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**TRANSMITTAL LETTER**

**March 17, 2014**

**Audit No. 1118**

TO: Members, Board of Supervisors  
Chair Shawn Nelson, 4<sup>th</sup> District Supervisor  
Vice Chair Patricia C. Bates, 5<sup>th</sup> District Supervisor  
Supervisor Janet Nguyen, 1<sup>st</sup> District  
Supervisor John M. W. Moorlach, 2<sup>nd</sup> District  
Supervisor Todd Spitzer, 3<sup>rd</sup> District

SUBJECT: Report on Audit of the Schedule of Assets Held by the County Treasury, as of June 30, 2013 and related Independent Auditor's Report

Macias Gini & O'Connell LLP (MGO) has completed the Audit of the Schedule of Assets held by the County Treasury as of June 30, 2013. MGO has also completed the Internal Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*. Attached are copies of these reports.

Jan E. Grimes  
Auditor-Controller

Enclosure

Other recipients of this report:

Members, Audit Oversight Committee  
Members, Treasury Oversight Committee  
Shari L. Freidenrich, Treasurer-Tax Collector  
Michael B. Giancola, County Executive Officer  
Frank Kim, Chief Financial Officer  
Paul C. Gorman, Chief Assistant Treasurer-Tax Collector  
Denise Steckler, Chief of Staff, Auditor-Controller  
Victoria Ross, Chief Deputy Auditor-Controller, Central Accounting Operations  
Susan Novak, Clerk of the Board of Supervisors

Members, Board of Supervisors  
March 17, 2014

Foreperson, Grand Jury  
Peter Hughes, Director, Internal Audit Department

**ORANGE COUNTY TREASURY**

**Report of the Schedule of Assets  
Held by the County Treasury**

**As of June 30, 2013**



**ORANGE COUNTY TREASURY**  
**Report of the Schedule of Assets Held by the County Treasury**  
**As of June 30, 2013**

**TABLE OF CONTENTS**

	<i>Page</i>
<b>Independent Auditor's Report</b> .....	1
 <b>Financial Schedule</b>	
Schedule of Assets Held by the County Treasury as of June 30, 2013.....	3
Notes to the Financial Schedule.....	5
 <b>Other Report</b>	
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> .....	15

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## INDEPENDENT AUDITOR'S REPORT

The Honorable Board of Supervisors  
County of Orange, California

### Report on the Financial Schedule

We have audited the accompanying Schedule of Assets Held by the County Treasury (Schedule) of County of Orange, California (County), as of June 30, 2013, and the related notes to the financial schedule, as listed in the table of contents.

#### *Management's Responsibility for the Financial Schedule*

Management is responsible for the preparation and fair presentation of this financial schedule in accordance with the modified cash basis of accounting as described in Note 1; this includes determining that the modified cash basis for accounting is an acceptable basis for preparation of the financial schedule in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial schedule that is free from material misstatement, whether due to error or fraud.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on the financial schedule based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedule is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial schedule. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial schedule in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial schedule.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the financial schedule referred to above presents fairly, in all material respects, the assets held in the County Treasury as of June 30, 2013, in accordance with the basis of accounting as described in Note 1.

**Basis of Accounting**

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. The financial schedule is prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to that matter.

**Other Report Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated March 14, 2014 on our consideration of the County's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering County's internal control over financial reporting and compliance.

*Macias Fini & O'Connell LLP*

Newport Beach, California  
March 14, 2014

**ORANGE COUNTY TREASURY**  
**Schedule of Assets Held by the County Treasury**  
**As of June 30, 2013**

	<u>County Pool</u>	<u>Educational Pool</u>	<u>Non- Pooled</u>	<u>Total</u>
<b>CASH</b>				
Cash on hand	\$ 36,628	\$ -	\$ -	\$ 36,628
Demand accounts	8,292,703	10,415,533	-	18,708,236
<b>Total cash</b>	<b>8,329,331</b>	<b>10,415,533</b>	<b>-</b>	<b>18,744,864</b>
<b>INVESTMENTS, stated at fair value</b>				
<i>Orange County Investment Pool</i>				
Money Market Fund	1,422,436,315	-	-	1,422,436,315
Extended Fund	1,674,292,976	-	-	1,674,292,976
<i>Orange County Educational Investment Pool</i>				
Money Market Fund	-	1,965,410,761	-	1,965,410,761
Extended Fund	-	1,344,042,321	-	1,344,042,321
<i>Non-Pooled</i>	-	-	50,924,494	50,924,494
<b>Total investments</b>	<b>3,096,729,291</b>	<b>3,309,453,082</b>	<b>50,924,494</b>	<b>6,457,106,867</b>
<b>TOTAL ASSETS</b>	<b><u><u>\$3,105,058,622</u></u></b>	<b><u><u>\$3,319,868,615</u></u></b>	<b><u><u>\$50,924,494</u></u></b>	<b><u><u>\$6,475,851,731</u></u></b>

See accompanying notes to the financial schedule.

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**ORANGE COUNTY TREASURY**  
**Notes to the Financial Schedule**  
**June 30, 2013**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying Schedule of Assets Held by the County Treasury (Schedule) is intended to separately report deposits and investments in the County Treasury included in the basic financial statements of the County of Orange, State of California (County). For additional disclosure information and contingencies, please refer to the latest publication of the County Comprehensive Annual Financial Report.

The Schedule includes the cash balances of all funds that the County Treasurer (Treasurer) pools for investing surplus funds according to California Government Code and certain other non-pooled specific investments. The County maintains two external investment pools: the Orange County Investment Pool (the OCIP); and the Orange County Educational Investment Pool (the OCEIP), the latter of which is utilized exclusively by Orange County's public school and community college districts. These pools are maintained for the County and other non-County entities for the purpose of benefiting from economies of scale through pooled investment activities. The schedule does not include cash and investments for the Orange County Employees Retirement System, CalOptima, certain deferred compensation funds and other debt reserve funds held in trust outside, and independent of, the County Treasury. The pools are not registered with the Securities and Exchange Commission ("SEC") as an investment company. The pools do not have any legally binding guarantees of share value.

Unless otherwise required in a trust agreement or other financing document, assessment districts and public school and community college districts are required by legal provisions to deposit their funds with the County Treasurer. The OCEIP consists entirely of public school and community college districts' funds and therefore includes 100% involuntary participants. At June 30, 2013, the OCIP includes approximately 11.06% of involuntary participant deposits including funds for the Superior Court, certain assessment districts, and certain bond related funds for public school districts.

The Schedule is presented on the cash basis, as modified, which is a comprehensive basis of accounting other than United States generally accepted accounting principles. Receipts are recognized when received by the Treasurer; disbursements are recognized when paid by the bank.

The Treasurer has stated required investments at fair value in the accompanying financial schedule. Management contracts with an outside service and its custodian bank to provide pricing for the fair value of investments in the portfolio. Securities listed or traded on a national securities exchange are valued at the last quoted sales price. Repurchase agreements and institutional money market funds are carried at book value (carrying cost).The investments are marked to market and the net asset values of the pools are calculated each business day.

The pools value participant's shares in the pools using amortized cost. Specifically, the pools distribute income to participants based on their relative participation during the period. Income is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and reduced by (4) estimated investment and administrative expenses. This method differs from the fair value method used to value investments in this financial schedule because the amortized cost method does not distribute to participants all unrealized gains and losses in the fair values of the pools' investments.

**ORANGE COUNTY TREASURY**  
**Notes to the Financial Schedule (Continued)**  
**June 30, 2013**

**2. DEPOSITS AND INVESTMENTS**

The Treasurer is responsible for authorizing all County bank accounts and pursuant to Government Code Sections (CGC) 27000.1-27000.5, 27130-27137 and 53600-53686, is responsible for conducting County investment activities of the County's investment pooled funds in addition to various individual investment accounts outside of the pooled funds. These public funds are called the Orange County Investment Fund (OCIF). Within the OCIF, the Treasurer maintains an OCIP and OCEIP, which are "external investment pools" wherein moneys of the County and other legally separate external entities, which are not part of the County reporting entity, are commingled (pooled) and invested on the participants' behalf. In addition, the Treasurer maintains the John Wayne Airport Investment Pool, and other separately managed investments. The County's Investment Pools are not registered with the Securities and Exchange Commission (SEC) as an investment company.

The Treasurer invests pooled funds from the OCIP and OCEIP into three funds, the Orange County Money Market Fund (OCMMF), the Orange County Educational Money Market Fund (OCEMMF) and the Extended Fund. On February 13, 2013, Standard & Poor's reaffirmed an AAA Principal Stability Fund Rating (AAAm) for the OCMMF and OCEMMF. The two Money Market Funds are required to maintain a Net Asset Value (NAV) of between \$.995 and \$1.005 to maintain an AAAM rating. Neither of the Money Market Funds nor the Extended Fund have any legally binding guarantees of share value.

The maximum maturity of investments for the two money market funds is 13 months with a maximum weighted average maturity of 60 days. The maximum maturity of the Extended Fund is 5 years per Government Code. The Investment Policy Statement (IPS) provides that the Extended Fund duration should not exceed a leading 1-3 Year Index +25%.

Pursuant to CGC Sections 27130-27137, the Board of Supervisors has established a Treasurer's Oversight Committee (TOC) that monitors and reviews the Treasurer's compliance with the IPS and ensures that the Treasurer has an audit annually, which includes limited tests of compliance with laws and regulations. The TOC consists of the County Executive Officer or designee, the County Auditor-Controller or designee, the County Superintendent of Schools or designee and two public members who are required to have expertise in finance.

The investment practices and policies of the Treasurer are based on compliance with State law and prudent money management. The primary goal is to invest public funds in a manner which will provide maximum security of principal invested with secondary emphasis on providing adequate liquidity to pool participants and lastly to achieve a market rate of return with the parameters of prudent risk management while conforming to all applicable statutes and resolutions governing the investment of public funds.

Interest is allocated to participants accounts monthly based on the average daily balances on deposit with the Treasurer. Interest assigned to another fund due to a management decision is recognized in the fund that reports the investments and reported as a transfer to the recipient fund.

**ORANGE COUNTY TREASURY**  
**Notes to the Financial Schedule (Continued)**  
**June 30, 2013**

**A. Deposits**

As of June 30, 2013, the carrying amount of noninterest-bearing deposits was \$18.74 million, which consisted of demand accounts in financial institutions plus a small amount in cash in the Treasury's vault. The Treasurer has established separate bank and investment custody accounts for the County's school and community college participants.

CGC Section 53652 et. seq. and the IPS prescribe the amount of collateral that is required to secure the deposit of public funds. The pledge to secure deposits is administered by the California Superintendent of Banks. Collateral is required for demand deposits at 110% of all deposits not covered by Federal depository insurance (FDIC) if obligations of the United States and its agencies, or obligations of the State or its municipalities, school districts, and district corporations are pledged. Collateral of 150% is required if a deposit is secured by first mortgages or first trust deeds upon improved residential real property located in California. All such collateral is considered to be held by the pledging financial institutions' trust departments or agents in the name of the County. Obligations pledged to secure deposits must be delivered to an institution other than the institution in which the deposit is made; however, the trust department of the same institution may hold them. Written custodial agreements are required that provide, among other things, that the collateral securities are held separate from the assets of the custodial institution.

FDIC is available for noninterest-bearing funds deposited at any one financial institution up to a maximum of \$250,000. In addition, from July 1, 2012 through December 31, 2012, FDIC insurance provided unlimited coverage for noninterest-bearing transaction accounts in accordance with Section 343 of the Dodd-Frank Act.

Custodial Credit Risk – Deposits:

The custodial credit risk for deposits is the risk that the County will not be able to recover deposits that are in the possession of an outside party. Deposits are exposed to custodial credit risk if they are not insured or collateralized. The County's deposits are not exposed to custodial credit risk, since all of its deposits are covered by FDIC or collateralized with securities held by the County or its agent in the County's name, in accordance with CGC section 53562.

**B. Investments**

CGC 53601, 53635, Board of Supervisors' ordinances and resolutions, the County's IPS, the bond indenture documents, trust agreements, and other contractual agreements govern the investments that may be purchased and may include certain restrictions on investment maturity, maximum portfolio percentages, term, value, credit quality and timing to minimize the risk of loss. The IPS adds further restrictions to permitted investments from the CGC. All investments must be United States dollar denominated. As of June 30, 2013, the Treasurer was in full compliance with the more restrictive IPS and therefore, was also in compliance with CGC. Table A provides a summary listing of the authorized investments as of June 30, 2013.

**ORANGE COUNTY TREASURY**  
**Notes to the Financial Schedule (Continued)**  
**June 30, 2013**

<b>Type of Investment</b>	<b>CGC % of Funds Permitted</b>	<b>County IPS Maximum % of Portfolio</b>	<b>CGC Maximum Final Maturity</b>	<b>County IPS Maximum Final Maturity (Long-Term, Short-Term)</b>
U.S. Treasury Securities	100%	100%	5 years	5 years, 397 days
U.S. Government Agency Securities	100%	100% total, no more than 30% in one issuer	5 years	5 years, 397 days
Municipal Debt	100%	30% total, no more than 5% in one issuer except 10% - County of Orange	5 years	5 years, 397 days
Medium-Term Notes	30%	30% total, no more than 5% in one issuer	5 years	5 years, 397 days
Bankers' Acceptances	40%, 30% in a single issuer	40% total, no more than 5% in one issuer	180 days	180 days, 180 days
Commerical Paper	40%, 10% in a single issuer	40% total, no more than 5% in one issuer	270 days	270 days, 270 days
Negotiable Certificates of Deposit	30%	30% total, no more than 5% in one issuer	5 years	5 years, 397 days
Repurchase Agreements	100%	20% total, no more than 10% in a single issuer	1 year	1 year, 1 year
Investment Pools / Money Market Mutual Funds	20%, 10% in a single fund	20% total, no more than 10% in one fund	N/A	N/A, N/A

The current IPS expressly prohibits leverage, reverse repurchase agreements as defined by CGC, structured notes, structured investment vehicles, and derivatives. No investment may be purchased from an issuer that has been placed on credit watch-negative by any of Nationally Recognized Statistical Rating Organizations (NRSROs), or whose credit rating by any of the NRSROs is less than the minimum rating required by the IPS for that class of security unless the issuer has a short-term rating of "A-1+" or "F1+" or a long-term rating of at least a "AA" or "Aa2" by S & P and Fitch or Moody's.

Investments by the Treasurer are stated at fair value. Investments in the pools are marked to market on a daily basis. Investments in the pools are marked to market on a daily basis. If the net asset value of the Money Market Fund for either the OCIP or the OCEIP is less than \$0.995 or greater than \$1.005, portfolio holdings may be sold as necessary to maintain the ratio between \$0.995 and \$1.005.

**ORANGE COUNTY TREASURY**  
**Notes to the Financial Schedule (Continued)**  
**June 30, 2013**

Investment Disclosures:

Table A presents a summary of the County's investments and the credit quality distribution and concentration of credit risk by investment type as a percentage of each pool's fair value at June 30, 2013 (Dollar amounts in thousands).

Table A

	Fair Value (in thousands)	Principal (in thousands)	Interest Rate Range (%)	Maturity Range	Weighted Average Maturity (Years) <sup>(3)</sup>	Ratings <sup>(1)</sup>	% of Portfolio
<b>County Investment Pool</b>							
U.S. Government Agencies <sup>(2)</sup>							
FNMA Discount Notes	\$ 178,784	\$ 178,835	0.05 - 0.16%	7/1/13 - 10/25/13	0.193	A-1	5.78%
FNMA Bonds	514,841	515,172	0.06 - 1.31%	7/17/13 - 4/11/18	2.241	AA	16.63%
FFCB Bonds	496,890	496,960	0.10 - 0.59%	7/26/13 - 11/16/15	0.520	AA	16.05%
FHLB Discount Notes	161,750	161,758	0.05 - 0.15%	7/3/13 - 9/13/13	0.066	A-1	5.22%
FHLB Bonds	483,129	482,112	0.10 - 0.85%	7/1/13 - 5/22/18	1.221	AA	15.60%
FHLMC Discount Notes	198,914	198,950	0.05 - 0.10%	7/8/13 - 10/21/13	0.135	A-1	6.42%
FHLMC Bonds	538,053	537,809	0.09 - 0.80%	9/3/13 - 6/29/17	1.496	AA	17.38%
Negotiable Certificates of Deposit	88,969	89,000	0.13 - 0.24%	7/19/13 - 6/19/14	0.035	A-1	2.87%
Medium-Term Corporate Notes							
Corporate Notes	100,670	99,116	0.23 - 2.16%	8/15/13 - 6/24/16	1.222	AA	3.25%
Corporate Notes	40,296	38,829	0.24 - 0.65%	5/15/14 - 5/15/16	2.852	AAA	1.30%
Municipal Debt	55,511	55,471	1.55%	8/15/2013	0.126	A	1.79%
U.S. Treasuries	114,967	114,870	0.16 - 0.44%	7/1/13 - 9/15/15	0.825	AA	3.71%
Money Market Mutual Funds	123,955	123,955	0.01 - 0.05%	7/20/13-8/22/13	0.055	AAA	4.00%
	<b>\$ 3,096,729</b>	<b>\$ 3,092,837</b>			<b>1.043</b>		<b>100.00%</b>
<b>Educational Investment Pool</b>							
U.S. Government Agencies <sup>(2)</sup>							
FNMA Discount Notes	\$ 257,709	\$ 257,738	0.06 - 0.09%	7/1/13 - 9/25/13	0.104	A-1	7.79%
FNMA Bonds	511,762	511,366	0.05 - 1.31%	7/17/13 - 4/11/18	1.862	AA	15.46%
FFCB Bonds	487,910	487,960	0.07 - 0.59%	7/2/13 - 11/16/15	0.438	AA	14.74%
FHLB Discount Notes	259,390	259,400	0.05 - 0.09%	7/3/13 - 9/11/13	0.111	A-1	7.84%
FHLB Bonds	488,817	487,933	0.08 - 0.85%	7/1/13 - 5/22/18	1.024	AA	14.77%
FHLMC Discount Notes	207,489	207,502	0.05 - 0.12%	7/8/13 - 11/12/13	0.096	A-1	6.27%
FHLMC Bonds	473,457	473,098	0.06 - 0.80%	7/15/13 - 6/29/17	1.380	AA	14.31%
Negotiable Certificates of Deposit	88,888	88,900	0.24 - 0.40%	7/26/13 - 6/17/14	0.047	A-1	2.68%
Medium-Term Corporate Notes							
Corporate Notes	136,356	134,621	0.20 - 2.16%	9/27/13 - 6/24/16	0.974	AA	4.12%
Corporate Notes	45,008	43,724	0.23 - 0.65%	5/15/14 - 5/15/16	2.295	AAA	1.36%
Municipal Debt	44,562	44,529	1.55%	8/15/2013	0.126	A	1.35%
U.S. Treasuries	118,364	118,130	0.06 - 0.44%	8/15/13 - 9/15/15	0.579	AAA	3.58%
Money Market Mutual Funds	189,741	189,741	0.01 - 0.05%	7/20/13-8/22/13	0.055	AAA	5.73%
	<b>\$ 3,309,453</b>	<b>\$ 3,304,642</b>			<b>0.822</b>		<b>100.00%</b>

**ORANGE COUNTY TREASURY**  
**Notes to the Financial Schedule (Continued)**  
**June 30, 2013**

Table A (Continued)

	Fair Value (in thousands)	Principal (in thousands)	Interest Rate Range (%)	Maturity Range	Weighted Average Maturity (Years) <sup>(3)</sup>	Ratings <sup>(1)</sup>	% of Portfolio
<b>Specific Investments</b>							
U.S. Government Agencies <sup>(2)</sup>							
FNMA Bonds	\$ 10,432	\$ 10,397	0.07 - 0.25%	7/12/13 - 3/4/14	0.089	AA	20.49%
FFCB Bonds	9,070	9,045	0.09 - 0.24%	7/22/13 - 3/11/14	0.106	AA	17.81%
FHLB Bonds	11,247	11,225	0.10 - 0.19%	7/12/13 - 12/18/13	0.084	AA	22.09%
FHLMC Bonds	6,106	6,073	0.07 - 0.39%	7/15/13 - 11/15/13	0.124	AA	11.99%
GNMA Bonds	123	111	6.25%	9/20/2029	16.236	AA	0.24%
Negotiable Certificates of Deposit	3,999	4,000	0.23 - 0.30%	8/13/13 - 6/24/14	0.104	A-1	7.85%
Medium-Term Corporate Notes							
Corporate Notes	5,224	5,200	0.21 - 0.28%	8/15/13 - 6/1/14	0.266	AA	10.26%
Corporate Notes	2,017	2,000	0.21 - 0.24%	9/27/13 - 5/15/14	0.874	AAA	3.96%
Repurchase Agreements	1,082	1,082	6.20%	8/15/2019	6.129	AA	2.12%
Money Market Mutual Funds	1,624	1,624	0.01 - 0.05%	7/20/13 - 8/22/13	0.055	AAA	3.19%
	<b>\$ 50,924</b>	<b>\$ 50,757</b>			<b>0.311</b>		<b>100.00%</b>

(1) The County obtains credit rating from S&P, Moody's and Fitch. The ratings indicative of the greatest degree of risk have been disclosed

(2) Legend:

- (a) FHLB - Federal Home Loan Bank
- (b) FHLMC - Federal Home Loan Mortgage Corporation
- (c) FNMA - Federal National Mortgage Association
- (d) GNMA - Government National Mortgage Association

(3) Portfolio weighted average maturity

Temporary Transfers to Orange County School Districts:

In February and April 2013, the Treasurer received requests from eight Orange County school districts to market temporary transfers as required by state law and authorized by the Board's Resolution 11-195. The resolution authorizes the Treasurer to make temporary transfers to school districts to address their short-term cash flow needs. The loans are secured by tax receipts to be received by the Treasurer as the banker for the school districts and will be repaid no later than August 31, 2013. At June 30, 2013, the outstanding temporary transfers from OCEIP totaled \$183,700,000 and related receivable and payable have been offset for financial reporting purposes.

Interest Rate Risk - Investments:

This is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, investments of longer maturities are more sensitive to changes in market interest rates. Declines in the fair value of investments are managed by limiting the length of the maturity of the securities. In general, the maximum maturity allowed is five years unless the Board has granted express authority. Actual weighted average maturity in years by investment type for the funds invested in the Pools are presented in Table A.

**ORANGE COUNTY TREASURY**  
**Notes to the Financial Schedule (Continued)**  
**June 30, 2013**

The OCIP funds of \$3,096,729,291 and the OCEIP funds of \$3,309,453,082 at June 30, 2013, have over 43.69% and 56.12%, respectively, of the investments maturing in six months or less, 50.65% and 39.63% respectively, maturing between six months and three years and 5.66% and 4.25% respectively, maturing from three to five years.

As of June 30, 2013, variable-rate notes comprised 13% and 14% of the OCIP and OCEIP, respectively. The notes are tied to the one-month and three-month London Interbank Offered Rate (LIBOR) with daily, weekly, monthly and quarterly coupon resets. The fair value of variable-rate securities is generally less susceptible to changes in value because the variable-rate coupon resets back to the market rate on a periodic basis. Effectively, at each reset date, a variable-rate investment reprices back to par value, eliminating interest rate risk at each periodic reset. For purposes of computing weighted average maturity (WAM), the maturity date of variable-rate notes is the length of time until the next reset date rather than the stated maturity.

The annual average daily investment balance of the OCIP and the OCEIP was \$3,312,083,115 and \$2,933,623,336 respectively, with an average gross effective yield of 0.40% and 0.39%, respectively, for the year ended June 30, 2013.

Interest Rate Risk - Weighted Average Maturity (Money Market Funds):

At June 30, 2013 the OCMMF and OCEMMF amounted to \$1,422,436,315 and \$1,965,410,761, respectively. In accordance with the Board of Supervisor formally approved IPS, the Treasurer manages the Pool's exposure to declines in fair value for deposits and investments by limiting the weighted average maturity to 60 days in the Money Market Funds. At June 30, 2013, the weighted average maturity of the OCMMF was 56 days and the OCEMMF was 55 days. At the same date, the NAV of the Money Market Funds for both pools was \$1.00 (in absolute dollar amounts).

Interest Rate Risk - Duration (Extended Fund):

At June 30, 2013, the Extended Fund (which includes funds from both OCIP and OCEIP) balance was \$3,018,335,297. Of this amount, the OCIP owned 55.47% and the OCEIP owned 44.53%. In accordance with the IPS, the Treasurer manages the Pool's exposure to declines in fair value for deposits and investments by having duration not to exceed a leading 1-3 Year Index +25% (2.36). The portfolio duration for the Extended Fund as of June 30, 2013 was 1.78 years. This was computed using the Macaulay duration method, which calculates the maturity date of callable bonds using their final maturity date.

**ORANGE COUNTY TREASURY**  
**Notes to the Financial Schedule (Continued)**  
**June 30, 2013**

As of June 30, 2013, the Extended Fund had the following duration by investment type (Dollar amounts in thousands):

**Table B**

<b>Investment Type</b>	<b>Fair Value (In Thousands)</b>	<b>Portfolio %</b>	<b>Macaulay Duration (In Years)</b>
Medium-Term Corporate Notes	\$ 174,739	5.79%	2.12
Municipal Debt	100,073	3.31%	0.13
Treasuries	152,942	5.07%	0.91
U.S. Government Agencies	2,590,581	85.83%	1.87
<b>Total Fair Value</b>	<b>\$ 3,018,335</b>		
<b>Portfolio Duration</b>			1.78

Custodial Credit Risk - Investments:

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the County will not be able to recover the value of its investments or collateral securities that are in possession of an outside party. The IPS does not permit investments in uninsured and unregistered securities not held by the County. The Treasurer utilizes third party delivery versus payment (DVP), which mitigates any custodial credit risk. Securities purchased by the Treasurer are held by a third party custodian, Northern Trust, in their trust department to mitigate custodial credit risk. At year-end, in accordance with the IPS, the County's external investment pools and specific investments did not have any securities exposed to custodial credit risk, and the Treasurer did not have any securities lending during the year (or at year-end).

Credit Risk - Investments:

This is the risk that an issuer or other counterparty to an investment may not fulfill its obligations. The IPS sets forth the minimum acceptable credit ratings for investments from any two of the NRSROs as explained above. For an issuer of short-term debt, the rating must be no less than "A-1" or "SP-1" (S&P), "P-1" or "MIG 1/VMIG 1" (Moody's), or "F1" (Fitch), while an issuer of long-term debt shall be rated no less than an "A" in the Money Market Funds and "AA" in the Extended Fund. Debts issued by the U.S. Government are exempt from the above credit rating requirements. As of June 30, 2013, the County's investments were in compliance with the IPS limits.

Concentration of Credit Risk - Investments:

This is the risk of loss attributed to the magnitude of a government's investment in a single issuer. As of June 30, 2013, all investments were in compliance with State law and with the IPS. See Table A above for concentrations of holdings including U. S. government agencies.

Foreign Currency Risk:

The IPS requires all securities to be U.S. dollar denominated. The County Pools are not exposed to foreign currency risk.

**ORANGE COUNTY TREASURY**  
**Notes to the Financial Schedule (Continued)**  
**June 30, 2013**

**3. SUBSEQUENT EVENTS**

Taxable Pension Obligation Bonds, 2014 Series A:

On January 14, 2014, the County issued its Taxable Pension Obligation Bonds, 2014 Series A (2014 POBs) in the principal amount of \$325,405,000 which, combined with \$21,474 in County funds, prepaid a portion of the County's FY 2014-15 pension contribution at a discount. The County issued the 2014 POBs in five fixed rate maturities with the final maturity on June 30, 2015. The County sold the 2014 POBs with interest rates between .65% and .83% depending on maturity in a direct purchase by the County Treasurer on behalf of the OCIF.

Annual IPS Change:

The Board of Supervisors approved the 2014 IPS on February 4, 2014, which made some changes to allowed investments including changes to conform to CGC. The following substantive changes to the IPS were approved by the Board of Supervisors: separate investment accounts longer than five years could be pooled subject to Board approval; \$1.00 Net Asset Value (NAV) not guaranteed or insured for any pool; pools are not registered with the SEC; additional due diligence requirements for the Money Market Mutual Funds; amended language related to conflict of interest filings and Treasurer responsibilities; additional language on the annual review of investment service providers; added language describing the earning apportionment process. These changes are not considered a significant change to the overall structure for the prudent investment of the balances entrusted to the Treasurer.

TOC Bylaw Change:

The Board of Supervisors approved the 2014 TOC Bylaws on December 17, 2013, which made one significant change increasing the number of TOC members from five to seven and the number of public members from two to four.

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**Independent Auditor’s Report on Internal Control Over Financial Reporting  
and on Compliance and Other Matters Based on an Audit of Financial Statements  
Performed in Accordance with *Government Auditing Standards***

The Honorable Board of Supervisors  
County of Orange, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Schedule of Assets Held by the County Treasury (Schedule) of County of Orange, California (Treasurer), as of June 30, 2013, and the related notes to the financial schedule, and have issued our report thereon dated March 14, 2014

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial schedule, we considered the Treasurer’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial schedule, 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* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Treasurer’ financial schedule is free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Macias Fini & O'Connell LLP*

Newport Beach, California  
March 14, 2014