

AUDITOR'S REPORT

FINANCIAL MANAGEMENT INVESTMENT PROCEDURES FOURTH QUARTER FISCAL YEAR 2019 THROUGH FIRST QUARTER FISCAL YEAR 2020



January 17, 2020

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HARRIS COUNTY AUDITOR

January 17, 2020

Mr. William J. Jackson
Executive Director / County Budget Officer
Budget Management Department
1001 Preston St, 5th floor
Houston, Texas 77002

RE: Review of the Investment Transactions as required by Texas Local Government Code §115.003(b) and Texas Government Code §2257.061 for the Fourth Quarter of Fiscal Year 2019 (December 1, 2018 through February 28, 2019) and the First Quarter of Fiscal Year 2020 (March 1, 2019 through May 31, 2019)

In accordance with Texas Local Government Code §115.003(b) and Texas Government Code §2257.061, the Audit Services Department performed procedures related to investments managed by the Budget Management Department's Financial Management Section (Financial Management) pursuant to the Investment Policy (Policy) approved on December 19, 2017, for the Fourth Quarter of Fiscal Year 2019 and the subsequent Policy approved on January 8, 2019 for the First Quarter of Fiscal Year 2020.

Summary of Results

Based on the procedures performed, Financial Management materially complied with the County Investment Policy and applicable statutory requirements. However, we identified one opportunity for improvement as listed below:

1. Understatement of Interest Reported to Commissioners Court

Interest reported in the First Quarter of Fiscal Year 2020 County Investment Report was understated by approximately \$1.3 million. In addition, this understatement was carried forward into the cumulative interest amount reported in the subsequent County Investment Report for the Second Quarter of Fiscal Year 2020. The understatement was due to the exclusion of the First Quarter Fiscal Year 2020 earnings associated with one seller's commercial paper holdings.

The enclosed Auditor's Report presents the issue identified during our procedures, our recommendations, and any actions you will take to address the issue.

Mr. William J. Jackson
Executive Director / County Budget Officer
Budget Management Department

Our procedures included the following:

- Selectively tested investment transactions to verify consistency of information on the investment transaction forms with external third-party information sources.
- Selectively compared County purchases and sales activity with transactions in the Trade Reporting and Compliance Engine (TRACE) that occurred on the same day and had equivalent characteristics.
- Selectively tested investment purchases and sales to verify that investments were competitively bid.
- Selectively tested investment transactions to verify that they were timely and accurately entered into the Advanced Portfolio System 2 (APS2) and that they were recorded accurately in the County's Financial System (IFAS).
- Selectively tested investment purchases regarding investment types and maturities to verify compliance with the Policy.
- Selectively tested commercial paper transactions and money market fund (MMF) balances to verify they were accurately entered into APS2.
- Verified the Investment Officer complied with Section 4.02, *Training*, and Section 4.03, *Disclosure of Relationships with Persons Selling Investments to the County*, of the Policy.
- Selectively traced balances at the County's depositories to the pledged collateral that secures the deposit of County Funds.
- Reviewed required documentation relative to adding or deleting qualified banks, broker/dealers, custodians, money market funds, and investment pools (Financial Institutions).
- Selectively tested the accuracy of the Quarterly Investment Reports submitted to Commissioners Court to verify whether the reports were accurately recorded in IFAS and were in compliance with the Public Funds Investment Act.
- Selectively reviewed Financial Institution concentration for indication of any noticeable trends.
- Reviewed for postdated transactions in APS2 subsequent to our previous audit engagement.

The work performed required our staff to exercise professional judgement in completing the scope procedures. As the procedures were not a detailed examination of all transactions, there is a risk that fraud, errors, or omissions were not detected during this engagement. The official, therefore, retains the responsibility for the accuracy and completeness of their financial records and for ensuring sufficient controls are in place to detect and prevent fraud, errors, or omissions.

Mr. William J. Jackson
Executive Director / County Budget Officer
Budget Management Department

We appreciate the time and attention provided by you and your staff during this engagement.

Sincerely,



Michael Post
County Auditor

cc: District Judges
County Judge Lina Hidalgo
Commissioners:
 R. Jack Cagle
 Rodney Ellis
 Adrian Garcia
 Steve Radack
Vince Ryan

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OVERVIEW

The County's investment and collateralization requirements are established by Texas Government Code Chapters 2256 and 2257, which are referred to as the Public Funds Investment Act (TGC 2256) and the Public Funds Collateral Act (TGC 2257), respectively. The Public Funds Investment Act requires both a written Investment Policy and an Investment Strategy. The County's Investment Policy acts as both the investment policy and the investment strategy for the County, in one single document. The Policy covers areas such as the County's investment objectives, authorized investment instruments, the system of internal controls, bid solicitation requirements, allowable maturity maximums by fund type, portfolio weighted average maturity maximums, and diversification and risk tolerance guidelines.

Financial Management is comprised of the Cash Management Section, the Investment Management Section, and the Debt Management Section. The Cash Management Section is responsible for ensuring all funds on deposit with County depositories are fully collateralized in accordance with the Policy and TGC 2257. The Investment Management Section is responsible for developing and implementing portfolio investment strategies in accordance with the Policy and TGC 2256. The Debt Management Section is responsible for the issuance of all debt by the County. Financial Management acts as the Investment Agent for the Harris County 9-1-1 Emergency Network, Community Supervision & Corrections Department, Harris County Juvenile Board, Harris Health System, Harris County-Houston Sports Authority, and the Harris County Sports & Convention Corporation. Each of these entities prepares and approves its own investment policy; thus, these entities are not included in the scope of this engagement.

The Executive Director of the Budget Management Department serves as the County Investment Officer (CIO) reporting to Commissioners Court. The Director of Financial Management, the Investment Manager, and three other designees from within Financial Management represent the five approved County designees who can initiate and approve investment transactions. The CIO, as well as the County designees, are responsible for the investment activities and compliance with state statutes and the Policy. Investment advisory services are provided by First Southwest, a division of Hilltop Securities.

As required by Section 5.05, *Internal Controls*, of the Policy, the County has a written documented system of management level and internal accounting controls for investments. These controls are established to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officials of the County. The design and operating effectiveness of these controls is not in the scope of this engagement.

ISSUES AND RECOMMENDATIONS

Understatement of Interest Reported to Commissioners Court

Background

Pursuant to Texas Government Code Section 2256.023, *Internal Management Reports*, and the current Harris County Investment Policy Section 4.04, *Reporting by the Investment Officer*, a written report of investment activity should be prepared and submitted to Commissioners Court on a quarterly basis. The report should accurately describe, in detail, the investment position of the County as of the date of the report.

Issue

Interest reported in the First Quarter FY 2020 County Investment Report, dated June 25, 2019, was understated by approximately \$1.3 million. The understatement was due to the exclusion of the First Quarter FY 2020 earnings for one seller's interest from commercial paper holdings. In addition, it was determined that this understatement was carried forward into the cumulative interest amount reported in the subsequent County Investment Report for the Second Quarter of Fiscal Year 2020, dated September 24, 2019. The understatement represented 5.6% of First Quarter Fiscal Year 2020 interest accrued/earned and 2.9% of cumulative interest accrued/earned as of the Second Quarter of Fiscal Year 2020.

Understated account balances could impact decision making by County Officials who rely upon Investment Report data.

Recommendation

Financial Management should implement procedures and controls to ensure that all investment related activity is selected within the APS2 system for inclusion in the County Investment Report. This might include a quarterly checklist or oversight by a secondary party. To ensure that cumulative data is accurately reported in the County Investment Report, Financial Management should individually retrieve quarterly data from the APS2 system during the preparation of each Quarterly Investment Report.

Management Action Plan

Exxon is a new commercial paper issuer for the County. We began buying this commercial paper in the first quarter of FY 2019-2020 and this would have been the first quarterly report that this interest would have been reported on. Due to the way our investment software (APS2) saves the filters for our reports we inadvertently omitted the investment earnings for Exxon commercial paper when we ran the report out of APS2. All investment activity was recorded accurately in APS2 and IFAS.

Financial Management has added to our current procedures to help mitigate this reporting issue in the future. The Investment section of Financial Management is now individually selecting the brokers each time the report is run instead of using a set template with filters and is reviewed by a second party. We are now retrieving the quarterly data individually as recommended. We implemented these new procedures in the second and third quarters of FY 2019-2020.

Responsible Party

Investment Management

Agreed Upon Completion Date

Already Implemented