

# Internal Audit Department

O R A N G E    C O U N T Y    5<sup>th</sup> Largest County in the USA

## INTERNAL CONTROL AUDIT: CEO/PUBLIC FINANCE CONTINUING BOND DISCLOSURE PROCESS

For the Year Ending  
March 31, 2009

**Critical  
Impact  
Audit**

**14 OUTSTANDING BONDS  
TOTALLING \$912  
MILLION**

We audited the County's continuing bond disclosure process required by the Securities Exchange Act to ensure compliance. The County's long-term obligations totaled **\$912 million** as of June 30, 2008. During fiscal year ending June 30, 2008, the County retired long-term obligations totaled **\$99 million**. Interest scheduled for long-term service requirements totaled **\$57 million**.

We identified four (4) **Significant Issues** and made four (4) recommendations to enhance existing controls and processes for continuing bond disclosures.

AUDIT NO: 2814  
REPORT DATE: APRIL 20, 2010

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**Deputy Director:** Eli Littner, CPA, CIA  
**Senior Audit Manager:** Alan Marcum, CPA, CIA  
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**RISK BASED AUDITING**

GAO & IIA Peer Review Compliant – 2001, 2004, 2007

-  2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year
-  2008 Association of Local Government Auditors' Bronze Website Award
-  2005 Institute of Internal Auditors' Award for Recognition of Commitment to Professional Excellence, Quality, and Outreach



ORANGE COUNTY BOARD OF SUPERVISORS'  
**Internal Audit Department**

*GAO & IIA Peer Review Compliant - 2001, 2004, 2007*

*Providing Facts and Perspectives Countywide*

**RISK BASED AUDITING**

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**OC Fraud Hotline (714) 834-3608**



## Transmittal Letter



**Audit No. 2814 April 20, 2010**

**TO:** Robert J. Franz, Deputy CEO  
Chief Financial Officer

**FROM:** Dr. Peter Hughes, CPA, Director  
Internal Audit Department

**SUBJECT:** Internal Control Audit: CEO/Public  
Finance Continuing Bond Disclosure  
Process

We have completed an Internal Control Audit of CEO/Public Finance Continuing Bond Disclosure Process for the year ending March 31, 2009, in which financial and operating information for municipal bonds is provided after the initial issuance of the bonds as required by the Securities Exchange Act. We performed this audit in accordance with our *FY 2008-09 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors. Our final report is attached for your review.

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). As a matter of policy, our **first Follow-Up Audit** will begin at six months from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **second Follow-Up Audit** will begin at six months from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented.

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.



Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

As always, the Internal Audit Department is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendations.

Additionally, we will request your department complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

## **Attachments**

Other recipients of this report are listed on the **OC Internal Auditor's Report** on page 6.

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Continuing Bond Disclosure Process  
Audit No. 2814***

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March 31, 2009**

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**Audit No. 2814**

**April 20, 2010**

TO: Robert J. Franz, Deputy CEO  
Chief Financial Officer

FROM: Dr. Peter Hughes, CPA, Director  
Internal Audit Department

SUBJECT: Internal Control Audit: CEO/Public Finance Continuing  
Bond Disclosure Process

## Audit Highlight

We audited the County's continuing bond disclosure process required by the Securities Exchange Act to ensure compliance.

The County's long-term obligations totaled **\$912 million** as of June 30, 2008. During fiscal year ending June 30, 2008, the County retired long-term obligations totaled **\$99 million**. Interest scheduled for long-term service requirements totaled **\$57 million**.

We identified four (4) **Significant Issues** and made four (4) recommendations to enhance existing controls and processes for continuing bond disclosures.

## OBJECTIVES

The Internal Audit Department conducted an Internal Control Audit of CEO/Public Finance continuing bond disclosure process. We included an evaluation of the adequacy and integrity of internal controls, compliance with department and County policies, and evidence of process efficiencies and effectiveness. Our audit was conducted in conformance with professional standards established by the Institute of Internal Auditors. Our audit objectives were to determine if controls were in place to ensure compliance with the Securities Exchange Act that:

1. Continuing bond disclosures are processed in accordance with department procedures and management's authorizations.
2. Continuing bond disclosures are processed accurately, completely, timely, and have appropriate supporting documentation.
3. Continuing bond disclosure processes are efficient and effective.

## BACKGROUND

The County Finance Office provides leadership and oversight of the overall financial operations of the County. Major responsibilities include long-range strategic financial planning, public finance, risk management, budget, corporate business planning, and corporate purchasing. The Public Finance Division is primarily responsible for managing the County's public debt programs. Public debt programs are designed to access funds through municipal bond issuances for the construction and acquisition of public facilities (e.g. airports, courts, schools) and infrastructure needs (e.g. roads, bridges, storm drains) and the implementation of programs targeted for the well-being of the community (e.g. housing programs for low-income residents). The Public Finance Division's responsibilities also include ensuring disclosure and accounting requirements are met.



The total principal due for the County's long-term obligations as of June 30, 2008 were the following:

Long-Term Obligations: Governmental Funds	\$786,352,000
Long-Term Obligations: Enterprise Funds	<u>126,074,000</u>
Total Long-Term Obligations	\$912,426,000

The long-term obligations for the County consist of general bonded debt, bankruptcy obligations, revenue bonds, and certificates of participation. The scheduled interest payable for fiscal year ending June 30, 2008 was \$57,484,000.

Special Assessment District Bonds consist of Assessment District Bonds and Community Facilities District Bonds. These bonds are not general or special obligations of the County. As such, the obligations for Special Assessment District Bonds are not included in the County's long-term debt obligations above. The Special Assessment District Bonds outstanding as of June 30, 2008, amounted to \$713,084,000. However, an external firm prepares the continuing bond disclosures for the Special Assessment District Bonds and CEO/Public Finance reviews the disclosures prior to dissemination to the municipal bond market.

### **Continuing Bond Disclosures**

Continuing bond disclosures consist of important information about public debt that arises after the initial issuance of the bond. This information generally would reflect the financial or operating condition of the issuer as it changes over time, as well as specific events occurring after issuance that can have an impact on the ability of the issuer to pay amounts owing on the bond, the value of the bond if it is bought or sold prior to its maturity, the timing of repayment of principal, and any number of other key features of the bond. Each bond will have its own unique set of continuing disclosures, and not all types of continuing disclosures will apply to every bond.

The Securities and Exchange Commission (SEC) Rule 15c2-12 requires issuers of municipal bonds to make regular continuing disclosures to the municipal bond market. The basic provisions are: (1) annual financial information by a date certain; (2) timely notice of certain events "if material" whenever they occur; and (3) notice of any failure to provide the required annual disclosure by the required date.

SEC Rule 15c2-12 requires continuing disclosures of annual financial information and operating data to mirror the official statement in connection with the primary offering. The official statement in connection with the primary offering provides a deadline that the information must be filed no later than a specified timeframe (e.g. eight or nine months) after the close of the County's fiscal year.

SEC Rule 15c-2-12 also requires disclosure in a timely manner any event that is both a specific event affecting a municipal security and material. These material events include the following:



1. Principal and interest payment delinquencies.
2. Non-payment related defaults.
3. Unscheduled draws on debt service reserves reflecting financial difficulties.
4. Unscheduled draws on credit enhancements reflecting financial difficulties.
5. Substitution of credit or liquidity providers, or their failure to perform.
6. Adverse tax opinions or events affecting the tax-exempt status of the security.
7. Modifications to rights of securities holders.
8. Bond calls.
9. Defeasances.
10. Release, substitution, or sale of property security repayment of the securities.
11. Rating changes.

The Official Statement is the document prepared in conjunction with the primary offering of municipal bonds that discloses material information on the offering. For offerings subject to SEC Rule 15c2-12, the Official Statement must include information on the terms of the bond, financial information or operating data concerning the municipal issuer of the offering, and a description of the continuing disclosures made in connection with the offering. The continuing disclosures include, but are not necessarily limited to, annual financial information and material event notices provided by the issuer.

Investors and other municipal market participants obtain current continuing disclosure information regarding bonds in order to make more knowledgeable investment decisions, effectively manage and monitor their investments, and better protect themselves from misrepresentations and fraudulent activities.

Accordingly, municipal bond issuers are primarily responsible for the accuracy, completeness, and timeliness of their continuing disclosure documents and are subject to federal securities laws.

Industry practices suggest issuers establish an organized system to ensure compliance with their continuing disclosure obligations. In most cases, the Chief Financial Officer would be the logical person to be responsible for the preparation and review of the annual financial disclosure, but that may vary from issuer to issuer. Event disclosure is likely to require a broader system, since a conscientious issuer's most significant challenge will be ensuring that it does not inadvertently fail to disclose a required event. This suggests a system in which an appropriate group of issuer's officials are charged with responsibility for monitoring specific areas.

### **SEC Cease-and-Desist Order**

The Securities and Exchange Commission conducted an investigation and issued a report in 1996 on the offer and sale of municipal securities issued by the County. The related investigative report entitled, *Report of Investigation in the Matter of County of Orange, California as it Relates to the Conduct of the Members of the Board of Supervisors, Exchange Act Release No. 36761*, stated, in part, the following:

*Public entities that issue securities are primarily liable for the content of their disclosure documents and are subject to proscriptions under the federal securities laws against false and misleading information in their disclosure documents. In addition to the government entity issuing municipal securities, public officials of the issuer who have ultimate authority to approve the issuance of securities and related disclosure documents have responsibilities under the federal securities laws as well.*



*In authorizing the issuance of securities and related disclosure documents, a public official may not authorize disclosure that the official knows to be false; nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts. In this matter, such steps could have included becoming familiar with the disclosure documents and questioning the issuer's officials, employees or other agents about the disclosure of those facts.*

*In this case, the Board of Supervisors approved Official Statements that, among other things, failed to disclose certain material information about Orange County's financial condition that brought into question the County's ability to repay its securities absent significant interest income from the County Pools. The Supervisors were aware of material information concerning Orange County's ability to repay its securities. Nevertheless, the Supervisors failed to take appropriate steps to assure disclosure of these facts. In light of these circumstances, the Board members did not fulfill their obligations under the antifraud provisions of the federal securities laws in authorizing the issuance of the municipal securities and related disclosure documents.*

The SEC instituted a cease-and-desist order against the County in 1996. As part of the cease-and-desist order settlement, the County implemented policies and procedures entitled *Consideration and Approval of Proposed Public Financings*. These policies and procedures were intended to provide a system of controls that ensure sufficient due diligence for bond offerings and post-issuance financial reporting along with compliance with federal securities laws. The implemented policies and procedures assigned responsibility for coordinating continuing bond disclosures to the County Executive Officer.

## **SCOPE**

Our audit evaluated internal controls and processes over CEO/Public Finance's continuing bond disclosures for the period from April 1, 2008 through March 31, 2009. Our audit conforms with the International Standards for the Professional Practice of Internal Auditing. Our methodology included inquiry, auditor observation and testing of relevant documents.

## **SCOPE EXCLUSIONS**

We did not audit CEO/Public Finance's bond financing process or information technology controls over the continuing bond disclosure process.

## **RESULTS**

We audited the internal controls and processes over CEO/Public Finance's Continuing Bond Disclosure Process during the audit period from April 1, 2008 through March 31, 2009.



We identified **four (4) Significant Issues** resulting in **four (4) recommendations** to enhance controls and processes as discussed in the *Detailed Findings, Recommendations and Management Responses* section of this report. See *Attachment A* for a description of Report Item Classifications. Based upon our audit, we noted:

- ▶ **Objective #1:** *Continuing bond disclosures are processed in accordance with department procedures and management's authorizations.*
- ▶ **Results:** We found written policies and procedures for the continuing bond disclosure process were not fully developed. In addition, we found the continuing bond disclosures prepared by the designated staff member in CEO/Public Finance and by an external consulting firm and submitted to the municipal bond market were not approved by supervisory management. We noted **two (2) Significant Issues** concerning Incomplete Policies and Procedural Manuals; and the Lapse of Supervisory Oversight. (See pages 7 and 8).
- ▶ **Objective #2:** *Continuing bond disclosures are processed accurately, completely, timely, and have appropriate supporting documentation.*
- ▶ **Results:** We found continuing bond disclosures were processed timely. However, it was noted that continuing bond disclosures were not always processed accurately, completely, and supported with documentation. We noted **two (2) Significant Issues** in the areas of Inaccurate and Incomplete Disclosures; and Insufficient Supporting Evidence. (See pages 9 through 11)
- ▶ **Objective #3:** *Continuing bond disclosure processes are efficient and effective.*
- ▶ **Results:** No inefficient or ineffective procedures such as backlogs or duplication of work came to our attention concerning continuing bond disclosures at CEO/Public Finance.

## Management's Responsibilities for Internal Controls

In accordance with the Auditor-Controller's County Accounting Manual section S-2 - *Internal Control Systems*, "All County departments/agencies shall maintain effective internal control systems as an integral part of their management practices. This is because management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls. Control systems shall be continuously evaluated and weaknesses, when detected, must be promptly corrected." The criteria for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations (COSO) control framework. Our Internal Control Audit enhances and complements, but does not substitute for CEO/Public Finance's continuing emphasis on control activities and self-assessment of control risks.



## **Inherent Limitations in Any System of Internal Control**

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in CEO/Public Finance's operating procedures, accounting practices and compliance with County policy.

## **Acknowledgment**

We appreciate the courtesy extended to us by CEO/Public Finance. If we can be of further assistance, please contact me directly or Eli Littner, Deputy Director at 834-5899 or Alan Marcum, Senior Audit Manager at 834-4119.

## **Attachments**

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors  
Members, Audit Oversight Committee  
Thomas G. Mauk, County Executive Officer  
Colleen Clark, Public Finance Director  
Foreperson, Grand Jury  
Darlene J. Bloom, Clerk of the Board of Supervisors



**Objective #1:** *Continuing bond disclosures are processed in accordance with department procedures and management's authorizations.*

## **Finding No. 1 – Incomplete Policy and Procedural Manuals (Significant Issue)**

We found that the following written policies and procedures for the continuing bond disclosure process should be improved:

- Sources of data for preparing continuing bond disclosures.
- Practices to ensure compliance with regulatory requirements.
- Detection, reporting and follow-up on enumerated material events.
- Practices to ensure data provided by various sources is accurate and complete.
- Oversight roles and responsibilities for management.

Policy and procedural manuals are a set of written instructions that document a recurring activity. The development and use of policy and procedural manuals are an integral part of a successful quality assurance system as it provides personnel with the information to perform their duties properly, facilitates consistency in the quality and integrity of an end-result, and ensuring compliance with government regulations.

The development and use of policy and procedural manuals minimizes variation and promotes quality through consistent implementation of a process, even if there are temporary or permanent personnel changes. Policy and procedural manuals can be used as a part of a personnel training program, since they should provide detailed work instructions. It minimizes opportunities for miscommunication and can address quality control concerns. When historical data are being evaluated for current use, policy and procedural manuals can also be valuable for reconstructing project activities when no other references are available. In addition, policy and procedural manuals can be used as checklists by reviewing management for monitoring quality assurance. The benefits of policy and procedural manuals are reduced work effort, along with improved comparability and credibility.

The absence of properly documented and effectively communicated operational policies and procedures increases the risk of inaccurate, incomplete, and unsupported continuing bond disclosures.

## **Recommendation No. 1**

We recommend that CEO/Public Finance improve policy and procedures to be followed in preparing and disseminating continuing bond disclosures. Documented policy and procedures should be reviewed and approved by management and current versions need to be readily accessible for reference by personnel responsible for the continuing bond disclosure process.

## **CEO/Public Finance Management Response:**

Concur. A combination of staff turnover resulting in the loss of two staff positions (40% of the department) and a series of financings delayed the finalizing of Policies and Procedures for the Continuing Disclosure Process. The recently appointed Public Finance Director will ensure completion of the policies and procedures. The updated policies will be reviewed and approved by the Public Finance Director and will be readily accessible electronically through the CEO's shared server.



## **Finding No. 2 – Lapse of Supervisory Oversight (Significant Issue)**

We found that the continuing bond disclosures prepared by the designated staff member in CEO/Public Finance and by an external consulting firm and submitted to the municipal bond market were not approved by supervisory management for the fiscal year ending June 30, 2008.

The CEO/Public Finance policies and procedures require that the Public Finance Manager review and approve all continuing bond disclosures prior to disseminating the reports to the municipal bond market.

All of the continuing bond disclosures with the exception of Community Facilities District (CFD) and Assessment District (AD) Bond Financings are prepared by the designated staff member in CEO/Public Finance. Continuing bond disclosures not prepared by the designated staff member are processed by an external consulting firm. The designated staff member reviews documentation prepared by the external consulting firm prior to dissemination to the municipal bond market.

During our review of the continuing bond disclosure process, we noted that the current designated staff member in CEO/Public Finance, an Administrative Manager I, is knowledgeable about the process and has administrative responsibility for ensuring the accuracy, completeness, timeliness, and analysis of documentary support for all data reported by the County in continuing bond disclosures.

Qualified and continuous supervision is required to provide reasonable assurance that the requirements for continuing bond disclosures will be accomplished. This practice requires supervisors to continuously review and approve the work of their assigned personnel. It also requires that they provide their assigned personnel with the necessary guidance and oversight to help ensure that errors and omissions are identified and corrected and that all directives for continuing bond disclosures are achieved.

The assignment, review, and approval of assigned personnel's work require:

- Clearly communicating the duties, responsibilities, and accountabilities to each assigned personnel.
- Systematically reviewing work completed by assigned personnel's to the extent necessary.
- Approving work at critical points to ensure that work is accomplished as intended.

The lapse of supervision by assigning of responsibilities to a designated staff member in CEO/Public Finance does not relieve County executive management of their fiduciary duty over continuing bond disclosures.

## **Recommendation No. 2**

We recommend that CEO/Public Finance ensure that qualified and systematic supervisory review is provided and documented to enhance the integrity of the continuing bond disclosures.



## CEO/Public Finance Management Response:

Concur. With the appropriate procedures in place, reviews will occur at the appropriate levels within the organization. A CEO/Public Finance designated staff member will continue preparing the continuing bond disclosure reports. The reports will be reviewed by another Public Finance staff member. The review will include a comparison of the continuing bond disclosures with supporting documentation or electronic files. Also, the Public Finance Director will review and approve of the continuing bond disclosures prior to submitting them to the official repository. Evidence of the reviews and approval will be documented and maintained to show that the continuing bond disclosures were verified to the requirements of the pertinent Official Statements.

**Objective #2:** *Continuing bond disclosures are processed accurately, completely, timely, and have appropriate supporting documentation.*

## Finding No. 3 – Inaccurate and Incomplete Disclosures (Significant Issue)

We selected a sample of five (5) continuing bond disclosures for the fiscal year ending June 30, 2008 for testing to determine whether information disseminated to the municipal bond market was presented accurately, completely, timely, and supported with sufficient evidence.

We found that all five (5) continuing disclosure documents were disseminated in a timely manner. However, our review disclosed that selected continuing bond disclosures were not entirely accurate and complete.

Continuing bond disclosures selected for testing and exceptions:

1. Orange County Development Agency Tax Allocation Refunding Bonds – Santa Ana Heights Project Area Series 2003 totaling \$38,465,000, dated March 31, 2009.

### Exception:

- Section 4(c)(3): The disclosure did not provide “Historic Assessed Values and Tax Increment Revenues” as required for the annual report.

2. Orange County Public Financing Authority – Juvenile Justice Center Facility Lease Revenue Refunding Bonds Series 2002 totaling \$80,285,000, dated February 21, 2009.

**Exceptions:** None

3. Orange County Public Financing Authority – Lease Revenue Refunding Bonds Series 2005 totaling \$419,755,000, dated February 21, 2009.

### Exceptions:

- Table A-4: The balances in the comparative General Fund Combined Balance Sheet agreed to the accounting records as of June 30, 2007. However, the heading for the balances in the disclosure were dated as of June 30, 2008.
- Table A-10: An outstanding bond balance for the County of Orange Taxable Pension Refunding Obligation Bonds, Series 1997A of \$32,730,769 as of June 30, 2008 did not agree to the bond maturity schedule of \$35,172,636.



- The understated outstanding bond balance of \$2,441,867 (variance of 6.94%) was attributed to the subsequent principal payment scheduled for September 1, 2008.

4. Single Family Mortgage Revenue Bonds – GNMA and Fannie Mae Mortgage-Backed Securities Program Issue A of 1999 totaling \$12,000,000, dated March 25, 2009.

**Exception:**

- Section A: The continuing bond disclosure requires the audited financial statement for the most recently ended fiscal year. However, the continuing bond disclosure submitted electronically did not include an audited financial statement.

5. South Orange County Public Financing Authority Special Tax Revenue Bonds – 2005 Series A Ladera Ranch totaling \$84,015,000, dated February 6, 2009.

**Exception:**

- Section A.3: The balance in each fund under the indenture agreed to the accounting records as of August 16, 2008. However, the balances in the disclosure were dated as of August 16, 2007.

Continuing bond disclosures should be properly reported if pertinent information is to maintain its relevance and value to the municipal bond market. The municipal bond market reasonably expects that continuing bond disclosures are accurate and complete enabling investors to protect themselves from misrepresentation and assist them in making more informed investment decisions.

### Recommendation No. 3

We recommend that CEO/Public Finance ensure the accuracy and completeness of continuing bond disclosures.

### CEO/Public Finance Management Response:

Concur. The review of continuing bond disclosures described in the management response for Recommendation No. 2 above should avert typographical and labeling errors as noted above and will further ensure the accuracy and completeness of the continuing bond disclosures.

### Finding No. 4 – Insufficient Supporting Evidence (Significant Issue)

We found that CEO/Public Finance did not retain adequate physical or electronic evidence to support data disseminated in the continuing bond disclosures.

During our review of selected continuing bond disclosures, it was noted that portions of data cited in the disclosures are shown in the County's Comprehensive Annual Financial Report (CAFR) and original statements in connection with the primary offering which are available to the public. For other disclosure data, CEO/Public Finance receives information from various sources, including other County departments, to prepare the disclosures. However, CEO/Public Finance did not initially retain either physical or electronic evidence on file to support data disseminated in continuing bond disclosures.



In addition, we found that CEO/Public Finance does not maintain any evidence to support the absence of specific/material events. SEC Rule 15c-2-12 requires disclosure of any event that is both a specific event affecting a municipal security and material. Our review disclosed that none of the five (5) selected continuing bond disclosures reported the occurrence of material events. Evidence for reporting the absence of material events should include the information obtained and analyzed, the knowledgeable individuals contacted, and the conclusions reached.

Supporting evidence on file for continuing bond disclosures provides the principal support to substantiate information disseminated to the municipal bond market. It also aids in the planning, preparation, and management review of the continuing bond disclosures. The supporting evidence on file provides support in unforeseen circumstances such third-party reviews and litigation.

#### **Recommendation No. 4**

We recommend that CEO/Public Finance ensure files evidence the work completed and contain physical and electronic data accumulated in support of the continuing bond disclosures.

#### **CEO/Public Finance Management Response:**

Concur. CEO/Public Finance will retain supporting documentation and electronic files for the continuing bond disclosures in a single accessible location. The compilation of supporting evidence will specifically include obtaining confirmation from departments responsible for monitoring material events described in SEC Rule 15c2-12. The supporting documentation and schedules will contain confirmation of the occurrence or absence of a material event. If a material event has occurred, the confirmation will contain a description and explanation for the event.



## ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

### **Material Weaknesses:**

Audit findings or a combination of Significant Issues that can result in financial liability and exposure to a department/agency and to the County as a whole. Management is expected to address "Material Weaknesses" brought to their attention immediately.

### **Significant Issues:**

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of processes or internal controls. Significant Issues do not present a material exposure throughout the County. They generally will require prompt corrective actions.

### **Control Findings:**

Audit findings concerning internal controls, compliance issues, or efficiency/effectiveness issues that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.



## ATTACHMENT B: CEO/Public Finance Management Responses



County of Orange  
California

Robert J. Franz  
Chief Financial Officer

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April 12, 2010

Dr. Hughes,

In connection with the Internal Control Audit of CEO/Public Finance Continuing Bond Disclosure Process, the management responses to the recommendations are as follows:

### Recommendation No. 1

We recommend CEO/Public Finance improve policy and procedures to be followed in preparing and disseminating continuing bond disclosures. Documented policy and procedures should be reviewed and approved by management and current versions need to be readily accessible for reference by personnel responsible for the continuing bond disclosure process.

#### CEO/Public Finance Management Response:

Concur. A combination of staff turnover resulting in the loss of two staff positions (40% of the department) and a series of financings delayed the finalizing of Policies and Procedures for the Continuing Disclosure Process. The recently appointed Public Finance Director will ensure completion of the policies and procedures. The updated policies will be reviewed and approved by the Public Finance Director and will be readily accessible electronically through the CEO's shared server.

### Recommendation No. 2

We recommend that CEO/Public Finance ensure that qualified and systematic supervisory review is provided and documented to enhance the integrity of the continuing bond disclosures.

#### CEO/Public Finance Management Response:

Concur. With the appropriate procedures in place, reviews will occur at the appropriate levels within the organization. A CEO/Public Finance designated staff member will continue preparing the continuing bond disclosure reports. The reports will be reviewed by another Public Finance staff member. The review will include a comparison of the continuing bond disclosures with supporting documentation or electronic files. Also, the Public Finance Director will review and approve of the continuing bond disclosures prior to submitting them to the official repository. Evidence of the reviews and approval will be documented and maintained to show that the continuing bond disclosures were verified to the requirements of the pertinent Official Statements.



## ATTACHMENT B: CEO/Public Finance Management Responses (continued)

### Recommendation No. 3

We recommend that CEO/Public Finance ensure the accuracy and completeness of continuing bond disclosures.

#### CEO/Public Finance Management Response:

Concur. The review of continuing bond disclosures described in the management response for Recommendation No. 2 above should avert typographical and labeling errors as noted above and will further ensure the accuracy and completeness of the continuing bond disclosures.

### Recommendation No. 4

We recommend that CEO/Public Finance ensure files evidence the work completed and contain physical and electronic data accumulated in support of continuing bond disclosures.

#### CEO/Public Finance Management Response:

Concur. CEO/Public Finance will retain supporting documentation and electronic files for the continuing bond disclosures in a single accessible location. The compilation of supporting evidence will specifically include obtaining confirmation from departments responsible for monitoring material events described by SEC Rule 15c2-12. The supporting documentation and schedules will contain confirmation of the occurrence or absence of a material event. If a material event has occurred, the confirmation will contain a description and explanation for the event.

Sincerely,

Robert J. Franz  
Deputy CEO, Chief Financial Officer