

Internal Audit Department

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

ANNUAL AUDIT OF TREASURER'S INVESTMENT COMPLIANCE

For the Year Ended
December 31, 2010

Critical
Impact
Audit

INVESTMENTS HELD AT FAIR VALUE BY
THE TREASURER AT DECEMBER 31, 2010
WERE \$7.28 BILLION.

In our opinion, the Orange County Treasurer complied in all material respects with the selected investment regulations of the California Government Code and the Orange County Treasurer Investment Policy Statement (IPS) for the year ended December 31, 2010.

Our examination disclosed **four (4) recommendations** where compliance and internal controls over compliance could be improved.

AUDIT NO: 1013
REPORT DATE: MAY 7, 2012

Director: Dr. Peter Hughes, MBA, CPA, CIA
Deputy Director: Eli Littner, CPA, CIA
Senior Audit Manager: Alan Marcum, CPA, CIA
Senior Internal Auditor: Lisette Free, CPA, CFE
Audit Intern: Michael Steinhaus

RISK BASED AUDITING

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



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 to IAD 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

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

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 Certified Information Technology Professional (CITP)
 Certified Internal Auditor (CIA)
 Certified Fraud Examiner (CFE)
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 OC Internal Audit Department, visit our website: www.ocgov.com/audit



OC Fraud Hotline (714) 834-3608



Transmittal Letter



Audit No. 1013 May 7, 2012

TO: Members, Treasury Oversight Committee

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

SUBJECT: Annual Audit of Treasurer's Investment
Compliance for Year Ended December 31, 2010

At the direction of the Board of Supervisors, we have completed our second 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 report is the second annual compliance attestation engagement since the Board of Supervisors revoked the investment authority of the elected County Treasurer-Tax Collector, Chriss W. Street, on March 16, 2010, and directed the County's Deputy CEO/Chief Financial Officer, Robert Franz, to manage the investment pools. On November 2, 2010, a new County Treasurer-Tax Collector, Shari L. Freidenrich, was elected, and on December 14, 2010, the Board of Supervisors delegated the Board's investment authority to the new County Treasurer-Tax Collector, effective January 14, 2011.

It is important to note that our engagement covered the calendar year, January 1, 2010 through December 31, 2010. Investment decisions from January 1, 2010 through March 15, 2010 were executed under the delegated authority of the elected County Treasurer-Tax Collector, Chriss W. Street. Investment decisions from March 16, 2010 through December 31, 2010 were executed under the authority of the County's Deputy CEO/Chief Financial Officer, Robert Franz.

Attached is a copy of our report on the Annual Audit of Treasurer's Investment Compliance for the year ended December 31, 2010. Our examination disclosed four (4) recommendations where compliance and internal controls over compliance could be improved.

Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant 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.

Additionally, we will request that the Treasurer-Tax Collector complete a Customer Survey of Audit Services. The Treasurer-Tax Collector will receive the survey shortly after the distribution of our final report.

Attachments

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

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Investment Compliance
Audit No. 1013*

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Independent Auditor's Report



INDEPENDENT AUDITOR'S REPORT

May 7, 2012

Audit No. 1013

Chair, Treasury Oversight Committee
625 North Ross Street, Building 11
Santa Ana, California 92701

We have examined the Orange County Treasurer's compliance with the 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, 2010. 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 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 Auditor's Report



We did not identify any deficiencies in internal control that we consider to be material weaknesses or a significant deficiency, as defined above. However, we identified areas where compliance and internal controls over compliance could be improved as shown in the accompanying schedule of Detailed 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, 2010.

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. William Habermehl, County Superintendent, OC Department of Education
Jan Grimes, Chief Deputy Auditor-Controller
Thomas G. Mauk, County Executive Officer
George Jeffries, Public Member
William "Andy" Dunn, Public Member

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Robert J. Franz, Deputy CEO/Chief Financial Officer
Shari L. Freidenrich, Treasurer-Tax Collector
Paul C. Gorman, Chief Assistant Treasurer-Tax Collector
Foreperson, Grand Jury
Susan Novak, Clerk of the Board of Supervisors



COUNTY OF ORANGE SUMMARY OF INVESTMENT COMPLIANCE REQUIREMENTS For Year Ended December 31, 2010

The investment compliance requirements in the 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 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 the 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

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 VI and VII.
14. 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.
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 X.
16. 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.
17. 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.
18. 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.

Independent Auditor's Report



19. 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.
20. 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.
21. 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.
22. 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 for a one-year period by the board. 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.

California law requires the Treasurer to prepare an annual investment policy statement. The County's Investment Policy Statement (IPS) is reviewed and approved by the County's Treasury Oversight Committee (TOC) and 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.

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 January 10, 2012 for calendar year 2012.

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 ending December 31, 2009, 2010, and 2011. As the public stewards of over \$7 billion of taxpayers' monies, compliance with the County's IPS is of the highest priority for the Board of Supervisors. We are reminded that in 1995, a former Treasurer, unbeknownst to the Board of Supervisors, invested billions of County funds into extremely high risk and prohibited securities that resulted in a \$1.6 billion loss. The importance of having the Treasurer's office establish and practice sound internal controls ensures that the Treasurer's office is in full compliance with the applicable California Government Code and the IPS.

On March 16, 2010, the Board of Supervisors revoked its investment authority from the County Treasurer-Tax Collector, Chriss W. Street, and directed the County Chief Financial Officer to exercise the Board of Supervisors' investment authority.

On November 2, 2010, a new County Treasurer-Tax Collector, Shari L. Freidenrich, was elected; and on December 14, 2010 the Board of Supervisors delegated investment authority, effective January 14, 2011, to the new County Treasurer-Tax Collector.

This examination represents the OC Internal Audit Department's second annual compliance examination of the County's Investment Pool since the Treasury Oversight Committee recommended the selection of an external auditing firm in 2004.



TREASURER'S 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 consists of from three to eleven members. The County of Orange Board of Supervisors established the treasury oversight committee that consists of the following: Auditor-Controller or designee, County Executive Officer or designee, County Superintendent of Schools or designee, and two (2) Public Members.

Detailed Findings, Recommendations, and Management Responses



1. Finding No. 1 – Amendments to the Treasury Oversight Committee Bylaws and Rules of Procedures Were Not Forwarded to the Board of Supervisors for Approval in a Timely Manner – Noncompliance with the Bylaws and Rules of Procedures of the County of Orange Treasury Oversight Committee Section VI – Miscellaneous Provisions

CRITERIA:

The Bylaws and Rules of Procedures of the County of Orange Treasury Oversight Committee (TOC), Section VI – Miscellaneous Provisions, establish under Rule 30 that the Rules are effective upon approval by the Board of Supervisors and are subject to amendment by the Committee, as appropriate for the efficient functioning of the Committee, to implement changes by the Board of Supervisors and to comply with the statutory and other legal requirements. In addition, Rule 31 requires that at any meeting, but not less frequently than the last meeting of each calendar year, the Committee shall review, discuss and approve any changes or amendments to the Bylaws and Rules of Procedures. Should any changes or amendments be approved by the Committee, such changes or amendments shall be presented to the Board of Supervisors for approval.

EXCEPTION NOTED:

On January 27, 2010, the Treasury Oversight Committee reviewed, discussed and approved changes/amendments to the Bylaws and Rules of Procedures of the County of Orange Treasury Oversight Committee as required. However, the Treasurer-Tax Collector (T-TC) presented the revised Bylaws and Rules of Procedures of the County of Orange Treasury Oversight Committee to the BOS on April 19, 2011 (fifteen (15) months after TOC's approval). The BOS approved the revised Bylaws and Rules of Procedures on April 19, 2011.

Recommendation No. 1

We recommend that the Treasurer-Tax Collector (T-TC) ensure changes/amendments to the Bylaws and Rules of Procedures of the County of Orange Treasury Oversight Committee are forwarded to the BOS for approval in a timely manner.

Treasurer-Tax Collector Response

Concur. The Treasurer-Tax Collector has implemented a new Administration Section in the Investment Policy Compliance Summary chart included in the Treasurer's Monthly Investment Report. The Administration Section will include a new line item to report on "TOC Bylaws Changes - Board of Supervisor's Approval". In addition this has been added to the Treasurer's Treasury Oversight Committee (TOC) Procedures. (The changes to the Bylaws made at the TOC meeting on October 26, 2011 were approved by the Board of Supervisors on January 10, 2012.)

2. Finding No. 2 – Treasurer-Tax Collector Review of Qualified Institutions was not Complete and Approved In a Timely Manner – Noncompliance with IPS Section XI – AUTHORIZED FINANCIAL DEALERS AND QUALIFIED INSTITUTIONS

CRITERIA:

IPS Section XI – AUTHORIZED FINANCIAL DEALERS AND QUALIFIED INSTITUTIONS requires that the Treasurer maintain a list of broker/dealers (Qualified Institutions) authorized to provide investment products to the Treasury. Any permitted investment, not purchased directly from the issuer, is required to be purchased either from a "primary" or

Detailed Findings, Recommendations, and Management Responses



regional broker/dealer qualifying under SEC Rule 15c3-1 (Uniform Net Capital Rule) or a “well capitalized” financial institution, as defined in Title 12 of the Code of Federal Regulations (CFR) Part 6.4. Qualified institutions must comply with the limitations contained in Rule G-37 of the Municipal Securities Rulemaking Board, Section 27133(c). The Treasury is required to make a best effort to conduct an annual review of each Qualified Institution’s financial condition and registrations to determine whether it should remain on the approved list.

Under *Rule G-37 of the Municipal Securities Rulemaking Board (MSRB)*, guidelines are provided to ensure that the standards and integrity of the municipal securities industry are maintained to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to perfect a free and open market, and to protect investors and the public interest. *Rule G-37 of the MSRB*: (a) prohibits brokers, dealers and municipal securities dealers from engaging in municipal securities business with issuers if certain political contributions have been made to officials of such issuers; and (b) requires brokers, dealers and municipal securities dealers to disclose certain political contributions, as well as other information, to allow public scrutiny of political contributions and the municipal securities business of a broker, dealer or municipal securities dealer.

In addition, *Rule G-37* requires all brokers, dealers and municipal securities dealers, by the last day of the month following the end of each calendar quarter, send to the MSRB disclosure for contributions to officials of issuers and payments to political parties of states and political subdivisions. Contributions are any gift, subscription, loan, advance, or deposit of money or anything of value made for the purpose of influencing any election for federal, state or local office, for payment of debt incurred in connection with any such election, or for transition or inaugural expenses incurred by the successful candidate for state or local office. The MSRB makes public a copy of each disclosure for contributions received from any broker, dealer or municipal securities dealer.

EXCEPTIONS NOTED:

During the most recent review of authorized financial dealers and qualified institutions:

- A. The broker dealer annual reviews were not completed on an annual basis. The two most recent reviews were completed in January 2010 and December 2011 (23 months).
- A. Broker Dealer Annual Review policies and procedures were updated on April 27, 2011; however, the policies and procedures should document the steps to be taken in the event of the financial dealers and/or qualified institutions noncompliance.

Recommendation No. 2

We recommend that the Treasurer-Tax Collector ensure the review of financial dealers and qualified institutions by staff is performed and approved in a timely manner and the policies and procedures are revised to include the steps to be taken in the event of noncompliance.

Treasurer-Tax Collector Response

Concur. The written procedure for the review of authorized dealers and qualified institutions has been updated to include steps to be taken in the event of noncompliance and the required supervisory review/approval by the Assistant Treasurer-Tax Collector. The broker dealer annual review for the year ended December 31, 2010 was completed and reviewed by the Assistant Treasurer-Tax Collector on December 20, 2011.

Detailed Findings, Recommendations, and Management Responses



In compliance with the Investment Policy Statement (IPS), approved by the BOS on January 10, 2012, the Treasurer shall conduct an annual review of each Qualified Institution's financial condition and registrations to determine whether it should remain on the approved list and require annual audited financial statements to be on file for each company. This has been added to Investment Policy Compliance Summary chart included in the Treasurer's Monthly Investment Report.

3. Finding No. 3 – Investment Policy Statement is Less Restrictive than Government Code Section 53601(h)

CRITERIA:

Government Code Section 53601(h) requires that the entity that issues commercial paper be **organized and operating in the United States** as a general corporation and has total assets in excess of five hundred million dollars (\$500,000,000) or be organized and operating in the United States as a special purpose corporation, trust, or limited liability company.

EXCEPTIONS NOTED:

The IPS, Section VI, Authorized Investments is less restrictive than the Government Code for issuers of commercial paper for the Extended Fund, which requires issuers to be a corporation with total assets in excess of five hundred million dollars (\$500,000,000), or be organized within the US as a special purpose corporation, trust, or limited liability company.

For investment purchases selected for testing, we did not note any instances of issuers of commercial paper that were not organized and operating in the United States.

Recommendation No. 3

We recommend the Treasurer-Tax Collector amend the Investment Policy Statement to ensure compliance with the Government Code. In addition, the revised Investment Policy Statement should be submitted to the Treasury Oversight Committee and Board of Supervisors for review and approval.

Treasurer-Tax Collector Response

Concur. The Treasurer-Tax Collector revised the IPS to be in compliance with California Government Code 53601(h), submitted the IPS for review to the Treasury Oversight Committee on October 26, 2011, and the Board of Supervisors approved the revised IPS at their regular meeting on January 10, 2012. The IPS annual approval requirement has been added to the Investment Policy Compliance Summary chart included in the Treasurer's Monthly Investment Report.

4. Finding No. 4 – Internal Controls Over Issuer Analyses Needs Improvement

EXCEPTIONS NOTED:

The Treasurer-Tax Collector performs analyses of issuers prior to adding them to the approved issuer listing for commercial paper and medium term notes. The issuer analyses performed by Treasurer-Tax Collector should include direct correlation with compliance requirements of the Government Code and Investment Policy Statement. We noted issuer analyses performed does not document the type of organization (whether it is organized and operating in the United States as a general corporation, special purpose

Detailed Findings, Recommendations, and Management Responses



corporation, trust or limited liability company), whether total assets are in excess of five hundred million (\$500,000,000), and/or whether the program has wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or a surety bond to ensure compliance with the Investment Policy Statement and the Government Code.

In addition, the analysis is performed prior to an issuer being added to the authorized issuer listing; however, continuous compliance review is not performed. The issuer should be reviewed periodically to ensure continuous compliance.

CRITERIA:

Government Code Section 53601(h) requires commercial paper to be of "prime" quality of the highest ranking or of the highest letter and number rating as provided for by a nationally recognized statistical rating organization (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions in either paragraph (1) or (2):

- (1) The entity meets the following criteria:
 - (A) Is organized and operating in the United States as a general corporation.
 - (B) Has total assets in excess of five hundred million dollars (\$500,000,000).
 - (C) Has debt other than commercial paper, if any, that is rated "A" or higher by an NRSRO.
- (2) The entity meets the following criteria:
 - (A) Is organized within the United States as a special purpose corporation, trust, or limited liability company.
 - (B) Has program wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or a surety bond.
 - (C) Has commercial paper that is rated "A-1" or higher, or the equivalent, by an NRSRO.

Government Code Section 53601(k) requires medium-term notes, defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States. Notes eligible for investment under this subdivision shall be rated "A" or better by an NRSRO. Purchases of medium-term notes shall not include other instruments authorized by this section and may not exceed 30 percent of the agency's moneys that may be invested pursuant to this section.

Recommendation No. 4

We recommend Treasurer-Tax Collector amends its issuer analyses process to include a direct correlation with compliance requirements in the Government Code and Investment Policy Statement.

Treasurer-Tax Collector Response

Concur. The Treasurer-Tax Collector has amended its issuer analyses process to document a direct correlation with compliance requirements in the Investment Policy Statement and the Government Code. The Treasurer-Tax Collector has implemented a weekly Investment Credit Committee meeting and the issuers are monitored daily. In addition, a formal review process of issuers is now performed on a quarterly basis.

Detailed Findings, Recommendations, and Management Responses



ATTACHMENT A: Treasurer-Tax Collector/Treasury Oversight Committee Responses



**OFFICE OF THE TREASURER-TAX COLLECTOR
SHARI L. FREIDENRICH, C.P.A.**

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INTERDEPARTMENTAL COMMUNICATION

TO: Dr. Peter Hughes, MBA, CPA, CIA, Internal Audit Director
FROM: Shari L. Freidenrich, CPA, CCMT, CPFA, CPFIM
DATE: April 30, 2012
SUBJECT: Response to Draft Report on the Annual Audit of Treasurer's Investment Compliance for the Year Ended December 31, 2010

Finding No. 1 – Amendments to the Treasury Oversight Committee Bylaws and Rules of Procedures Were Not Forwarded to the Board of Supervisors for Approval in a Timely Manner – Noncompliance with the Bylaws and Rules of Procedures of the County of Orange Treasury Oversight Committee Section VI –Miscellaneous Provisions

Recommendation No. 1

We recommend that the Treasurer-Tax Collector (T-TC) ensure changes/amendments to the Bylaws and Rules of Procedures of the County of Orange Treasury Oversight Committee are forwarded to the BOS for approval in a timely manner.

**Treasurer-Tax Collector Response to Recommendation No. 1
Concur.**

The Treasurer-Tax Collector has implemented a new Administration Section in the Investment Policy Compliance Summary chart included in the Treasurer's Monthly Investment Report. The Administration Section will include a new line item to report on "TOC Bylaws Changes – Board of Supervisor's Approval". In addition this has been added to the Treasurer's Treasury Oversight Committee (TOC) Procedures. (The changes to the Bylaws made at the TOC meeting on October 26, 2011 were approved by the Board of Supervisors on January 10, 2012.)

Finding No. 2 – Treasurer-Tax Collector Review of Qualified Institutions was not Complete and Approved In a Timely Manner – Noncompliance with IPS Section XI – AUTHORIZED FINANCIAL DEALERS AND QUALIFIED INSTITUTIONS

Recommendation No. 2

We recommend that the Treasurer-Tax Collector ensure the review of financial dealers and qualified institutions by staff is performed and approved in a timely manner and the policies and procedures are revised to include the steps to be taken in the events of noncompliance.

Detailed Findings, Recommendations, and Management Responses



ATTACHMENT A: Treasurer-Tax Collector/Treasury Oversight Committee Responses (continued)

Treasurer-Tax Collector Response to Recommendation No. 3 Concur.

The written procedure for the review of authorized dealers and qualified institutions has been updated to include steps to be taken in the event of noncompliance and the required supervisory review/approval by the Assistant Treasurer-Tax Collector. The broker dealer annual review for the year ended December 31, 2010 was completed and reviewed by the Assistant Treasurer-Tax Collector on December 20, 2011. In compliance with the Investment Policy Statement (IPS), approved by the BOS on January 10, 2012, the Treasurer shall conduct an annual review of each Qualified Institution's financial condition and registrations to determine whether it should remain on the approved list and require annual audited financial statements to be on file for each company. This has been added to Investment Policy Compliance Summary chart included in the Treasurer's Monthly Investment Report.

Finding No. 3 – Investment Policy Statement is Less Restrictive than Government Code Section 53601(h)

Recommendation No. 3

We recommend the Treasurer-Tax Collector amend the Investment Policy Statement to ensure compliance with the Government Code. In addition, the revised Investment Policy Statement should be submitted to the Treasury Oversight Committee and Board of Supervisors for review and approval.

Treasurer-Tax Collector Response to Recommendation No. 3 Concur.

The Treasurer-Tax Collector revised the IPS to be in compliance with California Government Code 53601(h), submitted the IPS for review to the Treasury Oversight Committee on October 26, 2011, and the Board of Supervisors approved the revised IPS at their regular meeting on January 10, 2012. The IPS annual approval requirement has been added to the Investment Policy Compliance Summary chart included in the Treasurer's Monthly Investment Report.

Finding No. 4 – Internal Controls Over Issuer Analyses Needs Improvement

Recommendation No. 4

We recommend Treasurer-Tax Collector amends its issuer analyses process to include a direct correlation with compliance requirements in the Government Code and Investment Policy Statement.

Treasurer-Tax Collector Response to Recommendation No. 4 Concur.

The Treasurer-Tax Collector has amended its issuer analyses process to document a direct correlation with compliance requirements in the Investment Policy Statement and the Government Code. The Treasurer-Tax Collector has implemented a weekly Investment Credit Committee meeting and the issuers are monitored daily. In addition, a formal review process of issuers is now performed on a quarterly basis.