



October 12, 2022

To: Finance and Administration Committee

From: Darrell E. Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit Department

Subject: Investments: Compliance, Controls, and Reporting, January 1 through June 30, 2022, Internal Audit Report No. 23-502

Overview

The Internal Audit Department has completed an audit of investments for the period January 1 through June 30, 2022. Based on the audit, the Orange County Transportation Authority generally complied with its debt, investment, and reporting policies and procedures; however, the Internal Audit Department made two recommendations related to documentation of compliance monitoring and classification of securities in monthly reports.

Recommendation

Direct staff to implement two recommendations provided in Investments: Compliance, Controls, and Reporting, January 1 through June 30, 2022, Internal Audit Report No. 23-502.

Background

The Treasury Department (Treasury) is responsible for the management of the Orange County Transportation Authority's (OCTA) Investment Portfolio (Portfolio). On June 30, 2022, the Portfolio's book value was approximately \$2.4 billion. The Portfolio consists of three managed portfolios: the liquid portfolio for immediate cash needs, a bond proceeds portfolio to meet Measure M2 transportation program needs, and the short-term portfolio for future budgeted expenditures. OCTA's Treasurer manages the liquid and bond proceeds portfolios, and four external investment managers administer the short-term portfolio. OCTA also has investments in debt service reserve funds for various outstanding debt obligations.

The Investment Policy sets forth guidelines for all OCTA investments to ensure conformance with the California Government Code. The Investment 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.

Monthly Investment and Debt Programs Reports (monthly reports) are submitted to the Board of Directors.

Discussion

Documentation addressing potential Investment Policy violations flagged by the Clearwater system's compliance module is not consistently maintained. Based on discussion with management and cursory review of the system, the module often flags violations in error. The Internal Audit Department (Internal Audit) recommends that management maintain required documentation and obtain updates by Clearwater to ensure only violations of the Investment Policy are flagged. Management agreed with the recommendation, noting that Clearwater has completed the updates.

In the April and May 2022 monthly reports, the First American Government Obligation Fund was labeled as United States Treasury Obligations in the bond proceeds and debt service reserve fund portfolios, when the actual classification is money market fund. In addition, \$20,000,157 in the First American Government Obligation Fund was classified as commercial paper rather than money market funds in the April bond proceeds portfolio. Internal Audit recommends that Treasury enhance secondary review of monthly reports to include verification of security classifications in these portfolios. Management agreed with the recommendation and has updated the labeling in the monthly reports.

Summary

Internal Audit has completed an audit of investments for the period January 1 through June 30, 2022, and has offered two recommendations for improvement.

Attachment

- A. Investments: Compliance, Controls, and Reporting, January 1 through
June 30, 2022, Internal Audit Report No. 23-502, September 30, 2022

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ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



Investments: Compliance, Controls, and Reporting January 1 through June 30, 2022

Internal Audit Report No. 23-502 September 30, 2022



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Conclusion

The Internal Audit Department (Internal Audit) has completed an audit of investments for the period January 1 through June 30, 2022. Based on the audit, the Orange County Transportation Authority (OCTA) generally complied with its debt, investment, and reporting policies and procedures; however, Internal Audit made two recommendations related to documentation of compliance monitoring and classification of securities in monthly reports.

Portfolio Management

The Treasury Department (Treasury) is responsible for the management of OCTA's Investment Portfolio (Portfolio). To accomplish this, Treasury uses the Clearwater treasury software system to monitor investments and investment manager performance.

On June 30, 2022, the Portfolio's book value was approximately \$2.4 billion. The Portfolio consists of three managed portfolios: the liquid portfolio for immediate cash needs, a bond proceeds portfolio to meet Measure M2 transportation program needs, and the short-term portfolio for future budgeted expenditures. OCTA's Treasurer manages the liquid and bond proceeds portfolios, and four external investment managers administer the short-term portfolio. OCTA also has investments in debt service reserve funds for various outstanding debt obligations. OCTA's Accounting Department (Accounting) is responsible for recording all debt and investment transactions, and for reconciling all bank and custodial accounts monthly.

Investment Policy

The Investment Policy sets forth guidelines for all OCTA investments to ensure conformance with the California Government Code (Code). The Investment 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 Investment Policy and requires investment managers to invest their portfolios in accordance with the provisions of the Investment Policy.

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Objectives, Scope, and Methodology

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

Audit objectives included determining if:

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

According to Generally Accepted Government Auditing Standards (GAGAS), internal control is the system of processes that an entity's oversight body, management, and other personnel implement to provide reasonable assurance that the organization will achieve its operational, reporting, and compliance objectives. The five components are control environment, risk assessment, control activities, information and communication, and monitoring.¹ The components and principles that were evaluated as part of this audit are:

- Control Environment
 - OCTA demonstrates a commitment to integrity and ethical values.
 - Management establishes, with Finance and Administration (F&A) Committee and Board of Director (Board) oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
 - OCTA demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
- Risk Assessment
 - OCTA specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
 - OCTA identifies and assesses changes that could significantly impact the system of internal control.
- Control Activities
 - OCTA selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- Information and Communication
 - OCTA obtains, or generates and uses, relevant quality information to support the functioning of other components of internal control.

¹ See U.S. Government Accountability Office publication, "Standards for Internal Control in the Federal Government," available at <http://www.gao.gov/products/GAO-14-704G>, for more information.

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- Monitoring
 - OCTA evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the Board, as appropriate.

The scope included investment transactions and investment-related controls for the period January 1 through June 30, 2022. OCTA's independent auditor, Crowe LLP (Crowe), will perform agreed-upon procedures with respect to the Treasury function for the year ended June 30, 2022. Internal Audit limited the scope of this audit to procedures that will not be performed by Crowe during the course of their agreed-upon procedures.

The methodology consisted of obtaining the most current Investment Policy and Debt and Investment Management Manual, reviewing any personnel changes and corresponding updates to bank authorization signature cards, reviewing a haphazard sample of daily cash worksheets prepared by Accounting and Treasury staff, testing a judgmental sample of wire and automated clearing house (ACH) transfers for accuracy and proper authorization, testing a haphazard sample of Treasury's weekly compliance review, and testing a haphazard sample of the monthly Investment and Debt Programs Reports provided to OCTA's Board, including testing a haphazard sample of 40 investment securities managed by investment managers for the selected month. Due to changes in personnel, an additional test to trace a judgmental sample of 40 investment securities from the custodial account statements to monthly Investment and Debt Program Reports was performed with a bias towards even coverage among investment managers. For wire and ACH transfer testing, Internal Audit judgmentally selected wire or ACH transfers with a bias towards large transactions. Since the samples are non-statistical, any conclusions are limited to the sample items tested. The methodology also included confirming that Treasury obtained investment managers' acknowledgement of receipt of OCTA's Investment Policy and confirming that investment managers' performance is reported and compared to indices in the monthly Investment and Debt Program Reports.

We conducted this performance audit in accordance with GAGAS. 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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Audit Comments, Recommendations, and Management Responses

Compliance Monitoring

Documentation addressing potential Investment Policy violations flagged by the Clearwater system's compliance module is not consistently maintained in the system or with the department manager, as required by the Debt and Investment Management Manual. Based on discussion with Treasury management and cursory review of the system, the Clearwater compliance module often flags violations in error.

Recommendation:

Internal Audit recommends management maintain documentation addressing all potential violations flagged by the Clearwater compliance module, in accordance with the Debt and Investment Management Manual. To improve the usefulness of the Clearwater compliance module, updates should be implemented by Clearwater to ensure only violations of the Investment Policy are flagged.

Management Response:

Management agrees with the recommendation and has worked with the software provider to address items flagged as non-compliant in error. During this time, staff continued to utilize the Daily Holdings reports in conjunction with the compliance module to monitor compliance. Staff also maintained documentation with the department manager addressing potential violations flagged by the system. The software provider has recently completed updates to the compliance module; therefore, staff anticipates utilizing the compliance module as the primary source for all compliance monitoring and reporting, effective October 3, 2022.

Monthly Reporting

In the April and May 2022 monthly Investment and Debt Programs Reports, the First American Government Obligation Fund was labeled as United States Treasury Obligations in the Bond Proceeds and Debt Service Reserve Fund portfolios, when the actual classification is Money Market Fund. In addition, in April 2022, \$20,000,157 in the First American Government Obligation Fund was classified as Commercial Paper in the Bond Proceeds portfolio rather than Money Market Funds.

Recommendation:

Internal Audit recommends that Treasury enhance secondary review of monthly reports to include verification of security classifications in the Bond Proceeds and Debt Service Reserve Fund portfolios.

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Management Response:

Management agrees with the recommendation to enhance the secondary review of monthly reports and has recently completed the recruitment process to fill the vacant position within the department that plays a key role in the monthly reporting process. Additionally, as reflected in the Monthly Investment and Debt Report for July 31, 2022 that was brought to the Board at the September 12, 2022 meeting, the asset label was updated to reflect the fund title instead of the underlying securities.