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INTERNAL AUDIT DEPARTMENT

File No. 2104

March 29, 2002

INTERNAL AUDITOR'S REPORT

David E. Sundstrom
Auditor-Controller

Attention: Shaun Skelly, Chief, Agency and Support Accounting

Pursuant to Government Code 26920(b) and 26921 through 26923, we have audited the accompanying Statement of Assets Held by the County Treasury as of December 31, 2001. 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, 2001, 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.

David E. Sundstrom
March 29, 2002

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

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**STATEMENT OF ASSETS HELD BY THE COUNTY TREASURY
AS OF DECEMBER 31, 2001**

ASSETS

	County Pool	Educational Pool	Non-Pooled	Total
Cash				
Cash in Banks	\$ 19,579,685	\$ 622,545	\$ 19,615,606	\$ 39,817,836
Cash on Hand	51,563			51,563
Total Cash	<u>19,631,248</u>	<u>622,545</u>	<u>19,615,606</u>	<u>39,869,399</u>
Investments, stated at fair value				
Orange County Investment Pool:				
Money Market Fund	2,170,232,155			2,170,232,155
Extended Fund	691,869,395			691,869,395
Orange County Educational Pool		1,540,753,792		1,540,753,792
Non-pooled			114,214,676	114,214,676
Total Investments	<u>2,862,101,550</u>	<u>1,540,753,792</u>	<u>114,214,676</u>	<u>4,517,070,018</u>
TOTAL ASSETS	<u>\$ 2,881,732,798</u>	<u>\$1,541,376,337</u>	<u>\$133,830,282</u>	<u>\$ 4,556,939,417</u>

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

See accompanying Internal Auditor's report.

**ORANGE COUNTY TREASURER-TAX COLLECTOR
NOTES TO FINANCIAL STATEMENT
DECEMBER 31, 2001**

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, 2001, there is no material difference between pool 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 (as of March 28, 2002, the Educational Pool is not participating in the Extended Fund). 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.

See accompanying Internal Auditor's report.

ORANGE COUNTY TREASURER-TAX COLLECTOR
NOTES TO FINANCIAL STATEMENT
DECEMBER 31, 2001

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 Pool. 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, 2001, the carrying amount of the County's deposits was \$22,810,032 and the corresponding bank balance for the County's demand deposits was \$21,974,017 of which \$300,000 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). In addition to the cash deposits reported above, the County held a portion of its investments in the form of a non-participating Bank Investment Contract (BIC). This BIC is considered a deposit with a financial institution, and amounted to \$17,007,804 of which, \$100,000 was insured by FDIC insurance with the remainder collateralized.

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.

See accompanying Internal Auditor's report.

**ORANGE COUNTY TREASURER-TAX COLLECTOR
NOTES TO FINANCIAL STATEMENT
DECEMBER 31, 2001**

NOTE 2 - DEPOSITS AND INVESTMENTS (continued)

External Investment Pools

The County Treasurer has a written IPS specifically for the separately managed County and Educational Investment 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 IBCA, Duff & Phelps ("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 with at least one billion dollars in assets (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%). 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 three-month maturity and can only be entered into with entities prescribed in California Government Code Sections 53601 and 53635. 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. The maximum term of any investment under the Extended Fund is three years and the weighted average maturity is limited to eighteen months. The maximum maturity of any investment in the Money Market Fund remains thirteen months or less, with the weighted average maturity limited to 90 days. Investments are marked to market on a daily basis. If the net asset value of the Money Market Funds 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. In addition, Fitch conducts a quarterly review of IPS compliance according to agreed upon procedures. On October 5, 2001, Fitch reaffirmed the Pools' ratings of "AAA/V1+". The Pools are not registered with the Securities and Exchange Commission.

See accompanying Internal Auditor's report.

**ORANGE COUNTY TREASURER-TAX COLLECTOR
NOTES TO FINANCIAL STATEMENT
DECEMBER 31, 2001**

NOTE 2 - DEPOSITS AND INVESTMENTS (continued)

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 percent involuntary participants. At December 31, 2001, the County Pool includes approximately 0.41 percent external involuntary participant deposits for certain assessment districts and certain bond related funds for public school districts.

As of December 31, 2001, floating rate notes comprised less than 8% and 4% 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.

Summary External Pool Financial Disclosures

Selected summary disclosures for each external pool as of December 31, 2001, are presented below:

	Fair Value	Principal	Interest Rate Range (%)	Maturity Range	Weighted Average Days to Maturity
<u>County Pool</u>					
U.S. Government Agencies	\$ 937,437,492	\$ 933,705,000	1.66-6.87%	01/08/02-11/08/04	387
Bankers' Acceptances	39,905,776	40,000,000	1.84-2.32%	01/15/02-03/26/02	48
Commercial Paper	846,166,277	847,199,000	1.87-2.43%	01/03/02-03/01/02	26
Negotiable Certificates of Deposit	493,233,184	492,000,000	1.77-5.41%	01/07/02-07/30/02	58
Medium-Term Notes	365,388,959	364,117,000	1.96-6.75%	01/14/02-12/17/04	76
Repurchase Agreements	40,000,000	40,000,000	2.05%	01/02/02	2
Money Market Mutual Funds	139,969,862	139,969,862	Variable	01/01/02	1
	<u>\$ 2,862,101,550</u>	<u>\$ 2,856,990,862</u>			<u>155</u>
<u>Educational Pool</u>					
U.S. Government Agencies	\$ 305,086,040	\$ 306,062,000	1.73-6.75%	01/03/02-05/23/02	71
Bankers' Acceptances	44,969,421	45,000,000	2.00-2.35%	01/02/02-03/27/02	15
Commercial Paper	592,291,212	592,856,000	1.80-2.45%	01/02/02-02/28/02	21
Negotiable Certificates of Deposit	370,419,262	370,000,000	1.75-4.63%	01/07/02-05/20/02	52
Medium-Term Notes	140,344,169	139,993,000	1.97-8.10%	01/14/02-06/17/02	38
Repurchase Agreements	40,000,000	40,000,000	2.05%	01/02/02	2
Money Market Mutual Funds	47,643,688	47,643,688	Variable	01/01/02	1
	<u>\$ 1,540,753,792</u>	<u>\$ 1,541,554,688</u>			<u>38</u>

At December 31, 2001, the weighted average maturity of the County Pool was 155 days and the Educational Pool was 38 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 \$2.50 billion and \$1.17 billion, with an average effective yield of 3.12% and 3.04%, respectively, for the quarter ended December 31, 2001.

See accompanying Internal Auditor's report.

**ORANGE COUNTY TREASURER-TAX COLLECTOR
NOTES TO FINANCIAL STATEMENT
DECEMBER 31, 2001**

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, 2001. 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 Categorization	Fair Value
	1	2	3		
<u>County Pool</u>					
U.S. Government Agencies	\$ 937,437,492	\$ -	\$ -	\$ -	\$ 937,437,492
Bankers' Acceptances	39,905,776	-	-	-	39,905,776
Commercial Paper	846,166,277	-	-	-	846,166,277
Negotiable Certificates of Deposit	493,233,184	-	-	-	493,233,184
Medium-Term Notes	365,388,959	-	-	-	365,388,959
Repurchase Agreements	40,000,000	-	-	-	40,000,000
Money Market Mutual Funds	-	-	-	139,969,862	139,969,862
Total County Pool	2,722,131,688	-	-	139,969,862	2,862,101,550
<u>Educational Pool</u>					
U.S. Government Agencies	305,086,040	-	-	-	305,086,040
Bankers' Acceptances	44,969,421	-	-	-	44,969,421
Commercial Paper	592,291,212	-	-	-	592,291,212
Negotiable Certificates of Deposit	370,419,262	-	-	-	370,419,262
Medium-Term Notes	140,344,169	-	-	-	140,344,169
Repurchase Agreements	40,000,000	-	-	-	40,000,000
Money Market Mutual Funds	-	-	-	47,643,688	47,643,688
Total Educational Pool	1,493,110,104	-	-	47,643,688	1,540,753,792
<u>Specific Investments</u>					
U.S. Government Agencies	16,681,179	-	-	-	16,681,179
Commercial Paper	14,481,917	-	-	-	14,481,917
Negotiable Certificates of Deposit	-	-	-	-	-
Medium-Term Notes	-	-	-	-	-
Repurchase Agreements	1,081,500	-	-	-	1,081,500
Collateralized Investment Agreement	-	-	-	23,411,883	23,411,883
Money Market Mutual Funds	-	-	-	58,558,197	58,558,197
Total Specific Investments	32,244,596	-	-	81,970,080	114,214,676
Total Investments	\$ 4,247,486,388	\$ -	\$ -	\$ 269,583,630	\$4,517,070,018

See accompanying Internal Auditor's report.