

December 12, 2023

City of Palo Alto

Office of the City Auditor

Investment Management Audit

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Executive Summary

Purpose of the Audit

Baker Tilly US, LLP (Baker Tilly), in its capacity serving as the Office of the City Auditor (OCA) for the City of Palo Alto (the City), conducted an Investment Management Audit based on the approved Task Order 4.17. The objectives of this review were to:

- 1) Determine whether adequate controls are in place and working effectively to ensure that investments are properly managed in accordance with the investment policy.
- 2) Assess the efficiency and the effectiveness of the investment portfolio management against the best practice.

Report Highlights

Finding 1: Segregation of duties and oversight of investment activities

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The City's Administrative Services Department (ASD)'s Treasury Division includes the investment function. The day-to-day operations of the investment function are performed by the Manager of Treasury, Debt, Investment (Manager). The Assistant Director of ASD (Assistant Director) oversees the function and has delegated the responsibility for managing the investment program to the Manager and authorized him to enter into the investment within the parameters set in the City's Investment Policy.

The Manager performs all tasks to manage the investment program as well as initiating wire transactions among all responsibilities of the Treasury Division. While an approval is required prior to sales of investments, formal independent reviews of investment purchase decisions prior to purchases are not in place. When the Manager is out of office, there is no backup personnel to buy/sell securities. The limited staffing of the Treasury Division and untimely authorization of investment activities cause a concern for the inadequate segregation of duties in the investment function even through there are some segregations of duties: the purchased investments are required to be delivered to the City's safekeeping custodian and recorded in the City's accounting system by the Accounting team.

Without adequate segregation of duties, the City has a higher risk of not preventing and detecting errors and fraudulent transactions in a timely manner. As mitigating controls, increased monitoring and oversight of the investment function are required.

Key Recommendations

The City should implement a formal process for a review and approval of investment activities by the Assistant Director and, if required, the Director prior to placing an order to buy or sell securities. Approvals should be documented.

Additionally, the City should reassess the City's Investment Policy to ensure that the City will comply with the requirement to perform a monthly performance review described in the City's Investment Policy and address Section 53607 of California Government Code that requires submission of a monthly report of investment transactions to the City Council.

Furthermore, the City should continue the efforts to adjust the staffing of the investment function to assign responsibilities to ensure adequate internal controls are in place for prevention of the loss of public funds arising from errors, imprudent actions, and fraud.

Finding 2: Supporting documents for investment activities

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The OCA reviewed 58 out of 850 investment activities from July 1, 2020, to March 26, 2023, and noted inadequate or lack of supporting documents related to the following:

- Manager's investment decisions
- Quotations from authorized brokers and dealers
- Qualification of brokers and dealers
- Broker's acknowledgement of the applicable California Government Code sections and the City's Investment Policy

Adequate supporting documents for investment decisions and transactions are important for transparency and accountability. The supporting documents provide the necessary information to demonstrate the validity, accuracy, and compliance to the approvers of the decisions and transactions and the oversight functions such as auditors and an oversight committee.

Key Recommendations

The City's ASD should implement a procedure to assemble and maintain adequate supporting documents such as the cash flow forecasts and evaluation of quotations for each investment decision and transaction to enable the approvers to review and approve them prior to purchases/sales and to allow the oversight functions to evaluate the validity, accuracy, and compliance when needed.

Additionally, the City should update the City's Investment Policy to require the brokers and dealers who wish to sell and buy securities to the City to provide documentation showing their financial condition and relevant registration. The City should also require them to certify in writing that they reviewed the applicable California Government Code sections and the City's Investment Policy. An annual review should be also conducted to maintain the List of Authorized Brokers and Dealers with the recent status.

Introduction

Objective

The objectives of this review were to:

- 1) Determine whether adequate controls are in place and working effectively to ensure that investments are properly managed in accordance with the investment policy.
- 2) Assess the efficiency and the effectiveness of the investment portfolio management against the best practice.

Background

The City of Palo Alto (City) invests idle cash pooled from all sources and all funds in accordance with the California Government Code and the City’s Investment Policy.

California Government Code states that trustees who are governing bodies or individuals authorized to make investment decisions on behalf of local agencies investing public funds are subject to the prudent investor standard that requires a trustee to act with care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency.¹

The City follows the prudent investor standard and defines the following investment objectives in the City’s Investment Policy:

1. Ensure the safety of the public funds
2. Maintain the liquidity to meet the City’s financial obligations
3. Achieve a reasonable yield on the City’s investment portfolio

The City’s Administrative Services Department (ASD) is responsible for cash management and investment activities. The Assistant Director of ASD who is authorized to make all investment transactions and responsible for managing the investment program oversees the activities while the Manager of Treasury, Debt, Investment (Manager) performs the day-to-day responsibilities, including purchasing and selling securities, recording investment transactions, maintaining the cash flow forecast, revenue analysis, and revenue projection spreadsheets.

The Note 3 in the City’s Annual Comprehensive Financial Report (ACFR) as of June 30, 2022, shows that cash and investments available for operations were \$553M as shown in Table 1:

Table 1 – Cash and Investment Classification (in thousands)

	Governmental Activities	Business-Type Activities	Fiduciary Funds	Total
Cash and investments:				
Available for operations	\$ 311,653	\$ 238,002	\$ 3,324	\$ 552,979
With fiscal agents and trustees	89,071	3,340	2,712	95,123
Total cash and investments	<u>\$ 400,724</u>	<u>\$ 241,342</u>	<u>\$ 6,036</u>	<u>\$ 648,102</u>

Source: page 64, Note 3, City of Palo Alto FY2022 Annual Comprehensive Financial Report

¹ Section 53600.3: https://leginfo.ca.gov/faces/codes_displaySection.xhtml?sectionNum=53600.3.&lawCode=GOV

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The City’s investment Policy describes limitations on types, maturity periods, and amounts of investments in accordance with the Section 53601 of the California Government Code. These limitations are summarized in the Note 3 in the City’s ACFR as of June 30, 2022 (Table 2 below).

Table 2 – Investments Authorized by the Investment Policy and Debt and Trust Agreements

Authorized Investment Type	Maximum Maturity	Minimum Credit Quality	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
U.S. Government Securities	10 years (*)	N/A	No Limit	No Limit
U.S. Federal Agency Securities (C)	10 years (*)	N/A	No Limit (A)	No Limit
Certificates of Deposit	10 years (*)	N/A	20%	10% of the par value of portfolio
Bankers Acceptances	180 days (D)	N/A (D)	30%	\$5 million
Commercial Paper	270 days	A-1	15%	\$3 million (B)
Local Agency Investment Fund	N/A	N/A	No Limit	\$75 million per account
Short-Term Repurchase Agreements	1 year	N/A	No Limit	No Limit
City of Palo Alto Bonds	N/A	N/A	No Limit	No Limit
Money Market Mutual Funds	N/A	N/A (E)	No Limit	No Limit
Mutual Funds (F)	N/A	N/A	20%	10%
Negotiable Certificates of Deposit	10 years (*)	N/A	10%	\$5 million
Medium-Term Corporate Notes	5 years	AA	10%	\$5 million
Bonds of State of California Municipal Agencies & Other U.S. States	10 years (*)	AA/AA2	30%	No Limit
Supranational	5 years	AA/AA2	20%	10% of the par value of portfolio

Source: page 65, Note 3, City of Palo Alto FY2022 Annual Comprehensive Financial Report
See the footnotes at

<https://www.cityofpaloalto.org/files/assets/public/v1/administrative-services/financial-reporting/comprehensive-annual-financial-reports-cafr/current-2011-cafrs/2022-acfr-final/city-of-palo-alto-acfr-fy2022-final-secured-2.pdf>

The ASD’s goals and key performance measures in the FY2023 Adopted Operating Budget include the following investment-related goal and key performance measure:

Goal: Ensure public funds and assets are invested prudently and are well-managed.

Objectives:

- Ensure sufficient cash is always available to meet current expenditures.
- Maintain a reasonable rate of return on investments while prioritizing the safety and liquidity needs.
- Invest in sound Environmental, Social, and Governance (ESG) securities, which include green and sustainable bonds, when available and appropriate, in alignment with the Investment Policy.

Key Performance Measure:

	FY2020 Actuals	FY2021 Actual	FY2022 Estimated	FY2023 Adopted Budget
Annual percentage yield on investments	2.22%	1.72%	1.70%	1.80%

Source: page 208, City of Palo Alto FY2023 Adopted Operating Budget

The ASD submits a quarterly report to the City Council that provides the information on the City’s investment portfolio ([Appendix A](#)) as required by the Section 53646 of the California Government Code.

Scope

The OCA evaluated the processes and controls that safeguard the City's investment of pooled idle cash to which the City's Investment Policy is applied to² and tested the selected controls by reviewing a sample of investment activities between July 1, 2020, to March 26, 2023 (audit period).

Methodology

To achieve the audit objectives, the OCA performed the following procedures:

- Reviewed the pertinent laws, policies, and guidelines related to investments.
- Gathered the City's financial and management reports related to investments.
- Interviewed the appropriate individuals to understand the roles and responsibilities, processes, and controls related to investment activities.
- Judgmentally³ selected a sample of investments purchased and sold during our audit period in order to cover all three fiscal years in our audit period, all brokers used, all types of investments, and all approval workflow types.
- Reviewed supporting documents for controls performed and approvals for the selected investment activities.
- Used the California Debt and Investment Advisory Commission (CDIAC) and the Government Finance Officers Association (GFOA) as best practices.

Compliance Statement

This audit activity was conducted from March 2023 to June 2023 in accordance with generally accepted government auditing standards, except for the requirement of an external peer review⁴. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Organizational Strengths

During this audit activity, we observed that the dedicated Manager of Treasury, Debt, Investment maintained the detailed spreadsheets to monitor the cash flow forecast and keep track of the compliance with the investment restrictions. We also observed the adequate supporting documents maintained by the detail-oriented Accounting team who posts the investment transactions in the City's accounting system and reconciles the transactions.

The Office of the City Auditor greatly appreciates the support of the Treasury and Accounting Divisions of the Administrative Services Department in conducting this audit activity.

Thank you!

² The Investment Policy does not cover funds held by the California Public Employees Retirement System (CalPERS), the California Employers' Retiree Benefit Trust (CERBT), Deferred Compensation program (ICMA, Hartford), the Authority for California Cities Excess Liability (ACCEL), and the Public Agency Retirement Services (PARS) Section 115 IRREVOCABLE Trust.

³ Judgmental sampling is a non-statistical sampling that involves selecting a sample based on auditors' experience, knowledge, and professional judgment and is appropriate when auditors do not need to draw conclusions about the population.

⁴ Government auditing standards require an external peer review at least once every three (3) years. The last peer review of the Palo Alto Office of the City Auditor was conducted in 2017. The Palo Alto City Council approved a contract from October 2020 through June 2022 with Baker Tilly US, LLP (Baker Tilly) and appointed Kyle O'Rourke, Senior Consulting Manager in Baker Tilly's Public Sector practice, as City Auditor. Given the transition in the City Audit office, a peer review was not conducted in 2020 and will be conducted after the third year of Baker Tilly's contract.

Detailed Analysis

Investment Policy

The City's Investment Policy describes the following internal controls over the City's investment activities:

Roles and Responsibilities

- The Director of ASD/Chief Financial Officer (Treasurer)
 - Must approve any sale of securities from the City's portfolio
- The Assistant Director of ASD
 - Is charged with the responsibility to manage the investment portfolio
 - Needs to approve a transfer more than total of \$10 million a day from the City's general account to any one financial institution
- Manager and Analyst
 - Are directed and supervised by Assistant Director of ASD
 - Prepare the quarterly report and record investment transactions (type of investment, amount, yield, and maturity)
- Custodian
 - All securities (with a few exceptions listed in the City's Investment Policy) must be delivered to the City's safekeeping custodian

List of Authorized and Prohibited Investments

- The investments authorized by Section 53601 of California Government Code are reflected in the City's Investment Policy

List of Authorized Brokers and Dealers

- Brokers and dealers meeting the City's two requirements must be approved by the Assistant Director before they are added to the City's List of Authorized Brokers and Dealers
- Brokers and Dealers will be removed from the list if a history of problems is developed

Reporting

- On a monthly basis, the ASD reviews performance against the City's Investment Policy
- On a quarterly basis, the ASD reports investment activities, including the portfolio's performance and compliance with the City's Investment Policy to the City Council, as well as a detailed list of all securities and the City's ability to meet expenditure requirements over the next six months

Policy Review

- Annually, the ASD presents a proposed investment policy to the City Council during the annual budget process

The [Appendix B](#) is the flowchart showing the current processes and controls in place.

Best Practices and Benchmarking

The California Debt and Investment Advisory Commission (CDIAC) provides guidance to local governments in California to improve the public finance practice. The CDIAC's publication, *Local Agency Investment Guidelines*⁵, includes the following recommendations.

The Annual Investment Policy

Although the California Government Code does not specify the elements of an investment policy for local governments other than counties, it should include at least the following elements required of counties:

- List of authorized investments with percentages by type of security and the maximum terms
- The manner of calculating and apportioning the authorized costs of investing, etc.
- Limits on the receipt of honoraria, gifts, and gratuities
- Criteria for selecting brokers and dealers
- A requirement that the treasurer provide an investment report

Reporting

The treasurer or designated official should provide the local government's legislative body a quarterly investment report that provides the status of the current investment portfolio. The quarterly investment report should include the following:

- A listing of individual securities held at the end of the reporting period by authorized investment category
- Average life and final maturity of all investments listed
- Coupon, discount, or earnings rate
- Par value, amortized book value and market value
- Percentage of the portfolio represented by each investment category
- A description of the funds, investments, and programs managed by contracted parties
- A statement of compliance with the investment policy or an explanation for non-compliance
- A statement of the local agency's ability to meet its pool's expenditure requirements for the next six months

In addition to a quarterly investment report required by California Government Code 53646, the treasurer should submit a monthly report of investment transactions to the legislative body even though the California Government Code 53607 does not specify the contents of the monthly report of transactions.

Treasury Oversight Committee

Local governments should consider whether an oversight committee is appropriate. Some cities⁶ have treasury oversight committees even though the law does not require them to have such a committee. The more discretion the

⁵ <https://www.treasurer.ca.gov/cdiac/LAIG/guideline.pdf>

⁶ For example, the Investment Advisory Committee is mentioned in the investment policies of City of San Diego and City of Burbank; The Investment Committee is mentioned in the investment policies of City of Riverside and City of Beverly Hills.

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treasurer has in making investment decisions, the greater the need for oversight procedures. The role of the oversight committee should be clearly specified.

The Government Finance Officers Association (GFOA) Investment Policy Best Practices recommends that the investment policy include the following elements⁷:

- A. Scope and investment objectives
- B. Roles, responsibilities, and standards of care – *“Standards of care should include language on prudence..... due diligence, ethics and conflicts of interest, delegation and authority, and knowledge and qualifications.”*
- C. Suitable and authorized investments
- D. Investment diversification
- E. Safekeeping, custody, and internal controls – *“Develop guidelines to enhance the separation of duties and reduce the risk of fraud.”*
- F. Authorized financial institutions, depositories, and broker/dealers – See the additional information provided by the GFOA below.
- G. Risks and performance standards
- H. Reporting and disclosure standards

The GFOA provides recommendations pertaining to selecting securities dealers for an approved vendor list in its website⁸ and includes the following in its Sample Investment Policy⁹:

“All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply the following as appropriate:

- *Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines*
- *Proof of Financial Industry Regulatory Authority (FINRA) certification (not applicable to Certificate of Deposit counterparties)*
- *Proof of state registration*
- *Completed broker/dealer questionnaire (not applicable to Certificate of Deposit counterparties)*
- *Certification of having read and understood and agreeing to comply with the [entity's] investment policy.*
- *Evidence of adequate insurance coverage.*

An annual review of the financial condition and registration of all qualified financial institutions and broker/dealers will be conducted by the investment officer.”

The OCA compared the City’s Investment Policy as well as the investment policies of the six California cities that have relatively similar revenue amounts as the City¹⁰ to the GFOA Sample Investment Policy (using the elements A through H listed above) for the benchmarking purpose (see Table 1 below). The GFOA states that its Sample Investment Policy is presented as a model to help entities customize a

⁷ <https://www.gfoa.org/materials/investment-policy>

⁸ <https://www.gfoa.org/materials/government-relationships-with-securities-dealers>

⁹ https://gfoaorg.cdn.prismic.io/gfoaorg/76b137b8-17e3-42bd-ae9f-7f7be8be50bd_GFOA_sample_investment_policy.pdf

¹⁰ Based on the “Revenues broken down by City”, California State Controller’s Office https://cities.bythenumbers.sco.ca.gov/#!/year/2021/revenue/0/entity_name

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policy to fit their needs, constraints, and capabilities, not to supplant an existing policy.

Table 1: Comparison of Investment Policies

GFOA Recommended Elements	Investment Policy for the City of:						
	Palo Alto	Sacramento	San Diego	Riverside	Burbank	Berkeley	Beverly Hills
A. Scope & objectives	√	√	√	√	√	√	√
B. Roles & standards of care	▲ Note 1	√	√	√	√	√	√
C. Authorized investments	√	√	√	√	√	√	√
D. Investment diversification	▲ Note 2	√	▲	▲	√	√	▲
E. Safekeeping & internal controls	▲ Note 3	√	√	√	√	√	√
F. Authorized broker/dealers	▲ Note 4	▲	▲	√	√	√	√
G. Rihs & performance standards	▲ Note 5	√	√	▲	√	√	▲
H. Reporting standards	▲ Note 6	▲	▲	▲	▲	▲	√

√ = All elements are covered in the policy
 ▲ = One or more elements are not covered

Note 1: Ethics and conflicts of interest is not discussed while other cities include a section

Note 2: Although dollar and/or percentage limits on securities are listed, an overall diversification strategy/approach is not discussed.

Note 3: Although safekeeping and custody are discussed, some requirements related to "Delivery Versus Payment" and internal controls are not discussed.

Note 4: Although a list of authorized broker/dealers are maintained, the information and documentation required from them for authorization are limited.

Note 5: The benchmark(s) to be used for the portfolio performance measurement is not established.

Note 6: Two reporting requirements by California Government Code are not clearly addressed.

Audit Results

Finding 1: Segregation of duties and oversight of investment activities

The City's Administrative Services Department (ASD)'s Treasury Division includes the investment function. The day-to-day operations of the investment function are performed by the Manager of Treasury, Debt, Investment (Manager). The Assistant Director of ASD (Assistant Director) oversees the function and has delegated the responsibility for managing the investment program to the Manager and authorized him to enter into the investment within the parameters set in the City's Investment Policy. The Manager also enters the investment transactions in the City's investment management software, maintains the cash flow forecast, revenue analysis, and revenue projection spreadsheets, and executes wire transactions. At the time of this audit in FY2023, there was no Senior Management Analyst who performed any of these tasks under supervision of the Manager.

The OCA reviewed 58 out of 850 investment activities from July 1, 2020, to March 26, 2023, and noted the following:

- None of purchased investments (45 of 58 investment activities reviewed) had the evidence of approval by the Assistant Director or other authorized personnel prior to the trade dates¹¹.
- Although the Assistant Director can check the reasonableness of investment activities using cash flow spreadsheets at the time the Manager notifies the custodian bank and the Assistant Director of an investment purchase (within a day or so of a purchase), there is no evidence of a review because a response from the Assistant Director is expected only when there is a question or an issue, which did not happen for the 45 purchased investments that were reviewed (or for the remaining investments in the audit period).
- The Manager prepares the final paperwork for each purchase (Memorandum) that requires a signature by the Assistant Director for securities under five years and by both the Assistant Director and the Director of ASD for securities over five years. The memorandums for all 45 purchased investments we reviewed were signed by the required authorized personnel four to 170 days (average 65 days) after the trade dates.
- Wire transfers to the custodian bank initiated by the Manager are approved by the Assistant Director after an order to buy a security is placed. However, three of 45 purchased investments we reviewed did not have any approval because there were no outgoing wire transfers for these purchases due to settlement netting¹² that nets incoming security maturity and interest earnings against a security purchase. As an independent review of a wire transaction is the only documented review the City has formally implemented in the

¹¹ The trade date is the day a trader/investor place an order to buy or sell a security.

¹² According to the data provided by the management, during FY21, there were 18 settlement netting (totaling \$24.3M purchase settlement) that were processed without approval and, during FY22, there were 14 settlement netting (totaling \$11.6M).

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investment purchasing process, there was no independent review of these three purchased investments until the memorandums were signed 11 to 130 days (average 72 days) after the trade dates.

- The proposed sale of investments made by the Manager in July 2022 was approved by a designee of the Director of ASD on July 7, 2022. The detailed listing of the sold investments shows 13 securities totaling \$10.7M (par value) were sold with a net gain of \$3.5K on July 12, 13, and 14, 2022, which was accurately reported in a quarterly report (Investment Activity Report for the Fourth Quarter, Fiscal Year 2022). However, the approval e-mail dated July 7, 2022, from a designee of the Director of ASD listed only five of 13 securities sold. According to the Manager, changes had to be made to the approved list of proposed securities to be sold due to the daily changes in market values of securities. The Manager sent e-mails to update a designee of the Director of ASD and the Director of ASD on July 7, 8, and 13, but there was no documentation of the final approval.

Additionally, a monthly review of performance has not been performed by the ASD as described in the City's Investment Policy for many years, according to the Manager. The City does not have other oversight mechanism such as an investment advisory committee. Another reporting requirement is submission of a monthly report of investment transactions to the legislative body, which is required by Section 53607 of the California Government Code. However, this reporting requirement is not mentioned in the City's Investment Policy.

As described above, the Manager performs all tasks to manage the investment program as well as initiating wire transactions among all responsibilities of the Treasury Division. While an approval is required prior to sales of investments, formal independent reviews of investment purchase decisions prior to purchases are not in place. When the Manager is out of office, there is no backup personnel to buy/sell securities. The limited staffing of the Treasury Division and untimely authorization of investment activities cause a concern for inadequate segregation of duties in the investment function even through there are some segregations of duties: the purchased investments are required to be delivered to the City's safekeeping custodian and recorded in the City's accounting system by the Accounting team.

Segregation of duties is a key internal control that disperses responsibilities of a process to more than one individual. Without adequate segregation of duties, the City has a higher risk of not preventing and detecting errors and fraudulent transactions in a timely manner. As mitigating controls, increased monitoring and oversight of the investment function are required.

According to the Assistant Director, the efforts to assign more employees to perform some of the cash management function tasks currently performed by the Manager were initiated at the end of our fieldwork of this audit.

Recommendation The City should implement a formal process for a review and approval of investment activities by the Assistant Director and, if required, the Director

prior to placing an order to buy or sell securities. Approvals should be documented.

Additionally, the City should reassess the City's Investment Policy to ensure that the City will:

- Comply with the requirement to perform a monthly performance review described in the City's Investment Policy. The City can take this opportunity to assess the suitability of an investment advisory committee to execute a monthly performance review to ensure appropriate investment decisions are made in compliance with the laws, regulations, and the City's Investment Policy.
- Address the Section 53607 of the California Government Code that requires submission of a monthly report of investment transactions to the City Council.

Furthermore, the City should continue the efforts to adjust the staffing of the investment function to assign responsibilities to ensure adequate internal controls are in place for prevention of the loss of public funds arising from errors, imprudent actions, and fraud. The new staff members should receive adequate training and a procedure manual to perform their job responsibilities, and succession planning should be reviewed and updated for the key positions.

Management Response

Responsible Department(s): Administrative Services Department

Concurrence: Agree

Target Date: February 2024

Action Plan:

The City agrees that a formal process for review and approval of investment activities by the Assistant Director will provide oversight of investment activities and transactions. A workplan has been developed for the team and will be amended to include clear approval processes for the purchase or sale of securities in advance of the transaction, however, staff does anticipate some authority to continue to be granted for real time transactions within approved guidelines and limits. Expected implementation is targeted for January 2024.

The City concurs with the City Auditor's recommendation that a monthly informational report of investment transactions be made available to the City Council, as required by California Government Code section 53607, and will implement this practice in January 2024.

The City agrees with segregation of duties in this function will provide adequate internal controls, additional oversight, and back fill for these activities when the key staff is on leave. A workplan for this was provided in early 2023 and under the guidance of an Assistant Director, has continuously worked on transitioning certain duties to ASD's analytical staff and administrative support staff. The workplan will be reviewed and amended to ensure documented adequate training and a procedure manual

for job responsibilities is available to other ASD staff. The targeted completion and transition of these duties is targeted for February 2024.

The analyst assigned to the Treasury Division has been tasked with creating a desk manual for certain treasury tasks. While full completion of this manual is not targeted for February 2024, it is continuously being worked on as the analyst increases exposure and knowledge of treasury operations.

Finding 2: Supporting documents for investment activities

The Manager maintains the cash flow forecast and revenue projection spreadsheets to monitor the City's cash needs and make investment decisions. According to the Manager, when the City needs to purchase or sell securities, the Manager verbally communicates the City's requirements and needs to the brokers/dealers who are listed on the City's List of Authorized Brokers and Dealers (List) approved by the Assistant Director. The City's Investment Policy requires brokers and dealers to meet two conditions before they can be added to the List. The Manager reviews the information e-mailed by authorized brokers/dealers and decides a security to purchase/sell. After a purchase/sale of a security, the Manager enters the trade information in the investment management software and prepares a Memorandum that will be approved by the Assistant Director and, if necessary, the Director.

The OCA reviewed 58 out of 850 investment activities from July 1, 2020, to March 26, 2023, and noted the following:

- The printouts of the spreadsheets or the versions of the spreadsheets that supported the Manager's investment decisions for the purchased investments (45 of 58 investment activities reviewed) are not available as they were not included in the supporting documents for the wire payments or in the Memorandums.
- The General Investment Guidelines in the City's Investment Policy encourages the City to obtain three or more quotations on the purchase or sale of comparable securities¹³ and take the higher yield on purchase or higher price on sale whenever possible. However, no multiple quotations were obtained for any of the 45 purchased investments we reviewed. In the supporting documents for eight of 45 investment purchases we reviewed, a standard language "Not required to obtain three or more quotations" was included. For the remaining investment purchases we reviewed, a standard language, "No comparable security offering maturing within 30 days of the one purchased were available" was included. There were no other documents such as evaluation of securities and the information obtained from the authorized brokers and dealers to support the unavailability of a comparable security.
- The OCA verified that the brokers and dealers associated with the selected investment activities were listed in the List of Authorized

¹³ The General Investment Guidelines in the City's Investment Policy states, "This rule will not apply to new issues, which are purchased at market no more than three (3) working days before pricing, as well as to LAIF, City of Palo Alto bonds, money market accounts and mutual funds, all of which shall be evaluated separately."

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Brokers and Dealers. During our audit period, there were two changes to the List: The List dated 10/27/2020 had a new broker; The List dated 11/16/2022 also had a new broker. Both changes were approved by the Assistant Director. However, there were no supporting documents showing that new brokers and dealers met the City's criteria. Additionally, the two requirements in the City's Investment Policy do not address Section 53601.5 of the California Government Code regarding authorized brokers and dealers. Furthermore, there was no documentation showing the broker's acknowledgement of the applicable California Government Code sections and the City's Investment Policy.

Adequate supporting documents for investment decisions and transactions are important for transparency and accountability. The supporting documents provide the necessary information to demonstrate the validity, accuracy, and compliance to the approvers of the decisions and transactions and the oversight functions such as auditors and an oversight committee.

Recommendation The City's ASD should implement a procedure to assemble and maintain adequate supporting documents such as the cash flow forecast and evaluation of quotations for each investment decision and transaction to enable the approvers to review and approve them prior to purchases/sales and to allow the oversight functions to evaluate the validity, accuracy, and compliance when needed.

The City should update the City's Investment Policy to require the brokers and dealers who wish to sell and buy securities to the City to provide documentation showing their financial condition and relevant registration. The City should also require them to certify in writing that they reviewed the applicable California Government Code sections and the City's Investment Policy. An annual review should be also conducted to maintain the List of Authorized Brokers and Dealers with the recent status.

Management Response

Responsible Department(s): Administrative Services Department

Concurrence: Agree

Target Date: January and June 2024

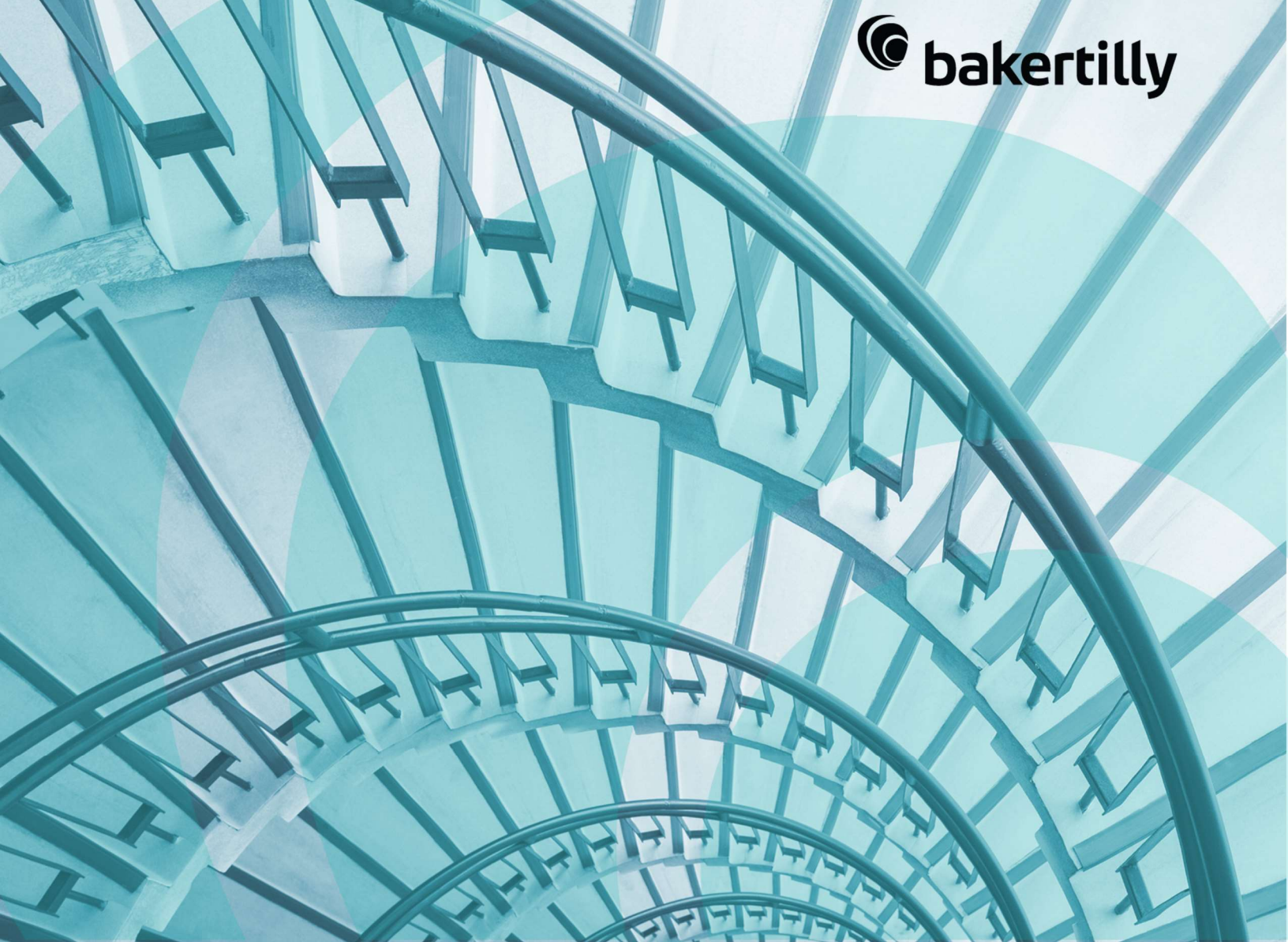
Action Plan:

The City agrees that the evaluation of investment options that are available at the time of purchase should be performed and documented before an investment is purchased. Investment offerings are received by the Manager via email and can be attached to investment paperwork as documentation. Furthermore, a workplan to formalize review and oversight of investment activities has been developed outlining expectations for routine reviews of cash flow and investment status. Expected implementation of this workplan is targeted for January 2024.

The City agrees that the Investment Policy should be updated to include the requirements that brokers and dealers who wish to buy or sell securities with the City must provide documentation of their financial condition and relevant

AUDIT RESULTS

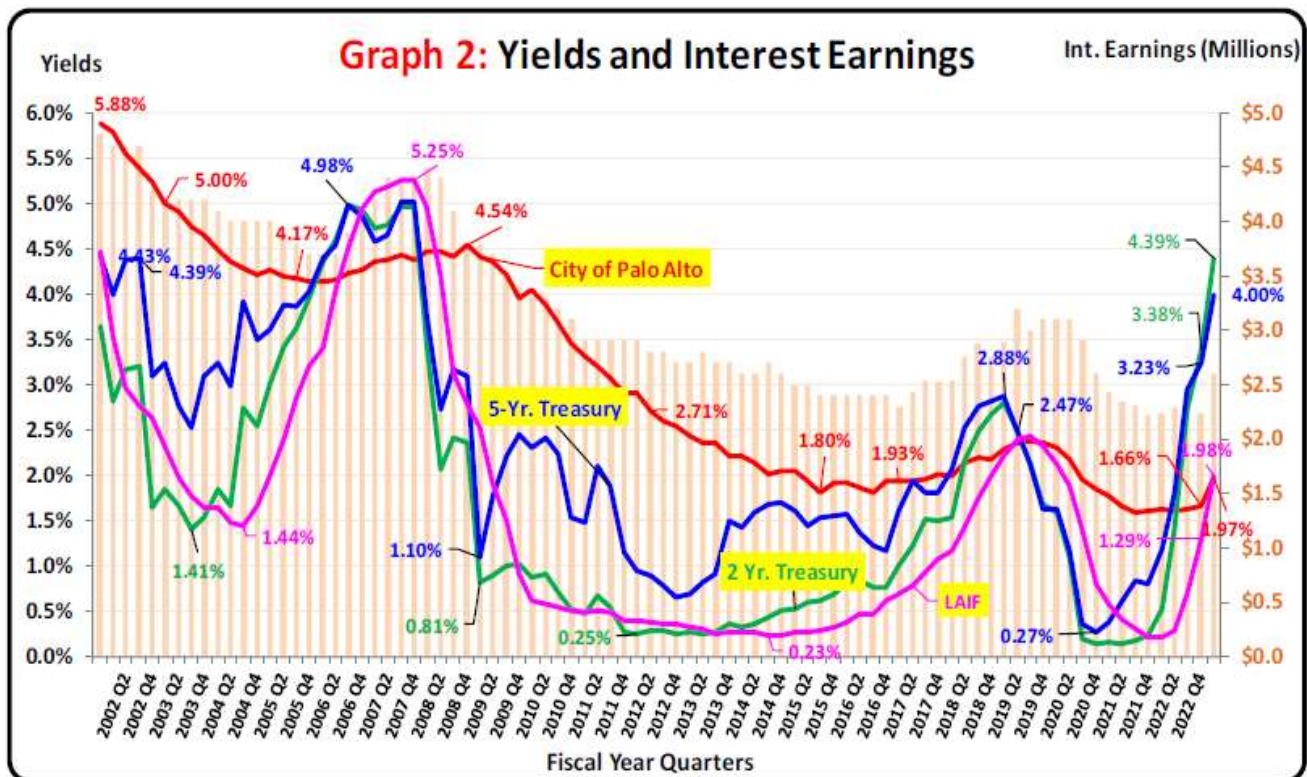
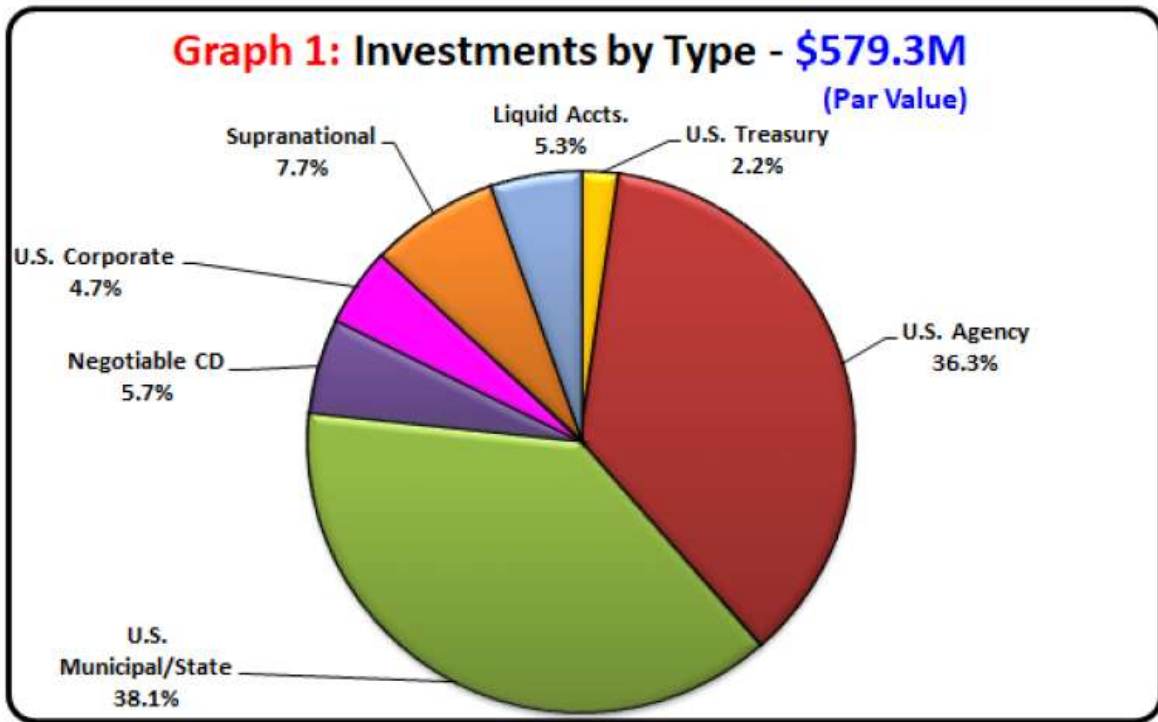
registration. ASD staff will consider these updates in the next Investment Policy review by the City Council in June 2024.



Appendices

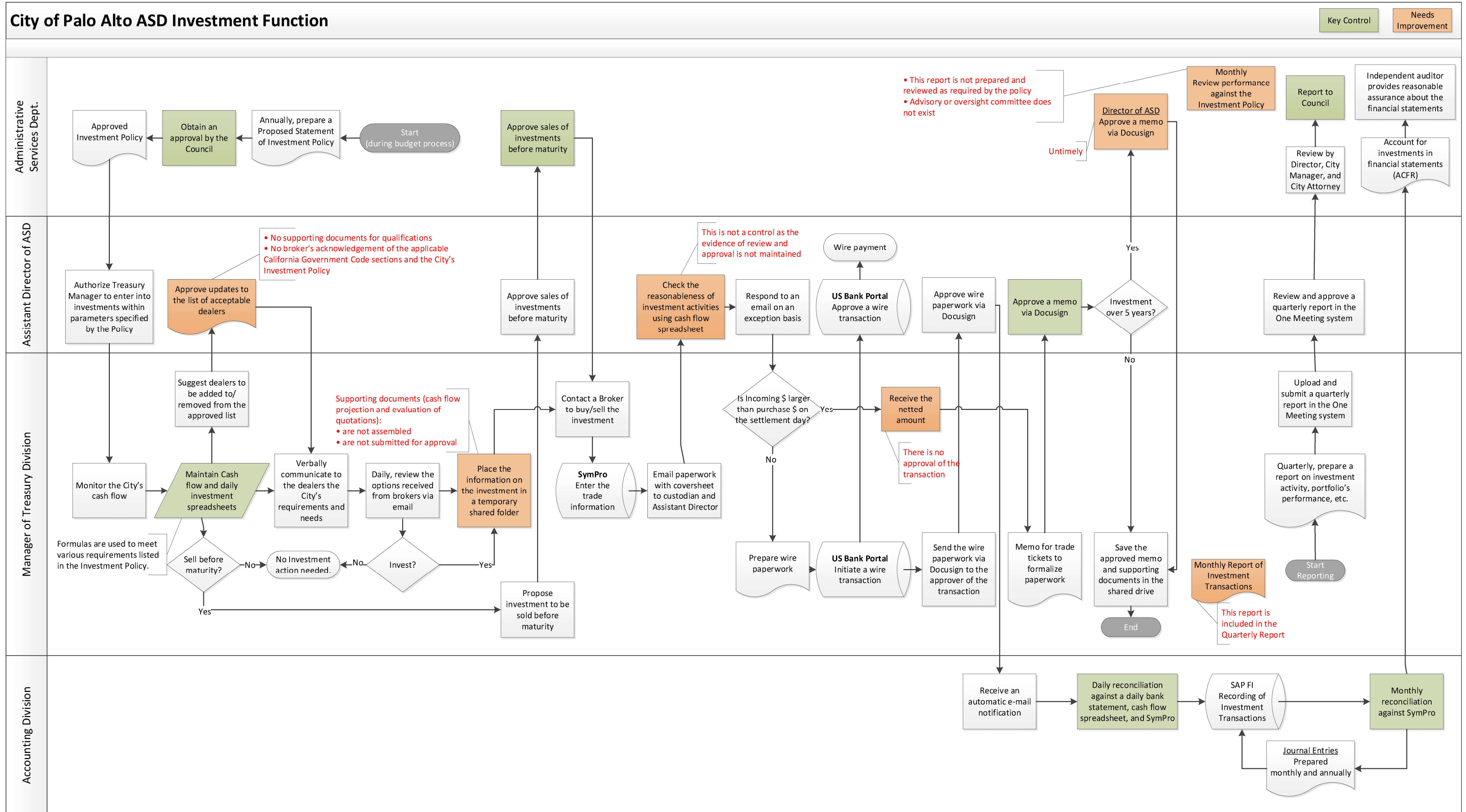
Appendix A: City of Palo Alto Investment Portfolio

The following information on the City's investment portfolio was reported in the Investment Activity Report for the Second Quarter, Fiscal Year 2023.



City's portfolio duration is 3.87 years.

Appendix B: Palo Alto Investment Management Processes and Controls



Appendix C: Management Response

Findings and Recommendation	Responsible Department(s)	Agree, Partially Agree, or Do Not Agree and Target Date and Corrective Action Plan
Fining 1: Segregation of duties and oversight of investment activities		
<p>The City should implement a formal process for a review and approval of investment activities by the Assistant Director and, if required, the Director prior to placing an order to buy or sell securities. Approvals should be documented.</p> <p>Additionally, the City should reassess the City's Investment Policy to ensure that the City will:</p> <ul style="list-style-type: none"> Comply with the requirement to perform a monthly performance review described in the City's Investment Policy. The City can take this opportunity to assess the suitability of an investment advisory committee to execute a monthly performance review to ensure appropriate investment decisions are made in compliance with the laws, regulations, and the City's Investment Policy. Address the Section 53607 of the California Government Code that requires submission of a monthly report of investment transactions to the City Council. 	Administrative Services	<p>Concurrence: Agree</p> <p>Target Date: February 2024</p> <p>Action Plan:</p> <p>The City agrees that a formal process for review and approval of investment activities by the Assistant Director will provide oversight of investment activities and transactions. A workplan has been developed for the team and will be amended to include clear approval processes for the purchase or sale of securities in advance of the transaction, however, staff does anticipate some authority to continue to be granted for real time transactions within approved guidelines and limits. Expected implementation of this is targeted to be completed in January 2024.</p> <p>The City concurs with the City Auditor's recommendation that a monthly informational report of investment transactions be made available to the City Council, as required by California Government Code section 53607.</p>
<p>The City should continue the efforts to adjust the staffing of the investment function to assign responsibilities to ensure adequate internal controls are in place for prevention of the loss of public funds arising from errors, imprudent actions, and fraud. The new staff members should receive adequate training and a procedure manual to perform their job responsibilities, and succession planning should be reviewed and updated for the key positions.</p>	Administrative Services	<p>Concurrence: Agree</p> <p>Target Date: February 2024</p> <p>Action Plan:</p> <p>The City agrees with segregation of duties in this function will provide adequate internal controls, additional oversight, and back fill for these activities when the key staff is on leave. A workplan for this was provided in early 2023 and under the guidance of an Assistant Director, has continuously worked on transitioning certain duties to ASD's analytical staff and administrative support staff. The workplan will be reviewed and amended to ensure documented adequate training and a procedure manual for job responsibilities is available to</p>

Findings and Recommendation	Responsible Department(s)	Agree, Partially Agree, or Do Not Agree and Target Date and Corrective Action Plan
		<p>other ASD staff. The targeted completion and transition of these duties is targeted for February 2024.</p> <p>The analyst assigned to the Treasury Division has been tasked with creating a desk manual for certain treasury tasks. While full completion of this manual is not targeted for February 2024, it is continuously being worked on as the analyst increases exposure and knowledge of treasury operations.</p>
Finding 2: Supporting documents for investment activities		
<p>The City's ASD should implement a procedure to assemble and maintain adequate supporting documents such as the cash flow forecast and evaluation of quotations for each investment decision and transaction to enable the approvers to review and approve them prior to purchases/sales and to allow the oversight functions to evaluate the validity, accuracy, and compliance when needed</p>	Administrative Services	<p>Concurrence: Agree</p> <p>Target Date: January 2024</p> <p>Action Plan:</p> <p>The City agrees that the evaluation of investment options that are available at the time of purchase should be performed and documented before an investment is purchased. Investment offerings are received by the Manager via email and can be attached to investment paperwork as documentation. Furthermore, a workplan to formalize review and oversight of investment activities has been developed outlining expectations for routine reviews of cash flow and investment status. Expected implementation of this workplan is targeted for January 2024.</p>
<p>The City should update the City's Investment Policy to require the brokers and dealers who wish to sell and buy securities to the City to provide documentation showing their financial condition and relevant registration. The City should also require them to certify in writing that they reviewed the applicable California Government Code sections and the City's Investment Policy. An annual review should be also conducted to maintain the List of Authorized Brokers and Dealers with the recent status.</p>	Administrative Services	<p>Concurrence: Agree</p> <p>Target Date: June 2024</p> <p>Action Plan:</p> <p>The City agrees that the Investment Policy should be updated to include the requirements that brokers and dealers who wish to buy or sell securities with the City must provide documentation of their financial condition and relevant registration. ASD staff will consider these updates in the next Investment Policy review by the City Council in June 2024.</p>