# INTERNAL AUDIT SERVICES

# REVIEW OF SOLANO COUNTY TREASURY CONTROLS OVER INVESTMENT TRANSACTIONS

May 12, 2010

Auditor-Controller: Simona Padilla-Scholtens, CPA Audit Manager: Ian Goldberg, CGAP Internal Auditor: Don Gall

# **Review of the Solano County Treasury Controls Over Investment Transactions**

# **Table of Contents**

	Page
Introduction	3
Background	3
Objective	4
Scope and Methodology	4
Conclusion	4
Opportunities for Improvement	6

# **INTRODUCTION**

In accordance with the Fiscal Year 2009/10 Audit Plan, and risks identified in our quarterly Treasury reviews, we conducted a review of the Treasury internal controls over investment transactions. We conducted our review in accordance with Standards for the Professional Practice of Internal Auditing.

# **BACKGROUND**

The Treasurer's portfolio is managed per California Government Code §53600.5 which states; "When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, the primary objective of a trustee shall be to safeguard the principal of the funds under its control. The secondary objective shall be to meet the liquidity need of the depositor. The third objective shall be to achieve a return on the funds under its control". Investment transactions are typically performed by the Assistant Treasurer, but in his absence may be performed by the Treasurer.

The Assistant Treasurer uses a list of authorized broker/dealers with proven records of performance to perform investment transactions which are approved by the Treasurer. The investment broker/dealer in conjunction with the third party safekeeper bank, Union Bank, completes the investment transactions. Union Bank, as the safekeeper agent, is the key control in the investment purchase/sale transactions. Confirmation of a trade is provided by the broker and serves as evidence that a trade was completed and the security was delivered as instructed. The role of the safekeeper is twofold, first they act as an independent agent or "middle man" to ensure the County receives and delivers what is expected of them in terms of cash and securities. Second, the safekeeper provides a place where securities are kept safe from any internal or external fiscal risks.

The Treasury also maintains depository investments with agencies such as the Local Agency Investment Fund (LAIF), California Asset Management Program (CAMP), and area banks. Depository transactions are not completed through the safekeeper; however the Treasury has an authorized account structure between banks though which Treasury funds may pass. Any

attempt to transfer funds to an account outside of that structure requires approval by the County Treasurer.

Treasury securities are received by "delivery vs. payment" to the Union Bank Safekeeper or as a depository with other agencies and banks. The Treasury does not maintain securities on-site. All physical securities the Treasury owns are kept at Union Bank.

The 12/31/09 account value of Treasury pool investments overseen by Union Bank was over \$430 million. During the past calendar year, the Treasury made security purchases of just over \$300 million. The Treasury initiated no sales during 2009.

# **OBJECTIVE**

The objective of our review was to evaluate the adequacy of internal controls over investment transactions.

# **SCOPE & METHODOLOGY**

The scope of our review included control procedures over the purchase and sale of Treasury investments. Specifically, we determined whether internal controls were sufficient to ensure purchases and sales of investments were properly initiated, authorized, verified, and reconciled. To achieve our objectives, we interviewed key individuals, reviewed records, and evaluated control procedures.

# **CONCLUSION**

The results of our review show a Treasury function with a system of controls over investment transactions and a management team focused on streamlining and continuous improvement. The use of a safekeeper and the delivery vs. payment method combined with a defined investment strategy assist in maintaining accountability for investment transactions and the related account balances.

While the Treasurer endeavors to implement strong controls over investment transactions, our review disclosed opportunities for improvement in the documentation of investment procedures, the support of monthly reconciliations, segregation of treasury staff duties, secondary approval of wire transfers and controls over Safekeeper delivery instructions.

The following pages provide a detailed description of the opportunities for improvement and the related recommendations. These recommendations will assist the Treasury to improve controls and will assist in the effort to ensure accountability over investment transactions.

# OPPORTUNITIES FOR IMPROVEMENT

#### 1. WRITTEN INVESTMENT PROCEDURES

Treasury investment procedures are not formalized in writing. Per the Government Finance Officers Association, written procedures ensure employees have detailed explanations of Treasury approved processes and controls, which promotes accountability and consistency in handling various functions. Complete written procedures also ensure daily duties and responsibilities are communicated in the event of employee absence or turnover, and can assist with staff training.

#### **RECOMMENDATION:**

A. Establish written investment procedures to ensure proper internal controls are identified and followed.

#### **MANAGEMENT RESPONSE:**

The Treasury maintains 300 plus pages of documentation on most operational procedures including but not limited to the acceptance of deposits, the processing of wires and other electronic transactions, handling exception items, daily balancing, and general operating procedures. In addition both the investment software and the ledger system contain detailed instructions as to their proper use and the controls built into them.

The one section of Treasury operations not documented in writing is the mechanics of initiating a purchase or sale, which the Treasurer is responsible for and the fiduciary for. Investment procedures will be written and controlled as to access.

# 2. SEGREGATION OF DUTIES

Our review identified the Assistant Treasurer has authority to initiate and approve investment transactions, and account access to initiate/approve wire transfers, record accounting entries in Sendero (the Treasury investment/accounting software program), and approve the reconciliation of those transactions. Effective segregation of duties requires that no one individual has the ability to both authorize and record a transaction.

Currently, the Treasury operates with a limited number of employees. As a result the Treasurer has assigned significant responsibility for Treasury and investment functions to the Assistant Treasurer. Improper segregation of duties may allow an individual to perpetrate and conceal errors and irregularities while performing regular assigned duties.

#### **RECOMMENDATION:**

- A. Require the approval of the Treasurer for the purchase or sale of all investments.
- B. Remove the Assistant Treasurer's access to record accounting entries in Sendero.

#### **MANAGEMENT RESPONSE:**

- A. The Assistant is authorized by the Treasurer to purchase and sell securities given established guidelines. The Assistant is required to have prior approval from the Treasurer to purchase or sell securities outside of those guidelines.
- B. The Treasurer concurs with this finding. Recommendation was implemented. Therefore, the Assistant no longer has access to record entry.

#### 3. SECONDARY APPROVAL OF WIRE TRANSFERS

Our review identified wire transfers for investment transactions initiated at the direction of the Assistant Treasurer are approved by a subordinate to the Assistant Treasurer. Strong internal controls require the approving authority for wire transfers be in a position to independently review and question the details of the transaction.

Approval authority by a subordinate may lead to improper approval of transactions at the direction of a superior.

# **RECOMMENDATION:**

A. Require the County Treasurer approve all non-repetitive wire transfers for investment transactions initiated within the Treasury.

#### **MANAGEMENT RESPONSE:**

The Treasurer does not concur with this recommendation. Wire transfers between the Treasurer's existing accounts are preapproved; all other wires require Auditor-Controller authorization, and dual authorization among treasury staff. Due to limited staff, this recommendation cannot be implemented at this time. Treasurer will continue to evaluate controls in conjunction with the Auditor-Controller's Office.

# 4. SUPPORT FOR MONTHLY RECONCILIATION OF CASH AND INVESTMENTS

The Auditor-Controller's Office does not request or receive adequate supporting documentation for cash and investment balances per the Treasurer in connection with the monthly reconciliation of cash and investment accounts.

Per Government Code section 26905 the cash and investment accounts of the Treasurer and the Auditor-Controller must be reconciled monthly. Proper reconciliation of the cash and investment accounts includes verifying the agreement and accuracy of the Treasurer and Auditor-Controller's records. All balances included in the reconciliation should be accompanied by supporting documentation verifying the accuracy of the account balances.

The current documentation provided in support of the Treasurer's cash and investment accounts, which consists of a balance sheet representing the total balance of cash and investments per the Treasurer's accounting records, does not allow for the verification of the accuracy of cash and investments. Inadequate supporting documentation may result in errors in the reconciliation of cash and investments and ultimately the overstatement/understatement of balances in the County's financial records.

#### **RECOMMENDATIONS:**

#### **Treasurer**

A. Provide the Auditor-Controller with monthly supporting documents for the total cash and investment account balances.

#### **Auditor-Controller**

B. Review sufficient supporting documentation for cash and investment accounts per the Treasurer to ensure the accuracy of the balances provided for reconciliation.

# **MANAGEMENT RESPONSE:**

#### Treasurer

The Treasury has always made available any documents requested by the Auditor-Controller's Office. We now provide through Documentum, independent access to all Treasury account information including bank statements, financial reports, and trade records. This provides the information in its entirety for independent review by the Auditor-Controller's Office without our consent, knowledge, or control.

#### **Auditor-Controller**

The Auditor-Controller's Office agrees to review the supporting documentation available through Documentum, to verify the accuracy of all Treasury cash and investment balances provided for monthly reconciliations.

#### 5. CONTROLS OVER SAFEKEEPER DELIVERY INSTRUCTIONS

Our review identified changes in delivery instructions for handling proceeds from the sale or dividend payment provided to the third party Safekeeper, are confirmed to only the County Treasurer and not to an independent party. In the event the Treasurer provided instructions for the transfer of funds to accounts outside the County's control, any irregularity would not be identified timely, or prevented. Controls over County funds should ensure that any change to Safekeeper instruction be communicated to an independent party.

#### **RECOMMENDATIONS:**

#### **Treasurer**

A. Require the contract with the Safekeeper stipulate the County Auditor-Controller be notified of all new and subsequent changes to Safekeeper delivery instructions.

# **Auditor-Controller**

B. The Auditor-Controller should review all Safekeeper delivery instructions to ensure the proceeds of all transactions are being deposited into bank accounts under the County's control.

# **MANAGEMENT RESPONSE:**

#### **Treasurer**

The safekeeper delivery instructions are established by contract with the Treasurer. Changes to this approval would require the Treasurer's Authorization. The Treasurer will work with the Auditor-Controller's Office to establish procedures for review of Safekeeper delivery instructions.

# **Auditor-Controller**

The Auditor-Controller's Office will work with the Treasurer's Office to establish procedures for review of Safekeeper delivery instructions.