



**April 8, 2015**

**To:** Finance and Administration Committee

**From:** Darrell Johnson, Chief Executive Officer

Janet Sutter, Executive Director  
Internal Audit

**Subject:** Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2014

### **Overview**

The Internal Audit Department has completed a review of investments for the period July 1 through December 31, 2014. Based on the review, the Orange County Transportation Authority complied with its debt, investment, and reporting policies and procedures, except for monitoring and reporting of investment manager compliance with diversification limits. The Internal Audit Department has made a recommendation to revise and enhance procedures for timely classification of securities and monitoring of investment manager compliance.

### **Recommendation**

Direct staff to implement the recommendation provided in Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2014, Internal Audit Report No. 15-508.

### **Background**

The Treasury Department is responsible for management of the Orange County Transportation Authority's (OCTA) investment portfolio (portfolio). On December 31, 2014, the portfolio's book value was approximately \$1.26 billion. The portfolio consists of three managed portfolios: liquid assets for OCTA's daily operations, a bond proceeds portfolio to meet Measure M2 transportation program needs, and the short term portfolio for future budgeted expenditures. External investment managers administer the short-term portfolio and bond proceeds portfolio, and OCTA's Treasurer manages the liquid assets portfolio.

The Investment Policy (Policy) sets forth guidelines for all OCTA investments to ensure conformance with the California Government Code. The Policy outlines permitted investments as well as diversification guidelines. The diversification limits ensure the portfolio is not unduly concentrated in securities of one type, industry, or entity, thereby assuring adequate portfolio liquidity should one sector or company experience difficulties.

### ***Discussion***

During the review period, the Internal Audit Department (Internal Audit) identified instances where investment managers' had exceeded portfolio diversification limits, but the conditions were not identified by the Treasurer because monitoring is performed only once per week. Other instances that were identified did not always result in a finding of non-compliance due to recently implemented procedures that allow investment managers of the bond proceeds portfolio to exceed limits for the purpose of drawdowns. However, these procedures do not address the timing for returning the portfolio to compliance upon notice by the Treasurer, and communications are not always documented. Finally, Internal Audit found that investments are not always classified in a timely manner, which could negatively affect the Treasurer's ability to monitor compliance with diversification limits.

As a result, Internal Audit recommended that detailed procedures be developed to evaluate investment managers' compliance with the Policy and documentation of communications and determinations be maintained. Further, securities should be classified in a timely manner, and monitoring of investment managers' compliance should include every day of the week to ensure instances of non-compliance do not go undetected. Management agreed and indicated that the Debt and Investment Management Manual would be revised within 60 days to include evidence of communication with investment managers, address expectations for returning portfolios to compliance, weekly classification of security purchases, and the daily review for portfolio compliance.

### ***Summary***

Based on the review, OCTA complied with its debt, investment, and reporting policies and procedures, except with regard to monitoring of investment manager compliance with diversification limits.

**Attachment**

- A. Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2014 Internal Audit Report No. 15-508

**Prepared by:**



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**Approved by:**



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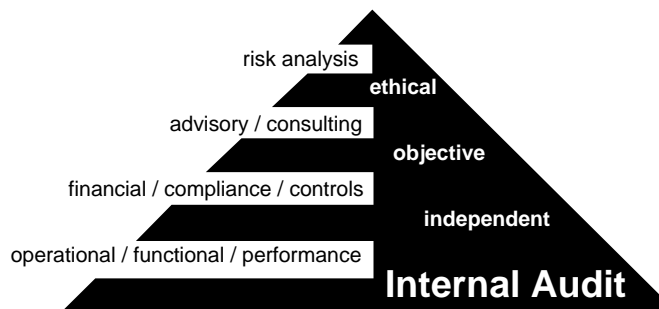
# ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



## Investments: Compliance, Controls, and Reporting July 1 through December 31, 2014

### Internal Audit Report No. 15-508

March 17, 2015



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**ORANGE COUNTY TRANSPORTATION AUTHORITY  
INTERNAL AUDIT DEPARTMENT**

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**Conclusion**

The Internal Audit Department (Internal Audit) has completed a review of investments for the period July 1, 2014 through December 31, 2014. Based on the review, the Orange County Transportation Authority (OCTA) complied with its debt, investment, and reporting policies and procedures, except for monitoring and reporting of investment manager compliance with diversification limits. Internal Audit has made a recommendation to revise and enhance procedures for timely classification of securities and monitoring of investment manager compliance.

**Background**

Portfolio Management

Treasury is responsible for the management of OCTA's investment portfolio (portfolio). On December 31, 2014, the portfolio's book value was approximately \$1.26 billion. The portfolio consists of three managed portfolios: liquid assets for OCTA's daily operations, a bond proceeds portfolio to meet Measure M2 transportation program needs, and the short term portfolio for future budgeted expenditures. External investment managers administer the short-term portfolio and bond proceeds portfolio, and OCTA's Treasurer manages the liquid assets portfolio. OCTA also has funds invested in debt service reserve funds for various outstanding debt obligations. OCTA's Accounting Department is responsible for recording all debt and investment transactions and reconciling all bank and custodial accounts monthly.

Investment Policy

The Investment Policy (Policy) sets forth guidelines for all OCTA investments to ensure conformance with the California Government Code (CGC). The Policy outlines permitted investments as well as diversification guidelines. The diversification limits ensure the portfolio is not unduly concentrated in securities of one type, industry, or entity, thereby assuring adequate portfolio liquidity should one sector or company experience difficulties.

OCTA has provided the investment managers with a copy of the Policy and requires investment managers to invest their portfolios in accordance with the provisions of the Policy.

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**Objectives, Scope and Methodology**

The primary objective of the review was to determine if OCTA complied with its debt, investment, and reporting policies and procedures.

Additional audit objectives included determining if:

- Internal controls over OCTA's investment activities were adequately designed;
- OCTA was in compliance with the CGC;
- Investment transactions were adequately supported; and
- OCTA was in compliance with investment requirements of debt issuances.

The methodology consisted of reviewing a judgmental sample of daily cash worksheets prepared by the Accounting Department and the Treasury Department, verifying a judgmental sample of wire transfers to source documents, reviewing and testing procedures for monitoring investment managers' compliance with the Policy, reviewing judgmental samples of daily investment holding reports and bank reconciliations, and reviewing the quarterly debt and investment reports provided to OCTA's Board of Directors.

The scope of the review included investment transactions and investment-related controls for the period July 1 through December 31, 2014.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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**Audit Comment, Recommendation and Management Response**

**Monitoring of Investment Manager Compliance**

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Bond drawdown requests to investment managers may alter the asset allocation of a portfolio causing a given asset class to exceed Policy diversification limits. As a result, the Policy was recently updated to allow bond proceeds to be invested in approved short-term investments without regard to diversification limits as required for scheduled drawdowns. During the review period, one bond proceeds investment manager exceeded diversification limits twice due to upcoming drawdowns and was cited for non-compliance in one instance. According to the Treasurer, non-compliance was cited when the investment manager had to be contacted twice before returning the portfolio to compliance. The Treasurer does not always maintain evidence of contact with the investment managers and expectations for returning the portfolio to compliance within a certain timeframe have not been defined or communicated to the investment managers.

Also during the review period, a bond proceeds investment manager and a short-term portfolio investment manager exceeded diversification limits. However, these conditions were not identified, cited, or reported because procedures for monitoring compliance require only weekly reviews, per direction from the Finance and Administration Committee in 2013. At the time of that direction, investment manager non-compliance was observed only rarely; however with the level of interest rates declining over the past couple of years, investment managers have increased certain allocations toward maximum levels. As a result, there has been an increase in the number of compliance violations since 2013. In addition, since implementation of investment portfolio software, the time required to perform monitoring has been greatly reduced.

Finally, Internal Audit found that investments are not always classified by Treasury staff as the trades occur. Each day, securities are purchased in the OCTA portfolio and the Treasurer must manually classify the security based on the Policy. Rather than classifying securities as of the trade date, staff posts these in batches every one to three weeks. Timely classification of securities would provide for more accurate information on portfolio diversification.

**Recommendation 1:**

Internal Audit recommends that detailed procedures be developed to evaluate investment managers' compliance with the Policy and documentation of communications and determinations be maintained. Further, securities should be classified in a timely manner and monitoring of investment managers' compliance



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should include every day of the week, to ensure instances of non-compliance do not go undetected.

**Management Response:**

Treasury/Toll Roads staff will revise the Debt and Investment Management Manual within 60 days to include evidence of communication with investment managers, address expectations for returning portfolios to compliance, weekly classification of security purchases, and the daily review for portfolio compliance.