



April 12, 2023

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, July 1 through December 31, 2022, Internal Audit Report No. 23-507

Overview

The Internal Audit Department has completed an audit of investments for the period July 1 through December 31, 2022. Based on the audit, the Orange County Transportation Authority generally complied with its debt, investment, and reporting policies and procedures; however, four recommendations were made to improve the review of monthly reports, improve documentation of weekly compliance monitoring reviews, ensure bank accounts are reconciled in accordance with policy, and ensure invoicing complies with the terms of the financial advisor contract.

Recommendation

Direct staff to implement four recommendations provided in Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2022, Internal Audit Report No. 23-507.

Background

The Treasury Department (Treasury) is responsible for the management of the Orange County Transportation Authority's (OCTA) Investment Portfolio (Portfolio). To accomplish this, Treasury uses the Clearwater treasury software system to monitor investments and investment manager performance. On December 31, 2022, the Portfolio's book value was approximately \$2.5 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 (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

The December 2022 monthly report initially submitted contained errors in the descriptions of medium term note securities that were corrected before publication, after notification by the Internal Audit Department (Internal Audit). Additionally, the checklist used to evidence secondary review of the October 2022 monthly report was signed by the preparer, rather than a secondary reviewer. Internal Audit recommended Treasury consistently obtain secondary review of monthly reports and enhance reviews to cover presentation of individual securities. Management agreed and indicated that this recommendation has been implemented.

Treasury's weekly monitoring includes a review of the Clearwater Holding reports to evaluate asset allocation by investment manager and a review of the compliance module; however, no notes were made to dispose of a potential violation reflected in two Clearwater Holding reports, and a note addressing another potential violation in the compliance module was not entered in a timely manner. Internal Audit recommended that Treasury add notes to Clearwater Holding reports to address potential violations and ensure all notes are prepared in a timely manner. Management agreed and indicated that, going forward, notes will be recorded in a timely manner.

OCTA's Bank Account Reconciliations Policy requires bank account reconciliations to be approved by the end of the month following the month being reconciled; however, the August 2022 investment account reconciliation was not approved until January 2023. In addition, bank account reconciliations are not currently being prepared for the Toll Road Operating account, a zero-balance account; however, the policy does not provide an exception for zero-balance bank accounts to be exempt from the reconciliation requirement. Internal Audit

recommended that all accounts be reconciled and approved in accordance with policy requirement. Management agreed and indicated that a control to ensure timely approval of reconciliations has been implemented.

OCTA's financial advisor billed one named key personnel at a classification title and rate higher than stated in the contract in one invoice and billed minor amounts for dinner and toll charges without receipts in another invoice. Internal Audit recommended that Treasury enforce contract invoicing requirements. Management responded that additional detail has been obtained and contract amendments to reflect personnel changes will be processed more timely going forward.

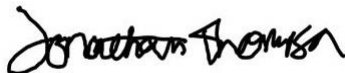
Summary

Internal Audit has completed an audit of investments for the period July 1 through December 31, 2022, and has offered four recommendations for improvement.

Attachment

- A. Investments: Compliance, Controls, and Reporting, July 1 through December 31, 2022, Internal Audit Report No. 23-507

Prepared by:



Jonathan Thompson
Internal Auditor
714-560-5930

Approved by:



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

ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



Investments: Compliance, Controls, and Reporting July 1 through December 31, 2022

Internal Audit Report No. 23-507 March 28, 2023



Audit Team: Jonathan Thompson, Internal Auditor, Internal Audit *JT*
Serena Ng, CPA, Senior Manager

Distributed to: Andrew Oftelie, Chief Financial Officer, Finance and Administration
Sean Murdock, Robert Davis, Rima Tan, Changsu Lee

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Investments: Compliance, Controls, and Reporting
July 1 through December 31, 2022
March 28, 2023**

Table of Contents

Conclusion	1
Objectives, Scope, and Methodology	2
Audit Comments, Recommendations, and Management Responses	4
Monthly Reporting.....	4
Documentation of Compliance Monitoring	4
Compliance Bank Account Reconciliation	5
Financial Advisor Contract Compliance	6

ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Investments: Compliance, Controls, and Reporting
July 1 through December 31, 2022
March 28, 2023

Conclusion

The Internal Audit Department (Internal Audit) has completed an audit of investments for the period July 1 through December 31, 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 four recommendations to improve the review of monthly reports, improve documentation of weekly compliance monitoring reviews, ensure bank accounts are reconciled in accordance with the Bank Account Reconciliations Policy, and ensure invoicing complies with the terms of the financial advisor contract.

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 December 31, 2022, the Portfolio's book value was approximately \$2.5 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. 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.

ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Investments: Compliance, Controls, and Reporting
July 1 through December 31, 2022
March 28, 2023

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;
- 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 Directors (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.

ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Investments: Compliance, Controls, and Reporting
July 1 through December 31, 2022
March 28, 2023

- 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 July 1 through December 31, 2022.

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 investment purchases executed by Treasury staff for compliance with the Investment Policy and evidence of supervisory review, 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.

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Investments: Compliance, Controls, and Reporting
July 1 through December 31, 2022
March 28, 2023**

Audit Comments, Recommendations, and Management Responses

Monthly Reporting

The December 2022 Investment and Debt Programs Report initially submitted contained errors in the descriptions of medium term note securities that were corrected before publication, after notification by Internal Audit. Additionally, while Treasury uses a checklist to evidence secondary review of the monthly Investment and Debt Programs Report, the checklist for the October 2022 Investment and Debt Programs Report was signed by the preparer of the report, rather than a secondary reviewer.

Recommendation:

Internal Audit recommends Treasury consistently obtain secondary review of the monthly Investment and Debt Programs reports provided to the Board and enhance review to include increased oversight over the presentation of individual securities.

Management Response (Treasury):

Management agrees with the recommendations. Staff automated the process of creating the portfolio listing (Attachment B of the Monthly Debt and Investment Report) to produce the report more efficiently on a monthly basis. However, in implementing this change for the first time, rows were inadvertently hidden on the report. This issue impacted individual lines on the report but did not impact totals displayed on the report. A process has been put in place to ensure this is not an issue going forward.

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. The position was filled mid-November 2022. Additionally, going forward, when there is a vacant position within the department, the secondary review will be handled by the Director of F&A.

Documentation of Compliance Monitoring

Treasury's weekly monitoring includes a review of the Clearwater Holdings Report to evaluate asset allocation by individual manager and a review of the compliance module of the Clearwater system for each day of the week; however, documentation of these reviews is not comprehensive and not always timely. Two of the six Clearwater holdings reports tested indicated one investment manager had exceeded the 20 percent limit for mortgage pass-through and asset-backed securities. These reports did not include any notes or other documentation disposing of the potential violation. Treasury did have notes

ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Investments: Compliance, Controls, and Reporting
July 1 through December 31, 2022
March 28, 2023

disposing of another potential violation flagged by Clearwater's compliance module; however, the notes were dated a few weeks after the violation appeared.

Recommendation:

Internal Audit recommends Treasury add notes to Clearwater holdings reports to address potential violations and ensure all notes are prepared in a timely manner.

Management Response (Treasury):

Management agrees with the recommendation to ensure notes are prepared in a timely manner; however, going forward, all notes will be reflected in the Clearwater compliance module, which has been the primary source for compliance monitoring and reporting since October 2022. It is important to note that there were no violations where an investment manager exceeded the 20 percent limit for mortgage pass-through and asset-backed securities. In the above two instances the holdings reports were incorrect, which was confirmed through the compliance module. As a result, no notes for these two issues were included within the compliance module.

Bank Account Reconciliation

OCTA's Bank Account Reconciliations Policy requires bank account reconciliations to be completed and approved by the end of the month following the month being reconciled; however, the August 2022 Commingled Investment Portfolio account reconciliation was not approved until January 07, 2023. In addition, the Accounting Department is not currently preparing bank account reconciliations of the Toll Road Operating account, due to the account being a zero-balance account; however, the policy does not provide an exception for zero-balance bank accounts to be exempt from the reconciliation requirement.

Recommendation:

Internal Audit recommends Accounting reconcile all accounts, including zero-balance accounts, and comply with policy requirements on timely approval of account reconciliations.

Management Response (Accounting):

Management agrees with the recommendations. The bank account reconciliation for August 2022 was completed; however, was not approved timely due to an oversight by staff. Staff has since implemented an internal control to ensure approval of the reconciliation is completed timely. Bank account reconciliations for the zero-balance

**ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT
Investments: Compliance, Controls, and Reporting
July 1 through December 31, 2022
March 28, 2023**

account for the Toll Road Operating account are completed on a monthly basis and going forward staff will provide documentation showing the reconciliation has been completed.

Financial Advisor Contract Compliance

In September 2022, OCTA's financial advisor billed one named key personnel at a classification title and rate higher than stated in the contract. In another invoice, the financial advisor billed minor amounts for a dinner and toll charges, without detailed receipts or other supporting documentation needed to confirm the allowability of the charges.

Recommendation:

Internal Audit recommends Treasury enforce contract invoicing requirements and follow up on the identified billings. If a key personnel's classification is changed, and such change is acceptable to Treasury, the contract should be amended accordingly.

Management Response (Treasury):

Management agrees with the recommendations. The key personnel billed at a classification and rate higher than stated in the contract had been promoted, which was noted by the consultant at the time the invoice was submitted. Upon review of the invoice, staff requested additional documentation from the consultant which was provided and maintained with the department. Staff reviewed the additional documentation provided to ensure the hourly rate listed on the invoice matched the classification noted on the agreement. This review was conducted by staff prior to processing the invoice for payment. Going forward, staff will amend the contract more promptly to incorporate the change in key personnel. In terms of additional supporting documentation for both dinner and toll charges, the consultant did provide a statement reflecting toll fees paid in the aggregate for the month upon submission of the invoice. Staff has since requested a more detailed statement which has been provided. Staff also requested and received more detailed supporting documentation for the dinner expense.