



**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

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J. TYLER McCAULEY
AUDITOR-CONTROLLER

August 29, 2002

TO: Supervisor Zev Yaroslavsky, Chairman
Supervisor Gloria Molina
Supervisor Yvonne Brathwaite Burke
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: J. Tyler McCauley 
Auditor-Controller

SUBJECT: AUDIT OF THE COUNTY TREASURY AS OF DECEMBER 31, 2001

Pursuant to Government Code Section 26920 through 26923, we have audited the Treasurer and Tax Collector's (TTC) Statement of Net Assets and Statement of Changes in Net Assets for the Treasury Pool as of December 31, 2001 and for the six months then ended. The statements and our report are attached.

We also reconciled the TTC's records with those of the Auditor-Controller to obtain reasonable assurance as to whether the TTC's records were free from material misstatement. We did not review the Treasurer's investment strategy, although we did review the TTC's compliance with the Government Code and the Board of Supervisors' Investment Policy.

As indicated in our report, the financial statements present fairly, in all material respects, the cash and investments arising from transactions of the TTC as of December 31, 2001, and the results of its operations for the six months then ended in conformity with generally accepted accounting principles.

JTM:PTM:DR:JS

Attachments

c: David E. Janssen, Chief Administrative Officer
Mark Saladino, Treasurer and Tax Collector
Public Information Officer
Violet Varona-Lukens, Executive Officer
Audit Committee (6)

LOS ANGELES COUNTY TREASURY
FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2001

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J. TYLER McCAULEY
AUDITOR-CONTROLLER

COUNTY OF LOS ANGELES DEPARTMENT OF AUDITOR-CONTROLLER

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500 WEST TEMPLE STREET, ROOM 525
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PHONE: (213) 974-8301 FAX: (213) 626-5427

August 29, 2002

The Honorable Board of Supervisors
County of Los Angeles
383 Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, California 90012

Independent Auditor's Report on the County Treasury as of December 31, 2001

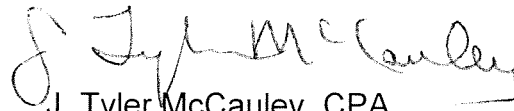
We have audited the Statement of Net Assets and Statement of Changes in Net Assets for the Los Angeles County's Treasury Pool as of December 31, 2001 and for the six months then ended. These financial statements are the responsibility of the Treasurer's management. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the cash and investments arising from transactions of the Treasurer as of December 31, 2001, and the results of its operations for the six months then ended in conformity with generally accepted accounting principles.

The accompanying statements do not include funds or investments of the Los Angeles County Employees Retirement Association, with the exception of amounts on deposit with the Treasurer as part of the External Investment Pool, which are intended mainly for warrant clearance. Retirement Association funds and investments are reported

annually as of June 30th by a private accounting firm. These statements also do not include investments made with the proceeds of debt issuance for the purpose of financing various County capital acquisitions. These investments are not part of Treasury Pool assets.



J. Tyler McCauley, CPA
Auditor-Controller

JTM:PTM:DR:JS

Attachments

c: David E. Janssen, Chief Administrative Officer
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LOS ANGELES COUNTY TREASURY
STATEMENT OF NET ASSETS
AS OF DECEMBER 31, 2001

| | | AMORTIZED COST | ACCRUED INTEREST PURCHASED | PRINCIPAL COST | FAIR VALUE |
|--|----|-------------------|----------------------------------|-------------------|----------------|
| <u>INVESTMENTS AND ASSETS</u> | | | | | |
| INVESTMENTS IN THE EXTERNAL POOL | | | | | |
| COMMERCIAL PAPER | \$ | 3,408,836,860 | | 3,408,836,860 | 3,408,788,722 |
| CORPORATE AND DEPOSIT NOTES | | 552,647,392 | 1,359,221 | 554,006,613 | 555,285,013 |
| MUNICIPALS | | 31,969,324 | | 31,969,324 | 31,968,075 |
| NEGOTIABLE CDS | | 1,084,992,819 | 3,017,347 | 1,088,010,166 | 1,095,327,760 |
| U.S. AGENCIES | | 7,368,222,034 | 336,076 | 7,368,558,110 | 7,408,783,914 |
| U.S. GOVERNMENT | | 818,160,071 | 5,124,321 | 823,284,392 | 827,044,321 |
| TOTAL INVESTMENT IN THE EXTERNAL POOL | \$ | 13,264,828,500 | 9,836,965 | 13,274,665,465 | 13,327,197,805 |
| TREASURER CASH | \$ | 32,123,428 | - | 32,123,428 | 32,123,428 |
| TOTAL NET ASSETS HELD IN THE EXTERNAL POOL | \$ | 13,296,951,928 | 9,836,965 | 13,306,788,893 | 13,359,321,233 |
| INVESTMENTS IN THE SPECIFIC INVESTMENT TRUST FUND | | | | | |
| COLLATERALIZED TIME DEPOSITS | \$ | 51,151,102 | | 51,151,102 | 51,344,818 |
| GUARANTEED INVESTMENTS CONTRACTS | | 112,706,723 | | 112,706,723 | 112,706,723 |
| MUNICIPALS | | 9,475,716 | | 9,475,716 | 9,666,651 |
| TRUST DEEDS | | 2,542,812 | | 2,542,812 | 2,542,666 |
| U.S. AGENCIES | | 30,825,842 | 163 | 30,826,005 | 31,655,104 |
| U.S. GOVERNMENT | | 39,015,322 | 135,658 | 39,150,980 | 39,659,718 |
| REPOs | | 517,500,000 | | 517,500,000 | 517,500,000 |
| TOTAL NET ASSETS IN THE SPECIFIC INVESTMENT TRUST FUND | \$ | 763,217,517 | 135,821 | 763,353,338 | 765,075,680 |
| TOTAL NET ASSETS IN THE TREASURY | \$ | 14,060,169,445 | 9,972,786 | 14,070,142,231 | 14,124,396,913 |

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT

LOS ANGELES COUNTY TREASURY
STATEMENT OF CHANGES IN NET ASSETS
FISCAL YEAR ENDED DECEMBER 31, 2001

| | EXTERNAL INVESTMENT POOL | SPECIFIC PURPOSE INVESTMENTS |
|---|--------------------------------|------------------------------------|
| INVESTMENT INCOME (LOSS): | | |
| NET EARNINGS | \$ 238,968,148 | \$ 24,546,422 |
| NET INCREASE (DECREASE) IN FAIR VALUE OF INVESTMENTS | <u>30,377,868</u> | <u>1,144,242</u> |
| NET INCREASE RESULTING FROM INVESTMENT INCOME | \$ 269,346,016 | \$ 25,690,664 |
| ACTIVITY BY POOL PARTICIPANTS | | |
| CONTRIBUTIONS BY POOL PARTICIPANTS | 19,727,403,568 | 990,938,223 |
| DISTRIBUTIONS TO POOL PARTICIPANTS | <u>(18,889,678,654)</u> | <u>(1,346,358,554)</u> |
| NET INCREASE (DECREASE) IN INVESTMENT TRANSACTIONS | \$ 837,724,914 | \$ (355,420,331) |
| TOTAL INCREASE (DECREASE) IN NET ASSETS | \$ 1,107,070,930 | \$ (329,729,667) |
| FAIR VALUE OF NET ASSETS HELD IN TRUST, JULY 1, 2001 | <u>12,252,250,303</u> | <u>1,094,805,346</u> |
| FAIR VALUE OF NET ASSETS HELD IN TRUST, DECEMBER 31, 2001 | \$ <u>13,359,321,233</u> | \$ <u>765,075,680</u> |

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2001

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Treasurer and Tax Collector (TTC) records investment purchases, maturities and sales on the settlement date. Generally Accepted Accounting Principles (GAAP) requires that transactions be recorded on the trade date. The difference between the Treasurer's approach and GAAP required trade date accounting is immaterial. The County's investments are reported by the Treasurer at amortized cost.

In accordance with Government Accounting Standards Board (GASB) Statement 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools," the accompanying financial statements reflect the fair value of investments. Special disclosures related to GASB 31 appear in Note 3.

Treasurer's Investment Strategy

The Los Angeles County Treasurer maintains two portfolios. The Pooled Surplus Investment (PSI) portfolio is used to account for net assets of the County's External Investment Pool. The Treasurer's investment strategy for the External Investment Pool is to maintain principal and to provide sufficient cash to meet expenditure needs. The cash flow needs of the pool members are monitored daily to ensure that sufficient liquidity is maintained to meet the needs of participants. The Treasurer's basic investment philosophy is to buy and hold, to a designated maturity, high quality fixed income investments.

The Specific Purpose Investment (SPI) portfolio is used to account for the net assets of individual investment accounts, in aggregate. The related investment activity occurs separately from the County's investment pool and provided as a service to external investors.

2. BANK DEPOSITS

Balances

As of December 31, 2001, the Treasurer maintained accounts in five banks. The carrying amount of the Treasurer's total deposits was \$31,949,138. The balance per the various financial institutions was \$30,994,179. In addition, as of December 31, 2001, the Treasurer maintained \$174,290 in their vault.

Of the total balance in financial institutions, \$4,292,861 was covered by federal depository insurance or collateralized with securities monitored by the State Treasurer's Local Agency Security Program. A total of \$27,657,192 was in process of deposit and uninsured and uncollateralized. Balances in financial institutions that are in process of deposit are not required to be insured or collateralized.

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2001

Under Government Code Section 53652, each financial institution in California is required to pledge a pool of securities as collateral against all of its public deposits. Depending upon the type of security in the pool, the pool must have a minimum market value of 110 to 150 percent of the total amount of the public deposits.

The Local Agency Security Program of the State of California Office of the Treasurer confirmed that the pools of collateral related to the Treasurer's deposits were maintained at required levels as of December 31, 2001. However, during the audit period, the Local Agency Security Program indicated that Bank of America did not maintain adequate collateral for approximately one week. Bank of America subsequently obtained adequate collateral with no impact on the County.

3. INVESTMENTS

Government Code Sections 53601 and 53635 authorize the Treasurer to invest the External Investment Pool and SPI funds (Notes 4 and 5, respectively) in obligations of the United States Treasury, federal agencies, municipalities, asset-backed securities, bankers' acceptances, commercial paper rated A-1 by Standard and Poor's Corporation or P-1 by Moody's Commercial Paper Record, negotiable certificates of deposit, medium-term notes, repurchase agreements and reverse repurchase agreements. Also, Government Code Section 53601(l) provides for additional investments under certain circumstances. These investments can include promissory notes, subordinated notes, guaranteed interest agreements, and floating rate notes.

The investments are managed by the County Treasurer who reports to the Board of Supervisors on a monthly basis. In addition, Government Code Section 27130 requires that the County establish a County Treasury Oversight Committee to review and monitor the County's investment policy. The committee membership includes the Treasurer and Tax Collector, Auditor-Controller, Chief Administrative Officer, Superintendent of Schools, and a non-county representative.

Investments held by the County Treasurer are stated at fair value, except for certain non-negotiable securities that are reported at cost because they are not transferable and have terms that are not affected by changes in market interest rates. The fair value of each participant's position in the pool is the same as the value of the pool shares. The method used to determine the value of participant's equity withdrawn is based on the book value of the participant's percentage participation on the date of such withdrawals.

The School Districts and the Courts are required by legal provisions to participate in the County's investment pool. The total percentage share of the Treasurer's pool that relates to these involuntary participants in addition to Los Angeles County and related entities is 90.83%. The voluntary participants in the County's investment pool consist of the Sanitation Districts, the Metropolitan Transportation Authority, the South Coast Air Quality

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2001

Management District, and municipal agencies. The deposits held for these entities are included in the External Investment Pool and SPI funds. Certain specific investments have been made by the County, as requested by external depositors. This investment activity occurs separately from the County's External Pool and is reported in the SPI fund.

Safekeeping of Securities

At December 31, 2001, all External Pool and SPI Investments were safekept by the Bank of New York, except for the bonds and Bond Anticipation Notes (BANs), certain certificates of participation issued by Los Angeles County entities, the State Investment Pool investment, and the trust deed mortgages.

The bonds, BANs, and certain certificates of participation were held in the Treasurer's vault, and the trust deed mortgages were held and administered by various branches of Bank of America or by the Treasurer.

In accordance with GASB Statement Number 3, the County's External Investment Pool and SPI securities are categorized to give an indication of the level of credit risk assumed as of December 31, 2001. Category 1 includes investments that are insured or registered or for which the securities are held by the County or its agent in the agent's nominee name, with subsidiary records listing the County, as the legal owner. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the County's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty, or by the counterparty's trust department or agent but not in the County's name.

Guaranteed Investment Contracts, Money Market Fund, the State Investment Pool, and Trust Deed investments are generally not evidenced by securities that exist physically and, per GASB Number 3, are not classified into credit risk categories. The County's External Investment Pool and SPI securities are categorized on the following schedule:

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2001

| EXTERNAL POOL | CATEGORY | | | FAIR VALUE | INTEREST RATE RANGE | MATURITY RANGE |
|---------------------------------|--------------------------|-------------|-------------|--------------------------|------------------------|---------------------|
| | 1 | 2 | 3 | | | |
| COMMERCIAL PAPER | \$ 3,408,788,722 | \$ - | \$ - | \$ 3,408,788,722 | 1.63% - 2.37% | 01/02/02 - 03/28/02 |
| CORPORATE AND DEPOSIT NOTES | 555,285,013 | - | - | 555,285,013 | 1.75% - 7.13% | 01/15/02 - 03/09/04 |
| MUNICIPALS | 31,968,075 | - | - | 31,968,075 | 2.23% - 5.55% | 06/30/04 - 08/01/07 |
| NEGOTIABLE CDS | 1,095,327,760 | - | - | 1,095,327,760 | 1.76% - 5.40% | 01/07/02 - 10/07/02 |
| U.S. AGENCIES | 7,408,783,914 | - | - | 7,408,783,914 | 1.67% - 9.25% | 01/02/02 - 12/01/08 |
| U.S. GOVERNMENT | 827,044,321 | - | - | 827,044,321 | 3.88% - 5.75% | 10/31/02 - 06/30/03 |
| TOTAL PSI INVESTMENTS | <u>\$ 13,327,197,805</u> | <u>\$ 0</u> | <u>\$ 0</u> | <u>\$ 13,327,197,805</u> | | |
| | | | | \$ | | |
| SPI | CATEGORY | | | FAIR VALUE | INTEREST RATE RANGE | MATURITY RANGE |
| | 1 | 2 | 3 | | | |
| MUNICIPALS | \$ 9,666,651 | \$ - | \$ - | \$ 9,666,651 | 5.00% - 10.00% | 01/02/05 - 09/02/21 |
| U.S. AGENCIES | 31,655,104 | - | - | 31,655,104 | 5.12% - 7.12% | 2/15/02 - 08/01/06 |
| U.S. GOVERNMENT | 39,659,718 | - | - | 39,659,718 | 1.67% - 11.25% | 01/31/02 - 05/15/16 |
| REPO | 517,500,000 | - | - | 517,500,000 | 4.520% | 06/30/04 |
| | <u>\$ 598,481,473</u> | <u>\$ 0</u> | <u>\$ 0</u> | | | |
| GUARANTEED INVESTMENT CONTRACTS | | | | 112,706,723 | 4.28% | 06/28/02 |
| COLLATERALIZED TIME DEPOSITS | | | | 51,344,818 | - | 12/31/02 |
| TRUST DEEDS | | | | 2,542,666 | 4.50% - 5.50% | 09/01/01 - 04/01/17 |
| TOTAL SPI INVESTMENTS | | | | <u>\$ 765,075,680</u> | | |

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2001

The County has not provided nor obtained any legally binding guarantees during the six months ended December 31, 2001 to support the value of shares in the Treasurer's External Investment Pool.

Fair value fluctuates with interest rates, and increasing interest rates could cause fair value to decline below original cost. County management believes the liquidity in the portfolio is adequate to meet cash flow requirements and to preclude the County from having to sell investments below original cost for that purpose.

The earned rate, which includes net gains on investment sold, on all investments held by the County Treasurer for the six months ended December 31, 2001 was approximately 4.11%. The unrealized gain on investments held in the Treasurer's External Investment Pool and SPI were \$52,532,340 and \$1,722,342, respectively, as of December 31, 2001. These amounts take into account all changes in fair value (including purchases, sales, and redemptions) that occurred during the six months.

Derivatives

The California Government Code and the County's investment guidelines allows the County Treasurer to invest in reverse repurchase agreements, securities lending agreements and derivatives such as floating rate notes, forwards, futures, options, and interest rate swaps. The guidelines limit the maturity term, maximum amount to be invested, and the type of security. During the period, the only derivative-based investments the County entered into were floating rate notes.

Floating Rate Notes

The California Government Code permits the County Treasurer to purchase floating rate notes and forward contracts. Floating rate notes are any instrument that has a coupon interest rate that is adjusted periodically due to changes in a base or benchmark rate.

The County's investment guidelines limit the amount of floating rate notes to 10% of the Los Angeles County Treasury Pool portfolio and prohibit the purchase of inverse floating rate note and hybrid or complex structured investments. As of December 31, 2001, the External Investment Pool contained floating rate notes at par of \$417,741,324 (3.2% of the External Investment Pool).

Included in the floating rate notes are Marina del Rey Certificates of Participation (COPs), which were issued by the County to finance fiscal year 1992-93 General Fund operations, issuance cost, and required reserves. The certificates are payable only from Marina del Rey operating lease revenues and other Marina del Rey associated revenues. These COPs have a variable interest rate, payable semi-annually, with a maturity date of August 1, 2007.

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2001

The Board of Supervisors authorized the Treasurer to purchase Los Angeles County Capital Asset Leasing Corporation's (LACCAL) BANS for the External Investment Pool, which are floating rate notes. LACCAL is a nonprofit Corporation established by the Board to issue tax-exempt bonds to finance the purchase of certain equipment on behalf of the County. The BANS were created to provide LACCAL with operating cash prior to the sale of financing bonds. LACCAL issues BANS and sells them to the Treasurer periodically, based on cash needs. As part of the 2001-2002 Debt Management Guidelines, the Board authorized the issuance of an aggregate amount of BANS not to exceed \$59,500,000. As of December 31, 2001, the External Investment Pool had \$10,000,000 invested in LACCAL BANS.

BANS are payable within five years of the purchase date. In addition, the BANS are issued with a formal agreement that, in the event they are not liquidated by the end of the five-year period, they convert to capital leases with a three-year term secured by County real property.

4. EXTERNAL INVESTMENT POOL

The TTC maintains the External Investment Pool, which includes all funds in the County pool deposited by County entities and separate legal entities the purpose of the pool is to provide safe, liquid investment opportunities for pooled surplus funds deposited into the County Treasury. Interest earned on pool investments is deposited monthly based upon the average daily deposit balance during the allocation period. Investment gains and losses are proportionately shared by the entities participating in the pool as an increase or reduction in investment net of administrative costs.

Investments purchased with the intent to be held to maturity are accounted for in the non-trading portion of the External Pool. Investments purchased with the intent to be sold prior to maturity are accounted for in the trading portion of the External Pool. During the period July 1, 2001 through December 31, 2001, the Treasurer did not purchase any investments for trading purposes.

5. SPECIFIC PURPOSE INVESTMENTS

The Treasurer maintains the SPI Portfolio to manage specific investments requested by specific entities with the approval of the Treasurer. Revenue/loss distribution is credited to the specific entity for which the investment was made.

6. MUNICIPAL SECURITIES IN SPI

As of December 31, 2001, the Municipal Securities category of the SPI fund includes the following investments:

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2001

A Rancho Palos Verdes Redevelopment Agency Tax Allocation Bond for \$5,455,000 was issued on December 2, 1997. It earns an interest rate of 5% per annum and matures in September 2021. The original loan provided funding for landslide mitigation measures in the Abalone Cove area pursuant to a 1987 settlement agreement.

The San Gabriel Hydroelectric Lease Project Bond for \$3,907,232 is used to finance the construction of a hydroelectric generating facility. The bond interest rate is currently 10% and is set to mature on September 9, 2016. Also, a \$113,484 Calle Del Barco Community Improvement Bond was issued in 1979 and matures on January 2, 2005. The bond has an interest rate of 7%.

7. TRUST DEED MORTGAGES

In December 1986 and October 1987, the Board of Supervisors approved the disbursing of funds for trust deed mortgages as part of the settlements of the Flying Triangle and the Abalone Cove landslide litigation. Such disbursements are authorized under Government Code Section 23004, the County's power to compromise and make payment of claims being implicit in the County's power to sue and be sued. Per the Flying Triangle and Abalone Cove settlements, the combined amount of all mortgage loans was not to exceed \$8,500,000.

The trust deeds, which are fully secured, have terms of 15 to 30 years and fixed interest rates of between 5.5% and 6.825%, except for one loan that had a variable rate of 4.5% on December 31, 2001. As of December 31, 2001, the General Fund investments of the SPI fund contained \$2,542,812 in Trust Deed Mortgages.

8. INVESTMENT PURCHASE COMMITMENTS

At December 31, 2001, the County had no open trade commitments.

9. SUBSEQUENT EVENTS

Capital Asset Leasing Corporation Bond Anticipation Note

On March 8, 2002, the Corporation issued \$5,000,000 in Bond Anticipation Notes due June 30, 2004. Proceeds of the note is being used to purchase equipment. The note is to be repaid from the proceeds of lease revenue bonds.

The note, which was purchased by the Los Angeles County External Investment Pool, has an initial interest rate of 2.507%. The rate is adjustable on January 2 and July 1 of each year.