



Review of Broward County's Investment Processes

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Office of the County Auditor
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Executive Summary

This report presents the results of our evaluation of Broward County's (the County) investment processes administered by the Records, Taxes and Treasury Division (RTT Division) within the Finance & Administrative Services Department.

The purpose of our review was to:

- Determine the adequacy of the internal controls designed to safeguard the County's investment assets,
- Evaluate compliance with the County's Investment Policies and State Statutes,
- Determine whether the Division implemented recommendations from a prior audit issued by the Office of Internal Audit in August 2002,¹ and
- Evaluate the County's investment performance against relevant benchmarks and peer counties over a five year period from August 1, 2004 to July 31, 2009.

We found no significant internal control deficiencies related to the County's investment processes, or non-compliance with the County's investment policy and State Statutes. All recommendations made within the Office of Internal Audit's "Investment Systems and Procedures Review" of August 2002 have been implemented.

However, we noted documentation supporting investment purchases did not include justification for the selection of investments that were not the highest yielding options available. As a result, the Division's compliance with Investment Policy requirements is not readily evident.

We recommend the Board of County Commissioners direct the County Administrator to require written justification for investment purchases when other than the highest yielding security is selected.

We also noted Broward County's investment portfolio performance exceeds relevant benchmarks and is slightly better than Miami-Dade's but lower than Palm Beach County's. Palm Beach County's higher yield may be attributable to differences in investment policies and strategies.

¹ The Office of Internal Audit and the Commission Auditor's Office were replaced by the Office of the County Auditor, effective July 1, 2003.

Purpose and Scope

The objectives of this review were to evaluate:

1. Internal controls over the County's investment process,
2. Investment compliance with the Broward County Investment Policy and applicable Florida Statutes,
3. Implementation of prior audit recommendations relative to the investment process, and
4. Investment portfolio performance

The scope of our review was the 12 month period ended June 30, 2009. We also reviewed data for the five years ended July 31, 2009 as part of our investment performance comparison.

Methodology

To accomplish our objectives, we:

- Interviewed Broward County investment and treasury staff;
- Documented the investment process;
- Reviewed the Broward County Investment Policy and related Florida Statutes;
- Analyzed:
 - Selected transactions, accounting records, and
 - Selected monitoring reports such as daily, weekly, monthly and quarterly investment reports;
- Conducted performance benchmarking and tested reported portfolio performance; and
- Surveyed Miami-Dade and Palm Beach Counties.

Background

The Records, Taxes and Treasury Division (RTT Division) is responsible for investing all funds held by the Broward County Board of County Commissioners.² Investments are typically comprised of highly-rated securities, including money market instruments, investment-grade corporate debt, and U.S. Treasury and Agency securities. As of September 30, 2009, Broward County's investment portfolio balance totaled approximately \$2.1 billion.³

Exhibit 1 below shows investment portfolio balances at September 30, 2007, 2008, and 2009.

Exhibit 1: Broward County's Fiscal Year End Investment Portfolio Values

<i>Fiscal Year</i>	<i>Portfolio Value</i>
2007	\$ 2,077,939,000
2008	\$ 2,140,799,000
2009	\$ 2,055,000,000

Source: Records, Taxes and Treasury Division

The County's primary investment goals, in order of importance, are:

- **Safety** – the portfolio should be structured to ensure the preservation of capital, and each investment transaction should seek to avoid risk
- **Liquidity** – the portfolio should be structured to provide sufficient liquidity to meet the County's operating requirements and future payment obligations
- **Yield** - the portfolio should be structured to maximize investment income subject to safety and liquidity constraints

The Broward County Investment Policy provides guidelines and sets objectives for the investment of County funds. The Investment Policy identifies the types of securities eligible for purchase, and establishes portfolio diversification standards and maturity limits. For example, the Investment Policy restricts the RTT Division from purchasing securities with maturities greater than five years, and specifies that no more than 5% of the value of the portfolio may be invested in the securities of any single issuer.⁴ Additionally, the Investment Policy specifies that

² Excludes proceeds of refunded bond issues which are deposited in escrow, debt service funds governed by their bond indentures and funds of the Constitutional Officers and other component units of the County, governed by independent Boards unless as authorized by mutual agreement.

³ The average portfolio balance for fiscal year 2009 was \$2.4 billion.

⁴ This limitation does not apply to securities issued by the United States Government, or Government Sponsored Enterprise (GSE) securities.

investment performance should regularly exceed the average return of the 3-month U.S. Treasury Bill, which is an acknowledged benchmark for low risk, short-term investment transactions.

In July 2007, Standard & Poor's Rating Services ("S&P") assigned Broward County's investment portfolio the "AAAF" fund credit quality rating and "S1+" volatility rating, making it the first County portfolio in the State of Florida to receive this top rating. The "AAAF" credit quality rating signifies that the "portfolio holdings provide extremely strong protection against losses from credit defaults". The "S1+" volatility rating signifies the fund possesses "extremely low sensitivity to changing market conditions", and a level of risk that is less than or equal to that of a portfolio comprised of the highest quality fixed-income instruments with an average duration⁵ of one year or less.

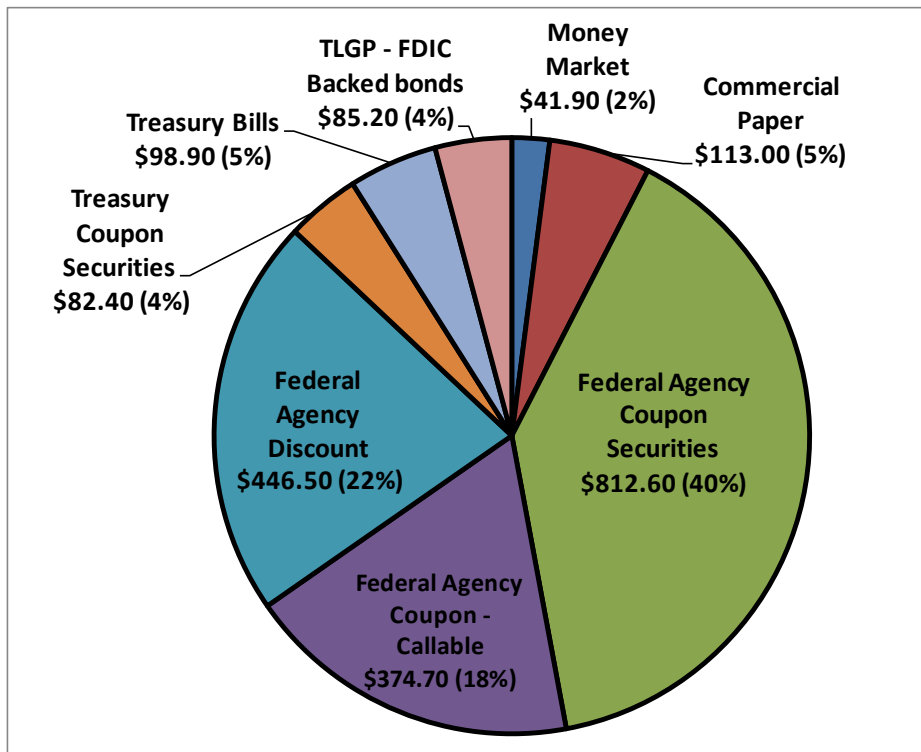
Investment Process

To ensure sufficient funds are available throughout the fiscal year to meet its financial obligations, Broward County employs various cash management and investment strategies.

The RTT Division's Investment Coordinators evaluate the County's cash position on a daily basis. Current bank account balances, incoming deposits and outgoing disbursements are compiled to determine whether an adequate level of cash is on hand. Cash in excess of current needs is invested in federal agency securities, treasury bills, commercial paper, and money market accounts as shown in Exhibit 2 on the next page.

⁵ "Duration is a measure of the average time that it takes to receive the interest and principal [and] has a positive correlation to maturity" (Public Fund Investing for Dummies; Koetting, Jim). For example, an investment purchased at par value with a maturity of three years has a duration of three whereas the same investment which pays a portion of the interest semi-annually has a duration of slightly less than three.

Exhibit 2: Broward County Portfolio Summary – Book Value by Asset Type (Millions)



Source: Records, Taxes, and Treasury Division September 30, 2009 Portfolio Management Report

Investment purchases are planned to ensure maturities correspond with forecasted outflows. Investment Coordinators prepare a monthly cash flow forecast which estimates significant upcoming deposits (e.g. ad valorem taxes) and disbursements (e.g. payroll, debt service, etc.). Investments are then selected which will mature at the time of significant outflows. Once the desirable maturity is established, the Investment Coordinators evaluate the financial market and assess available investments. The Coordinators utilize the Bloomberg Professional Service to access financial markets, search for and research specific securities that meet time horizon requirements, and communicate with brokers.

Once a desirable security is identified, it is required to be competitively procured in accordance with the Investment Policy. Each purchase must also comply with the Investment Policy with regard to allowable securities, diversification and maturity requirements.

When a transaction is executed, the broker sends a copy of the trade ticket confirming the purchase to the Investment Coordinators, investment manager and treasury staff. The Investment Coordinators then send a copy of the trade ticket to the County's third party custodian (Wachovia Bank as of September 30,

2009) who releases payment once the security is delivered. The Investment Coordinators enter each transaction into the investment management software (called “SymPro”) which is used to calculate and allocate interest among the various County funds. All investment transactions (i.e. purchases, sales, etc) are uploaded from SymPro and reconciled to the County’s financial system (Advantage) on a daily basis by the treasury staff.

Portfolio performance and compliance with the County’s Investment Policy is monitored through the preparation and review of daily, weekly, monthly, and quarterly reports generated primarily from SymPro and compiled by the Investment Coordinators. Daily reports are reviewed by the investment manager and include an analysis of the daily cash position and supporting documentation for investment purchases. Weekly and monthly reports are reviewed by the Director of Finance & Administrative Services and the monthly reports are submitted to the Office of the County Auditor; quarterly reports are submitted to the Board of County Commissioners. All reports include portfolio analysis and performance summaries.

Observations and Recommendation

Observation 1

Documentation supporting investment purchases did not include justification for the selection of investments that were not the highest yielding options available. As a result, the Division’s compliance with Investment Policy requirements is not readily evident.

The Investment Policy states that “all transactions shall be competitively bid” and “the bid deemed to best meet the investment objectives...must be selected.”

Investment Coordinators exercise a substantial level of discretion in performing purchase transactions. Although some types of investments are electronically bid solely on price/yield, other investments are selected from a list of available comparable options. In some cases, the Investment Coordinators may not select the highest yielding security. The Investment Coordinators stated that consistent with County policy, yield was not the single most important determining factor in purchasing an investment. Safety (through diversification) and liquidity objectives could preclude obtaining the highest available yields. Furthermore, investment quotes and purchases are retained and subsequently reviewed by the investment manager daily.

However, we found supporting documentation of investment purchases does not contain sufficient justification that “the bid deemed to best meet investment objectives [was] selected.” Our test sample included three instances where the

investment purchased provided a relatively lower yield than other available investments but the rationale for selecting the lower yielding investment was not documented. The Investment Coordinators supplemented our file review with verbal explanations for the selection of the lower yielding investments.

Failure to document investment decisions prevents an independent supervisory review for safety, liquidity and performance goals and places reliance of the Investment Coordinator's ability to recall information that can be forgotten or lost with employee turnover.

Recommendation

We recommend the Board of County Commissioners direct the County Administrator to require written justification for investment purchases when other than the highest yielding security is selected.

Observation 2

Broward County's investment performance exceeds relevant benchmarks and its yield is slightly better than Miami-Dade's but lower than Palm Beach County's.

Section 218.415(2), *Florida Statutes* states "investment objectives shall include safety of capital, liquidity of funds and investment income, in that order". To ensure a government maintains safety and sufficient liquidity to meet operating requirements, risky investment strategies and other speculative investment practices are considered inappropriate.

Broward County's Investment Policy consists of various restrictions designed to minimize risk. For example, the Investment Policy restricts the purchase of securities with maturities greater than five years, and limits securities of a single issuer⁶ to no more than 5% of the portfolio.

Due to these and other risk minimization strategies, Broward County's investment portfolio maintains the AAf/S1+ rating from Standard & Poor's Ratings Services (S&P). According to S&P, this rating indicates "extremely strong protection against losses from credit defaults, and extremely low sensitivity to changing market conditions."

⁶ This limitation does not apply to securities issued by the United States Government or Government Sponsored Enterprise (GSE) securities.

Comparison to Required Benchmark

The Investment Policy designates the rate of return of the 3-month U.S. Treasury Bill as the minimum standard for the portfolio and each month the Division compares its annualized investment performance to this benchmark.

We compared Broward County’s investment performance for the five-year period of August 2004 through July 2009 to the 3-month U.S. Treasury Bill. We found the County’s average annualized rate of return for this period was better than the 3-month U.S. Treasury Bill as shown in Exhibit 3 below:

Exhibit 3: Broward County outperformed its investment benchmark for the five-year period, August 2004 to July 2009

	Yield
Broward County Investment Portfolio	3.63%
3-Month U.S. Treasury Bill	2.96%

Source: Office of the County Auditor Analysis

Additionally, Appendix A on page 14 presents a month-by-month performance comparison

Comparison to Industry Standard Benchmark

While Broward County Investment Policy designates the 3-Month U.S Treasury Bill as a performance benchmark, our discussions with Treasury staff indicate other benchmarks may be more appropriate. Specifically, Broward County’s investment portfolio contains, on average, securities with maturities significantly longer than 3 months (or 90 days). As of September 30, 2009, the weighted average maturity of Broward County’s investment portfolio was 508 days.⁷

To better evaluate Broward County’s investment returns, we compared Broward’s five-year performance against a common benchmark for short-term investments, the Merrill Lynch 1-3 Year Treasury Index. This benchmark is an unmanaged index produced by Merrill Lynch to measure the returns of U.S. Treasury fixed income securities (direct sovereign debt of the U.S. Government) in the maturity range of 1 to 3 years. Broward’s Investment Coordinators agreed the Merrill Lynch benchmark more closely mirrors the County’s portfolio than the 3-Month U.S. Treasury Bill because its mix of investments is closer in duration and type to Broward’s investments.

⁷ Weighted average maturity reflects the time necessary, on average, for Broward County’s investment holdings to mature.

We compared Broward County’s investment performance for the five-year period from of August 2004 through July 2009 to the Merrill Lynch 1-3 Year Treasury Index. We found the County’s average annualized rate of return for this period was better than the Merrill Lynch 1-3 Year Treasury Index as shown in Exhibit 4 below:

Exhibit 4: Broward County outperformed the Merrill Lynch 1-3 Year Treasury Index portfolio benchmark for the five-year period examined

	Yield
Broward County Investment Portfolio	3.63%
Merrill Lynch 1-3 Year Treasury Index	3.47%

Source: Office of the County Auditor Analysis

Additionally, Appendix A on page 14 presents a month-by-month performance comparison.

Comparison to Peer Benchmarks

To provide additional context for Broward County’s investment performance, we conducted a peer comparison with Miami-Dade and Palm Beach counties for the five-year period of August 2004 through July 2009.⁸ Similar to Broward County, Miami-Dade and Palm Beach Counties have one of the highest Standard & Poor’s (S&P) credit ratings.

Our comparison indicates Broward County’s investment yield slightly exceeds Miami-Dade’s for the five-year period reviewed but is lower than Palm Beach County’s, as shown in Exhibit 5 on the next page:

⁸ Miami-Dade and Palm Beach County performance information were provided by their respective staff and this information was not verified or otherwise audited.

Exhibit 5: Broward County’s yield exceeds Miami-Dade’s, but is lower than Palm Beach County’s for the five-year period examined

County	Yield	S&P Rating ⁹
Broward	3.63%	AAAf/S1+
Miami-Dade	3.56%	AAAf/S1
Palm Beach	4.40%	AAAf/S1

Source: Office of the County Auditor Analysis

Additionally, Appendix B on page 15 presents a month-by-month investment performance comparison of Broward, Miami-Dade and Palm Beach Counties.

As indicated above, Palm Beach County’s average yield was 0.84% in excess of Broward County’s notwithstanding the portfolios’ similar S&P ratings.

To determine the factors that influence investment performance, we contacted Investment Coordinators at Miami-Dade and Palm Beach counties to compare their investment policies and strategies with those of Broward County. We found Miami-Dade County generally operates under the same investment restrictions as Broward County. However, Palm Beach County’s investment policy is less restrictive than Broward’s. For example, Palm Beach County practices active trading and purchases securities with longer maturities.

Active trading involves selling a security before it matures in order to acquire an alternative investment that is expected to outperform the original holding. This strategy may involve taking a loss on the initial investment. While Broward County’s Investment Policy does not prohibit active trading, historically all investments are held until maturity (known as “buy-and-hold”).

Additionally, Palm Beach County’s Investment policy permits the purchase of securities with maturities of up to ten years whereas Broward County’s Investment Policy prohibits the purchase of securities with maturities greater than five years.

Appendix C on page 15 compares the investment policies of Broward, Miami-Dade and Palm Beach counties.

⁹According to S&P rating literature, the difference between Broward County’s investment portfolio rating of “AAAf/S1+” and Palm Beach and Miami-Dade ratings of “AAAf/S1” is a function of the average duration for each county’s respective investment portfolio. Funds receiving the “S1+” rating are generally considered enhanced cash or money market plus funds and are designated as having “extremely low sensitivity to changes in interest rates” whereas “S1” ratings are defined as having “low sensitivity to changing market conditions.”

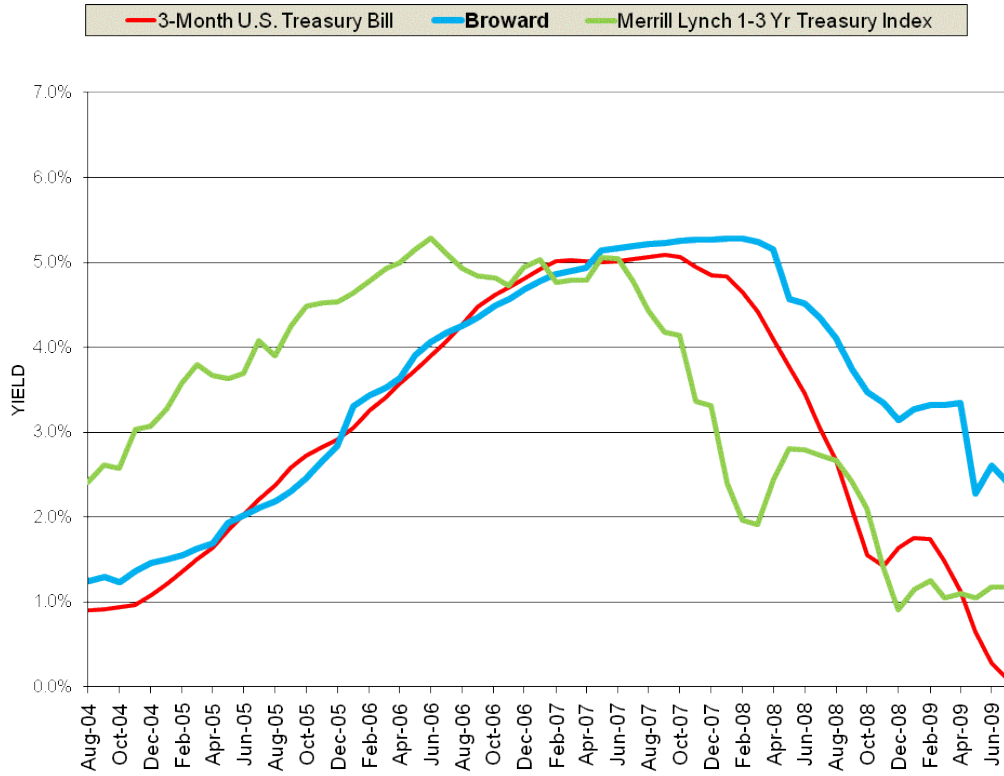
Evaluation of Broward County Investment Policy on Portfolio Performance

Broward County's Investment performance exceeds established and industry benchmarks as well as the performance of Miami-Dade County but is lower than Palm Beach County. Palm Beach County's average yield for the 5 years ended July 31, 2009 was 0.84% better than Broward County's. This may be attributable to differences in the investment policies and strategies.

Since the Investment audit in August 2002, the RTT Division has implemented positive changes in the investment process including hiring more qualified investment staff and implementing additional controls. As a result, Broward County is performing well, given the constraints of the current investment policy and structure.

Appendix A

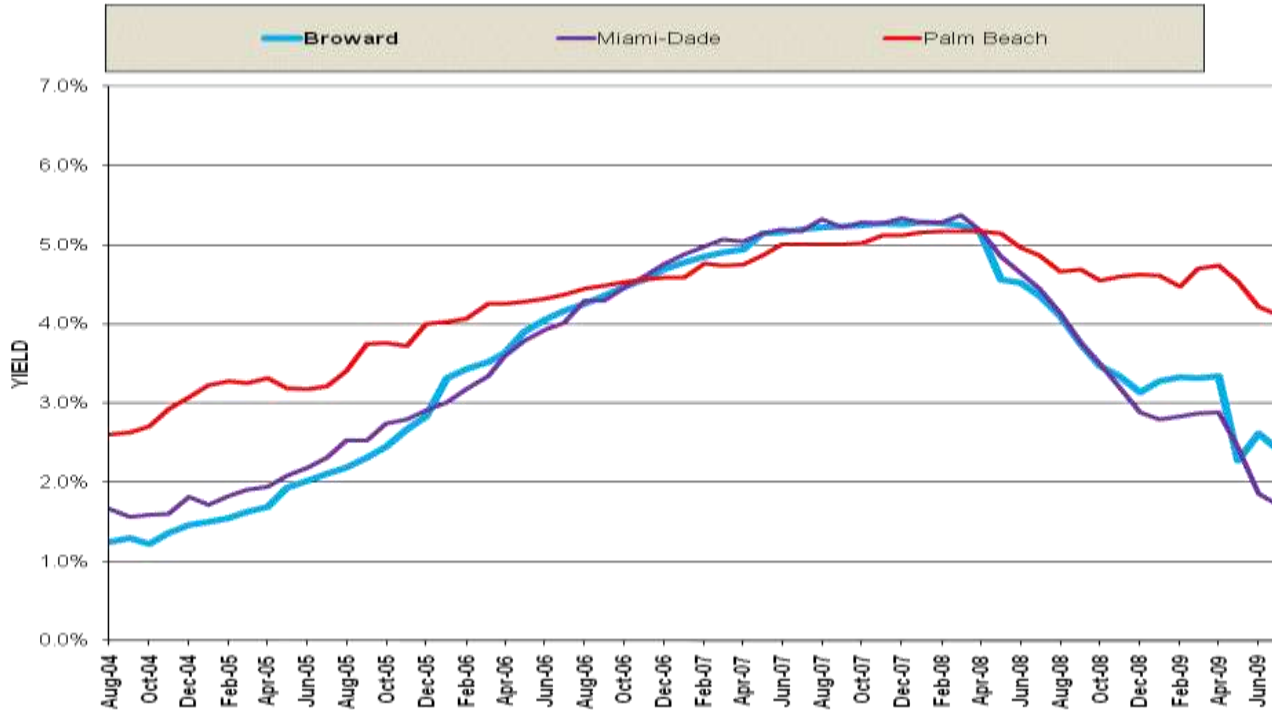
Comparison of Broward County's Investment Portfolio to the 3-Month U.S. Treasury Bill's and Merrill Lynch 1-3 Yr Treasury Index's Performance for the period August 2004 to July 2009 (by month)



Source: Broward County Records, Taxes & Treasury Division

Appendix B

Comparison of Broward County’s Investment Portfolio Performance to Miami-Dade, and Palm Beach Counties for the period August 2004 to July 2009 (by month)



Source: Office of the County Auditor Analysis

Appendix C

Broward County’s Investment Policy is Similar to Miami-Dade’s, but More Restrictive than Palm Beach County’s

	BROWARD	Miami-Dade	Palm Beach
Portfolio Value (as of September 30, 2009) (Billions)	\$2.1	\$3.9	\$1.8
S&P Rating	AAAf/S1+	AAAf/S1	AAAf/S1
Portfolio Performance Benchmark	90 Day Treasury Bill	180 Day Treasury Bill	2 Year Constant Maturity Treasury (CMT)
Maximum Allowable Maturity	5 Years	5 Years	10 Years
Sell Before Maturity	No	No	Yes (often)

Source: Office of the County Auditor Analysis