

**INTERNAL AUDITOR'S REPORT
ON AGREED-UPON PROCEDURES FOR
PORTFOLIO COMPLIANCE MONITORING
OF THE COUNTY TREASURY FOR
QUARTER ENDED MARCH 31, 2004**

REPORT DATE: September 7, 2004

File Number 2414

Audit Director:	Peter Hughes, Ph.D., CPA, CIA
Deputy Director:	Eli Littner, CPA, CIA
Audit Manager:	Alan Marcum, CPA, CIA
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**INTERNAL AUDIT DEPARTMENT
COUNTY OF ORANGE**

**INTERNAL AUDITOR'S REPORT
ON AGREED-UPON PROCEDURES
FOR PORTFOLIO COMPLIANCE MONITORING
OF THE COUNTY TREASURY
FOR QUARTER ENDED MARCH 31, 2004**

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**COUNTY OF ORANGE
INTERNAL AUDIT DEPARTMENT**

OFFICE OF THE DIRECTOR

*Integrity
Objectivity
Independence*

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Transmittal Letter

File No. 2414

September 7, 2004

TO: John M.W. Moorlach
Treasurer-Tax Collector

SUBJECT: Report on Agreed-upon Procedures for Portfolio Compliance Monitoring of
the County Treasury for Quarter Ended March 31, 2004 (File No. 2414)

Attached is a copy of our Report on Agreed-upon Procedures for Portfolio Compliance
Monitoring of the County Treasury for Quarter Ended March 31, 2004 (File No. 2414).

Respectfully submitted,

Peter Hughes, Ph.D., CPA
Director, Internal Audit

/PH:ts

Attachments

Other recipients of this audit report:

Members, Board of Supervisors
Members, Audit Oversight Committee
James D. Ruth, County Executive Officer
Foreman, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors
Paul Gorman, Treasurer Accounting/Compliance Manager



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File No. 2414

September 7, 2004

**INTERNAL AUDITOR'S REPORT
ON AGREED-UPON PROCEDURES FOR PORTFOLIO COMPLIANCE MONITORING
OF THE COUNTY TREASURY FOR QUARTER ENDED MARCH 31, 2004**

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

We have performed the agreed-upon procedures enumerated below, which were agreed to by the Treasurer for the purpose of assisting in determining whether the County funds managed by the Orange County Treasurer's office, the Money Market Funds (Funds 283, 692 and 694) and the Extended Fund (Fund 699), are in compliance as of that date with certain provisions of the Treasurer's Investment Policy Statement (IPS). This engagement to apply agreed-upon procedures was conducted in accordance with the attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of Treasurer management. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

We conducted our engagement in accordance with a series of agreed-upon procedures which required that we review, on a test basis, evidence of the portfolio holdings, perform certain mathematical calculations, and review the results with respect to the Treasurer's IPS. In conducting our review, the Internal Audit Department examined the portfolio holdings on the following dates: January 5, February 13, March 24 and March 31, 2004.

The agreed-upon procedures and the associated findings are as follows:

1. We will verify the completeness and accuracy of the portfolio downloads obtained from the Treasurer's office.

Finding:

We found no exceptions as a result of the procedure.

2. We will perform calculations to determine that the portfolio concentrations of the Money Market and Extended Funds have met the diversification limits for investment types and allowable issuer percentages in accordance with Sections V.2 and VI of the Treasurer's IPS.

Finding:

We found no exceptions as a result of the procedure.

3. We will perform calculations to determine that a Net Asset Value (NAV) of approximately \$1 (within a range of .995 – 1.005) was maintained for the Money Market Funds in accordance with Section II.4 of the Treasurer's IPS.

Finding:

We found no exceptions as a result of the procedure.

4. We will perform calculations to determine that a weighted average maturity (WAM) of less than 90 days was maintained for the Money Market Funds and a WAM of less than 18 months was maintained for the Extended Fund in accordance with Section VI.1 of the Treasurer's IPS.

Finding:

We found no exceptions as a result of this procedure.

5. We will select a representative sample of investment purchases made during the quarter from each fund and will independently confirm that the investments conform with authorized investment requirements in accordance with Sections IV, V.3, V.7~V.9, VI.2 and XI of the Treasurer's IPS.

Finding:

Noncompliance with IPS Section V. – Investment Restrictions and Prohibited Transactions

Section V.7 of the IPS states "Reverse Repurchase Agreements, as defined by California Government Code Section 53601.7 (e)(8) or otherwise are prohibited."

As of March 31, 2004, the Treasurer had invested \$110,113,376.93 (JWA – 1,339,113.43; County – 29,864,152.52; and Schools – 78,910,110.98) in the BlackRock Provident TempFund. Our review of the BlackRock TempFund prospectus identified reverse repurchase agreements as one of twelve security types in which the fund principally invests and the fund may invest up to one-third of its total assets in reverse repurchase agreements.



We reviewed the BlackRock Provident TempFund unaudited Schedule of Investments as of March 31, 2004 and found that the fund did not hold any reverse repurchase agreements. However, during the period the investments were held BlackRock Provident TempFund could have bought and sold investments in reverse repurchase agreements.

Treasurer-Tax Collector response:

Do not concur. BlackRock TempFund is a AAA-rated money market mutual fund. The Treasurer's Money Market Investment Pools have invested in this AAA-rated fund and not the underlying individual investments made by the BlackRock TempFund. We do not concur with Internal Audit's opinion that IPS Section V applies to the underlying investments made by money market mutual funds.

IPS section IV.7 sets forth the requirements and limitations for an approved investment in money market mutual funds. This section of the IPS does not list a prohibition against a money market mutual fund's investment in reverse repurchase agreements and does not require the Treasurer to look through to determine whether or not a money market mutual fund is investing in reverse repurchase agreements.

Although we are not prohibited from investing in money market mutual funds that are authorized to invest in reverse repurchase agreements, we are sensitive to how and why the fund's portfolio manager may utilize them in the fund's portfolio. Prior to approving BlackRock TempFund as an approved money market mutual fund, our financial analysts performed due diligence and research by contacting the fund representatives and rating agency, reviewing the prospectus, Statement of Additional Information, rating agency credit opinion, fund size, acceptable investments, yield and fees. They noted that reverse repurchase agreements were an authorized investment of the fund and included questions about their use when talking to BlackRock representatives. Our analysts were assured that reverse repurchase agreements are not used as an investment strategy. However they were told the fund might enter into reverse repurchase agreements if the fund had liquidity needs.

Our analysts also discussed BlackRock TempFund with Marty Duffy, who covers BlackRock Liquidity Funds for Moody's Investors Service, Inc. Mr. Duffy's observation was that the money market mutual funds he looks at have the authority to invest in reverse repurchase agreements, but do not. Based on our financial analysts' discussions with ratings agencies and their own research concerning AAA-rated money market mutual funds, this is common practice.

The Statement of Additional Information for BlackRock Liquidity Funds, dated January 30, 2004 (to be read in conjunction with the current prospectus for each of the funds), includes the following excerpted statement concerning the TempFund's investment in reverse repurchase agreements (page 12):



“Reverse repurchases are considered to be borrowings under the 1940 Act and may be entered into only for temporary or emergency purposes. Each of TempFund, TempCash, FedFund and T-Fund is permitted to invest up to one-third of its total assets in reverse repurchase agreements and securities lending transactions. Investments in reverse repurchase agreements and securities lending transaction will be aggregated for purposes of this investment limitation.”

The Treasurer changed his internal policy regarding money market mutual funds subsequent to a review by and input from the Treasurer’s Advisory Committee at their July 21, 2004 meeting. The purpose was to review two internal requirements (not IPS requirements). The first internal policy being “If we can’t buy it, our approved money market mutual funds can’t be allowed to purchase it.” The second internal policy was to preclude our investment in AAA-rated funds that allow “foreign investments.” The suggestion was to remove these internal limitations and rely on the strength of the AAA-rating from two NRSROs with additional internal review. The Treasurer also asked for confirmation of earlier internal policy changes regarding money market mutual funds investment in reverse repurchase agreements (where they are not used as an investment strategy), simple floating rate notes, and Euro certificates of deposit issued out of London.

California Government code and IPS section IV.12 allow securities that meet the terms of an “eligible security” as defined under SEC Rule 2a-7 of the Investment Company Act of 1940.

In addition to meeting 2a-7 guidelines, AAA-rated money market mutual funds are even more conservative, must meet a shorter weighted average maturity restriction, and can only invest in top tier credits.

The unanimous recommendation of the Treasurer’s Advisory Committee, which was adopted by the Treasurer, was to expand our internal policy to include any AAA-rated money market mutual funds with consideration to be given to:

- Conservative fund management
- Company size and experience
- Fund size
- Fund yield

Our internal policies concerning money market mutual funds have evolved over the years and we routinely monitor our approved funds along with other authorized issuers. We have met the spirit of our avoidance of reverse repurchase agreements while utilizing investment vehicles that uniformly allow for them under certain circumstances, but have, to the best of our knowledge, not used them.



Internal Audit Response:


We professionally disagree with the Treasurer. We will submit a request to County Counsel for opinion as to whether the Treasurer may purchase money market mutual funds that may invest in reverse repurchase agreements, which is a prohibited investment according to the Investment Policy Statement Section V.7.

We were not engaged to and did not perform an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of the specified users listed above and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes. However, the report will be a matter of public record and its distribution is not limited.

The working papers for this engagement are the property of the County of Orange Internal Audit Department and constitute public information. If requested, access to such working papers will be provided under the supervision of the County of Orange Internal Audit Department personnel.

Sincerely,



Peter Hughes, Ph.D., CPA

Attachment: Treasurer-Tax Collector's Response



ATTACHMENT: Treasurer-Tax Collector Response



COUNTY OF ORANGE
OFFICE OF THE TREASURER-TAX COLLECTOR
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September 2, 2004

Dr. Peter Hughes, CPA
Director, Internal Audit Department
County of Orange
400 Civic Center Drive West
Building 12, Room 232
Santa Ana, CA 92701

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SEP 02 2004

**INTERNAL AUDIT
DEPARTMENT**

Dear Dr Hughes:

We do not concur with the finding in your Draft Internal Auditor's Report On Agreed-Upon Procedures For Portfolio Compliance Monitoring of the County Treasury for the Quarter Ended March 31, 2004 under agreed-upon procedure number 5. The finding is as follows:

Internal Audit Finding

Noncompliance with IPS Section V. – Investment Restrictions and Prohibited Transactions

As of March 31, 2004, the Treasurer had invested \$110,113,376.93 (JWA – \$1,339,113.43; County – \$29,864,152.52; and Schools – \$78,910,110.98) in the BlackRock Provident TempFund. Our review of the BlackRock TempFund prospectus identified reverse repurchase agreements as one of the twelve security types in which the fund principally invests and the fund may invest up to one-third of its total assets in reverse repurchase agreements. We reviewed the BlackRock Provident TempFund unaudited Schedule of Investments as of March 31, 2004 and found that the fund did not hold any reverse repurchase agreements. However, during the period the investments were held BlackRock Provident TempFund could have bought and sold investments in reverse repurchase agreements.

Treasurer-Tax Collector Response

Do not concur. BlackRock TempFund is a AAA-rated money market mutual fund. The Treasurer's Money Market Investment Pools have invested in this AAA-rated fund and not the underlying individual investments made by the BlackRock TempFund. We do not concur with Internal Audit's opinion that IPS Section V applies to the underlying investments made by money market mutual funds.



ATTACHMENT A: Treasurer-Tax Collector Responses (con't)

Dr. Peter Hughes, CPA
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IPS section IV.7 sets forth the requirements and limitations for an approved investment in money market mutual funds. This section of the IPS does not list a prohibition against a money market mutual fund's investment in reverse repurchase agreements and does not require the Treasurer to look through to determine whether or not a money market mutual fund is investing in reverse repurchase agreements.

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ATTACHMENT A: Treasurer-Tax Collector Responses (con't)

Dr. Peter Hughes, CPA
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Our internal policies concerning money market mutual funds have evolved over the years and we routinely monitor our approved funds along with other authorized issuers. We have met the spirit of our avoidance of reverse repurchase agreements while utilizing investment vehicles that uniformly allow for them under certain circumstances, but have, to the best of our knowledge, not used them.

If you have any questions concerning this matter or require additional information, please contact Paul Gorman, Accounting/Compliance Manager at 834-2288.

Sincerely,



John M. W. Moorlach

