CITY OF COSTA MESA

STATEMENT OF INVESTMENT POLICY~~ Essential Mark Up~~

2013-2014

I. GENERAL INTRODUCTION

Under the laws of the State of California, it is the responsibility of the City Treasurer, at the direction of the City Council, to secure and protect the public funds of the City, and to establish proper safeguards, controls, and procedures to maintain these funds in a lawful, rational and auspicious manner. Said maintenance shall include the prudent and secure investment of those funds that are deemed temporarily excess, in a manner anticipated to provide additional benefit to the people of the City of Costa Mesa. The City's Finance Director serves as the City Treasurer.

This Statement of Investment Policy will be provided annually for the review by the Finance Advisory Committee and the approval of the City Council in an open public meeting. It will be provided to securities dealers, banks, and brokers currently approved for conducting investment transactions with the City Treasurer's office in the ongoing effort to manage the excess cash portfolio; to other affected persons or entities; and to any member of the electorate wishing to review this document upon request. The Treasurer reserves the right to provide these documents on a cost basis.

Comment [KU1]: Edit from 10/3/13

II. SCOPE

This Statement of Investment Policy pertains to those temporarily excess funds under the control of the Treasurer, designated for the daily ongoing operations of the City; and concerns the deposit, maintenance, safekeeping, and preservation of all such funds, and the investments made with these funds. This Policy does not apply to pension trust funds, deferred compensation funds, and certain other trust or non-operating funds.

III. PURPOSE

The purpose of this Statement of Investment Policy is to provide the City Council, the Finance Advisory Committee, those involved in servicing the investment requirements of the City, and any other interested party, a clear understanding of the regulations and internal guidelines that will be observed in maintaining and investing those pooled funds deemed temporarily excess. This statement is intended to provide guidelines for the prudent investment of the City's temporary idle cash, and outline the procedures for maximizing the efficiency of the City's cash management system. The ultimate goal of the Investment Policy is to enhance the economic status of the City while safeguarding its assets.

Comment [KU2]: Mr. Riva's edit of 10/3/13

IV. OBJECTIVE

The City's cash management system is designed to accurately monitor and forecast revenues and expenditures, thus enabling the City to invest funds to the fullest extent possible only after the criteria established for safety and liquidity have been met.

The City of Costa Mesa operates its pooled idle cash investments with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

This affords the City a broad spectrum of investment opportunities as long as the investment is deemed prudent and is allowable under current legislation of the State of California Government Code Section 53600 et seq. and the general laws of the City of Costa Mesa.

The City of Costa Mesa strives to maintain the level of investment of all idle funds as near 100% as possible, through daily and projected cash flow determinations. Idle cash management and investment transactions are the responsibility of the City Treasurer or his/her designee.

Criteria for selecting investments and the order of priority are:

1. Safety: The safety and risk associated with an investment refers to the potential loss of principal, interest, or a combination of these amounts. The City only operates in those investments that are considered very safe.

2. Liquidity: This refers to the ability to "cash in" at any moment in time with a minimal chance of losing some portion of principal or interest.

3. Yield: Yield is the potential dollar earnings an investment can provide, and sometimes is referred to as the rate of return.

4. Safekeeping: Securities purchased shall be held in third party safekeeping in the Trust Department of a financial institution, in the City's name and control. The account established shall be protected from seizure by creditors should the financial institution holding the City's securities file for bankruptcy protection. The basic premise underlying the City's investment philosophy is and continues to be, to insure that surplus funds are always safe and available when needed.

V. DELEGATION OF INVESTMENT AUTHORITY

Authority to manage the City of Costa Mesa's investment program is derived from City of Costa Mesa Council Resolution No. _____. Management responsibility for the investment program is hereby delegated for fiscal year 2013-2014 to the City Treasurer or his/her designee, who shall establish written procedures for the operation of the investment program consistent with this Investment Policy. Procedures should include references to: safekeeping, repurchase agreements, wire transfer agreements, banking service contracts, and collateral/ depository agreements. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the City Treasurer or his/her designee. The City Treasurer or his/her designee shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

The City may engage the services of an external investment manager to assist in the management of the City's investment portfolio in a manner consistent with the City's objectives. Such an external manager may be granted discretion to purchase and sell investment securities in accordance with this Investment Policy. Such a manager must be registered under the Investment Advisers Act of 1940.

Comment [TP3]: Explicitly acknowledge the use of an investment adviser.

VI. STANDARD OF PRUDENCE

The Treasurer shall perform the investment function in conjunction with the "Prudent Person Rule." This rule states, in principle that whenever investing property for the benefit of others, a trustee shall exercise the judgment and care, under circumstances then prevailing that persons of prudence, discretion, and intelligence, would exercise in the management of their own affairs not in regards to speculation, but in regard to the permanent disposition of their funds, considering the probability of safety of, as well as the probable income from their capital. The Treasurer and his designees are considered to have a fiduciary, trustee, relationship with the public for the public funds and all investment decisions will be made in a manner sustaining this responsibility.

Comment [KU4]: Mr. Riva's edit of 10/3/13

VII. AUTHORIZED INVESTMENTS

The California Government Code allows the City to invest in the following media:

- Securities of the U.S. Government, or its government sponsored agencies
- Small Business Administration loans
- Certificates of deposit, placed with commercial banks and savings and loan companies
- Negotiable certificates of deposit
- Bankers' acceptances
- Commercial paper
- Corporate notes and bonds, including medium term notes
- Local Agency Investment Fund
- Repurchase agreements
- Passbook savings account demand deposits
- County Treasurer demand deposits
- Asset-backed and mortgage-backed securities
- Money market mutual funds

As a matter of practice, however, the City of Costa Mesa generally limits its investments to the following vehicles:

U.S. Treasury Bills - Issued weekly with maturity dates up to one year. They are issued and traded on a discount basis with interest figured on a 360-day basis, actual number of days. They are issued in amounts of $10,000 and up, in multiples of $5,000. They are a highly liquid security.

U.S. Treasury Notes - Initially issued with two- to ten-year maturities. They are actively traded in a large secondary market and are very liquid. The Treasury may issue Note issues with a minimum of $1,000, however, the average minimum is $5,000.

Federal Agency/U.S. Government-Sponsored Enterprise Issues - Guaranteed directly or indirectly by the United States Government. All agency/GSE obligations qualify as legal investments and are acceptable as security for public deposits. These securities usually provide higher yields than U.S. Treasury securities with generally all of the same advantages in terms of safety and liquidity. Examples include:

- FICBs (Federal Intermediate Credit Bank Debentures) - Loans to lending institutions used to finance the short-term and intermediate needs of farmers, such as seasonal production. These securities are usually issued monthly in minimum denominations of $3,000 with a nine-month maturity. Interest is payable at maturity and is calculated on a 360-day, 30-day month basis.

- FFCBs (Federal Farm Credit Bank) - Debt instruments used to finance the short and intermediate term needs of farmers and the national agricultural industry. They are issued monthly with three- and six-month maturities. The FFCB issues larger issues (one to ten year) on a periodic basis. These issues are highly liquid.

- FLBs (Federal Land Bank Bonds) - Long-term mortgage credit provided to farmers by Federal Land Banks. These bonds are issued at irregular times for various maturities ranging from a few months to ten years. The minimum denomination is $1,000. They carry semi-annual coupons. Interest is calculated on a 360-day, 30-day month basis.

- FHLBs (Federal Home Loan Bank Notes and Bonds) - Issued by the Federal Home Loan Bank System to help finance the housing industry. The notes and bonds provide liquidity and home mortgage credit to savings and loan associations, mutual savings banks, cooperative banks, insurance companies, and mortgage-lending institutions. They are issued irregularly for various maturities. The minimum denomination is $5,000. The notes are issued with maturities of less than one year and interest is paid at maturity. The bonds are issued with various maturities and carry semi-annual coupons. Interest is calculated on a 360-day, 30-day month basis.

- FNMAs (Federal National Mortgage Association) - Used to assist the home mortgage market by purchasing mortgages insured by the Federal Housing Administration and the Farmers Home Administration, as well as those guaranteed by the Veterans Administration. They are issued about four times a year for maturities ranging from a few months to eight years. They are issued in minimum denominations of $10,000. They carry semi-annual coupons. Interest is computed on a 360-day, 30-day month basis.

- FHLMCs (Federal Home Loan Mortgage Corporation) - A government-sponsored enterprise established to develop the secondary market for conventional home mortgages. Mortgages are purchased solely from the Federal Home Loan Bank System member lending institutions whose deposits are insured by agencies of the United States Government. They are issued for various maturities and in minimum denominations of $10,000. Interest is paid semi-annually and is calculated on a 360-day, 30-day month basis.

- Other federal agency issues are Small Business Administration notes (SBAs), Government National Mortgage Association notes (GNMAs), and Tennessee Valley Authority notes (TVAs). As a matter of practice, the City does not invest in these issues as they do not suit our purposes as well as other investment opportunities available.

The City limits its investments to no more than 60% of its surplus funds in any one Federal Agency.

Bankers' Acceptances - Short-term credit arrangements to enable businesses to obtain funds to finance commercial transactions. They are time drafts drawn on a bank by an exporter or importer to obtain funds to pay for specific merchandise. By its acceptance, the bank becomes primarily liable for the payment of the draft at its maturity. An acceptance is a high-grade negotiable instrument. Bankers' Acceptances can be purchased with various maturities, but no longer than 180 days. The interest is calculated on a 360-day discount basis similar to Treasury Bills. Local agencies may not invest more than 40% of their surplus funds in bankers' acceptances or more than 10% of the City's surplus funds in bankers' acceptances of any one commercial bank.

Certificates of Deposit - Time deposits of a bank or savings and loan. They are purchased in various denominations with maturities ranging from 30 to 360 days. The interest is calculated on a 360-day, actual-day month basis and is payable monthly.

Negotiable Certificates of Deposit - Unsecured obligations of the financial institution, bank or savings and loan, bought at par value with the promise to pay face value plus accrued interest at maturity. They are high-grade negotiable instruments, paying a higher interest rate than regular certificates of deposit. The primary market issuance is in multiples of $1,000,000; the secondary market usually trades in denominations of $500,000, although smaller lots are occasionally available. As a matter of practice, only the ten largest U.S. banks where there is a secondary market established for continued liquidity are considered for investment. The City's total investment in negotiable certificates of deposit may not exceed 30% of surplus funds.

Commercial Paper - Short-term unsecured promissory notes issued by a corporation to raise working capital. These negotiable instruments are purchased at a discount to par value or at par value with interest bearing.

The City is permitted by State law to invest in commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided for by a nationally recognized statistical-rating organization (NRSRO). Eligible paper is further limited to issuing corporations that are organized and operating within the United States and having total assets in excess of five hundred million dollars ($500,000,000) and having an "A" or higher rating for the issuer's debt other than commercial paper as rated by an NRSRO. Commercial Paper issued by an Issuer that has a rating of "A" on their debt other than commercial paper but are on credit watch for a possible downgrade by an NRSRO shall not be considered for investment purposes. Purchases of eligible commercial paper may not exceed 270 days maturity nor represent more than 10% of the outstanding paper of an issuing corporation. Purchases of commercial paper may not exceed 25 percent of the portfolio.

Medium Term Corporate Notes - Unsecured promissory notes issued by a corporation organized and operating in the United States. These are negotiable instruments and are traded in the secondary market. Medium term corporate notes can be defined as extended maturity commercial paper.

Local agencies are restricted by the Government Code to investments in corporations rated in the top three note categories by Moody's Investors Service, Inc., and/or Standard and Poor's Corporation. For medium-term notes, eligible purchases consist of instruments that have a rating of "A" or better by both Moody's Investors Service, Inc., and Standard and Poor's Corporation. Corporate Notes issued by an issuer that has a rating of "A" but are on credit watch for a possible downgrade by a nationally recognized rating agency shall not be considered for investment purposes. If the security's credit rating falls below an "A" rating by one of these agencies, then awareness is heightened and the security monitored closely to determine if credit risk has been significantly increased. If a security falls below an "A" rating by both rating agencies, the City Treasurer or his/her designee will evaluate the need to sell the security prior to maturity. Further restrictions include a maximum term of five years to maturity and total investments in medium term corporate notes may not exceed 30% of the City's surplus funds or 5% in any one issuer name.

Comment [KU5]: Deleted because of "City"

Repurchase Agreements - A repurchase agreement is a short-term investment transaction. Banks buy temporarily idle funds from a customer by selling U.S. Government or other securities with a contractual agreement to repurchase the same securities on a future date. Repurchase agreements are typically for one to ten days in maturity. The customer receives interest from the bank. The interest rate reflects both the prevailing demand for Federal funds and the maturity of the repurchase agreement. Some banks will execute repurchase agreements for a minimum of $100,000 to $500,000, but most banks have a minimum of $1,000,000. The term of a repurchase agreement may not exceed one year. The market value of securities that underlay a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be adjusted no later than quarterly. Repurchase Agreements can only be executed with financial institutions or broker/dealers that have signed a Master Repurchase Agreement with the City.

LAIF (Local Agency Investment Fund) - A special fund in the State Treasury which local agencies may use to deposit funds for investment. There is no minimum investment period and the minimum transaction is $5,000, in multiples of $1,000 above that, with a maximum balance of $50,000,000 for any agency. The City is restricted to a maximum of fifteen transactions per month. It offers high liquidity because deposits can be converted to cash in 24 hours and no interest is lost. All interest is distributed to those agencies participating on a proportionate share basis determined by the amounts deposited and the length of time they are deposited. Interest is paid quarterly. The State retains an amount for reasonable costs of making the investments, not to exceed one-quarter of one percent of the earnings. California Government Code §16429.3 states, in part:

> "money placed with the State Treasurer for deposit in the Local Agency Investment Fund by cities, counties, or special districts shall not be subject to impoundment or seizure by any state official or state agency."

Orange County Treasurer's Pool - A special fund in the County Treasury which local agencies may use to deposit funds for investment. The City may not invest more than 35% of its surplus money with the Orange County Treasurer's Pool. The County Treasurer charges 12.5 basis points (.125%) to all pool participants for its direct costs. Direct Costs include proper staffing, bank and custodial fees, software maintenance fees, and other indirect costs relating to the investment. Investment earnings are distributed to the pool participants on a monthly basis, net of the above charges. The earnings are credited to the participant's accounts on either the last day of each month or the first day of the subsequent month.

Money Market Mutual Funds - Shares of beneficial interest issued by diversified management companies. To be eligible for investment, shares must:

1. attain the highest rating provided by Moody's Investors Service, Inc., which is currently "Aaa," and/or Standard and Poor's Corporation, which is currently "AAA;" and

2. the investment adviser managing the shares must be registered with the Securities and Exchange Commission with not less than five year's experience investing in instruments authorized under California Government Code §53601 subdivisions (a) to (m) inclusive, and with assets under management in excess of five hundred million dollars ($500,000,000); and

3. the purchase price of shares shall not include any commission that these companies may charge; and

4. investment in shares shall not exceed 20 percent of surplus funds.

However, no more than 10 percent of the City's surplus funds may be invested in shares of beneficial interest of any one mutual fund. Furthermore, any investment in a money market mutual fund must comply with other self-imposed restrictions as specified in this Investment Policy.

Asset-Backed and Mortgage-Backed Security - Bonds backed by payments from receivables/mortgages having a maximum of five years maturity. These securities must have an "AA" or better rating by Moody's Investors Services, Inc., and/or Standard and Poor's Corporation. No more than 20% of the City's surplus money may be invested in these securities.

VIII. INVESTMENT OF BOND PROCEEDS

When investing proceeds from the issuance of bonds, the City of Costa Mesa will follow this Investment Policy when determining allowable investments. Should the trust agreement of a particular bond issue be more restrictive than the City's policy on permitted investments, then the trust agreement will take precedence.

IX. CITY CONSTRAINTS

The City Treasurer or his/her designee will evaluate local banks and savings institutions and may invest idle cash funds with such institutions when the criteria for prudent investment previously stated are met. The City operates its investment pool according to State and self-imposed constraints. It does not buy stocks; it does not speculate; it does not deal in futures or options. Any investment extending beyond a five-year period requires prior City Council approval. Additionally, a minimum of 20% of the outstanding investments must mature within a one-year time period.

X. SAFEKEEPING AND COLLATERALIZATION

All security transactions, including collateral for repurchase agreements, entered into by the City shall be conducted on a delivery-versus-payment (DVP) basis. Securities will be held by a third party custodian designated by the City Treasurer or his/her designee.

Collateralization will be required on two types of investments: certificates of deposit and repurchase (and reverse repurchase) agreements. In order to anticipate market changes and provide a level of security for all funds, a minimum collateralization level is required.

Surplus funds must be deposited in State or national banks, State or Federal savings and loan associations, or State or Federal credit unions within the State of California. The deposits cannot exceed the amount of the bank's or savings and loan's paid-up capital and surplus.

The bank or savings and loan must secure public funds deposits with eligible securities having a market value of 110% of the total amount of the deposits. State law also allows as an eligible security, first trust deeds having a value of 150% of the total amount of the deposits. A third class of collateral is 105% in the form of a letter of credit drawn on the Federal Home Loan Bank.

The City Treasurer or his/her designee may waive security for that portion of a deposit, which is insured pursuant to Federal law. Currently, the first $250,000 of a deposit is federally insured and deposits in excess of $250,000 are collateralized as previously indicated.

XI. DERIVATIVE INVESTMENTS

A derivative is a generic term often used to categorize a wide variety of financial instruments whose value "depends on" or is "derived from" the value of an underlying asset, reference rate, or index.

Investments in derivative instruments are limited to debt securities that have periodic increases, or step-up interest rate adjustments that provide upward mobility in yield return. Investments in debt securities, which contain a callable feature are also allowable, but must comply with other restrictions as specified in this Investment Policy.

Investments purchased after June 19, 1995, in derivative instruments known as "inverse floaters," "dual index," or "stepped inverse" securities that produce higher than market yields at purchase date (when interest rates are low), but have the possibility of producing low or no coupon rates as market interest rates rise through the life of the instrument are not allowable. Furthermore, investments in range notes or interest-only strips that are derived from a pool of mortgages are not allowable. However, debt securities that have a floor or a built-in feature that prevents the instrument from potentially returning no yield are allowable.

XII. POLICY COMPLIANCE REGULATIONS

Should the portfolio, for any reason, fall out of compliance with this Investment Policy, immediate liquidation of securities in order to bring the portfolio back into compliance is not required. However, the Treasurer must take action to bring the portfolio into compliance within 12 months from the date the portfolio was determined to be in non-compliance with the provisions of this Investment Policy so long as the action is deemed to be prudent under then current market conditions. Additionally, adequate disclosure as to all instances of noncompliance, and the efforts undertaken to bring the portfolio into compliance, must be made on the monthly Treasurer's Report.

XIII. REPORTING

Comment [TP6]: Suggest revamping reporting requirements to align with state code

Under provisions of Section 53646 of the California Government Code, the Treasurer or his/her designee shall render a quarterly investment report to the City Council, the Chief Executive Officer, and the City Attorney within 30 days following the end of the quarter covered by the report. However, as a matter of practice, a monthly report shall be submitted listing the type of investments, institution, date of maturity, par value, amount of deposit, rate of interest, current market value for all securities, and such other data as may be required by the City Council on a monthly basis. Furthermore, a Finance Advisory Committee comprised of the following individuals will meet quarterly to review the City's portfolio and investment strategy.

Comment [TP7]: State Code requires this to be done within 30 days if a report is rendered. (I think we discussed lengthening the 30 day limit.)

- Mayor, or his/her designee
- Chief Executive Officer, or his/her designee
- City Treasurer
- Assistant Finance Director
- Revenue Supervisor
- Eight Committee Members appointed by City Council who are either residents or conduct business within the City and have experience in banking, securities trading, or financial planning.

Comment [KU8]: Only reference of Finance Director that wasn't already deleted

Monthly reports

Monthly investment reports will be submitted by the City Treasurer or his/her designee to the City Council members and the Finance Advisory Committee. These reports will disclose, at a minimum, the following information about the risk characteristics of the City's portfolio:

1. An asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate;

2. Monthly transactions for the period;

3. A one-page summary report that shows:

   a. Average maturity of the portfolio and modified duration of the portfolio;
   b. Maturity distribution of the portfolio;

c. Average portfolio credit quality; and,
d. Time-weighted total rate of return for the portfolio for the prior one month, three months, twelve months, year to date, and since inception compared to the Benchmark Index returns for the same periods;

4. A statement of compliance with investment policy, including a schedule of any transactions or holdings which do not comply with this policy or with the California Government Code, including a justification for their presence in the portfolio and a timetable for resolution; and,

5. A statement that the City has adequate funds to meet its cash flow requirements for the next six months.

XIV. QUALIFIED DEALERS

The City of Costa Mesa shall transact business only with banks, savings and loans, and registered investment securities dealers. The City will limit the number of broker/dealers authorized to do business with the City to no more than one (1) broker/dealer for every $10,000,000 of portfolio size. Each authorized broker/dealer shall be required to annually file a signed certification with the City Treasurer or his/her designee certifying that they have read and understand the City's most recently adopted investment policy.

The City Treasurer or his/her designee will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved broker/dealers who are authorized to provide investment services in the State of California. These may include "primary" and "regional" broker/dealers with offices located in the State of California. All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must be approved by and supply the City Treasurer or his/her designee with a completed broker/dealer questionnaire.

XV. POLICY REVIEW

This Statement of Investment Policy shall be reviewed at least annually to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law, financial and economic trends.

Should conditions change or legislation become effective that behooves subsequent changes or a liberalization of terms within the policy during the next fiscal year, the revised policy will be submitted to both the Finance Advisory Committee and Council for adoption of the recommended action.

CITY OF COSTA MESA

INVESTMENT GUIDELINES AND STRATEGY

I. GUIDELINES - Guidelines are established to direct and control activities in such a manner that previously established goals are achieved.

1. Investment Transactions. Investment transactions will be periodically reviewed by the Treasurer or his/her designee.

2. Pooled Cash. Whenever practical, City cash is consolidated into one bank account and invested on a pooled concept basis. Interest earnings are allocated quarterly according to month-end cash and investment balances for each fund.

3. Competitive Bids. Purchase and sales of securities are made on the basis of competitive offers and bids when practical.

4. Cash Forecast. The cash flow for the City is analyzed with the receipt of revenues and maturity of investments scheduled so that adequate cash will be available to meet disbursement requirements.

5. Investment Limitations. Security purchases and holdings are maintained within statutory limits imposed by the California Government Code. Current limits are:

Bankers' Acceptances	40% Section 53601(g)
Commercial Paper	25% Section 53601(h)
Negotiable Certificates of Deposit	30% Section 53601(i)
Medium Term Notes	30% Section 53601(k)
Money Market Mutual Funds	20% Section 53601l)
Asset-Backed/Mortgage-Backed Securities	20% Section 53601(o)
Federal Agency restriction	60% per Agency Section VI of Policy
Local Agency Investment Fund	$50,000,000 per Section VI of Policy
Orange County Treasurer's Pool	35% per Section VI of Policy
Portfolio Maturing within one year	20% per Section IX of Policy

6. Liquidity. The marketability of a security is considered at the time of purchase, as the security may have to be sold at a later date to meet unanticipated cash demands.

7. Diversification. The portfolio should consist of a mix of various types of securities, issuers, and maturities.

Comment [TP9]: If using an investment adviser, you would want to remove

Comment [KU10]: Deleted because of "City"

Comment [TP11]: Section reference need revising

Comment [TP12]: Section reference need revising

8. Evaluate Certificates of Deposit
   (a) Certificates of Deposit shall be evaluated in terms of FDIC coverage. For deposits in excess of the insured maximum of $250,000, approved collateral at full market value shall be required. (California Government Code Section 53652 and/or 53651(m) and 53651.2(a)(1).
   (b) Negotiable Certificates of Deposit shall be evaluated in terms of the credit worthiness of the issuer, as these deposits are uninsured and uncollateralized promissory notes.

II. STRATEGY - Strategy refers to the ability to manage financial resources in the most advantageous manner.

1. Economic Forecasts. Economic Forecasts are obtained periodically from economists and financial experts through bankers and brokers to assist the Treasurer or his/her designee with the formulation of an investment strategy for the local agency.

2. Implementing Investment Strategy. Investment transactions are executed which conform with anticipated interest rate trends and the current investment strategy plan.

3. Rapport. A close working relationship is maintained with large vendors of the city. The objective is to pinpoint when large disbursements will clear the city's bank account. It is essential for good cash control that such large expenditures be anticipated, estimated as to dollar amount, and communicated to the Treasurer or his/her designee for liquidity planning purposes.

4. Preserve Portfolio Value. Field standards are developed in order to maintain earnings near the market and to preserve the value of the portfolio.

CITY OF COSTA MESA

INVESTMENT PROCEDURES
INTERNAL CONTROL - GUIDELINES

OBJECTIVES OF INTERNAL CONTROL

Internal control is the plan of organization and all the related systems established by the management's objective of ensuring, as far as practicable:

- The orderly and efficient conduct of its business, including adherence to management policies.
- The safeguarding of assets.
- The prevention or detection of errors and fraud.
- The accuracy and completeness of the accounting records.
- The timely preparation of reliable financial information.

LIMITATIONS OF INTERNAL CONTROL

No internal control system, however elaborate, can by itself guarantee the achievement of management's objectives. Internal control can provide only reasonable assurance that the objectives are met, because of its inherent limitations, including:

- Management's usual requirement that a control be cost-effective.
- The direction of most controls at recurring, rather than unusual, types of transactions.
- Human error due to misunderstanding, carelessness, fatigue, or distraction.
- Potential for collusion that circumvents controls dependent on the segregation of functions.
- Potential for a person responsible for exercising control abusing that responsibility; a responsible staff member could be in a position to override controls which management has set up.

CITY OF COSTA MESA

INVESTMENT PROCEDURES
INTERNAL CONTROL - GUIDELINES
(Continued)

ELEMENTS OF INTERNAL CONTROL

Elements of a system of internal control are the means by which an organization can satisfy the objectives of internal control. These elements are:

1. ORGANIZATION
   Specific responsibility for the performance of duties should be assigned and lines of authority and reporting clearly identified and understood.

2. PERSONNEL
   Personnel should have capabilities commensurate with their responsibilities. Personnel selection and training policies together with the quality and quantity of supervision are thus important.

3. SEGREGATION OF FUNCTIONS
   Segregation of incompatible functions reduces the risk that a person is in a position both to perpetrate and conceal errors or fraud in the normal course of duty. If two parts of a transaction are handled by different people, collusion is necessary to conceal errors or fraud. In particular, the functions that should be considered when evaluating segregation of functions are authorization, execution, recording, custody of assets, and performing reconciliations.

4. AUTHORIZATION
   All transactions should be authorized by an appropriate responsible individual. The responsibilities and limits of authorization should be clearly delineated. The individual or group authorizing a specific transaction or granting general authority for transactions should be in a position commensurate with the nature and significance of the transactions. Delegation of authority to authorize transactions should be handled very carefully.

5. CONTROLS OVER AN ACCOUNTING SYSTEM
   Controls over an accounting system include the procedures, both manual and computerized, carried out independently to ascertain that transactions are complete, valid, authorized, and properly recorded.

CITY OF COSTA MESA

CASH CONTROLS

PROCEDURES PERFORMED BY EXTERNAL AUDITORS WITH RESPECT TO CASH RECEIPTS

A. City procedures and controls are reviewed. Some of the system strengths are:

1. Receipts are controlled upon receipt by proper registration devices.
2. Receipts are reconciled on a daily basis.
3. Amounts are deposited intact.
4. All bank accounts are authorized by City Council.
5. Cash counts are done by two or more individuals.
6. Bank reconciliations are reviewed.
7. Prompt posting of cash receipt entries in books.
8. Receipt forms are prenumbered, accounted for, and physically secured.
9. Proper approval required for write-off's of customer accounts.
10. Checks are restrictively endorsed upon receipt or when run through cash register.
11. Adequate physical security over cash.
12. Individuals that handle cash do not post to customer account records or process billing statements.
13. Adequate supervision of Finance Department operations.

B. Significant revenues are confirmed directly with payor and compared with City books to make sure amounts are recorded properly.

C. Cash balances are substantiated by confirming all account balances recorded in books. Bank reconciliations are reviewed for propriety and recalculated by the auditor. All significant reconciling items on bank reconciliations are verified as valid reconciling items by proving to subsequent bank statements.

CITY OF COSTA MESA

SEGREGATION OF RESPONSIBILITIES OF THE TREASURY FUNCTIONS

	Function	**Responsibility**
1.	Authorization of investment transactions:	
	Formal investment policy should be:	
	* Prepared by:	City Treasurer
	* Submitted to:	City Council
	Investment transactions should be approved by	City Treasurer and/or External Investment Manager
2.	Execution of investment transactions	Assistant Finance Director and/or Revenue Supervisor and/or External Investment Manager
3.	Investment transactions approved ~~Investment Manager~~ for compliance with investment policy and/or State law	Assistant Finance Director and/or External Investment Manager
4.	Timely recording of investment transactions:	
	Recording of investment transactions in the Treasurer's records	Revenue Supervisor
	Recording of investment transactions in the accounting records	Accounting Supervisor and/or Accountant
5.	Verification of investment, i.e., match broker confirmation to Treasurer's records ~~Manager~~	Assistant Finance Director and/or Revenue Supervisor and/or External Investment Manager
6.	Safeguarding of assets and records:	
	Reconciliation of Treasurer's records to the accounting records	Revenue Supervisor
	Reconciliation of Treasurer's records to bank statements and	Accounting Supervisor and/or Accountant

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safekeeping records

CITY OF COSTA MESA

SEGREGATION OF RESPONSIBILITIES OF THE TREASURY FUNCTIONS (Continued)

	Function	Responsibility
6.	Safeguarding of Assets and Records (continued):	
	Annual review of (a) financial institution's financial condition, (b) safety, liquidity, and potential yields of investment instruments.	Assistant Finance Director with Treasurer's approval
7.	No less than an annual review of investment portfolio as prepared by Treasurer including: • Investment types • Purchase Price • Par values • Market values • Maturity dates • Investment yields • Conformance to stated investment policy • Safekeeping reports	External Independent Auditors
8.	Periodic review of investment portfolio and strategies.	Finance Advisory Committee