



**COUNTY OF ORANGE  
INTERNAL AUDIT DEPARTMENT**

**OFFICE OF THE DIRECTOR**

*Integrity  
Objectivity  
Independence*

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File No. 2310

July 28, 2004

TO: John M.W. Moorlach  
Treasurer-Tax Collector

SUBJECT: Report on Annual Audit of Treasury Investment Compliance for the Orange  
County Treasury Oversight Committee

Attached are nine copies of our Report on Annual Audit of Treasury Investment Compliance for the Year Ending December 31, 2003(Audit No. 2310) for distribution to the Treasury Oversight Committee and appropriate members of your staff. If you have any questions, please contact Alan Marcum, Audit Manager, at 834-4119 or Toni Smart, Senior Auditor, at 834-5934.

Respectfully submitted,

Dr. Peter Hughes, CPA  
Director, Internal Audit

/PH:ts  
Attachments

Other recipients of this audit report:

Members, Board of Supervisors  
Members, Audit Oversight Committee  
James D. Ruth, County Executive Officer  
Foreman, Grand Jury  
Darlene J. Bloom, Clerk of the Board of Supervisors  
Paul Gorman, Treasurer Accounting/Compliance Manager

**REPORT  
ON ANNUAL AUDIT OF  
TREASURY INVESTMENT COMPLIANCE  
FOR THE  
YEAR ENDED DECEMBER 31, 2003**

**Report Date: July 28, 2004**

**Audit Number 2310**

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<b>Director:</b>	<b>Dr. Peter Hughes, CPA, CIA</b>
<b>Deputy Director:</b>	<b>Eli Littner, CPA, CIA</b>
<b>Audit Manager:</b>	<b>Alan Marcum, CPA, CIA</b>
<b>In-Charge Auditor:</b>	<b>Pamela L. Parisien, CPA, CIA</b>
<b>Staff Auditors:</b>	<b>Toni Smart, CPA</b>



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**INTERNAL AUDIT DEPARTMENT  
COUNTY OF ORANGE**

**REPORT  
ON ANNUAL AUDIT OF  
TREASURY INVESTMENT COMPLIANCE  
FOR THE  
YEAR ENDING DECEMBER 31, 2003**

TABLE OF CONTENTS

	<u>Page No.</u>
Internal Auditor's Report .....	1
Findings, Recommendations, and Responses .....	6
I. Adequacy of internal controls over securities lending transactions .....	6
II. Noncompliance with Investment Policy Statement Section VII – <u>Ethics and Conflict of Interest</u> .....	6
III. Noncompliance with California Government Code Section 27131 .....	7
 APPENDIX: Treasury Management Responses (Full Text)	



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# COUNTY OF ORANGE INTERNAL AUDIT DEPARTMENT

## OFFICE OF THE DIRECTOR

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## INDEPENDENT AUDITOR'S REPORT

File No. 2310

July 28, 2004

County of Orange  
Treasury Oversight Committee  
12 Civic Center Plaza, Room G-76  
Santa Ana, CA 92701-4521

We have examined the Treasury management's assertions in the accompanying Summary of Investment Compliance Requirements which was included in the representation letter dated June 4, 2004, that Orange County Treasurer complied with California Government Code Sections 27130 through 27137 and related provisions of the Orange County Treasurer Investment Policy Statement for the Money Market and the Extended Funds for the year ended December 31, 2003. Treasury management is responsible for compliance with those requirements. Our responsibility is to express an opinion on Treasury management's assertions about Orange County Treasurer's compliance based on our examination.

Our examination was made in accordance with the attestation standards established by the American Institute of Certified Public Accountants, and accordingly included examining on a test basis evidence about the County Treasury's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on the County Treasury's compliance with specified requirements.

As described in the accompanying schedule of Findings, Recommendations and Responses, Orange County Treasurer did not comply with the Investment Policy Statement regarding the review of the Statement of Economic Interest Disclosure and California Government Code Section 27131, for the nomination of Treasury Oversight Committee members. In addition, we identified where internal controls could be improved over securities lending transactions.

In our opinion, except for the noncompliance described in the preceding paragraph, management's assertions that Orange County Treasurer complied with the aforementioned requirements during the year ended December 31, 2003, are fairly stated, in all material respects.

County of Orange  
Treasury Oversight Committee  
July 28, 2004

This report is intended solely for the information and use of the County Treasury Oversight Committee and is not intended to be and should not be used by anyone other than the party specified. However, this report is a matter of public record and its distribution is not limited.

Sincerely,



Dr. Peter Hughes, CPA  
Director, Internal Audit

Other recipients of this audit report:

Members, Board of Supervisors  
Members, Audit Oversight Committee  
James D. Ruth, County Executive Officer  
Foreman, Grand Jury  
John M.W. Moorlach, Treasurer-Tax Collector  
Paul Gorman, Treasurer Accounting/Compliance Manager  
Darlene J. Bloom, Clerk of the Board of Supervisors

**COUNTY OF ORANGE**  
**SUMMARY OF INVESTMENT COMPLIANCE REQUIREMENTS**  
**SCHEDULE I**  
**For Year Ended 12/31/03**

The investment compliance requirements presented in the California Government Code Sections 27130 through 27137 and related provisions of the Orange County Treasurer Investment Policy Statement are as follows:

**Government Code Sections 27130 through 27137**

1. The Legislature finds and declares that local agencies, including school districts, should participate in reviewing the policies that guide the investment of those funds. (Section 27130)
2. The Board of Supervisors in each county shall, if the county is investing surplus funds, establish a county treasury oversight committee that consists of from three to eleven members. (Section 27131)
3. The county treasury oversight committee shall consist of members appointed from the following: county treasurer; county auditor, auditor-controller or finance director; a representative appointed by the county board of supervisors; the county superintendent of schools or designee; a representative selected by a majority of the presiding officers of the governing bodies of the school or community college districts; a representative selected by a majority of the presiding officers of the legislative bodies of the special districts; up to five other members of the public who either have expertise or academic background in finance or are economically diverse and bipartisan in political registration. (Section 27132)
4. Committee members may not be employed by an entity that has contributed to the campaign of a candidate for the office of local treasurer, or contributed to the campaign of a candidate to be a member of a legislative body of any local agency that has deposited funds in the county treasury, in the previous three years or during the period that the employee is a member of the committee. (Section 27132.1)
5. Committee members may not directly or indirectly raise money for a candidate for local treasurer or a member of the governing board of any local agency that has deposited funds in the county treasury while a member of the committee. (Section 27132.2)
6. Committee members may not secure employment with bond underwriters, bond counsel, security brokerages or dealers, or with financial services firms with whom the treasurer is doing business during the period that the person is a member of the committee or for three years after leaving the committee. (Section 27132.3)
7. Committee meetings shall be open to the public and subject to the Ralph M. Brown Act. (Section 27132.4)
8. The county treasurer shall annually prepare an investment policy that will be reviewed and monitored by the county treasury oversight committee. The investment policy shall include the following: a listing of authorized securities or other instruments in which the treasurer may invest; maximum security terms; criteria for the selection of brokers and dealers; limits on the receipt of gifts; investment reporting requirements; cost calculation and apportionment policy for managing funds; deposit terms and conditions for voluntary participants; and funds withdrawal criteria. (Section 27133)

**COUNTY OF ORANGE**  
**SUMMARY OF INVESTMENT COMPLIANCE REQUIREMENTS**  
**SCHEDULE I (Continued)**  
**For Year Ended 12/31/03**

9. The county treasury oversight committee shall cause an annual audit to be conducted to determine the county treasury's compliance with the investment compliance requirements presented in the California Government Code Sections 27130 through 27137. (Section 27134)
10. The costs of complying with this article shall be county charges and may be included with those charges enumerated under Section 27013. (Section 27135)
11. Local or public agencies that have funds on deposit in the county treasury pool and seek to withdraw funds for the purpose of investing or depositing those funds outside the county treasury pool shall first submit the request for withdrawal to the county treasurer. The county treasurer shall evaluate each proposed withdrawal for its consistency with the criteria adopted pursuant to Section 27133. Prior to approving a withdrawal, the county treasurer shall find that the proposed withdrawal will not adversely affect the interests of the other depositors in the county treasury pool. (Section 27136)
12. The county treasury oversight committee shall not direct individual investment decisions, select individual investment advisors, brokers, or dealers, or impinge on the day-to-day operations of the county treasury. (Section 27137)

**Orange County Treasurer Investment Policy Statement (IPS)**

13. Investments maintained in the portfolios shall be consistent with those authorized per Government Code Sections 53601 et seq. and 53635, as stated in IPS Sections IV and V.
14. Investments maintained in the portfolios shall comply with investment criteria as stated in IPS Sections IV, V and VI, including the maximum allowable percentage by type of security, allowable percentage per issuer, maximum term limits and credit ratings requirements.
15. Treasurer, investment personnel, and Treasury Oversight Committee members shall annually complete the Statement of Economic Interests Disclosure (State of California Form 700) and must comply with the Orange County Gift Ban Ordinance which prohibits the receipt of specified gifts, as stated in IPS Section VII.
16. All security transactions must be executed through brokers/dealers and financial institutions that meet the selection criteria specified in IPS Section VIII and are placed on the list of qualified institutions.
17. All security transactions entered into by the Treasurer shall be conducted on a delivery-versus payment basis and a third party custodian, as stated in IPS Section X, shall hold securities.
18. Repurchase agreements and securities lending agreements are required to be collateralized by securities authorized under Government Code Section 53601 at a minimum of 102% of market value of the principal and accrued interest, and shall be adjusted no less frequently than weekly. Collateral is to be held by an independent third party with whom the treasurer has a current custodial agreement. Evidence of ownership must be supplied to the Treasurer and retained as stated in IPS Section XI.

**COUNTY OF ORANGE**  
**SUMMARY OF INVESTMENT COMPLIANCE REQUIREMENTS**  
**SCHEDULE I (Continued)**  
**For Year Ended 12/31/03**

19. The Treasurer will charge all pool participants for administrative and overhead costs of investing, depositing, banking, auditing, reporting, or otherwise handling or managing the funds as authorized by Government Code Section 27013, as stated in IPS Section XIV.
20. Local agencies that voluntarily deposit monies with the Treasurer must provide to the Treasurer a resolution adopted by its governing board stating that excess funds are available for investing, in compliance with requirements stated in IPS Section XV.
21. Withdrawal of participant funds shall require prior written approval from the Treasurer. Prior to approving the withdrawal request, the Treasurer shall make a finding of the effect of the withdrawal on the stability and predictability of the investments, as stated in IPS Section XVI.
22. The Treasurer shall provide monthly report and any audit report in accordance with Government Code Sections 53646 and 53686, as stated in IPS Section XIX.



## **FINDINGS, RECOMMENDATIONS, AND RESPONSES**

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### **I. Adequacy of internal controls over securities lending transactions**

We found that the Treasurer has not established procedures for monitoring the Securities Lending– Cash Collateral Client Investment Reports to determine if the securities purchased by the Bank of New York are approved investment types. According to our Securities Lending Agreement (Agreement), with the Bank of New York, they have the authority to reinvest the cash portion of the collateral amounts received from a borrower. The Cash Collateral Client Investment Report lists the securities that have been purchased with the cash collateral. The Treasurer should be monitoring this report to determine if the securities purchased by the agent are approved investment types based on Schedule I in the Agreement as the County is responsible for compensating the agent for any loss arising from a deficiency in the amount of collateral available for return to a borrower.

#### **Recommendation No. 1**

We recommend that the Treasurer review/monitor the Bank of New York Securities Lending – Cash Collateral Client Investment report on a daily basis to determine if the securities purchased by our agent are approved investment types.

#### **Treasurer-Tax Collector response:**

Concur. The Treasurer Tax-Collector will incorporate in their daily compliance procedures a review of approved investment types in securities lending activity reports. We will implement this review by July 31, 2004.

### **II. Noncompliance with Investment Policy Statement Section VII – Ethics and Conflict of Interest**

Section VII of the IPS states “The County Treasurer, Assistant Treasurer, Investment Officer, Assistant Investment Officer and Treasury Oversight Committee members shall complete on an annual basis, State of California Form 700, Statement of Economic Interests Disclosure. In addition, each member mentioned above is subject to the State Gift Ban restrictions. Should any conflicts be disclosed, the Treasurer will resolve such matters as soon as practical.”

The Treasurer’s office is responsible for ensuring that any conflicts disclosed on the Forms 700 be resolved as soon practical. As part of the process, we found that Clerk of the Board (COB) does not review any of the form 700s to identify noncompliance or conflicts of interest. The COB performs a random review of only 20% the forms for “completeness and timeliness”.

Furthermore, Code Section 87200 of the Political Reform Act, requires that the Forms 700 for certain county officials (Board of Supervisors, District Attorney, County Counsel, County Treasurer and CEO) be forwarded directly to the Fair Political Practices Commission (FPPC) for review. The FPPC then reports instances of noncompliance or conflicts of interest directly to the county official.

Because the COB does not perform a review the Form 700s to identify noncompliance or conflicts of interest, any instances of noncompliance or conflicts of interest would not get reported to the Treasurer, further preventing the Treasurer from complying with the requirements of Section VII of the IPS.

**Recommendation No. 2**

We recommend that the Treasurer establish controls over the Forms 700 to ensure all instances of noncompliance or conflicts of interest are either identified by or reported to the Treasurer enabling them to comply with the requirements of Section VII of the IPS.

**Treasurer-Tax Collector response:**

Concur. The Treasurer Tax-Collector will obtain copies as set forth in the IPS of all Forms 700 and review for any noncompliance or disclosures of conflicts of interest. Should any conflicts be disclosed, The Treasurer-Tax Collector will resolve such matters as soon as practical.

**III. Noncompliance with California Government Code Section 27131**

Pursuant to Section 27131, members of the Treasury Oversight Committee shall be nominated by the treasurer and confirmed by the board of supervisors.

We found that for one of the current public members of the Treasury Oversight Committee (TOC), their membership (term) had expired on March 13, 2003. Apparently, the Assistant Treasurer handled all board nominations, however, effective December 26, 2003 the Assistant Treasurer retired and the reappointment of the public member was overlooked.

**Recommendation No. 3**

We recommend that the Treasurer nominate the public member for reappointment as a public member of the Treasury Oversight Committee, effective March 14, 2003.

**Treasurer-Tax Collector response:**

Concur. The Board of Supervisors approved the public member for reappointment on June 15, 2004.

**APPENDIX  
TREASURER MANAGEMENT RESPONSE**

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COUNTY OF ORANGE  
**OFFICE OF THE TREASURER-TAX COLLECTOR**  
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July 16, 2004

Dr. Peter Hughes, CPA  
Director, Internal Audit  
County of Orange  
400 Civic Center Drive West  
Building 12, Room 232  
Santa Ana, CA 92701-4521

Dear Dr Hughes:

Pursuant to Audit Oversight Committee Administrative Procedure No. 1, we have prepared our response to the draft results of your examination of the investment compliance requirements presented in California Government Code Sections 27130 through 27137, and related provisions of the Orange County Treasurer Investment Policy Statement, for the year ended December 31, 2003. The recommendation numbers used in your report reference our response.

**Recommendation No. 1**

We recommend the Treasurer review/monitor the Bank of New York Securities lending – Cash Collateral Client investment report on a daily basis to determine if the securities purchased by our agent are approved investment types.

**Treasurer-Tax Collector response:**

Concur. The Treasurer Tax-Collector will incorporate in their daily compliance procedures a review of approved investment types in securities lending activity reports. We will implement this review by July 31, 2004.

**Recommendation No. 2**

We recommend the Treasurer establish controls over the Forms 700 to ensure all instances of noncompliance or conflicts of interest are either identified by or reported to the Treasurer enabling them to comply with the requirements of Section VII of the IPS

**Treasurer-Tax Collector response:**

Concur. The Treasurer Tax-Collector will obtain copies as set forth in the IPS of all Forms 700 and review for any noncompliance or disclosures of conflicts of interest. Should any conflicts be disclosed, The Treasurer-Tax Collector will resolve such matters as soon as practical.

**APPENDIX**  
**TREASURER MANAGEMENT RESPONSE (con't)**

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Dr. Peter Hughes, CPA  
Page 2

**Recommendation No. 3**

We recommend that the Treasurer nominate the public member for reappointment as a public member of the Treasury Oversight Committee, effective March 14, 2003.

**Treasurer-Tax Collector response:**

Concur. The Board of Supervisors approved the public member for reappointment on June 15, 2004.

If you have additional questions or follow-up comments, please contact Paul Gorman, Treasury Accounting/Compliance Manager at 834-2288.

Very truly yours,



John M. W. Moorlach, C.P.A., CFP®  
Orange County Treasurer-Tax Collector