business during the period that the person is a member of the committee or for one year after leaving the committee.
7. Section 27132.4  
Committee meetings shall be open to the public and subject to the Ralph M. Brown Act.





8. Section 27133

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 all of the following:

- a. A list of securities or other instruments in which the county treasury may invest, according to law, including the maximum allowable percentage by type of security.
- b. The maximum term of any security purchased by the county treasury.
- c. The criteria for selecting security brokers and dealers from, to, or through whom the county treasury may purchase or sell securities or other instruments. The criteria shall prohibit the selection of any broker, brokerage, dealer, or securities firm that has, within any consecutive 48-month period following January 1, 1996, made a political contribution in an amount exceeding the limitations contained in Rule G-37 of the Municipal Securities Rulemaking Board, to the local treasurer, any member of the governing board of the local agency, or any candidate for those offices.
- d. Limits on the receipt of honoraria, gifts, and gratuities from advisors, brokers, dealers, bankers, or other persons with whom the county treasury conducts business by any member of the county treasury oversight committee. These limits may be in addition to the limits set by a committee member's own agency, by state law, or by the Fair Political Practices Commission.
- e. A requirement that the county treasurer provide the county treasury oversight committee with an investment report as required by the board of supervisors.
- f. The manner of calculating and apportioning the costs, authorized by Section 27013, of investing, depositing, banking, auditing, reporting, or otherwise handling or managing funds.
- g. The terms and conditions under which local agencies and other entities that are not required to deposit their funds in the county treasury may deposit funds for investment purposes.
- h. Criteria for considering requests to withdraw funds from the county treasury, pursuant to Section 27136. The criteria shall include an assessment of the effect of a proposed withdrawal on the stability and predictability of the investments in the county treasury.

9. Section 27134

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 California Government Code Sections 27130 through 27137. The audit may include issues relating to the structure of the investment portfolio and risk.

10. Section 27135

The costs of complying with this article shall be county charges and may be included with those charges enumerated under Section 27013.





## 11. Section 27136

- a. Notwithstanding any other provision of law, any local agency, public agency, public entity, or public official that has funds on deposit in the county treasury pool and that seeks to withdraw funds for the purpose of investing or depositing those funds outside the county treasury pool, shall first submit the request for withdrawal to the county treasurer before withdrawing funds from the county treasury investment pool.
- b. The county treasurer shall evaluate each proposed withdrawal for its consistency with the criteria adopted pursuant to subdivision (h) of 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.

## 12. Section 27137

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.

## Orange County Investment Policy Statement

1. Investments maintained in the portfolios shall be consistent with those authorized per Government Code Sections 53601 et seq., and 53635, as stated in IPS Sections VI and VII.
2. Investments maintained in the portfolios shall comply with investment criteria as stated in IPS Sections VI, VII and VIII, including the maximum allowable percentage by type of security, allowable percentage per issuer, maximum term limits and credit ratings requirements.
3. 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 X.
4. All security transactions must be executed through brokers/dealers and financial institutions that meet the selection criteria specified in IPS Section XI and are placed on the list of qualified institutions.
5. All security transactions entered into by the Treasurer shall be conducted on a delivery-versus payment basis and a third party custodian, as stated in IPS Section XIII, shall hold securities.
6. 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 than weekly. Collateral is to be held by an independent third party with whom the treasurer has a current custodial agreement. Evidence of ownership must be supplied to the Treasurer and retained, as stated in IPS Section VI.
7. 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 XVI.



8. 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 XVII.
9. 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 XVIII.
10. The Treasurer shall provide a monthly report and any audit report in accordance with Government Code Sections 53646 and 53686, as stated in IPS Section XXI.



## BACKGROUND

California Government Code Sections 27000.1, 27000.3, and 53600.3 grant a county board of supervisors, not a county treasurer, with authority for investing public funds. Thus, under California law, county boards of supervisors generally have primary responsibility for investment of public funds in a county treasury. The authority of the board to invest or reinvest funds deposited in a county treasury may be delegated to an individual or a fund manager for a one-year period by the Board of Supervisors. Subject to review, such a delegation may be renewed annually (Government Code Section 53607). It is common practice for the Board of Supervisors for counties in the State to delegate its investment responsibility to elected and appointed county treasurers.

California Government Code Section 27133 requires the Treasurer to prepare an annual investment policy statement. The County's Investment Policy Statement (IPS) is reviewed by the County's Treasury Oversight Committee (TOC) and approved by the Board of Supervisors on an annual basis. The IPS, to the extent consistent with the restrictions of state law, establishes the legal parameters by which the Treasurer, or other qualified party to which investment authority is delegated, may invest monies deposited and held within the County treasury.

Specifically the IPS maybe more conservative/restrictive than Government Code as regards to the quality and corresponding safety of the types of investment instruments and holdings that the Treasurer may purchase.

Historically, the Board of Supervisors performs an annual review of the Treasurer's performance and has delegated its investment authority to the County Treasurer. The most recent renewal of investment authority was February 4, 2014 for calendar year 2014.

On February 2, 2010, the Board of Supervisors directed the Internal Audit Department to conduct this examination to determine whether the treasury investments complied with both applicable California law and the IPS for the years ended December 31, 2009, 2010, and 2011, with a two-year renewal option.

The Treasurer-Tax Collector exercised the renewal option for a two-year term for the years ended December 31, 2012 and 2013. This examination represents the OC Internal Audit Department's **fifth annual** compliance examination of the County's Investment Pool on this contract.

## TREASURY OVERSIGHT COMMITTEE

California Government Code Section 27131 states that the Board of Supervisors in each county may, if the county is investing surplus funds, establish a county treasury oversight committee that shall consist of from three to eleven members. The County of Orange Board of Supervisors established the treasury oversight committee that consists of the following: the elected Auditor-Controller or designee, the Board appointed County Executive Officer or designee, County Superintendent of Schools or designee, and two (2) Public Members.



## **Finding No. 1 – The Treasurer-Tax Collector Purchased an Investment (Repurchase Agreement) from a Non-Authorized Issuer without a Master Repurchase Agreement in place. Non-Compliance with Section VI – AUTHORIZED INVESTMENTS and Section VIII – DIVERSIFICATION AND MATURITY RESTRICTIONS**

### **CRITERIA**

IPS Section VIII – DIVERSIFICATION AND MATURITY RESTRICTIONS states that “Only debt issued by firms listed on the Approved Issuer List may be purchased.” IPS Section VI – AUTHORIZED INVESTMENTS states that “To participate in repurchase agreements, a master repurchase agreement must be completed and signed by all parties involved.”

### **EXCEPTION NOTED**

We were informed by Treasurer-Tax Collector management, and subsequently confirmed that due to excess cash on hand, Wells Fargo Bank reinvested Treasurer-Tax Collector funds into a repurchase agreement which matured the following day. Wells Fargo Bank was not on the Approved Issuer List and the Treasurer-Tax Collector did not have a Master Repurchase Agreement in place with Wells Fargo.

This issue was reported by the Treasurer in its December 2013 Monthly Investment Report. As a result of this occurrence, the Treasurer-Tax Collector terminated its sweep agreement with Wells Fargo Bank in April 2014 which eliminated the possibility of a recurrence of this non-compliance incident.

### **Recommendation No. 1**

Although the Treasurer-Tax Collector purchased an investment from a non-authorized issuer without a Master Repurchase Agreement in place during the year under review, the Treasurer-Tax Collector subsequently terminated its sweep agreement with Wells Fargo Bank to eliminate the possibility of recurrence of this non-compliance incident. Therefore, no further action is required.