

**Audit of Treasury Investment Compliance
for the Two Years Ending December 31, 2003
Open Item - Investment Policy Statement**

Review Questions and Answers

At the AOC meeting of September 24, 2003, general discussion was held concerning a professional disagreement between Internal Audit and the Treasurer-Tax Collector over a specific interpretation of the Investment Policy Statement (IPS) as stated in the Audit of Treasury Investment Compliance for the Two Years Ending December 31, 2003. As it stands, this issue remains an open item. Detailed below are specific questions and answers for the basis of Internal Audit's position. County Counsel has been contacted for clarification of the interpretation and a status will be provided to the Audit Oversight Committee at its first meeting in 2004.

1. What was the original language and what did it get changed to?
 - A. IPS dated March 27, 2001, Section V.11 - Investment Restrictions and Prohibited Transactions, states: "No security purchased may have a rating by any of the three nationally recognized rating agencies less than the minimum rating required for that class of security."
 - B. In the IPS dated December 18, 2001, Section V.11 was revised as follows: "No security at the time of purchase may be rated below the minimum required under this policy."
 - C. In the Proposed IPS for 2003, dated December 3, 2002, the wording in the December 18, 2001 IPS was completely eliminated.

2. Did the changed language get identified as a change to the Treasury Oversight Committee (TOC) and the Board of Supervisors (BOS)?
 - A. **Change in IPS from March 27, 2001 to December 18, 2001:** The Treasurer at the October 10, 2001 TOC meeting presented to the TOC a document titled "Summary of 2002 Investment Policy Statement Second Draft (10-5-01)" which contained proposed changes to the IPS. Within this document the Treasurer explained this proposed change, as "The original section was confusing." In the Treasurer's letter dated December 4, 2001, regarding Investment Policy Statement Review issued to the BOS for review and approval, the change was identified as "a wording simplification".

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The Treasurer in his response to this finding/recommendation stated:

“Do not concur. We have a professional disagreement regarding this recommendation.

By way of background, this section is a reiteration of other provisions, Section IV, within the Investment Policy Statement (IPS). This Section’s purpose is to remind the Treasurer that no investment may be purchased if it does not meet the minimum investment requirement of each separate investment category as stipulated in Section IV. Accordingly, it is helpful, but redundant.

A rewrite change was proposed in December of 2001 to Section V., Paragraph 11 because the March 2001 version was duplicative. Accordingly, addressing the change as clarifying something “confusing” or “a wording simplification” is irrelevant. A modification was consistent with the minimum requirements within Section IV. The wording in Section IV specifically prohibits the acquisition of investments with a short-term split-rating.”

See the Attachment of the language stipulated in the March 2001 IPS, Section IV for minimum investment requirements for the various investment categories.

- B. **Change in IPS from December 18, 2001 to the Proposed IPS for 2003:** The eliminated wording was not noted in the proposed IPS dated November 1, 2002 given to TOC members at the November 6, 2002 TOC meeting. In addition, the eliminated wording was not identified as a revision in the cover letter dated December 3, 2002 for the BOS to review and approve.

3. Has any split rated securities been purchased?

Based on the sample of investments that were tested in the annual compliance audit and the quarterly compliance monitoring engagements, we have not identified any securities with split ratings. All securities tested either had two of the required ratings, or when there were three ratings, all three met the minimum requirements.

<p align="center">Investment Policy Statement Effective as of March 2001 Revised 3-27-01</p>	<p align="center">IAD Interpretation of IPS</p>
<p>3. COMMERCIAL PAPER Commercial paper of “prime” quality of the highest ranking or of the highest letter and numerical rating (A-1/P-1/F-1) as provided for by at least two of the following nationally recognized rating agencies: Standard and Poor’s Corporation (Standard & Poor’s); or Moody’s Investors Service, Inc. (Moody’s) or Fitch IBCA Inc. (Fitch).</p>	<p>This language does not address the minimum requirements for a third rating if there is one. Therefore, it would allow the purchase of split rated securities.</p>
<p>4. NEGOTIABLE CERTIFICATES OF DEPOSIT Issuers of certificates of deposit must be rated by at least two of the following nationally recognized rating agencies, and must not be rated below the following minimum ratings: “A-1” by Standard & Poor’s, “P-1” by Moody’s, “F-1” by Fitch and “B/C” by Thomson BankWatch.</p>	<p>This language does not address the minimum requirements for a third rating if there is one. Therefore, it would allow the purchase of split rated securities.</p>
<p>6. BANKERS ACCEPTANCES Issuing banks must be rated by at least two of the following nationally recognized rating agencies, and must not be rated below the following minimum short-term ratings: “A-1” by Standard & Poor’s, “P-1” by Moody’s, “F-1” by Fitch and “B/C” by Thomson Bankwatch.</p>	<p>This language does not address the minimum requirements for a third rating if there is one. Therefore, it would allow the purchase of split rated securities.</p>
<p>9. RECEIVABLE-BACKED SECURITIES Securities eligible for investment shall have a credit rating of “AA” or better and its issuer shall have a credit rating of “A” or higher for the issuer’s debt by at least two nationally recognized rating services.</p>	<p>This language does not address the minimum requirements for a third rating if there is one. Therefore, it would allow the purchase of split rated securities.</p>
<p>10. MEDIUM-TERM NOTES Eligible notes shall be rated “A” or better by at least two of the following nationally recognized rating agencies: Standard and Poor’s, or Moody’s, or Fitch. Furthermore, if the medium-term note issuer has a commercial paper rating, it must have at least two of the following ratings: “A-1” by Standard and Poor’s, “P-1” by Moody’s or “F-1” by Fitch.</p>	<p>This language does not address the minimum requirements for a third rating if there is one. Therefore, it would allow the purchase of split rated securities.</p>