PETER HUGHES, Ph.D, MBA, CPA, CIA, CFE, CITP
Director

400 Civic Center Drive West
Building 12, Room 232
Santa Ana, California 92701-4521

(714) 834-5475 Fax: (714) 834-2880

INTERNAL AUDIT DEPARTMENT

File No. 2308

May 7, 2004

TO: David E. Sundstrom
Auditor-Controller

Attention: Jim McConnell, Assistant Auditor-Controller, Central Operations

SUBJECT: Report on Audit of the Statement of Assets
Held by the County Treasury as of December 31, 2003

Attached is a copy of our Report on Audit of the Statement of Assets Held by the County Treasury as of December 31, 2003 (Audit No. 2308).

Respectfully submitted,

Dr. Peter Hughes, CPA
Director, Internal Audit

/PH:cg

Attachment

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

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INTERNAL AUDIT DEPARTMENT

File No. 2308

May 7, 2004

TO: Members, Board of Supervisors
Hall of Administration Building
10 Civic Center Plaza
Santa Ana, CA 92701

SUBJECT: Report on Audit of the Statement of Assets
Held by the County Treasury as of December 31, 2003

Dear Honorable Board Members:

Attached is a copy of our Report on Audit of the Statement of Assets Held by the County Treasury as of December 31, 2003 (File No. 2308).

Respectfully submitted,

Dr. Peter Hughes, CPA
Director, Internal Audit

/PH:cg

Attachment

Other recipients of this audit report:
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Director
Internal Audit Department
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File No. 2308

May 7, 2004

INDEPENDENT AUDITOR'S REPORT

Board of Supervisors

Pursuant to Government Code 26920(b) and 26922, we have audited the accompanying Statement of Assets Held by the County Treasury as of December 31, 2003. This statement is the responsibility of the Treasurer's management. Our responsibility is to express an opinion on this statement based on our audit.

We conducted our audit in accordance with United States generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statement presentation. We believe our audit provides a reasonable basis for our opinion.

As described in Note 1, the statement was prepared on the cash basis, as modified, which is a comprehensive basis of accounting other than United States generally accepted accounting principles.

In our opinion, the Statement of Assets Held by the County Treasury presents fairly, in all material respects, the amount and type of assets in the County Treasury as of December 31, 2003, on the basis of accounting described in Notes 1 and 2.

The required supplementary information is not a required part of the financial statement but is supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it.

This report is intended for the information of the management of the County of Orange Auditor-Controller.

However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Dr. Peter Hughes, CPA
Director, Internal Audit

COUNTY OF ORANGE

OFFICE OF THE TREASURER-TAX COLLECTOR

HALL OF FINANCE & RECORDS
12 CIVIC CENTER PLAZA, ROOM G76
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ASSISTANT TAX COLLECTOR
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STATEMENT OF ASSETS HELD BY THE COUNTY TREASURY
AS OF DECEMBER 31, 2003

ASSETS

	County Pool	Educational Pool	Non-Pooled	Total
Cash				
Cash on Hand	$ 27,657	$ -	$ -	$ 27,657
Demand Accounts	17,966,116	5,604,586	14,526	23,585,228
Total Cash	17,993,773	5,604,586	14,526	23,612,885
Investments, stated at fair value				
Orange County Investment Pool:				
Money Market Fund	2,225,721,517			2,225,721,517
Extended Fund	572,430,380			572,430,380
Orange County Educational Pool:				
Money Market Fund		2,489,255,449		2,489,255,449
Extended Fund		199,412,063		199,412,063
Non-pooled			68,777,112	68,777,112
Total Investments	2,798,151,897	2,688,667,512	68,777,112	5,555,596,521
TOTAL ASSETS	**$ 2,816,145,670**	**$ 2,694,272,098**	**$ 68,791,638**	**$ 5,579,209,406**

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

ORANGE COUNTY TREASURER-TAX COLLECTOR
NOTES TO FINANCIAL STATEMENT
DECEMBER 31, 2003

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying Statement of Assets Held by The County Treasury is intended to separately report deposits and investments included in the Comprehensive Annual Financial Report of the County of Orange, State of California. For additional disclosure information and contingencies, please refer to the latest publication of the County Comprehensive Annual Financial Report.

The statement includes the cash balances of all funds that the Treasurer pools for investing surplus funds according to the California Government Code and certain other non-pooled specific investments. The County sponsors two external investment pools: the Orange County Investment Pool (the County Pool), and the Orange County Educational Investment Pool (the Educational Pool). The statement does not include cash and investments for the Orange County Employees Retirement System, certain deferred compensation funds and other debt reserve funds held in trust outside, and independent of, the County Treasury.

This statement is presented on the cash basis, as modified, which is a comprehensive basis of accounting other than United States generally accepted accounting principles. Receipts are recognized when received by the Treasurer; disbursements are recognized when paid by the bank.

The Treasurer has stated required investments at fair value in the accompanying financial statement. Management contracts with an outside service to provide pricing for the fair value of investments in the portfolio. The investments are marked to market and the net asset values are calculated each business day for both the Money Market Funds of the County Pool and the Educational Pool. Securities listed or traded on a national securities exchange are valued at the last quoted sales price. Short-term money market instruments are valued using an average of closing prices and rate data commonly known as matrix pricing. The fair value for investments presented in the statement include the use of estimates and in some cases results in the presentation of a number of approximate rather than exact amounts.

The County has not provided or obtained any legally binding guarantees during the period to support the value of participants' shares in the pool.

The participant's shares in the pools are valued using an amortized cost basis. Specifically, the pool distributes income to participants based on their relative participation during the period. Income is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and reduced by (4) investment and administrative expenses. This method differs from the fair value method used to value investments in this financial statement because the amortized cost method does not distribute to participants all unrealized gains and losses. At December 31, 2003, there is no material difference between pools participants' shares valued on an amortized cost basis compared to fair value.

NOTE 2 - DEPOSITS AND INVESTMENTS

The Treasurer maintains the County Pool and the Educational Pool for the County and other non-County entities for the purpose of benefiting from economies of scale through pooled investment activities. The Investment Policy Statement (IPS) establishes a Money Market Fund and an Extended Fund as components of the County Pool and Educational Pool. The Treasurer determines, on a cash flow basis, the percentage of monies to be invested in both the Money Market Fund and Extended Fund. The maximum maturity of investments under the Money Market Fund is 13 months with a maximum weighted average of 90 days. The maximum maturity of the Extended Fund is 3 years, with a maximum weighted average of 18 months.

NOTE 2 - DEPOSITS AND INVESTMENTS (continued)

The primary investment objectives of the Treasurer's investment activities are in priority order: protecting the safety of the principal invested, meeting the liquidity needs of the participants, attaining a money market rate of return, and attempting to stabilize at a $1 net asset value for the County Money Market Fund and the Educational Money Market Fund. These external investment pools contain deposits, repurchase agreements, and investments. Interest is allocated to individual funds monthly based on the average daily balances on deposit with the Treasurer.

A. Deposits

Monies must be deposited in state or national banks, or state or federal savings and loan associations located within the State. The County is authorized to use demand accounts and certificates of deposit. Additionally, monies deposited at national banks are used for compensating balances. The Treasurer has established separate bank and investment custody accounts for the County's school participants.

Obligations pledged to secure deposits must be delivered to an institution other than the institution in which the deposit is made; however, the trust department of the same institution may hold them. Written custodial agreements are required that provide, among other things, that the collateral securities are held separate from the assets of the custodial institution. The pledge to secure deposits is administered by the California Superintendent of Banks.

Collateral is required for demand deposits at 110 percent of all deposits not covered by federal deposit insurance if obligations of the United States and its agencies, or obligations of the State or its municipalities, school districts, and district corporations are pledged. Collateral of 150 percent is required if a deposit is secured by first mortgages or first trust deeds upon improved residential real property located in California. All such collateral is considered to be held by the pledging financial institutions' trust departments or agents in the name of the County.

At December 31, 2003, the carrying amount of the County's deposits was $23,585,228 and the corresponding bank balance for the County's demand deposits was $18,074,682 of which $100,000 was insured by FDIC insurance with the remainder collateralized as described above. (The carrying amount of the County's deposits differs from corresponding bank balances primarily due to deposits in transit and other timing differences).

B. Investments

State statutes, Board of Supervisors' ordinances and resolutions, the respective bond documents, trust agreements, and other contractual agreements govern the County's investment policies.

External Investment Pools

The County Treasurer has a written IPS specifically for the separately managed County and Educational Investment Pools (Pools). The IPS requires the assets in the Pools to consist of the following investments and maximum permissible concentrations based on market value: U.S. Treasury instruments backed by the full faith and credit of the United States government (100%); obligations issued or guaranteed by agencies of the United States government (100%); commercial paper of a high rating (A1/P1/F1) as provided by at least two of the following nationally recognized rating agencies: Standard & Poor's Corporation, Moody's Investors Service, Inc., or Fitch Ratings ("Fitch"), with further restrictions regarding issuer size and maturity (40%); negotiable certificates of deposit issued by a nationally or state-chartered bank or state or federal association or by a state-licensed branch of a foreign bank (30%); bankers' acceptances (40%); money market funds (20%); State of California or municipal debt (10%); "AA" or better receivable-backed securities (10%); medium-term notes (30%); and repurchase agreements collateralized by securities at 102% of the cost adjusted no less frequently than weekly (50%). The IPS authorizes the County Treasurer to enter into securities lending agreements (as defined by

NOTE 2 - DEPOSITS AND INVESTMENTS (continued)

California Government Code sections 53601 and 53601.7(f)(4)) where the final maturity does not exceed 92 days. In addition, no investment may be purchased from an issuer that has been placed on credit watch-negative by any of the three nationally recognized rating agencies, or whose credit rating by any of the three nationally recognized rating agencies is less than the minimum rating required by the IPS for that class of security. All permitted investments are required to comply in every respect with California Government Code Sections 53601 and 53635 (governing the investment of public funds) and other relevant California Government Code provisions.

Repurchase agreements are limited to a one-year maturity and can only be entered into with entities prescribed in California Government Code Section 53601. The securities underlying the agreements must be delivered to the County's custodial banks. The County enters into written master repurchase agreements that outline obligations of both the County and the dealers, and also enters into written contracts with custodial institutions that outline the basic responsibilities of those institutions for securities underlying the repurchase agreements. These custodial contracts and the County's procedures for monitoring the securities are similar to those for collateral on deposits.

The IPS expressly prohibits leverage, reverse repurchase agreements, and volatile structured notes or derivatives. Investments are marked to market on a daily basis. If the net asset value of the Money Market Fund for either the County Pool or the Educational Pool is less than $.995 or greater than $1.005, portfolio holdings may be sold as necessary to maintain the ratio between $.995 and $1.005. Under the IPS, no more than 5% of the total market value of the pooled funds may be invested in securities of any one issuer, except for obligations of the United States government, U.S. government agencies or government-sponsored enterprises. No more than 10% may be invested in one money market mutual fund. All investments will be United States dollar denominated.

The County Treasury Oversight Committee, established in December 1995, which consists of the County Executive Officer, the elected County Auditor-Controller, the elected County Superintendent of Schools and two public members, conducts treasury oversight. On January 7, 2004, Fitch reaffirmed the Pools' ratings of "AAA/V1+". In January 2004, Moody's Investor Service reaffirmed credit ratings of Aaa and MR1 market risk ratings for the County and Educational Investment Pools. The Pools are not registered with the Securities and Exchange Commission.

Unless otherwise required in a trust agreement or other financing document, assessment districts and public school districts are required by legal provisions to deposit their funds with the County Treasurer. The Educational Pool consists entirely of public school districts and therefore includes 100% involuntary participants. At December 31, 2003, the County Pool includes approximately 4.71% external involuntary participant deposits for the state courts, certain assessment districts, and certain bond related funds for public school districts.

As of December 31, 2003, floating rate notes comprised less than 4.94% and 2.81% of the County Pool and Educational Pool, respectively. Interest received on floating rate notes will rise or fall as the underlying index rate rises or falls. The use of floating rate notes in the County and Educational Pools is such that they hedge the portfolios against the risk of increasing interest rates.

NOTE 2 - DEPOSITS AND INVESTMENTS (continued)

Summary External Pool Financial Disclosures

Selected summary disclosures for each external pool as of December 31, 2003, are presented below:

	Fair Value	Principal	Interest Rate Range (%)	Maturity Range	Weighted Average Days to Maturity
County Pool					
U.S. Government Agencies	$ 829,822,071	$ 828,401,973	0.97-6.25%	01/20/04-06/12/06	359
Bankers' Acceptances	25,683,434	25,716,243	1.08-1.11%	02/02/04-02/17/04	42
Commercial Paper	993,695,884	995,024,000	1.03-1.20%	01/02/04-08/10/04	46
Negotiable Certificates of Deposit	574,995,780	575,000,000	1.05-1.40%	01/08/04-08/26/04	65
Medium-Term Notes	222,424,581	221,246,224	1.24-7.25%	02/03/04-02/01/05	68
Repurchase Agreements	100,000,000	100,000,000	1.05%	01/02/04	2
Money Market Mutual Funds	51,530,147	51,530,147	Variable	01/02/04	2
	$ 2,798,151,897	**$ 2,796,918,587**			142
Educational Pool					
U.S. Government Agencies	$ 836,690,788	$ 835,610,027	0.97-6.25%	01/20/04-06/12/06	184
Bankers' Acceptances	15,090,070	15,170,260	1.10%	6/21/2004	173
Commercial Paper	991,491,448	992,794,000	1.02-1.20%	01/02/04-08/10/04	45
Negotiable Certificates of Deposit	605,995,502	606,000,000	1.05-1.40%	01/02/04-08/26/04	55
Medium-Term Notes	109,164,269	108,753,776	1.24-7.25%	02/03/04-02/01/05	54
Repurchase Agreements	80,000,000	80,000,000	1.05%	01/02/04	2
Money Market Mutual Funds	50,235,435	50,235,435	Variable	01/02/04	2
	$ 2,688,667,512	**$ 2,688,563,498**			89

At December 31, 2003, the weighted average maturity of the County Pool was 142 days and the Educational Pool was 89 days. At the same date, the Net Asset Value (NAV) of Money Market Funds for both pools was $1.00. The average daily investment balance of the County Pool and the Educational Pool amounted to $2.66 billion and $2.09 billion, with an average effective yield of 1.27% and 1.18%, respectively, for the quarter ended December 31, 2003.

NOTE 2 - DEPOSITS AND INVESTMENTS (continued)

Level of Custodial Credit Risk

Investments are categorized below as prescribed by GASB Statement No. 3 to indicate the level of custodial credit risk assumed by the County at December 31, 2003. Category 1 includes investments that are insured or registered, or securities held by the County or its agent in the County's name. Category 2 includes uninsured and unregistered investments with securities held by the counterparty's trust department or agent in the County's name. Category 3 includes uninsured and unregistered investments with securities held by the counterparty, or by its trust department or agent but not in the County's name.

LEVEL OF CUSTODIAL RISK					
	Category			Not Subject to	
	1	2	3	Categorization	Fair Value
County Pool					
U.S. Government Agencies					
Not on securities loan	$ 784,821,685	$ -	$ -	$ -	$ 784,821,685
On securities loan	-	-	-	45,000,386	45,000,386
Bankers' Acceptances	25,683,434	-	-	-	25,683,434
Commercial Paper	993,695,884	-	-	-	993,695,884
Negotiable Certificates of Deposit	574,995,780	-	-	-	574,995,780
Medium-Term Notes	222,424,581	-	-	-	222,424,581
Repurchase Agreements	100,000,000	-	-	-	100,000,000
Money Market Mutual Funds	-	-	-	51,530,147	51,530,147
Total County Pool	**2,701,621,364**	**-**	**-**	**96,530,533**	**2,798,151,897**
Educational Pool					
U.S. Government Agencies					
Not on securities loan	821,014,437	-	-	-	821,014,437
On securities loan	-	-	-	15,676,351	15,676,351
Bankers' Acceptances	15,090,070	-	-	-	15,090,070
Commercial Paper	991,491,448	-	-	-	991,491,448
Negotiable Certificates of Deposit	605,995,502	-	-	-	605,995,502
Medium-Term Notes	109,164,269	-	-	-	109,164,269
Repurchase Agreements	80,000,000	-	-	-	80,000,000
Money Market Mutual Funds	-	-	-	50,235,435	50,235,435
Total Educational Pool	**2,622,755,726**	**-**	**-**	**65,911,786**	**2,688,667,512**
Specific Investments					
U.S. Government Agencies	21,336,219	-	-	-	21,336,219
Commercial Paper	14,186,147	-	-	-	14,186,147
Repurchase Agreements	1,081,500	-	-	-	1,081,500
Money Market Mutual Funds	-	-	-	32,173,246	32,173,246
Total Specific Investments	**36,603,866**	**-**	**-**	**32,173,246**	**68,777,112**
Total Investments	**$ 5,360,980,956**	**$ -**	**$ -**	**$ 194,615,565**	**$ 5,555,596,521**

NOTE 2 - DEPOSITS AND INVESTMENTS (continued)

Securities Lending Transactions

State statutes and the IPS approved by the board of supervisors, permit the County Treasurer to use investments of the County and Educational Investment Pools to enter into securities lending transactions. The County participates in a securities lending program as a means to augment income. Securities lending transactions are loans of securities to broker-dealers and other entities (borrowers) for collateral with a simultaneous agreement to return the collateral for the same securities in the future. Collateral may be cash or securities issued by the U.S. government or its agencies. Collateral securities cannot be pledged or sold by the County unless the borrower defaults. Under California Government Code the total of all securities lending agreements on investments owned by the County may not exceed 20 percent of the base value of the portfolio. The County Treasurer's custodial bank (lending agent) is the agent in lending the Pools' securities for collateral of 102 percent of the market value of securities lent. Securities on loan at December 31 are presented as uncategorized in the preceding schedule of custodial credit risk. The contract with the lending agent requires them to indemnify the County if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the County for income distributions by the securities' issuers while the securities are on loan.

Cash collateral is invested by the lending agent in a short-term investment pool in the County's name. The County approves the investment guidelines for this pool. As of December 31, the securities in this pool had a weighted average maturity of 5 days. The County bears the risk of any loss of principal from investing cash collateral. If the investment pool fails to obtain or retain enough value to repay the borrower its collateral and the borrower rebate, the County must provide the necessary amount from its own resources. Either the County or the borrower can terminate all securities loans on demand, although the average term of the loans at quarter-end is 51 days. The term to maturity of securities loans is generally matched with the term to maturity of the cash collateral by investing in overnight repurchase agreements and short-term investments. Such matching existed at quarter-end. At quarter-end, the County has no credit risk exposure to borrowers because the amounts the County owes the borrowers exceeds the amounts the borrowers owe the County.

At December 31, the total market value of investments lent to borrowers was $60,676,737, the related amount of cash collateral owed to borrowers was $62,288,043 including $25,458 of accrued rebates, and the book value of the investments in the short-term investment pool was $62,268,162.