



PRINCE WILLIAM COUNTY, VIRGINIA

Prince William County, Virginia

Internal Audit Report – Cash Management and Investments

Report Date: May 31, 2016



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May 31, 2016

The Audit Committee of
Prince William County, Virginia
1 County Complex Court
Prince William, Virginia 22192

Pursuant to the internal audit plan for fiscal year (“FY”) 2015-16 for Prince William County, Virginia (the “County”), approved by the Board of County Supervisors on October 13, 2015, we hereby present the internal audit of the County’s cash management and investments process. We will be presenting this report to the Audit Committee of Prince William County at the next scheduled meeting on July 12, 2016.

Our report is organized in the following sections:

Executive Summary	This provides a summary of the overview and issues related to the internal audit of the cash management and investments process.
Background	This provides an overview of the cash management and investments process.
Objectives and Approach	The internal audit objectives and focus are expanded upon in this section as well as a review of the various phases of our approach.
Issues Matrix	This section gives a description of the items noted during this internal audit and recommended actions, management’s response, responsible party and estimated completion date.
Process Map	This section provides a process map depicting the flow of the County’s cash management and investment process.

We would like to thank the staff and all those involved in assisting our firm in connection with the internal audit of the cash management and investments process.

Respectfully Submitted,

RSM US LLP

INTERNAL AUDITORS

Executive Summary

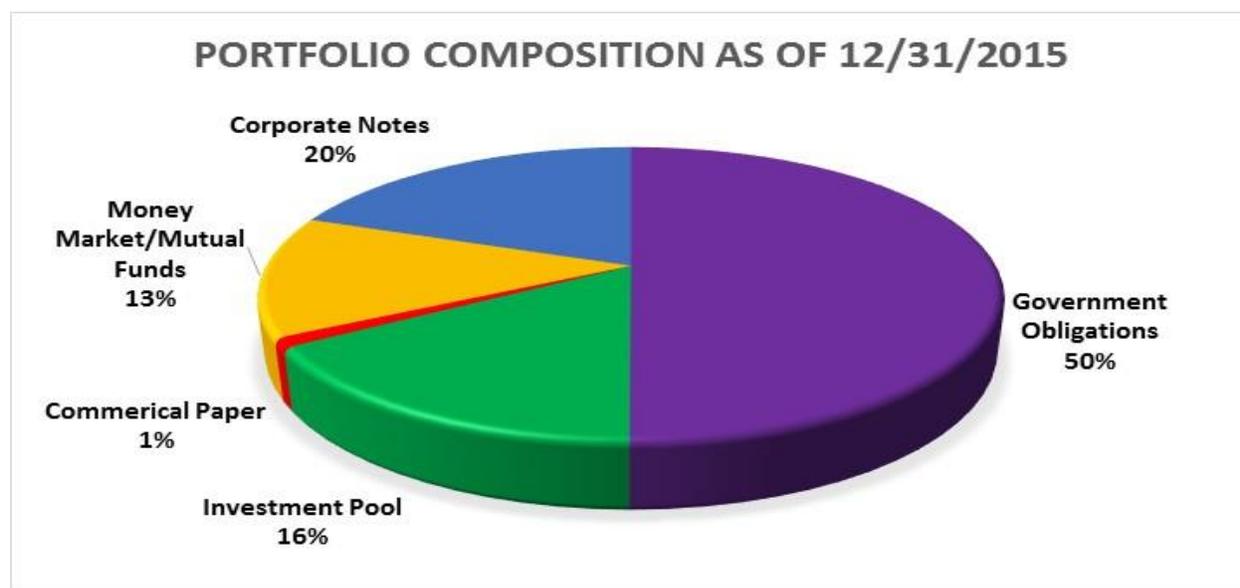
Executive Summary

The audited financial statements as of June 30, 2015, show that the County primary government has cash and investments of \$759,132 million and component units with \$288,257 million. The County maintains a single cash and investment pool for use by all funds and component units, except for the Supplemental Pension Plan Trust Fund, certain enterprise funds, the School Board Activity Fund, and the Community Services Board Payee Accounts. The consolidated account allows the County to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration.

Currently the County performs investment trades in-house, and outsources the investment function for funds other than the pooled investments. This is a specialized function that would not be easily replaced if the County were to lose its current Investment and Cash Management (“ICM”) staff. Larger jurisdictions, such as Prince William County, tend to perform this function in-house, whereas smaller jurisdictions often outsource the function.

This cash management and investment audit is intended to evaluate the controls over investments and daily cash balances. Our procedures were designed to evaluate that County funds are invested in accordance with the County’s adopted investment strategy, policies and procedures and Virginia Code. The scope of our audit also included testing around accounting, timely reconciliations and monitoring. We evaluated the impact of any instances of noncompliance and looked to identify potential improvements in the drafted updates to the investment policies. The scope of our audit did not include evaluating controls over funds and investments outside of the pooled fund, such as the Supplemental Pension Plan Trust Fund.

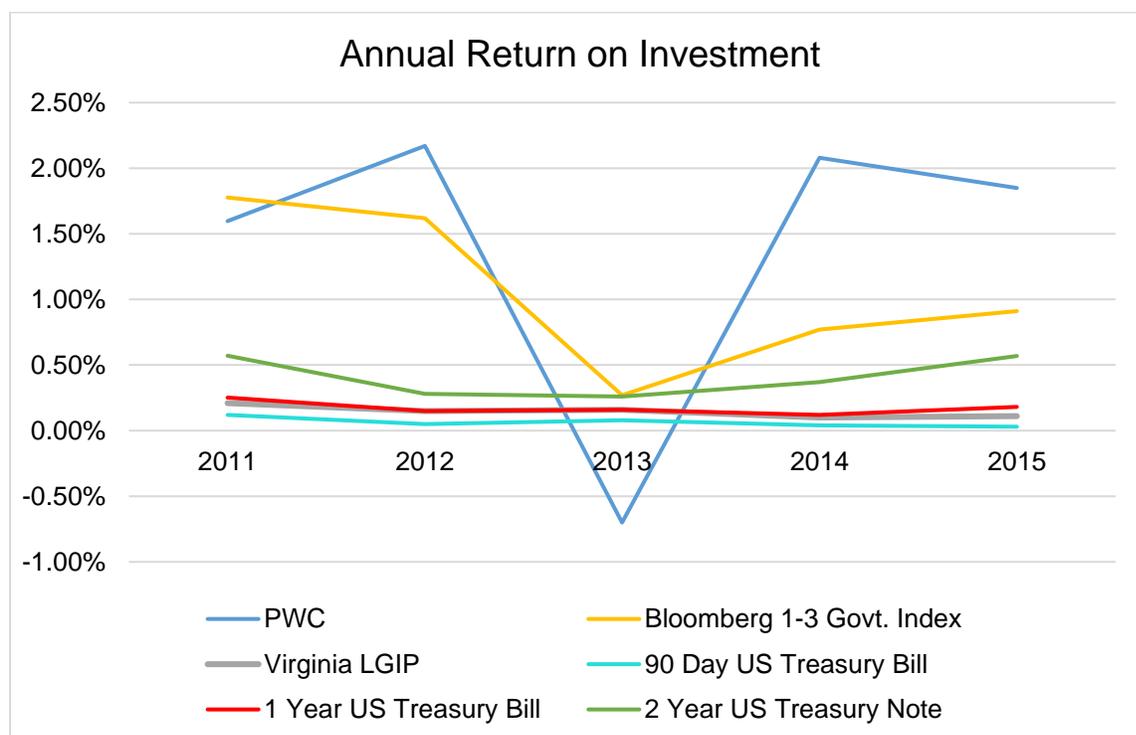
The chart below details the composition of the County’s portfolio as of December 31, 2015:



Source: Wells Fargo Account Statement as of December 31, 2015.

The total return on investments for the General Portfolio was 1.85% for FY 2015. The chart on the following page provides a comparison of the returns of various government securities and funds for the fiscal years 2011 through 2015. The County’s total return has been greater than the portfolio benchmark indices four out of the last five years. Per FY 2013 Q4 Investment Performance Report, the County’s total return on investments for the General Portfolio was -0.70%. This is a result of large negative mark-to-market adjustments that occurred during FY 2013.

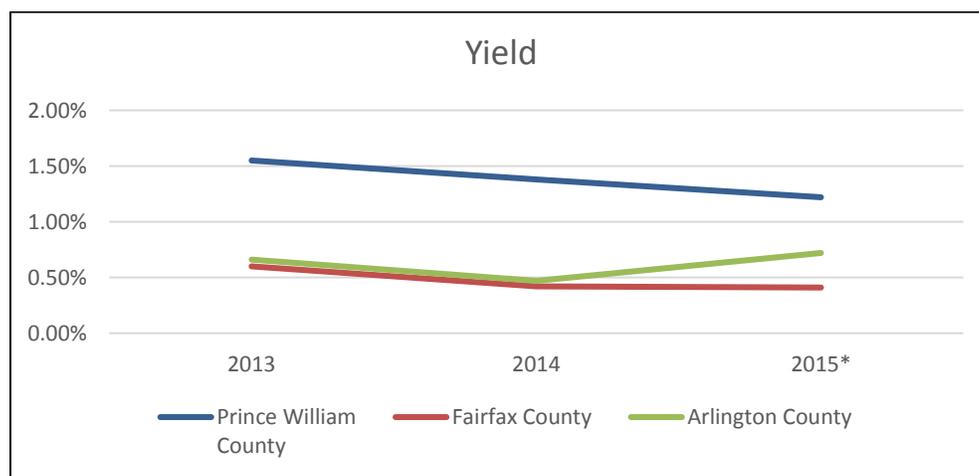
Executive Summary - continued



Source: *Prince William County Quarterly Investment Performance Report*

While the County reports both its total return (includes mark-to-market adjustments) and its earnings yield on a quarterly basis to the Investment Oversight Committee, for purposes of measuring a realistic return over time, the earnings yield is a more accurate indicator of actual performance.

The investment portfolio information below reflects the separate investment policies adopted by each jurisdiction. Different reporting and investing practices further complicate efforts to make direct comparisons among other local jurisdictions. The pooled investment portfolios include monies maintained and invested for participating county funds and component units. The investment portfolio information does not include restricted bond funds or pension (retirement) funds. Retirement fund investments are separately managed and maintained.



*Source: *Auditor of Public Accounts*

Executive Summary - continued

A summary of issues identified and their relative risk rating is provided below. We have assigned relative risk factors to each issue identified. This is the evaluation of the severity of the concern and the potential impact on operations. There are many areas of risk to consider in determining the relative risk rating of an issue, including financial, operational, and/or compliance, as well as public perception or 'brand' risk. Items are rated as High, Moderate, or Low.

- *High Risk Items* are considered to be of immediate concern and could cause significant operational issues if not addressed in a timely manner.
- *Moderate Risk Items* may also cause operational issues and do not require immediate attention, but should be addressed as soon as possible.
- *Low Risk Items* could escalate into operational issues, but can be addressed through the normal course of conducting business.

The details of the below summarized issues are included within the Issues Matrix section of this report.

Issues	Risk Rating
1. Enhancements to the Controls over Investments	Moderate
<p>Per discussion with the Director of Finance, the County is in the process of updating their investment policies, and is expected to submit this update to the Board of County Supervisors ("BOCS") in the first quarter of FY 2017 for approval. During our review of the County's investment policies (the current and draft versions), we noted the following which would further strengthen the County's control environment over investments.</p> <p>Secondary Review - During our discussions with the Treasury Management Division staff, it was noted that a procedure had been implemented to provide for a secondary review of the purchases and sales of investments. Neither the County's policy nor the draft of the updated policy require a secondary review at the time of purchase or sale of the investment(s). For an accuracy check, the Daily Trade Authorization Letter (screenshot of the day's Cash Flow Spreadsheet) is emailed by a member of the Investment and Cash Management ("ICM") team to the County's dedicated representative at Wells Fargo (the "Investment Custodian") and copied to the other staff within ICM. While this does provide a mathematical accuracy check, it does not provide for a secondary review of transactions by another staff member. A bi-monthly report is submitted to the Director of Finance providing a summary of investment transactions, policy compliance and investment holdings. In addition, the Investment Policy §17.0 requires staff to notify the County Executive in writing, if an exception to the policy is made or when policy guidelines are breached inadvertently. Such report shall be made on a most timely basis, but no later than five business days from the decision or discovery date of the policy exception. .</p> <p>We selected a sample of investments purchased and investments sold, and reviewed supporting documentation for the transactions. The documentation we reviewed included pre-purchase analysis documentation, purchase request forms and approvals, trade tickets, trade confirmations, journal entry records, and County statements showing the funds paid out for the transaction. We noted the following:</p> <ul style="list-style-type: none"> • For three (3) out of four (4) purchases sampled post implementation there was no evidence of a secondary review of the trade ticket by the Treasury Division. • For four (4) out of five (5) sales transactions sampled post implementation there was no evidence of a secondary review of the trade ticket by the Treasury Division. <p>Despite not performing a secondary review during the time period of the above transactions, no policy violations were noted. A secondary review would serve to strengthen segregation of duties within the investment function.</p>	

Executive Summary - continued

Issues	Risk Rating
1. Enhancements to the Controls over Investments - continued	Moderate
<p>Investment Oversight Committee - Neither the County's current policy nor the draft policy being considered, require:</p> <p><i>Annual Policy Review</i> - the Investment Policy should be reviewed annually by the Investment Oversight Committee. Annual review of the County's investment policies is a best practice recommended by the Government Finance Officers Association. The Policy is reviewed and updated periodically for code changes and required legal changes, however it is not reviewed on a consistent annual basis to determine if the Policy is operating effectively on the County's behalf.</p> <p><i>Annual Performance Evaluation</i> – the performance of all parties involved with the investment function should be formally evaluated annually by the Investment Oversight Committee. The Committee does review the Quarterly Investment Performance Reports at their meetings, however an annual performance evaluation has not been formerly documented. Staff has provided an informal notification to the Investment Oversight Committee regarding their routine year-end activities and performance evaluations.</p>	
2. SSAE 16 Reports – Review of Controls at a Service Organization	Moderate
<p>Service Organizations generally are required by Statements on Standards for Attestation Engagements (“SSAE”) to have a “Service Organization Control” report performed and will provide them to vendors for whom they provide service. SSAE 16 has two different kinds of reports; a SOC 1 Type 1 report is an independent snapshot of the organization's control landscape on a given day, while a SOC 1 Type 2 report also adds a historical element, showing that controls were managed over time. A best practice would be for the County to obtain copies of these reports and review the testing that has been performed to gain an understanding of the operating effectiveness of controls that could impact the County operations. The County currently does not obtain and perform a review of the reports from their Service organizations. We obtained and reviewed SSAE 16 Reports for Wells Fargo, SunTrust Bank and US Bank. All reports demonstrated that the controls relied upon by the County are operating effectively.</p> <p>SSAE 16 reports provide assurance over processes and controls that are performed by the user organization and relied upon by the County or to provide information where there are controls that cannot be relied upon and may require compensating controls by the County.</p>	

Background

Background

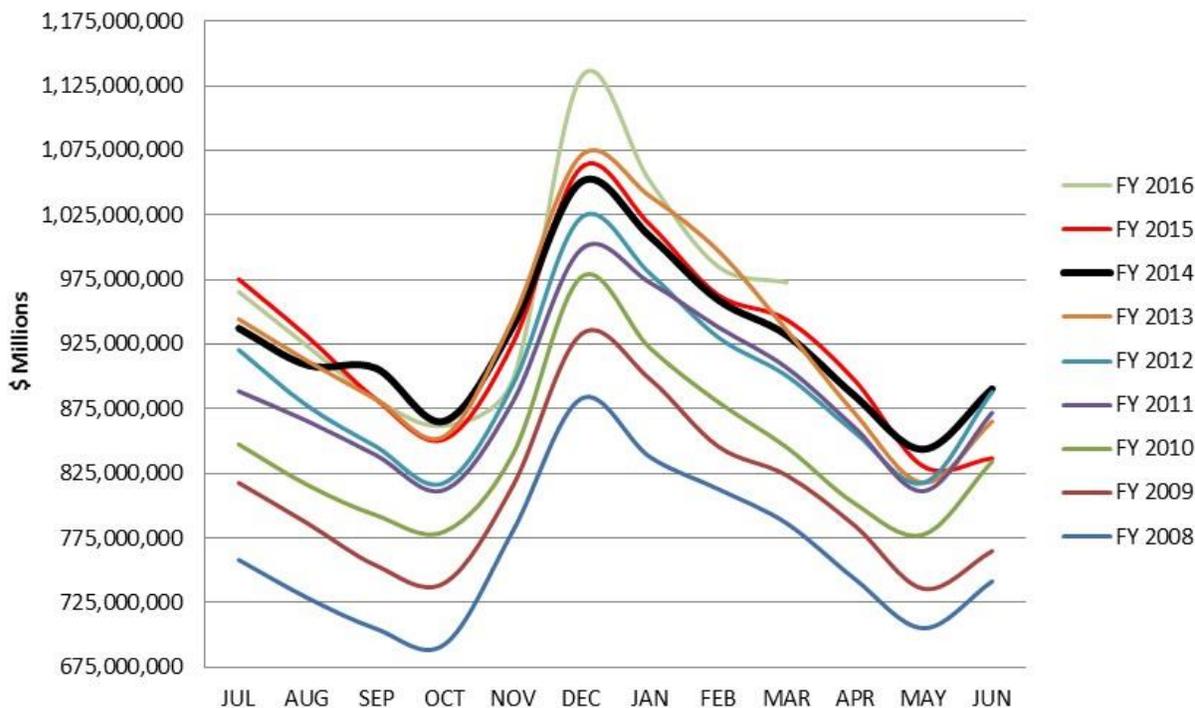
Overview

The County maintains a single cash and investment pool for use by all funds and component units, except for the Supplemental Pension Plan Trust Fund, certain enterprise funds, the School Board Activity Fund, and the Community Services Board Payee Accounts. The consolidated account allows the County to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration. Each fund participates on a dollar equivalent and daily transaction basis. A “zero balance account” mechanism provides for daily sweeps of deposits made to the county’s checking accounts, resulting in an instantaneous transfer to the investment account. Hence, the majority of the County’s funds are invested at all times. Investments are carried at fair value based on quoted market prices. Interest earnings are allocated monthly to the respective funds, based on the percentage of each fund’s average daily balance of cash investments in the total pool.

The audited financial statements as of June 30, 2015, show the County primary government has cash and investments of \$759,132 million and component units with \$288,257 million.

The County’s investment is cyclical in nature as depicted in the following graph:

Prince William County Avg. Monthly Portfolio Size

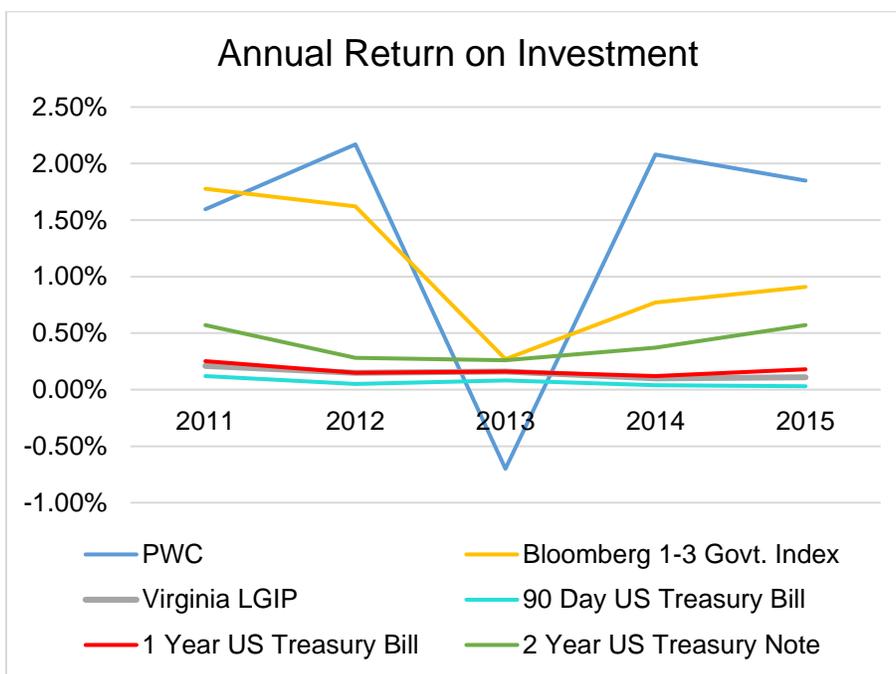


Source: Prince William County Quarterly investment Performance Report

Background - continued

Overview – continued

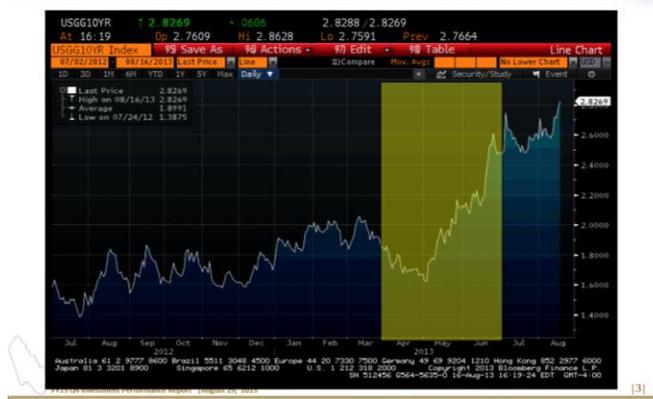
The total return on investments for the General Portfolio was 1.85% for FY 2015. The table below provides a comparison of the returns of various government securities and funds for the fiscal years 2011 through 2015. The County's total return has been greater than the portfolio benchmark indices four out of the last five years. Per FY 2013 Q4 Investment Performance Report, the County's total return on investments for the General Portfolio was -0.70%. This was a result of large negative mark-to-market adjustments and the geo-political environment in FY 2013. This was the most volatile quarter on a valuation basis that the County has ever experienced.



Source: Prince William County Quarterly investment Performance Report

The chart below was presented to the Investment Oversight Committee during the FY 2013 Q4 quarterly meeting to help the Committee understand the impact of Quantitative Easing (“QE”) -- a period of time when the Federal Reserve kept interest rates at exceptionally low levels. The rise in rates during the final quarter of the County’s fiscal year was the result of market reaction to comments made by the Federal Reserve Chairman about tapering QE (which would not happen until the fall of 2014).

10-YR TREASURY YIELD RISES DURING THE LAST QUARTER OF FY 2013

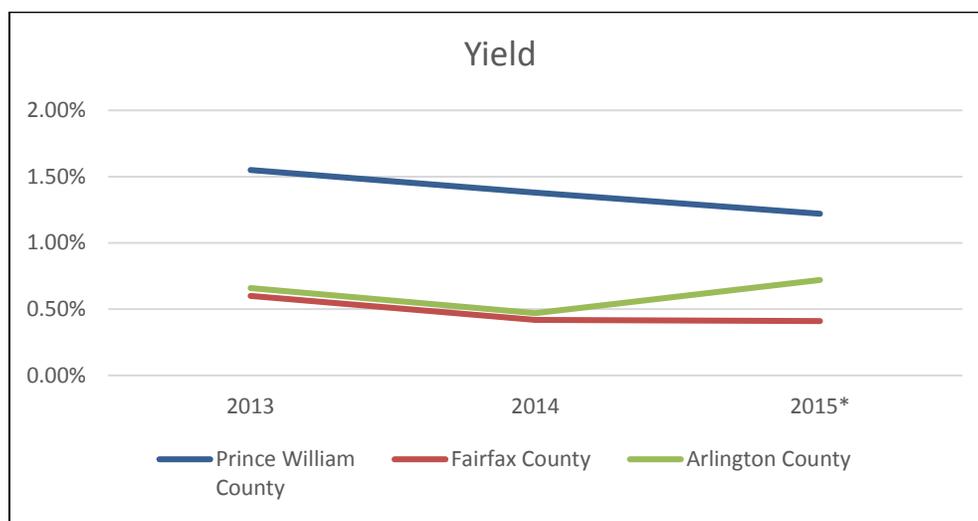


Background - continued

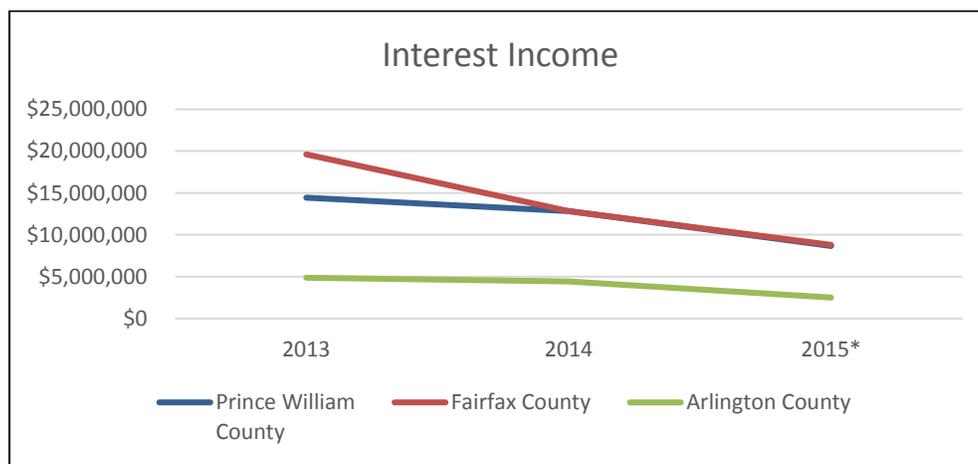
Overview – continued

While the County reports both its total return (includes mark-to-market adjustments) and its earnings yield on a quarterly basis to the Investment Oversight Committee, for purposes of measuring a realistic return over time, the earnings yield is a more accurate indicator of actual performance.

The investment portfolio information below reflects the separate investment policies adopted by each jurisdiction. Different reporting and investing practices further complicate efforts to make direct comparisons among other local jurisdictions. The pooled investment portfolios include monies maintained and invested for participating county funds and component units. The investment portfolio information does not include restricted bond funds or pension (retirement) funds. Retirement fund investments are separately managed and maintained.



*County of Fairfax, Virginia Office of Financial and Program Audit, July 2015 Quarterly Report



* County of Fairfax, Virginia Office of Financial and Program Audit, July 2015 Quarterly Report

Note:

(1) Average Daily Balance (Portfolio Size)

Fairfax County includes General Obligation bond proceeds in its pooled investment portfolio. Arlington County considers all bond funds to be restricted in their reported pooled investment portfolio. Arlington County invests all unexpended bond funds in the State Non-Arbitrage Program (Snap).

(2) Yield (Rate of Return)

Yields are reported before fees (e.g. banking custodian, rating agency, Bloomberg). Arlington County marks to market monthly and tracks the total return of their portfolio taking market changes into account.

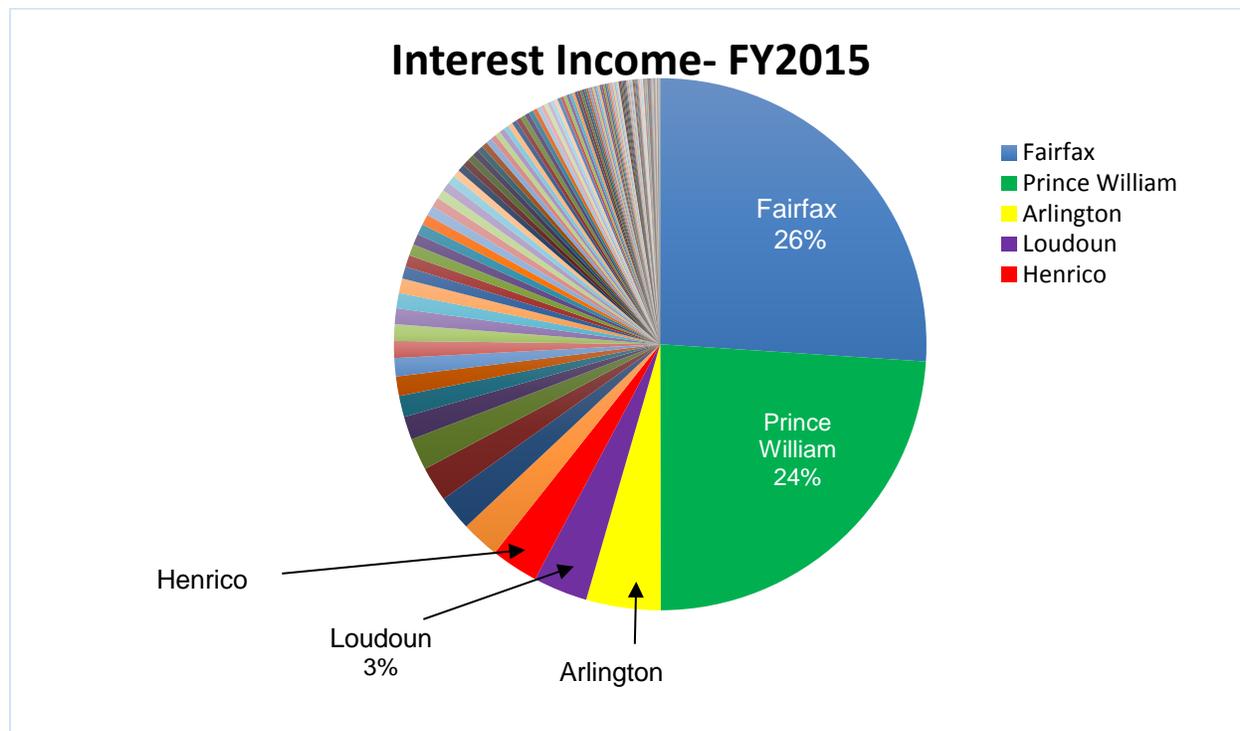
(3) Weighted Average Maturity (WAM)

Prince William County and Arlington County reported the WAM as a period-end snapshot. Prince William County annualized the WAM for fiscal year 2015. Fairfax County reported the WAM as the weighted monthly average.

Background - continued

Overview – continued

The chart below depicts interest income earned by county. Prince William County accounts for almost one-fourth of all of Virginia's Interest income.



Source: Auditor of Public Accounts Website

The County's Department of Finance provides financial and risk management services to a broad range of internal and external stakeholders. The Department of Finance has various divisions, including the Treasury Management Division.

The Department of Finance's Treasury Management Division has six (6) full time employees, including a vacant position for a Financial Analyst II. It is a critical component of the County's financial management infrastructure, managing the County's cash flow, investments, and debt portfolio. The Treasury Management Division also performs economic and revenue analysis and forecasting, produces the County's demographic and economic statistics, and provides analysis and recommendations on issues involving financial policy.

Custodians

The County contracts with Wells Fargo Institutional Retirement and Trust ("Wells Fargo IRT") for safekeeping services for the physical control of investment securities purchased or sold by the County pursuant to Code of Virginia §2.2-45.15. Wells Fargo also provides sweep account services for incoming funds that are swept into money market funds. Bond Proceeds funds are held by US Bank.

Background - continued

Policies and Procedures

In December 2011, the Board of County Supervisors adopted the Prince William County Investment Policy (the "Policy"). It should be noted that the Policy is currently under review, and is anticipated to be presented to the Board of County Supervisors in the first quarter of FY 2017. The goal of the Policy is to strengthen and improve the County's investment management program.

A separate Investment Procedures document maintained by both the Financial Reporting & Control Division and Treasury Management Division provides details and step-by-step guidance for the staff as well as the Director level responsibilities in performing the following processes within cash management and investments:

- Establishing Daily Cash Position
- Investment Transactions
 - Fixed Income Securities
 - CDs/NOW Accounts
 - Money Market Sweep Accounts
- Wire Transfers
- Cash Flow Report
- Reporting

The County's Investment Policy outlines its expectations for both cash management and investments, as well as how the Financial Reporting & Control Division and Treasury Management Division should be operating in order to achieve them:

- Delegation of Authority
- Investment Oversight Committee
- Investment Procedures
- Authorized Financial Dealers and Institutions
- Authorized Investments
- Collateralization
- Safekeeping and Custody
- Performance Standards
- Reporting
- Policy Exceptions

Cash Management

All of the County's cash is maintained in accounts collateralized in accordance with Virginia Security for Public Deposits Act (the "Act"), §2.2-4400 through 2.2-4410 of the *Code of Virginia*. Under the Act, qualified public depositories shall elect to secure deposits by either the pooled method or the dedicated method. Every qualified public depository shall deposit with a qualified escrow agent eligible collateral equal to or in excess of the required collateral. If any public depository fails, the collateral pool becomes available to satisfy the claims of the governmental entities. The Commonwealth Treasury Board is responsible for monitoring compliance with the collateralization and reporting requirements of the Act. Funds deposited in accordance with the requirements of the Act are considered fully secured and are not subject to custodial credit risk.

The County's Treasury Management Division monitors the cash balance on a daily basis to make certain sufficient funds are available to meet current expenses and also to confirm large amounts of excess funds are transferred and invested elsewhere to earn a higher rate of return. Wells Fargo serves as the County's safekeeping custodian of investments.

The County's investment strategy addresses the requirements of legality, safety and liquidity by investing in a diversified portfolio with specific security types, financial institutions, and sufficient liquidity to meet anticipated operating requirements. In addition, the County seeks to match its cash flow needs to the overall maturity structure of the portfolio in order to maximize yield.

Background - continued

Policies and Procedures - continued

The Treasury Management Division's Financial Analyst establishes the daily cash position and determines if any additional funds are available to invest (generally any amount above the \$20 million maintained to offset any bank fees). Once this is determined, the Financial Analyst creates a wire payment within the SunTrust Online Treasury Management wire payment system ("OTM"). The County has established pre-existing wire templates for use in the wire transfer process in order to mitigate the risk of online and internal fraud, errors made by County staff, and losing wire transfer documentation. The Financial Analyst selects the applicable wire template from the pre-populated drop-down menu and enters all the necessary payment information.

Investments

The Policy is in compliance with *Code of Virginia* §2.24501 through 2.2-4600, which details which investments the County is authorized to invest in. In addition to specifying which investments the County may invest in, the Policy details the following:

- Scope
- Investment Objectives
- Duties of the Oversight Committee
- Authorized Financial Dealers and Institutions
- Standards of Care
- Delegation of Authority
- Investment Procedures
- Authorized Investments

While the County's policies comply with the *Code of Virginia*, in some instances the County's policies are more stringent than the Virginia Code. For example, *Code of Virginia* §2.2-4501 provides a list of permissible investments. The County's Policy Section 9.1 details credit ratings and percentage limits whereas the Code is silent on these. In another instance, *Code of Virginia* §2.2-4504 has one paragraph regarding bankers' acceptances whereas in the County's Policy Section 9.3, there is detail regarding ratings, maximum percentage, and length to maturity limitation.

Scope

The Policy applies to all investments held or controlled by Prince William County Department of Finance. The Policy excludes pension fund assets held by a third-party custodian and/or money manager. Bond proceeds shall be invested in accordance with the requirements and restrictions outlined in bond documents. Bond proceeds placed in the following are invested in money market funds and individual portfolios to provide improved earnings and are exempt from portfolio composition, individual issuers, and maturity limitations.

1. Virginia State Non-Arbitrage (SNAP)
2. Other Bonds Proceeds Investment Funds

Standards of Care

1. *Prudence* – In accordance with § 2.2-4514 of the *Code of Virginia*, the Director of Finance and authorized designees shall discharge their duties with respect to the investments of the County solely in the interest of the County and shall invest the assets of the portfolio with the care, skill, prudence, and diligence under the circumstances a reasonable person familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. The Director of Finance (or designees) shall also diversify such investments so as to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so.
2. *Ethics and Conflicts of Interest* – Officers, employees and citizens, including the Investment Oversight Committee, involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. They shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial /investment positions that could be related to the performance of the investment portfolio. They shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the County.

Background - continued

Investments – continued

Investment Objectives

The primary objectives, in priority order of the County's investment activities are:

1. *Legality* – the investment program shall be operated in conformance with federal, state and other legal requirements. Investment instruments shall at a minimum be limited to security issues, issuers and maturities in compliance with §2.2-4500 thru 2.2-4518 of the *Code of Virginia*.
2. *Safety* – Investments of the County shall be undertaken in a manner that seeks to ensure the preservation of capital and the protection of investment principal. The County will employ mechanisms to control risk and diversify its investments regarding specific security types or individual financial institutions.
3. *Liquidity* – The investment portfolio will remain sufficiently liquid to enable the County to meet operating requirements which might be reasonable anticipated.
4. *Yield* – The County will maximize the yield on the portfolio but will avoid assuming unreasonable investment risk to preserve the purchasing power of the portfolio. Return on investment is of secondary importance compared to the legality, safety and liquidity objectives.

Delegation of Authority

The Director of Finance (or authorized designee), consistent with approved guidelines, is authorized to:

1. Purchase investment securities at prevailing market prices/rates on behalf of and in the name of Prince William County.
2. Sell such obligations or securities at the prevailing market price and to pay the proceeds of such sale into the proper accounts or funds of Prince William County consistent with the guidelines approved by the Board of County Supervisors (“BOCS”).
3. Delegate the day-to-day management of the investment program to the portfolio manager or other appropriately trained person. The portfolio manager shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this investment policy. No person may engage in an investment transaction except as provided under the terms of the policy and under the procedures established by the Director of Finance. The Director of Finance has delegated this management to the Treasury Manager.

Investment Oversight Committee

As required in the Investment Policy, the Investment Oversight Committee consists of the following:

- Director of Finance
- Deputy Finance Director
- County Staff (3)
 - Deputy County Executive
 - Public Works Director
 - Budget Director
- Citizen Volunteers (2), appointed by the BOCS

The Committee meets quarterly, or more often as deemed necessary by the Director of Finance, to review investment performance and the Quarterly Investment Performance Reports.

Background - continued

Investments – continued

Investment Procedures

The Department of Finance created Treasury Management Investment Procedures as required by the Investment Policy. The most recent version is dated April 30, 2010. As required by the Policy, the procedures include reference to the following:

1. *Safekeeping* – all securities purchased by the County shall be properly and clearly designated as an asset of the County and held in safekeeping by the custodial bank or other third party custodial institution.
2. Securities Industry and Financial Markets Association (“SIFMA”) repurchase agreements.
3. Wire transfer agreements – in order to efficiently process recurring wire transfer requests to the custodian and other financial institutions, the County has established templates in SunTrust Bank’s Online Treasury Management Wire payment system. Dual approval for the creation and approval is required of these transactions and provides the following benefits:
 - a. Increased protection from online fraud;
 - b. Less chance of inadvertently transposing numbers due to errors;
 - c. Helps avoid the need to reverse wire transfers; and
 - d. Provide greater protection from embezzlement or internal fraud.
4. Banking service contracts.
5. Collateral / depository agreements.

Authorized Financial Dealers / Institutions

The portfolio manager is required to maintain a list of financial institutions, selected on the basis of credit worthiness, financial strength, experience, and minimal capitalization, authorized for provide investment services to the County. A copy of the Policy should be delivered to all financial dealers and institutions. The purpose is to assure all parties possess a copy of the State Code and any further restrictions imposed by the County.

Authorized Financial Dealers and Institutions shall include any of the following:

1. Primary government securities dealers reporting to the Markets Report Division of the Federal Reserve Bank of New York or subsidiaries of primary government securities dealers.
2. Any regional or secondary market dealers who meet the following criteria or as specifically approved by the Committee:
 - a. Financial institution must comply with the SEC minimum net capital requirement rule (RULE 15c31). The firm shall provide immediate disclosure to the investing government whenever the firm’s capital position falls short of the capital adequacy standard.
 - b. Financial institution shall submit audited financial statements annually.
 - c. Financial institution shall submit proof of Financial Industry Regulatory Authority (FINRA) certification.
 - d. Financial institution must be currently licensed and in good standing in Virginia, the Securities and Exchange Commission, the National Association of Securities Dealers or other applicable self-regulatory organizations.
3. Any direct issuer of commercial paper that meets the credit criteria as outlined in the investment policy.

Staff is required to conduct an annual review of the financial condition, registrations, responsiveness, competitiveness and other qualifications of all approved financial dealers and institutions to determine if they continue to meet the County’s guidelines for qualification.

Background - continued

Investments – continued

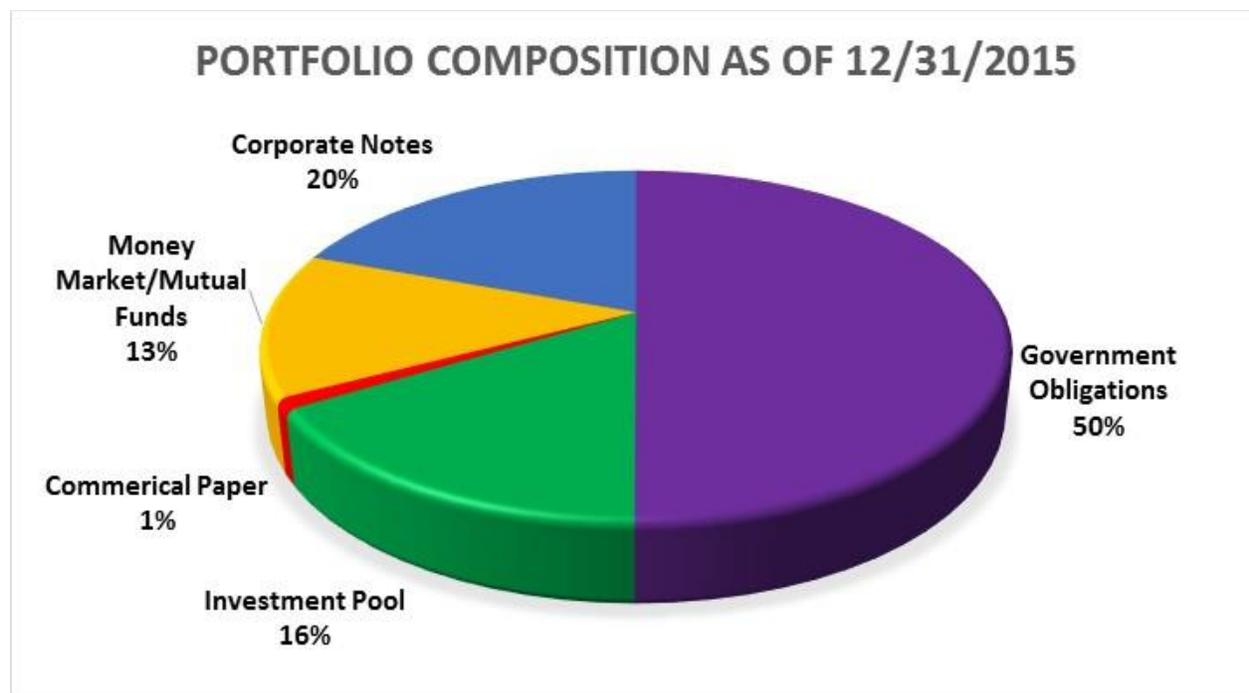
Authorized Investments

Authorized investments for public funds are set forth in the “Investment of Public Funds Act” of the *Code of Virginia* § 2.2-4500 through §2.2-4519. Within the permitted statutory framework, the County limits the investment of assets to the following categories of securities:

Investment	Minimum	Maximum
Government Obligations	33%	100%
Commercial Paper	N/A	35%
Negotiable Certificates of Deposit	N/A	40%
Banker's Acceptances	N/A	40%
Treasury Agreements	N/A	10%
Repurchase Agreements	N/A	30%
Money Market Mutual Fund	N/A	60%
Corporate Notes	N/A	20%
Non-negotiable Certificates of Deposit	N/A	40%
Investment Pools	N/A	25%

Variable / floating rate securities may account for no more than 20% of the portfolio at the time of purchase. To avoid exposure to the fluctuation of foreign exchange rates, all investments will be limited to U.S. dollar denominated instruments.

The graph below details the composition of the County’s portfolio as of December 31, 2015:



Source: Wells Fargo Account Statement as of December 31, 2015.

Objectives and Approach

Objectives and Approach

Objectives

The objectives of this internal audit of the County's cash management and investment process were to assess whether the system of internal controls is adequate and appropriate for promoting and encouraging the achievement of management's objectives of investing funds in accordance with the County's adopted investment strategy and Virginia Code, accounting for and reconciling transactions timely and appropriately, and providing for effective and efficient use of available funds. Areas of focus to achieve the objectives included:

- Determine compliance with Virginia Code for allowable cash and investment strategies;
- Determine compliance with County policies or internal procedures;
- Review the County's draft investment policy that is under consideration for compliance with Virginia Code and for opportunities to strengthen the policies;
- Review authorization of transactions and reconciliation of accounts;
- Assess segregation of duties;
- Review for monitoring of investment performance;
- Review for monitoring of cash flows and key performance indicators;
- Evaluate the adequacy of internal controls of the custodian, Wells Fargo, as noted in the Statement on Standards for Attestation Engagements ("SSAE") 16 report(s); and
- Identify control gaps, opportunities for process improvement, and efficiency gains.

Approach

Our audit approach consisted of the following phases:

Understanding and Documentation of the Process

During this phase, we held an entrance conference with representatives of the Treasury Management Division and other members of the Department of Finance to discuss the scope and objectives of the audit work, obtain preliminary data and establish working arrangements. We also interviewed several others with cash management and investments responsibilities and documented their role in the process, including: Treasury Division Chief, Financial Analyst Managers, Financial Analysts, Management & Fiscal Analyst, System Administrator and Accountant in the Financial Reporting and Control Division.

Evaluation of the Design of Process and Effectiveness of Controls

The purpose of this phase was to evaluate the design of internal controls surrounding the investment process, and to evaluate the effectiveness of the controls based on our understanding of cash management and investment process. Testing was conducted utilizing sampling and other auditing techniques to meet our audit objectives outlined above for the period January 1, 2015, to December 31, 2015. Specific procedures performed included:

- Reviewed County policies and procedures that pertained to cash management and investments;
- Assessed and reviewed investments processes within the division and the responsibilities of the custodian;
- Performed on-site visit and observed daily cash management process, investment research and decision making, and obtained detailed documentation of the process;
- Performed testing on a sample of investments purchased and sold for the following:
 - Proper research and authorization per policy;
 - Accounting functions;
 - Communication and record-keeping between responsible individuals and Divisions; and
 - Reporting of investment strategies and trends.
- Reviewed and benchmarked the County's cash management and investments policy and rates of return to various government securities and funds.
- Reviewed SSAE 16 reports from Wells Fargo and US Bank. Specifically, we reviewed controls over the processing of investments and the banking process.

Reporting

At the conclusion of this audit, we summarized our findings into this report. We have reviewed the results with the appropriate management personnel, and have incorporated management's response into the report.

Issues Matrix

Issues Matrix

Rating	Issue
Moderate	1. Enhancements to the Controls Over Investments
	<p>Per discussion with the Director of Finance, the County is in the process of updating their investment policies, and is expected to submit this update to the Board of County Supervisors in the first quarter of FY 2017 for approval. During our review of the County's investment policies (the current and draft versions), we noted the following which would further strengthen the County's control environment over investments.</p> <p>Secondary Review - During our discussions with the Treasury Management Division staff, it was noted that a procedure had been implemented to provide for a secondary review of the purchases and sales of investments. Neither the County's policy nor the draft of the updated policy require a secondary review at the time of purchase or sale of the investment(s) by the County trader upon receipt of the broker trade ticket(s). For an accuracy check, the Daily Trade Authorization Letter (screenshot of the day's Cash Flow Spreadsheet) is emailed by a member of the Investment and Cash Management team to the County's dedicated representative at Wells Fargo (the "Investment Custodian") and copied to the other staff within ICM. While this does provide a mathematical accuracy check, it does not provide for a secondary review of transactions by another staff member. A bi-monthly report is submitted to the Director of Finance providing a summary of investment transactions, policy compliance and investment holdings. In addition, the Investment Policy §17.0 requires staff to notify the County Executive in writing, if an exception to the policy is made or when policy guidelines are breached inadvertently. Such report shall be made on a most timely basis, but no later than five business days from the decision or discovery date of the policy exception. .</p> <p>We selected a sample of investments purchased and investments sold, and reviewed supporting documentation for the transactions. The documentation we reviewed included pre-purchase analysis documentation, purchase request forms and approvals, trade tickets, trade confirmations, journal entry records, and County statements showing the funds paid out for the transaction. We noted the following:</p> <ul style="list-style-type: none"> • For three (3) out of four (4) purchases sampled post implementation there was no evidence of a secondary review of the trade ticket by the Treasury Division. • For four (4) out of five (5) sales transactions sampled post implementation there was no evidence of a secondary review of the trade ticket by the Treasury Division. <p>Despite not performing a secondary review during the time period of the above transactions, no policy violations were noted. A secondary review would serve to strengthen segregation of duties within the investment function.</p> <p>Investment Oversight Committee - Neither the County's current policy nor the draft policy being considered, require:</p> <p><i>Annual Policy Review</i> - the Investment Policy should be reviewed annually by the Investment Oversight Committee. Annual review of the County's investment policies is a best practice recommended by the Government Finance Officers Association. The Policy is reviewed and updated periodically for code changes and required legal changes, however it is not reviewed on a consistent annual basis to determine if the Policy is operating effectively on the County's behalf.</p> <p><i>Annual Performance Evaluation</i> – the performance of all parties involved with the investment function should be formally evaluated annually by the Investment Oversight Committee. The Committee does review the Quarterly Investment Performance Reports at their meetings, however an annual performance evaluation has not been formerly documented. Staff has provided an informal notification to the Investment Oversight Committee regarding their routine year-end activities and performance evaluations.</p>

Issues Matrix - continued

Rating	Issue
Moderate	1. Enhancements to the Controls Over Investments - continued
	<p style="text-align: center;">Recommendation</p> <p>We recommend that the County consider including the below recommendations in the Policy:</p> <ul style="list-style-type: none"> • Secondary Review – Develop and implement a timely secondary review process over all purchases and sales of investments. The review process should be performed by someone independent of the purchase/sale transaction. • Investment Oversight Committee – Submit the Policy to the Investment Oversight Committee for review on an annual basis and conduct an annual performance evaluation.
	<p style="text-align: center;">Management's Response</p> <p>Response: Secondary Review – Management concurs with this finding and has already implemented an effective secondary review for investment transactions. This secondary review was informally incorporated into the trading process in the latter part of 2015 as staff realized an additional step should be added to tighten investment trading. This secondary review became more valuable as part of the Treasury Management Division staff responsible for the Investment Program moved to a different location within the McCoart complex. This additional step ensures that the individual executing a trade validates the details of the trade ticket received by the broker prior to sending the information to the investment custodian. Notification to the other staff members is provided via email. Only at that point is the trade forwarded to the investment custodian for settlement.</p> <p>It is also important to note that the County's current Investment Policy §11.0 includes a requirement that all securities purchased by the County will be executed, where applicable, on a delivery-versus-payment (DVP) basis. If any details of the trade do not match (dollar, price, CUSIP), account, etc.,) the investment custodian will not settle the trade.</p> <p>Responsible Party: Department of Finance, Treasury Division Chief</p> <p>Estimated Completion Date ("ECD"): Staff fully implemented the secondary review step in January 2016. Procedures are being updated to formally document this additional step and should be completed by July 15, 2016.</p> <p>Investment Oversight Committee – Management concurs with best practices for a documented annual review as recommended in the audit report. The County's Investment Program is formally evaluated on a quarterly basis by the Investment Oversight Committee. This review includes a variety of performance measures as listed within the current Investment Policy §16.0. The Director of Finance has also been delegated the authority by the Board of County Supervisors to make administrative adjustments to the policy per §18.0. These changes are not meant to alter the existing authorized investments but would incorporate changes such as staff title changes, <i>Code of Virginia</i> references, and other grammatical or formatting changes.</p> <p>The Treasury Management Division also submitted the County's Investment Policy for certification by the Association of Public Treasurers of the United States and Canada (APT US&C) and it was designated a <i>Model Investment Policy</i> in July 2013.</p> <p>Responsible Party: Department of Finance, Treasury Division Chief</p> <p>ECD: Expected to be completed by the end of the first quarter of FY 2017. To document the review of the Investment Policy, Treasury Management Division staff will incorporate a discrete line item for Investment Policy Review in the agenda for the Investment Oversight Committee. Completion of such review will be incorporated in the minutes. In addition, language will be added to the Investment Policy stating, "The Investment Policy will be reviewed by the Investment Oversight Committee at a minimum annually or more often as needed."</p>

Issues Matrix - continued

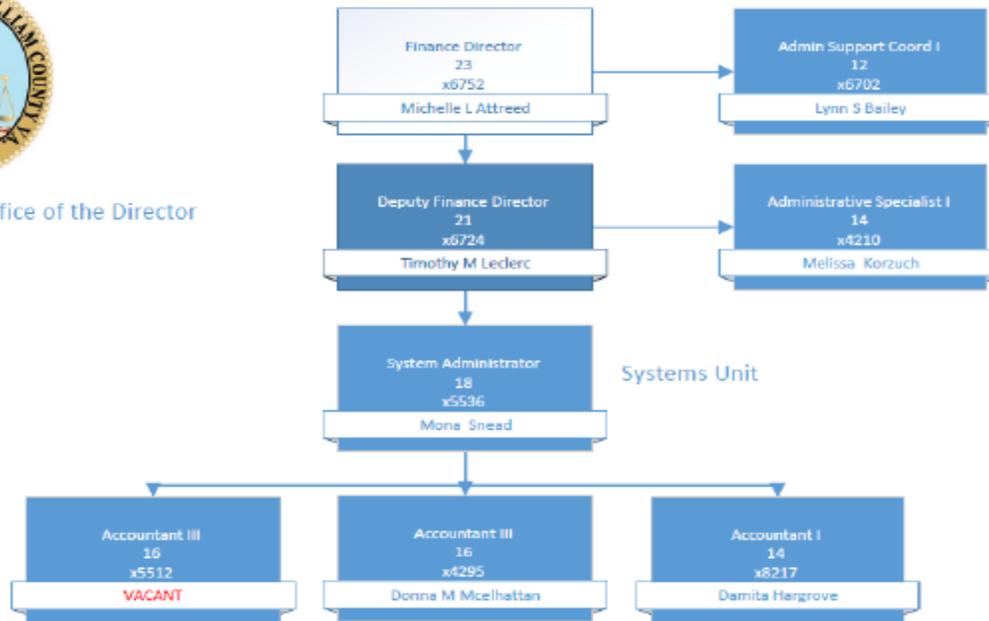
Rating	Issue
Moderate	2. SSAE 16 Reports – Review of Controls at Service Organizations
	<p>Service Organizations generally are required by Statements on Standards for Attestation Engagements to have a “Service Organization Control” report performed and will provide them to vendors for whom they provide service. SSAE 16 has two different kinds of reports; a SOC 1 Type 1 report is an independent snapshot of the organization's control landscape on a given day, while a SOC 1 Type 2 report also adds a historical element, showing that controls were managed over time. A best practice would be for the County to obtain copies of these reports and review the testing that has been performed to gain an understanding of the operating effectiveness of controls that could impact the County operations. The County currently does not obtain and perform a review of the reports from their Service organizations. We obtained and reviewed SSAE 16 (SOC 1 Type 2) Reports for Wells Fargo (SOC 1 Type 2), US Bank and SunTrust Bank (SOC 1 Type 2). All reports demonstrated that the controls relied upon by the County are operating effectively.</p> <p>SSAE 16 reports provide assurance over processes and controls that are performed by the user organization and relied upon by the County or to provide information where there are controls that cannot be relied upon and may require compensating controls by the County.</p>
	<p style="text-align: center;">Recommendation</p>
	<p>The County should annually request and review service organization reports covering the operating effectiveness of the internal controls over the processing of investments, user controls, report date, management’s assertion stating the report’s accuracy, locations that are relevant, and the extent of the testing.</p> <p>Also, we recommend that the County include language in all service organization contracts requiring SSAE16 reports be submitted to the County on an annual basis.</p>
	<p style="text-align: center;">Management’s Response</p>
	<p>Response: Management concurs with best practices for an annual review of Service Organization Control Reports (SSAE16: SOC 1 & SOC 2) as recommended in the audit report. Such reports have typically been requested during the RFP solicitation phase for banking and financial services to validate the security, reliability and backup process for Information Reporting Services. Staff will incorporate this request with the annual year-end due diligence and financial review activities. It is important to note, that the information reporting systems utilized by the County for banking and custodial services are accessed daily by County staff across various departments. Therefore, the reliability of the system is tested daily. In addition, message dashboards on the respective reporting service portals and dedicated client managers, add additional layers of notification for service issues or breaches.</p> <p>Responsible Party: Department of Finance, Treasury Division Chief</p> <p>ECD: The Treasury Management Division staff will make formal requests for the SSAE16 reports in November of 2016. In addition, the County plans to solicit proposals for banking and financial services in the Spring of 2017. Language requiring annual submission of the SSAE 16: SOC 1 and SOC2 reports will be included in the scope of work.</p>

Organization Chart

Organization Chart



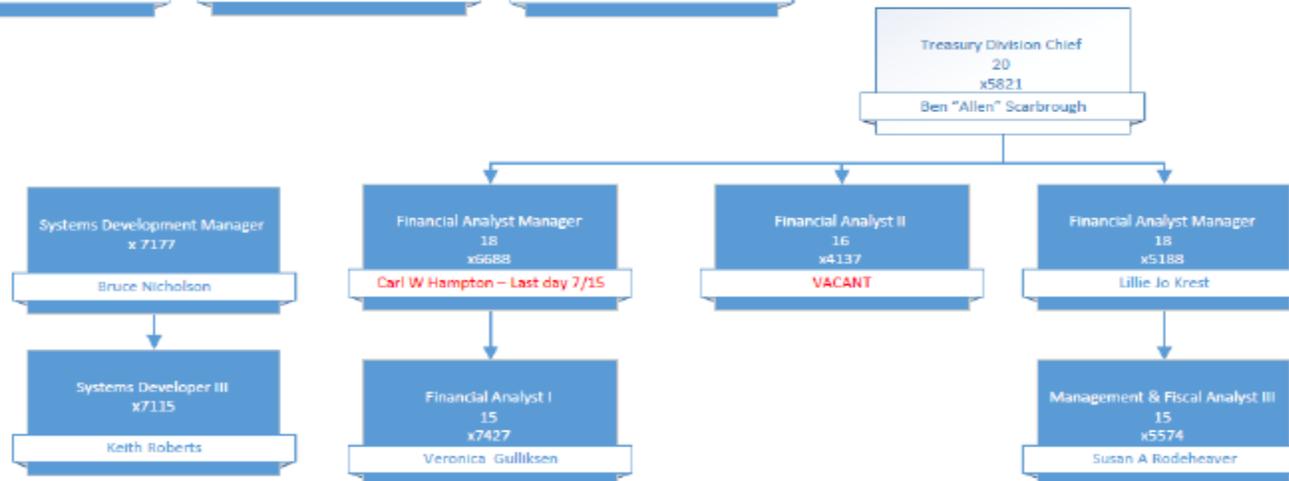
Finance: Office of the Director



As of June 28, 2016

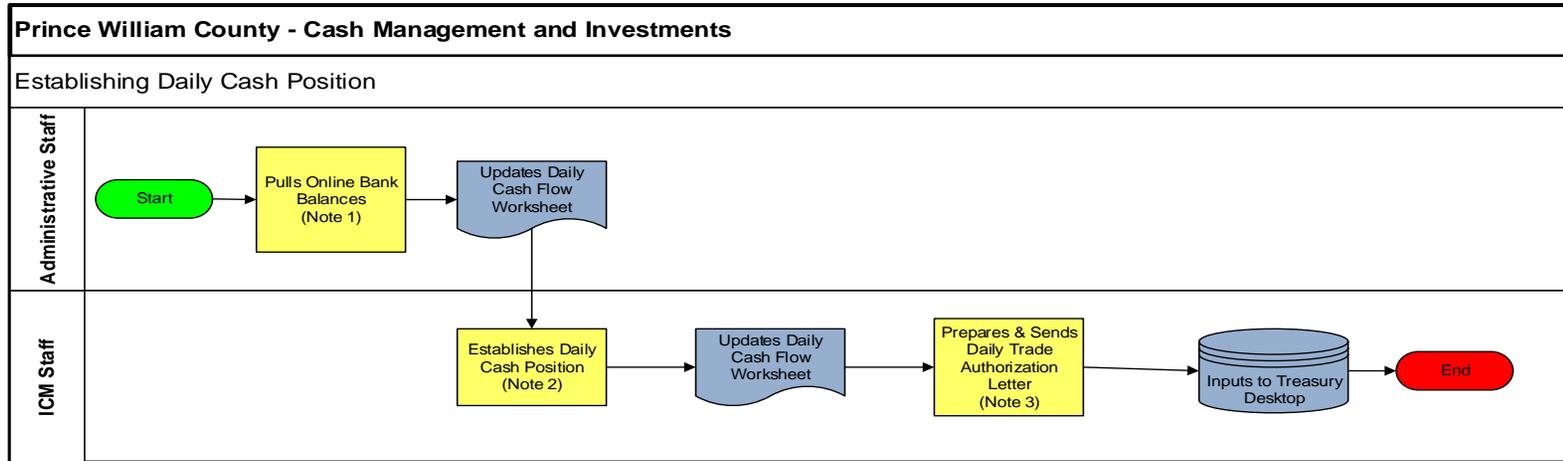


Finance: Treasury



Process Map

Process Map

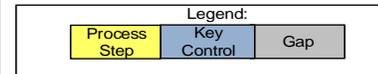


Note 1: The administrative staff within the Finance Director's Office accesses the "Daily Cash Flow Worksheet" from the secured shared network folder and updates with the day's most current bank balances (balance, ACH, check clearings) as per the SunTrust OTM bank statements. Currently the Financial Analyst has been establishing the Daily Cash Position while the Admin position is being filled.

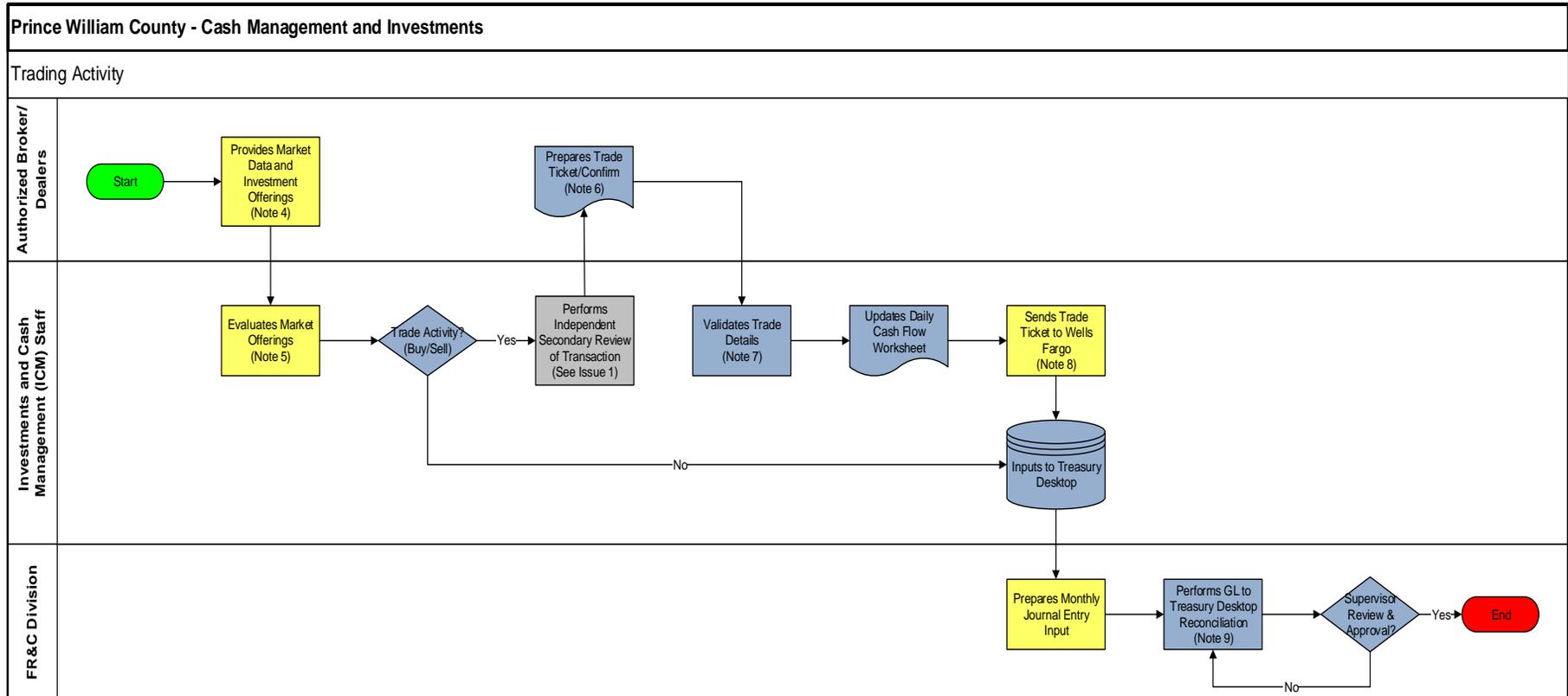
Note 2: The Investments and Cash Management (ICM) Staff establishes the Daily Cash Position by entering account balance, controlled disbursements, wire, ach and trade activity is input into the cash flow worksheet in order to determine daily liquidity needs.

Note 3: The ICM Staff prepares and sends the Daily Trade Authorization Letter to Wells Fargo, the County's investments custodian. The Letter provides a summary of all transactions with applicable trade instructions and/or deposit & disbursement instructions.

Flowchart Legend:



Process Map - continued



Note 4: The County currently has a list of authorized brokers from whom they are allowed to accept offerings from and invest with. Offerings are communicated primarily through emails and phone calls on a daily basis.

Note 5: The ICM Staff evaluates offerings and executes trade(s).

Note 6: The Broker/Dealer sends the trade ticket(s) to the ICM Staff while mailing a hard copy of the trade confirmation(s) and monthly statements to the Financial Reporting & Control Division (FR&C) Accountant.

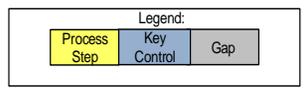
Note 7: The ICM Staff who executed the trade validates details of trade and sends confirmation email to a secondary independent ICM Staff.

Note 8: The ICM Staff sends the trade ticket to Wells Fargo for settlement through DTC. This is communicated through email to the designated Wells Fargo representative. Wells Fargo then settles trades DVP, matching all details from staff directive.

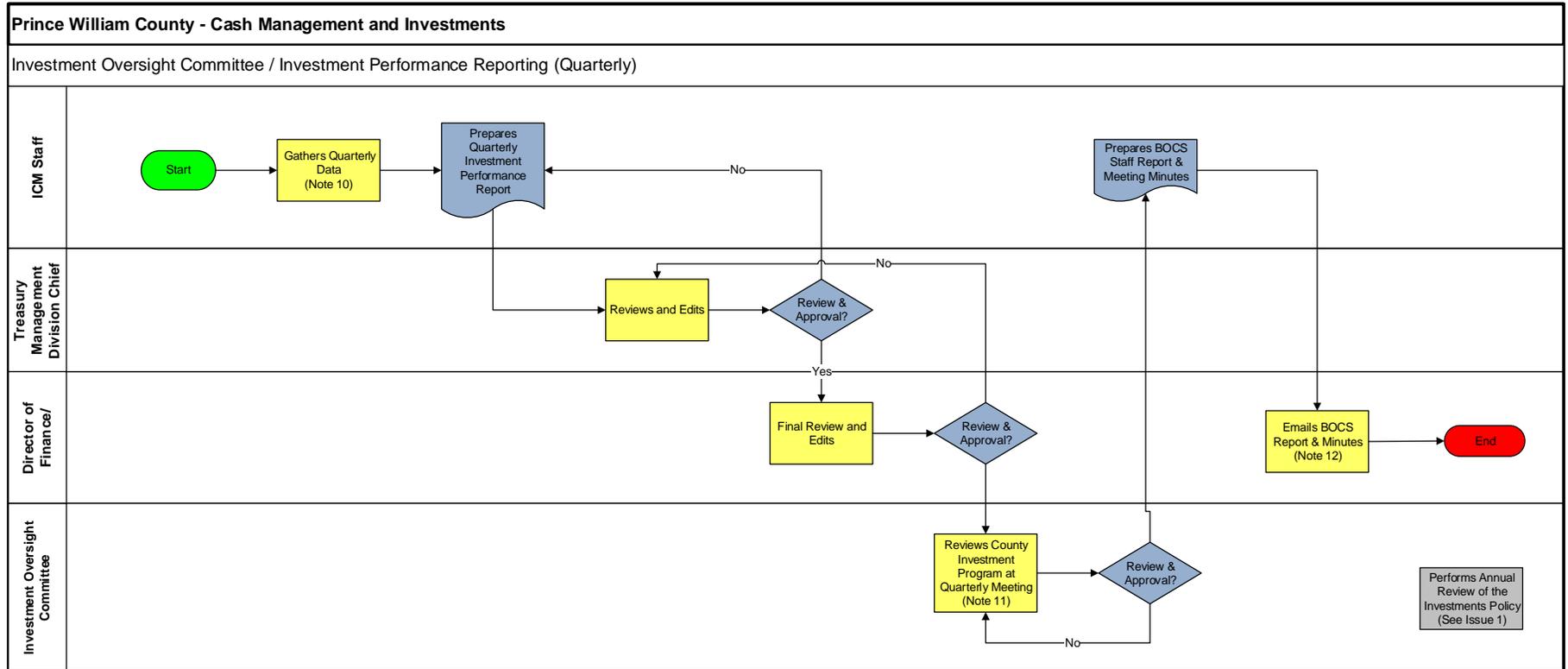
Note 9: The Financial Reporting & Control Division (FCR) Accounting staff receive the paper trade confirmations whenever trade activity has been executed. The FCR Division utilizes the confirmations as well as what has been input into Treasury Desktop, the County's investment tracking system, to prepare the monthly journal entry and ultimately the month end GL reconciliation. Any variances discovered by the FCR Division are communicated to the Treasury Department for investigation and resolution.

Flowchart Legend:

- Start/End
- Database
- Document
- Decision
- Process Step/Control Point



Process Map - continued



Note 10: After month end closing, ICM Staff will gather the Quarterly Investment Performance Report for the General Portfolio Holdings only. A separate report will be prepared for the Bond Proceeds (SNAP funds).

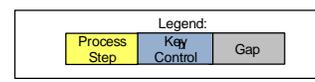
Note 11: The Treasury Management Division Chief or designated staff presents the Report to the the Investment Oversight Committee (IOC) at the Quarterly Meeting. The IOC is responsible for reviewing the following Investment Objectives:

- Authorized Instruments
- Maturity
- Risk and Diversification
- Institutions
- Issuers and Dealer Relationships

Note 12: Any further discussion or follow up action items by the Committee are maintained within the Meeting Minutes. The Committee's approval of any new initiatives or changes to the Investments Procedure and the overall approval of the Investment Performance Report is communicated via the Meeting Minutes. The Director of Finance emails the BOCS Quarterly investment Performance Report, Staff Report, and Meeting Minutes.

Flowchart Legend:

- Start/End
- Database
- Document
- Decision
- Process Sep/ Control Point



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