

CALIFORNIA STATE AUDITOR
BUREAU OF STATE AUDITS

February 2, 1995

94026.2

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

This letter represents our second status report on our audit of the Orange County (county) investment funds. Our first report focused on the reconciliation and verification of the assets held by the county. In our second report, we had planned to assess the short-term cash demands of the county's operational needs and the cash needed to pay interest on the county's outstanding bonds. In its most recent cash flow analysis, the county estimates that its General Fund will need approximately \$122 million by June 30, 1995, to meet its cash needs. However, until we determine the full impact of the conditions outlined below, we cannot rely on the cash flow information.

We doubt the accuracy and reliability of the county's cash flow analysis because of amounts transferred to the county's General Fund from other county funds. Specifically, in December 1994, the county transferred approximately \$282 million from various funds to the county's General Fund. Approximately \$73 million of this amount was transferred from the Teeter Plan Taxable Note Repayment Fund, whose use is restricted. We will obtain a legal opinion to determine the propriety of this transfer.

Furthermore, doubt exists regarding the accuracy and reliability of the cash flow analysis in light of the recent discovery that investment pool interest earnings have been overallocated to the county. Specifically, in late January 1995, Arthur Andersen & Co., an accounting and consulting firm, discovered that the former treasurer had been misallocating interest revenue from the investment pool to the benefit of the county and detriment of other investors. Although we have not determined the full extent of the misallocation, for February 1994 alone, the former treasurer allocated to the county more than \$10 million in interest from the investment pool that it did not earn. To determine the full impact of the misallocation, we will determine when the misallocations began and the total amount the county was overpaid. In order to develop this information, we will have to obtain access to records currently held by the Orange County District Attorney.

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Because these significant issues are unresolved and other irregularities in the county's investment portfolio have recently surfaced, we will not release a separate report on cash flows. Instead, these and other issues will be addressed in our final report, which we plan to release in March.

Sincerely,

KURT R. SJOBERG
State Auditor