



**OFFICE OF THE CITY AUDITOR**  
Long Beach, California

**C-6**

LAURA L. DOUD, CPA  
City Auditor

June 2, 2009

HONORABLE MAYOR AND CITY COUNCIL  
City of Long Beach  
California

RECOMMENDATION:

Receive and file the 3<sup>rd</sup> and 4<sup>th</sup> Quarter FY 2008 Investments Audit for the quarters ending June 30, 2008, and September 30, 2008.

DISCUSSION:

Pursuant to Section 803 of the City Charter, the Office of the City Auditor is charged with verifying cash in the City Treasury on a quarterly basis and providing a written report to the City Council. Due to recent events in the economy, our office initiated an audit focused solely on the City's investment activities for the quarters ending June 30, 2008 and September 30, 2008. The results of our audit are presented in the attached report.

TIMING CONSIDERATIONS:

This item is not time sensitive.

FISCAL IMPACT:

There is no fiscal impact.

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,

Laura L. Doud, CPA  
CITY AUDITOR

Attachment

Office of the City Auditor

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**3<sup>rd</sup> and 4<sup>th</sup> Quarter FY 2008  
Investments Audit**

May 2009



**Audit Staff**

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City Auditor: Laura L. Doud  
Assistant City Auditor: James Johnson  
Deputy City Auditor: Janet Day  
Senior Auditor: Sotheary Hul  
Staff Auditors: Kris Lopez, Scott Gardiner, Jessica Machado

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## EXECUTIVE SUMMARY

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The Office of the City Auditor has completed an audit of the City of Long Beach (City) pooled investments for the quarters ending June 30, 2008 and September 30, 2008. Article 8 § 803 of the City Charter requires the City Auditor to verify the City's cash quarterly and provide a written report to the City Council. In light of the Lehman Brothers bankruptcy that resulted in the \$20 million loss of City investments and considering the general economic downturn, our office initiated an audit that focused solely on the City's pooled investments.

Our audit procedures included evaluating the City's compliance with the California Government Code and City's Investment Policy, and to verify investment balances with outside depositories.

For the quarters ending June 30, 2008 and September 30, 2008, the City's pooled investments totaled approximately \$1.80 billion and \$1.66 billion, respectively. Based on our audit, the investment balances recorded on the City's books as of June 30, 2008 and September 2008, agree as to the amount and description with outside depositories.

We also found the City to be in compliance with the California Government Code §53601 and the City's Investment Policy. Additionally, we found the City's Investment Policy to be similar to policies adopted by other comparable California cities. In fact, the City's investment percentage limits are more restrictive than the maximum percentage limits permitted by the California Government Code (Appendix A).

## BACKGROUND

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Resolution No. C-22401 gives the City Treasurer the authority to invest the City's funds in accordance with the California Government Code §53601 (Code). The Code provides guidance in safeguarding public funds entrusted to local governments, including limits on the types of investments that a local government entity may hold. In addition to the Code, the City maintains its own Investment Policy. The City Treasurer is responsible for ensuring that the City's investment portfolio is in compliance with both the Code and the City's Investment Policy.

### *Investment Policy*

The objective of the Investment Policy is to ensure that the temporary surplus funds of the City are prudently invested to preserve principal and to provide necessary liquidity, while maximizing interest earnings. The Investment Policy sets forth the City's guidelines for the investment of surplus funds in the Treasurer's Pooled Fund. Surplus funds are City funds that are not required for immediate cash expenditures.<sup>1</sup> In order to minimize portfolio risk, the City Treasurer is responsible for ensuring that surplus funds are invested in income producing investments while conforming to the City's policy and the Code.

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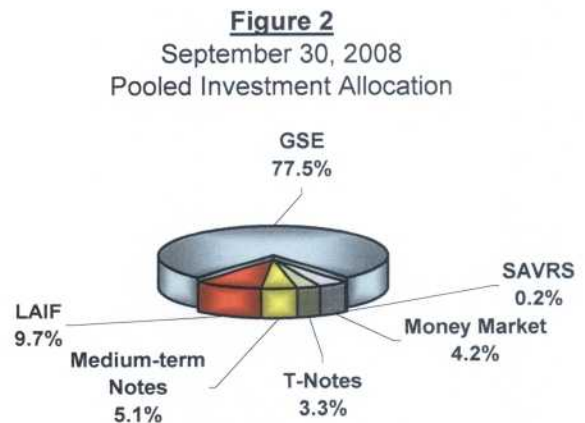
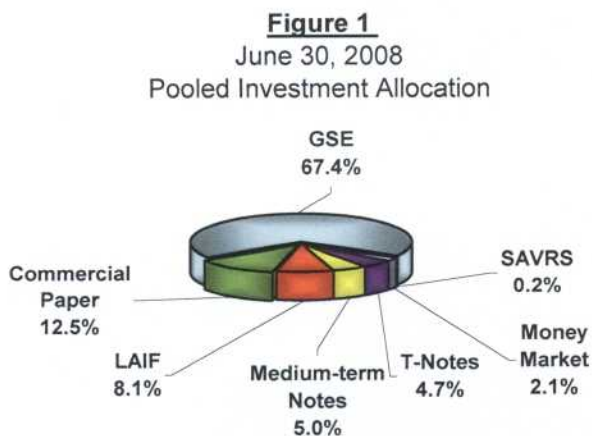
<sup>1</sup> The City's Investment Policy excludes guidelines for the investment of Debt Service and Reserve and Deferred Compensation Funds. The investment of debt proceeds is governed by provisions of the debt agreements. Deferred Compensation Funds are employee-owned, and as such, employees select the investments for their deferred compensation accounts.

The Investment Policy is reviewed annually, or as needed, by an advisory Investment Committee, which is comprised of advisory representatives from the following departments: City Manager, City Attorney, City Auditor, Financial Management, Harbor, Water, Community Development, and Development Services. The Investment Committee provides strategic advice and recommendations on the Investment Policy. Further, the Treasury Department determines the appropriate procedures in ensuring the City's compliance with the City's investment objective and the Code. The City Treasurer is responsible for drafting and revising the Investment Policy, as needed. The Investment Policy is then presented to City Council on an annual basis for approval.

The Investment Policy establishes the types of investments that the City Treasurer may invest in, as well as the maximum percentage limits for each type of investment. Examples of authorized investments include the following:

- Commercial paper;
- Treasury notes (T-Notes);
- Bonds issued by the City or agency of the City;
- Federal agency or United States Government-Sponsored Enterprise (GSE) obligations, participations, or other instruments;
- Time certificates of deposits;
- Repurchase agreements;
- Medium-term notes;
- Money market funds;
- State of California Local Agency Investment Fund (LAIF); and
- Department of Health and Human Services SAVRS Loan (SAVRS).<sup>2</sup>

Figures 1 and 2 below illustrate the allocation of the City's pooled funds among the different types of investments on June 30, 2008 and September 30, 2008.<sup>3</sup>



<sup>2</sup> The City's Investment Policy requires that the City Council approve in advance the purchase of any investment instrument, for the investment pool maturing more than five years from the date of purchase. On April 22, 2005, the City refinanced a Select Auction Variable Rate Securities (SAVRS) bond for the Health Department issued by the California Health Facilities Financing Authority (CHFFA). The City Council authorized the investment on February 8, 2005.

<sup>3</sup> During 4th Quarter FY 2008, the City's investment portfolio included commercial paper, permitted by the City's investment policy. However, those investments matured during the period, thus, no commercial paper investments were held at September 30, 2008.

## Investment Processing

Under the City Treasurer's oversight, the City's Investment Manager (or the City Treasurer's designated representative) evaluates, selects, and initiates investment transactions as permitted by the City's Investment Policy. Using an investment system<sup>4</sup>, the Investment Manager or designated representative executes an investment transaction depending upon the existing investment strategy and the available cash to be invested. The Investment Manager selects investments that provide the desired yield between two to five securities dealers. The decision to purchase a particular investment is based on the amount (dollar limit), rating, yield, discounts, and maturity/call dates, as well as the available cash.

Once the investment purchase has been initiated, the Investment Manager prepares various internal documents and provides them to the Treasury Accountant for verification. The internal documents are then provided to the City Treasurer for review and to obtain the second approval. Once approved, a wire transfer request is prepared and sent to the City Auditor's Office for authorization and release of the wire transfer. The actual purchase of the investment takes place once the security dealer has received the wire transfer.



In addition to initiating investment purchases, the Investment Manager is authorized to sell investments. The City buys investment securities with the intention to hold them until maturity; however, an investment may be sold prior to maturity if certain circumstances occur, such as an unexpected cash flow need, market condition, or other events deemed appropriate by the Treasury Bureau.

## AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our audit were as follows:

- Reconcile pooled investments as to the amount and description as recorded on the City's books with outside depositories;
- Determine whether the City's pooled investments were in compliance with the California Government Code §53601 and the City's Investment Policy; and
- Determine whether the City's Investment Policy is in accordance with provisions of the California Government Code.

The scope of this audit was limited to the City's pooled investments for the quarters ending June 30, 2008 and September 30, 2008.

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<sup>4</sup> System which provides investment security data such as maturity, call dates, discounts, yield, investment amounts, and other details relevant to an available security, including the available dealers selling such securities.

We performed the following procedures in our audit:

- Conducted interviews of Treasury staff and management to gain an understanding of the investment process and the internal controls in place to safeguard the City's investments.
- Obtained written confirmations of all investments held by the City Treasurer's safekeeping agent and other custodians as of June 30, 2008 and September 30, 2008 and reconciled them to the City's general ledger.
- Traced the balance of total investments on the City Treasurer's Investment Holdings Report as of June 30, 2008 and September 30, 2008 to the City's general ledger.
- Analyzed the investment reconciliations as of June 30, 2008 and September 30, 2008 and reconciled them to the City's general ledger.
- Compared investments listed on the City Treasurer's Investment Activity Portfolio Statistics Report as of June 30, 2008 and September 30, 2008 to the types of investments authorized for the City in accordance with the City's Investment Policy and California Government Code §53601.
- Compared the portfolio mix of investment types listed in the City Treasurer's Investment Activity Portfolio Statistics Report as of June 30, 2008 and September 30, 2008 to the portfolio mix limitations imposed by the City's Investment Policy and California Government Code §53601 for specific investment types.
- Recomputed and reviewed supporting documentation, on a sample basis, relevant to the purchase, sale and maturity of individual investments to determine compliance with the following provisions of the California Government Code §53601; and/or the City's Investment Policy:
  - Purchase of investments meet minimum rating requirements and maximum allowable maturity periods;
  - All sections of the investment transaction record are properly completed and authorized by the City Treasurer; and
  - Transactions are supported by documentation from third-party sources (individual broker confirmations, safekeeping statements, custodian statements, etc.).
- Performed analytical testwork on accrued interest for pooled investments to determine reasonableness for the quarters ending June 30, 2008 and September 30, 2008.

We conducted this audit in accordance with Generally Accepted Government Auditing Standards. 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.

## RESULTS AND CONCLUSIONS

At June 30, 2008 and September 30, 2008, the City's pooled investments had book values of \$1.80 billion and \$1.66 billion, respectively. The City's pooled investment balances are presented in the table below:

Investment Type <sup>5</sup>	3rd Quarter FY 2008	% of Total Portfolio	4th Quarter FY 2008	% of Total Portfolio	4th Quarter FY 2008 (Market Value) <sup>6</sup>	% of Total Portfolio
SAVRS Loan	\$ 2,945,264	0.2%	\$ 2,891,879	0.2%	\$ 2,891,879	0.2%
Money Market	38,120,513	2.1%	69,931,057	4.2%	69,931,057	4.2%
Treasury Notes	85,403,011	4.7%	55,293,052	3.3%	55,816,625	3.3%
Medium-Term Notes	90,400,537	5.0%	85,240,310	5.1%	84,152,097	5.1%
LAIF	146,196,890	8.1%	160,973,672	9.7%	160,973,672	9.7%
Commercial Paper	224,832,696	12.5%	-	-	-	0.0%
GSE	1,213,327,778	67.4%	1,289,213,079	77.5%	1,289,369,873	77.5%
Total	\$ 1,801,226,689	100.0%	\$ 1,663,543,049	100.0%	\$ 1,663,135,203	100.0%

Based on our audit, the investment balances recorded on the City's books as of June 30, 2008 and September 30, 2008, agree as to the amount and description with outside depositories. We also found the City to be in compliance with the California Government Code §53601 and the City's Investment Policy. Additionally, we found the City's Investment Policy to be similar to policies adopted by other comparable California cities. In fact, the City's investment percentage limits are more restrictive than the maximum percentage limits permitted by the California Government Code. (See Appendix B for a comparison of investment policies by selected cities).

<sup>5</sup> As noted in our procedures, we selected days during the quarters to determine compliance during those periods; however, the schedules and charts noted in this report reflect the investment balances at periods ending 6/30/2008 and 9/30/2008.

<sup>6</sup> As of 4<sup>th</sup> Quarter FY2008, the City implemented GASB 31 in compliance with GAAP where it accounts and reports certain investments and external investment pools at fair market value rather than book value.



## **MANAGEMENT'S COMMENTS**

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City Management would like to thank the City Auditor's Office for this audit and concurs with the report.

Appendix A

City of Long Beach  
Investment Percentages by Investment Types

Investment Types	CA Gov Code Max % of Portfolio Permitted for Cities	Long Beach Max % of Portfolio Permitted	Long Beach Actual % of Portfolio (Q3, FY08) <sup>1</sup>	Long Beach Actual % of Portfolio (Q4, FY08) <sup>1</sup>
Local Agency Bonds	100%	30%	0.0%	0.0%
U.S. Treasuries	100%	100%	4.7%	3.3%
California (or other state) Debt	100%	30%	0.0%	0.0%
Cal Local Agency Debt	100%	30%	0.0%	0.0%
Gov't Sponsored Enterprise (GSE) Agencies	100%	100%	67.4%	77.5%
Banker's Acceptances	40%	40%	0.0%	0.0%
Commercial Paper	25%	25%	12.5%	0.0%
Negotiable Certificates of Deposit	30%	30%	0.0%	0.0%
Time Certificates of Deposit	100%	100%	0.0%	0.0%
Repurchase Agreements	100%	100%	0.0%	0.0%
Reverse Repurchase Agreements	20%	20%	0.0%	0.0%
Securities Lending Agreements	20%	20%	0.0%	0.0%
Medium-Term Notes	30%	30%	5.0%	5.1%
Mutual Funds	20%	20%	0.0%	0.0%
Money Market Funds	20%	20%	2.1%	4.2%
Mortgage/Asset Backed Debt	20%	20%	0.0%	0.0%
LAIF (Local Agency Investment Fund)	\$40 million/account (no % limit)	per state limit	8.1%	9.7%
SAVRS Loan (Special Long Beach Investment with Council Approval)		By special approval	0.2%	0.2%

<sup>1</sup> The investment percentages represented is the book value of investments at the end of the period. These investment percentages do not include accrued interest and discounts.

Appendix B

City of Long Beach  
Comparison of Investment Policies  
Selected Cities<sup>1</sup>

Investment Types	CA Gov Code Max % of Portfolio Permitted for Cities (percentages may differ for multi-jurisdiction investment pools)	Long Beach Max % of Portfolio Permitted (2008)	Los Angeles Max % of Portfolio Permitted (2004)	Fresno Max % of Portfolio Permitted (2008-2009)	Sacramento Max % of Portfolio Permitted (2006)	Oakland Max % of Portfolio Permitted (2008-2009)	Anaheim Max % of Portfolio Permitted (2008)
Local Agency Bonds	100%	30%	100%	100%	100%	Prudent person std	20%
U.S. Treasuries	100%	100%	100%	100%	100%	20%	100%
California (or other state) Debt	100%	30%	100%	100%	100%	100%	20%
Cal Local Agency Debt	100%	30%	100%	100%	100%	100%	10%
Government Sponsored Enterprise (GSE) Agencies	100%	100%	100%	70%	100%	100%	100%
Banker's Acceptances	40%	40%	40%	40%	40%	40%	40%
Commercial Paper	25%	25%	40%	25%	25%	25%	25%
Negotiable Certificates of Deposit	30%	30%	30%	30%	30%	30%	25%
Time Certificates of Deposit	100%	100%	30%	100%	100%	Prudent person std	20%
Repurchase Agreements	100%	100%	15%	100%	100%	100%	30%
Reverse Repurchase Agreements <sup>3</sup>	20%	20%	5%	20%	20%	20%	20%
Securities Lending Agreements <sup>3</sup>	20%	20%	20%	20%	20%	20%	20%
Medium-Term Notes	30%	30%	30%	30%	30%	30%	30%
Mutual Funds	20%	20%	20%	20%	20%	N.A. <sup>2</sup>	20%
Money Market Funds	20%	20%	N.A. <sup>2</sup>	20%	20%	20%	N.A. <sup>2</sup>
Mortgage/Asset Backed Debt	20%	20%	20%	20%	20%	N.A. <sup>2</sup>	N.A. <sup>2</sup>
LAIF (Local Agency Investment Fund)	\$40 million/account (no % limit)	Per state limit	Per state limit	Per state limit	Per state limit	Per state limit	Per state limit
SAVRS Loan (Special Long Beach Investment with Council Approval)		By special approval					

<sup>1</sup> Selected cities are California cities among the top ten in population for which investment policies were readily available. City policies compared to are the most recent known as of October 2008.

<sup>2</sup> Information in a city's investment policy for that particular investment category is not available.

<sup>3</sup> The total of all reverse repurchase agreements and securities lending agreements on investments owned by local agency is limited to 20% of the base value of the portfolio.