



**October 23, 2024**

**To:** Finance and Administration Committee

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

Janet Sutter, Executive Director  
Internal Audit Department

**Subject:** Investment Manager Contracts, Internal Audit Report No. 25-504

### **Overview**

The Internal Audit Department of the Orange County Transportation Authority has completed an audit of investment manager contracts. Based on the audit, oversight, contract compliance, and invoice review controls are generally adequate; however, two recommendations have been made to improve compliance with contract terms related to replacing key personnel and to improve the timeliness of invoice processing.

### **Recommendation**

Direct staff to implement two recommendations provided in Investment Manager Contracts, Internal Audit Report No. 25-504.

### **Background**

The Treasury/Public Finance Department (Treasury) is responsible for overall management of the Orange County Transportation Authority's (OCTA) investment portfolio. On June 30, 2024, OCTA's portfolio book value was approximately \$2.5 billion, of which approximately \$2.0 billion is in a short-term portfolio managed by four investment firms.

Treasury maintains contracts with external investment managers Chandler Asset Management, Inc. (CAM), MetLife Investment Advisors, LLC (MetLife), Payden & Rygel (P&R), and PFM Asset Management, LLC (PFM) under Agreement Nos. C-7-1813, C-7-2062, C-7-2063, and C-7-2064 (contracts), respectively. The firms are responsible for investing funds in compliance with the OCTA Investment Policy and the California Government Code. The firms serve as a general resource for OCTA staff for economic insight, investment advice,

and education regarding fixed-income securities and investments. Per the contracts, investment managers are required to provide monthly reports of investments, earnings, and the value of the portfolio. Invoices are submitted quarterly, and fees are calculated based on the value of assets under management. Treasury is responsible for oversight and contract compliance, as well as review and approval of invoices in accordance with the contract terms and OCTA policy.

### ***Discussion***

Changes to investment manager key personnel are not identified and approved timely. The agreement requires the resume and qualifications of proposed replacement key personnel be submitted to OCTA for approval seven calendar days prior to the departure of the incumbent, and that OCTA respond to these requests within seven calendar days. Internal Audit identified six instances in which an investment management firm replaced key personnel without notifying OCTA, and two instances in which the notification was not made within seven calendar days and the response from OCTA was not made within seven calendar days. Internal Audit recommended management remind investment managers of contract requirements for replacement of key personnel and implement a procedure to periodically validate key personnel. Management agreed and indicated that staff will remind investment managers of the contract requirement, will request that investment managers limit the designations of key personnel, and will implement a process to periodically validate key personnel.

Internal Audit identified delays in invoice review and processing. The agreement requires payment within 30 calendar days of receipt of an invoice. Internal Audit identified four invoices that were paid beyond 30 calendar days of receipt, with delays ranging from 44 to 101 days. Internal Audit recommended management improve the timeliness of invoice review, approval, and processing. Management agreed and indicated additional controls will be implemented to ensure timely payment.

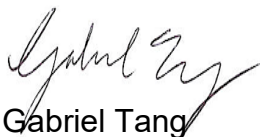
### ***Summary***

Internal Audit has completed an audit of investment manager contracts, and has offered two recommendations, which management has agreed to implement.

**Attachment**

- A. Investment Manager Contracts, Internal Audit Report No. 25-504

**Prepared by:**



Gabriel Tang  
Principal Internal Auditor  
714-560-5746

**Approved by:**



Janet Sutter  
Executive Director, Internal Audit  
714-560-5591

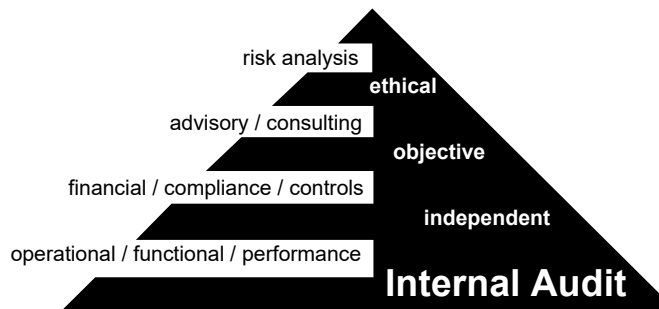
# ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



## Investment Manager Contracts

### Internal Audit Report No. 25-504

October 11, 2024



**Audit Team:**

Gabriel Tang, CPA, Principal Internal Auditor  
Janet Sutter, CIA, Executive Director

**Distributed to:**

Andrew Oftelie, Chief Financial Officer, Finance and Administration  
Sean Murdock, Robert Davis, Changsu Lee, Pia Veesapen

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## **Conclusion**

The Internal Audit Department (Internal Audit) of the Orange County Transportation Authority (OCTA) has completed an audit of investment manager contracts. Based on the audit, oversight, contract compliance, and invoice review controls are generally adequate; however, two recommendations have been made to improve compliance with contract terms related to replacing key personnel and to improve the timeliness of invoice processing.

## **Background**

The Treasury/Public Finance Department (Treasury) is responsible for overall management of OCTA's investment portfolio. On June 30, 2024, OCTA's portfolio book value was approximately \$2.5 billion, of which approximately \$2.0 billion is in a short-term portfolio managed by four investment firms.

Treasury maintains contracts with external investment managers Chandler Asset Management, Inc. (CAM), MetLife Investment Advisors, LLC (MetLife), Payden & Rygel (P&R), and PFM Asset Management, LLC (PFM), under Agreement Nos. C-7-1813, C-7-2062, C-7-2063, and C-7-2064 (contracts), respectively. The contracts' initial term ran from April 2, 2018 to March 30, 2023, and the first option-term, extending the contracts through March 31, 2025, was approved by the Board of Directors on February 22, 2023. The firms are responsible for investing funds in compliance with the OCTA Investment Policy and the California Government Code. The firms serve as a general resource for OCTA staff for economic insight, investment advice, and education regarding fixed-income securities and investments. Per the contracts, investment managers are required to provide monthly reports of investments, earnings, and the value of the portfolio. Invoices are submitted quarterly, and fees are calculated based on the value of assets under management. Treasury is responsible for oversight and contract compliance, as well as review and approval of invoices in accordance with the contract terms and OCTA policy.

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## **Objectives, Scope, and Methodology**

The objectives were to assess and test oversight, contract compliance, and invoice review controls related to short-term investment management services provided by CAM, MetLife, P&R, and PFM.

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, communication, and monitoring.<sup>1</sup> The components and principles that were evaluated as part of this audit are:

- Control Environment
  - OCTA demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
- Control Activities
  - OCTA deploys control activities through policies that establish what is expected and procedures that put policies into action.

The scope was limited to Agreement Nos. C-7-1813, C-7-2062, C-7-2063, and C-7-2064, and the scope period is from July 1, 2022 through June 30, 2024.

The methodology consisted of testing evidence of compliance with key contract terms, including insurance requirements, pre-approval for use of subcontractors, and pre-approval for changes to key personnel. The methodology also included testing a judgmental sample of invoices paid for compliance with contract terms, and evidence of timely review, authorization, and payment, as well as a judgmental sample of investment manager monthly reports for accuracy and compliance with contract reporting requirements. The judgmental samples were selected to provide coverage throughout the scope period.

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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<sup>1</sup> 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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**Audit Comments, Recommendations, and Management Responses**

**Investment Manager Key Personnel Changes**

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Changes to investment manager key personnel are not identified and approved timely.

Per the contracts, “Should the services of any key person become no longer available to consultant, the resume and qualifications of the proposed replacement shall be submitted to OCTA for approval as soon as possible, but in no event later than seven (7) calendar days prior to the departure of the incumbent key person, unless consultant is not provided with such notice by the departing employee. OCTA shall respond to consultant within seven (7) calendar days following receipt of these qualifications concerning acceptance of the candidate for replacement.”

Internal Audit identified six instances in which an investment management firm replaced key personnel without notifying Treasury. In addition, Internal Audit identified two instances whereby investment managers notified Treasury of key personnel changes; however, the requests to replace key personnel were not made in accordance with agreement terms (within seven days prior to departure of incumbent staff) and review and approval of key personnel replacements was not provided in accordance with agreement terms (within seven days of the request).

**Recommendation 1:**

Internal Audit recommends management remind investment managers of contract requirements for replacement of key personnel and implement a procedure to periodically validate key personnel.

**Management Response:**

Management agrees with the recommendation. Staff will continue to remind investment managers of the contract requirements regarding the replacement of key personnel. Additionally, staff has requested that investment managers limit the designation of key personnel to those employees who directly work with OCTA staff. Furthermore, staff will implement a process to periodically validate key personnel.



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**Delays in Invoice Processing**

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Internal Audit identified delays in invoice review and processing.

Per the contract, "OCTA shall remit payment within thirty (30) calendar days of the receipt and approval of each invoice."

Internal Audit noted four out of 16 invoices were paid beyond 30 calendar days of receipt. Delays in payment ranged from 44 to 101 days after invoice receipt.

**Recommendation 2:**

Internal Audit recommends management improve timeliness of invoice review, approval and processing.

**Management Response:**

Management agrees with the recommendation. Staff has implemented additional checks in the review process to ensure the timeliness of payments is carefully monitored.