




# California Debt and Investment Advisory Commission

Developing and Administering Internal Controls for Bond Accountability

September 5, 2019



CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

DEVELOPING AND ADMINISTERING  
INTERNAL CONTROLS FOR BOND  
ACCOUNTABILITY  
SEPTEMBER 5, 2019

---

---

---


---

---

---

---

---



## II Audience Polling

**Detailed Directions in Program**  
 Link: [b.Socrative.com/login/student](https://b.Socrative.com/login/student)  
 Room Name: CDIAC

**Questions**

- What type of agency do you work for?
- How many years of experience do you have administering public debt?
- What motivated you to attend this program?

2

---

---

---

---

---

---

---

---



CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

SESSION 1  
RISK ASSESSMENT FOR YOUR AGENCY –  
WHAT CAN GO WRONG?

---

---

---

---

---

---

---

---

### Learning Objectives

By the end of this session attendees will be able to:

- 1) Identify need for and objectives of internal controls.
- 2) Identify the potential risks and the likelihood that the risk will occur.
- 3) Determine the impact should the risk occur.

---

---

---

---

---

---

---

---

### Internal Controls Defined

**Internal control**, as defined by accounting and auditing, is a process for assuring of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies. It encompasses all of the policies and procedures management uses to achieve the following goals:

- Safeguard assets - well designed internal controls protect assets from accidental loss or loss from fraud.
- Ensure the reliability and integrity of financial information - Internal controls ensure that management has accurate, timely and complete information, including accounting records, in order to plan, monitor and report business operations.
- Ensure compliance - Internal controls help to ensure the University is in compliance with the many federal, state and local laws and regulations affecting the operations of our business.
- Promote efficient and effective operations - Internal controls provide an environment in which managers and staff can maximize the efficiency and effectiveness of their operations.
- Accomplishment of goals and objectives - Internal controls system provide a mechanism for management to monitor the achievement of operational goals and objectives

---

---

---

---

---

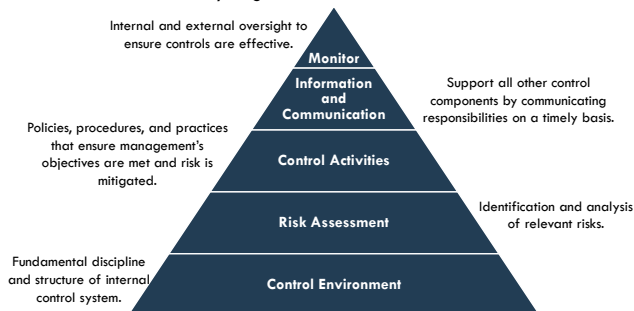
---

---

---

### Internal Controls Framework

Each agency is structured differently, but there is a general framework for analyzing internal controls:




---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

## Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

### Recent Consequences of the Lack of Effective Internal Controls

#### Misrepresent or omit financial information.

##### New Jersey – 2010

- First state charged with breaking federal securities laws.
- SEC found they misrepresented and omitted information in bond documents, preliminary official statements, official statements, and continuing disclosures.

#### Intentionally fail to disclose material information.

##### San Diego – 2010

- First time SEC fined municipal officials in a municipal bond fraud case.
- Four officials assessed fines: Former City Manager (\$25K), Comptroller (\$25K), Deputy City Manager (\$25K), Treasurer (\$5k)

#### Misuse funds.

##### Harvey, IL – 2014

- First time SEC filed an emergency court order to keep a municipality's bonds off the market.
- City allegedly siphoned bond funds for general city operations. Additionally, the City allegedly paid and did not disclose \$269,000 of bond proceeds being paid to the comptroller.

---

---

---

---

---

---

---

---

---

---

### General Considerations

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Variability of bond programs – depending on the purpose of the bond, there can be one or many programs, administering agencies, intended recipients/beneficiaries, funding sources, etc. Accordingly, there is no single set of controls/procedures that will fit every circumstance.
- Ensure adequate separation of duties – particularly risky/challenging for smaller issuers/administering agencies
- Ensure appropriate levels/layers of supervisory/ management review

---

---

---

---

---

---

---

---

---

---

### Internal Controls - Bond Lifecycle

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Program Start/Planning Phase
- Awarding of Bond Proceeds (e.g. grant awards)
- Disbursement of Bond Proceeds
- Monitoring Activities
- Reporting and Close Out Activities

---

---

---

---

---

---

---

---

---

---

CDIAC **II Audience Polling**

**Detailed Directions in Program**  
Link: [b.Socrative.com/login/student](https://b.Socrative.com/login/student)  
Room Name: CDIAC

**Question**  
What activity of the bond lifecycle are you the most interested in learning about today?

10

---

---

---

---

---

---

---

---



---

---

---

---

---

---

---

---

### Control Environment

- Organizational Integrity
- Maintain Highest Practical Credit Rating
- Timely Dissemination of Material Financial Information
- Minimize Transaction Risks
- Maintain Access to Capital Markets
- Ensuring Compliance with Legal Requirements

12

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

## Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### The Control Activity – Risk Assessment

- Pre-Issuance
  - ▣ Project Identification – Schedule, Sources and Uses of Funds, etc.
  - ▣ Requisitions Control
  - ▣ Tax Due Diligence
  - ▣ Preparation of Financing Schedule
  - ▣ Expenditure/Cash Flow Management
  - ▣ Document Preparation/Review
  - ▣ Fund Establishment

13

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### The Control Activity – Risk Assessment (cont.)

- Post-Issuance
  - ▣ Project Management
  - ▣ Fund Monitoring
  - ▣ Requisitions Approval
  - ▣ Expenditure/Payment Approval
  - ▣ Annual certifications pursuant to bond covenants
  - ▣ Annual arbitrage calculation
  - ▣ Debt Service Payments
  - ▣ Reliability of financial data

14

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### Risk Assessment: Possible Risks

- Pre-Issuance
  - ▣ Project Identification Risk Requisitions incorrect
  - ▣ Incorrect Tax Compliance Identified
  - ▣ Incomplete/Incorrect Financing Schedule
  - ▣ Incorrect Funds Established/Incorrect Disbursement Instructions
  - ▣ Restrictive Covenants in Documents not Discovered

15

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### Risk Assessment: Possible Risks

- Post-Issuance
  - ▣ Lack of Segregation of Duties
  - ▣ Missed Debt Service Payment
  - ▣ Incorrect Tax Calculations
  - ▣ Continuing Disclosures not Made
  - ▣ Record Retention
  - ▣ Fraud
  - ▣ Administrative Cost Limits Exceeded
  - ▣ Expenditures Made for Unallowable Purposes

16

---

---

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### Risk Assessment: Likelihood Criteria Scoring

Likelihood that the risk event will occur in the next year

<b>Likelihood that the event will occur in the next year</b>	<b>Very Unlikely</b> (0% - 20%)	<b>Unlikely</b> (20% - 50%)	<b>Likely</b> (50% - 80%)	<b>Very Likely</b> (80% - 100%)
	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>

17

---

---

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### Risk Assessment: Impact Criteria Scoring

Likelihood that the risk event will occur in the next year

<b>Impact on programming if risk event occurs</b>	<b>Very Limited</b> <b>1</b> <small>Very limited impact on development programming operations and outcomes. Consequences can be managed under normal operation conditions.</small>	<b>Limited</b> <b>2</b> <small>Limited impact on development programming operations and outcomes. Consequences can be managed with limited additional resources and/or managerial effort.</small>	<b>Moderate</b> <b>3</b> <small>Moderate impact on development programming operations and outcomes. Consequences can be managed with moderate additional resources and/or managerial effort.</small>	<b>High</b> <b>4</b> <small>Significant impact on development programming operations and outcomes. Senior management required to make major adjustments to plans and/or resource allocations.</small>
---	--	---	--	---

18

---

---

---

---

---

---

---

---

---

---

## Risk Assessment: Factors for Assessing Likelihood

- How the action (control) is performed and the skills of the person performing the action.
- What level of reliance can be placed on IT solutions if the processes are automated?
- Whether or not a action is preventative or detective, i.e. whether it would stop something from happening or merely detect something that has already happened.
- The frequency and timeliness of the action, e.g. daily/weekly/monthly/annually reconciliations.
- The process (reporting mechanism) for flagging errors or control failures.

---

---

---

---

---

---

---

---



With so much potential for risk, are there any tools an agency can use to meet their debt management objectives?

*Internal controls help reduce risk and prevent fraud. However, no matter how well-designed the control system, there is always a chance that a determined individual will fraudulently misuse resources. But without an internal control system, management has no reasonable assurance that this is not regularly occurring.*

---

---

---

---

---

---

---

---

## QUESTIONS

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

## Developing and Administering Internal Controls for Bond Accountability

September 5, 2019



CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### SESSION 3

DETERMINING STAFFING AND TRAINING NEEDS:  
WHO SHOULD BE INVOLVED?

---

---

---

---

---

---

---

---

### Learning Objectives

By the end of this session attendees will be able to:

- 1) Determine who should be involved in the tasks outlined in your policies and procedures.
- 2) How to ensure the segregation of duties.
- 3) The types of oversight needed.
- 4) Whether the functions can be performed in-house or must be out sourced.

23

---

---

---

---

---

---

---

---

### The Control Activities

- Identify agency/division responsible for issuance and management of debt
  - ▣ Appropriate staffing levels
  - ▣ Qualified staff
  - ▣ On-going training
- Identify roles and responsibilities of internal participants in debt management
  - ▣ Issuing agency: Public Finance
  - ▣ Sponsor department: Public Works, Recreation & Parks, Public Health, Fire, etc.
  - ▣ Account set-up: Accounting Operations and Systems Division
  - ▣ Budgeting: Budget Office and Debt Management
  - ▣ Governing Board and/or its staff

24

---

---

---

---

---

---

---

---





# California Debt and Investment Advisory Commission

Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

## The Control Activities

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Identify quantifiable measures and performance evaluation; semi-annual reporting
- Prepare a Debt Policy
  - Set specific targets for:
    - Timeliness of disclosure and noticing
    - Debt service payments
    - Turnaround time of paying invoices
    - Due diligence: frequency
    - Staff and stakeholder training
    - Credit rating management
    - Refunding Opportunities
    - IRS reporting
    - Updates to existing policies

25

---

---

---

---

---

---

---

---

## Information & Communication

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Internal Staff
  - Tone at the top critical to meaningful program
  - Train governing board members, management and staff responsible for administration and compliance
    - Make sure they have a basic understanding of the process
    - Make sure they have a thorough understanding of their role and responsibilities
  - May require documented completion of biennial debt and ethics training
  - Develop annual checklist to determine compliance obligations

26

---

---

---

---

---

---

---

---

## Information & Communication

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Internal Staff cont'd.
  - Resources for bond issuance and administration training
    - [CDIAC Seminars](#)
    - [GFOA Trainings](#)
    - [Bond Buyer Conferences](#)
    - Disclosure Counsel
    - [State of CA Ethics Training](#)
    - [CA Debt Financing Guide](#)

27

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

## Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### Information & Communication

- Internal Staff cont'd.
  - Establish fund and account structure to record and report use of proceeds
    - Tracking sources and uses of funds is critical
  - Establish process to periodically evaluate changed risks, legislative or legal actions or events requiring changes to control system
  - Ensure process in place to communicate to responsible staff changes in reporting, disclosure or other requirements

28

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### Information & Communication

- External Audiences
  - Establish accountability and level of trust with public and interested parties
  - Annual reports
    - Highlight purpose and use of proceeds
    - Provide milestones of success toward meeting objectives
    - Account for bond expenditures
    - Provide status of bond funds

29

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### Disbursement of Bond Proceeds

- Preventive Controls
  - Documentation – Segregation of Duties
    - Designate individuals with authority to initiate, submit, reconcile, view or approve different types of transactions
      - Ideally at a minimum two designees
      - Maintain signature cards and update from time to time
    - Designate a point person for processing transactions
    - Institute timely authorizations and processing of transaction
    - Conduct periodic staff-level trainings for individuals in oversight and internal control functions

30

---

---

---

---

---

---

---

---



CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### Disbursement of Bond Proceeds

- Preventive Controls
  - Format of source documents
    - Establish standard forms or templates
    - Establish internal tracking record of activities including but not limited to date, amount, payee information, tracking/transaction number
    - Establish red flag exception reporting
      - Significant errors and discrepancies
      - Payee information varies from the pre-authorized payee information

31

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### Disbursement of Bond Proceeds

- Detective/Corrective Controls
  - Accuracy of activities
    - Verify that transactions and activities are for the correct purpose and amount, and allowable
    - Verify recording of transactions in a timely manner
    - Establish consistent reconciliation processes
    - Make cash confirmations part of the post-audit and/or financial audit, prepared-by-client procedures
    - Timely preparation of annual review of process narratives and cash confirmation reporting to external auditors or internal auditors
    - Maintain proper documentation for purposes of the annual audit process by the City's external auditor pursuant to City Charter and CA Government Code.
    - Maintain proper documentation for purposes of any audit
      - IRS
      - SEC

32

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### Disbursement of Bond Proceeds

- Resolution of errors and discrepancies
  - Notify interested parties on extent of error and/or discrepancy
    - Trustee
    - Tax/Bond/Disclosure Counsel
    - EMMA
  - Establish expectations for timeliness of error correction or recovery of unallowable funds disbursed

33

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

## Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

### Training for Post Issuance Compliance

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Contract Management
- Budget Actions
- Post-Issuance Compliance
  - Tax Law Requirements
  - Disclosure Requirements
  - Bond Covenants and Agreements
- Disbursement of Bond Proceeds
- Investment of Bond Proceeds
- Facility Use Monitoring

34

---

---

---

---

---

---

---

---

### Training for Post Issuance Compliance – Contract Management

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Consultants and Service Providers
  - Establish contract procedures
  - Track payments and encumbrances
  - Contract payment process

35

---

---

---

---

---

---

---

---

### Training for Post Issuance Compliance – Budgeting for Debt Service Payments

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Annual budget actions necessary to appropriate debt service and related payments
  - Who in your organization is responsible for debt service payment activities?
  - How are reserve fund earnings treated?
  - How are you going to annually “clean out” your debt service payment funds
- Require Trustee/Fiscal Agent to send debt service invoice
- Ensure sufficient time for internal wire/check processing
- Work with investment/cash management staff, debt service critical component of any cash flow analysis

36

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

## Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

### Training for Post-Compliance – Budgeting for Variable Rate Debt

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Objective: minimize program impact by making a reasonable interest rate assumption
- Create a methodology and use consistently
- Involves a programmatic budgetary trade-offs
- Interest rate risk
  - Think about establishing a set-aside reserve
- Assume average rate in effect through next budget period and monitor throughout the budget year
- Annual debt service (principal x interest rate)+portion of principal
  - Future interest rates are unknown for variable rate debt

37

---

---

---

---

---

---

---

---

### Training for Post Issuance Compliance – Tax Law Compliance

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Tax Law Requirements
  - General Matters
  - Use of Proceeds
  - Private Activity Bonds
  - Arbitrage
  - Pool Bonds
  - Record Retention

38

---

---

---

---

---

---

---

---

### Training for Post Issuance Compliance – Disclosure Compliance

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Disclosure Requirements
  - SEC Rule 15c2-12
  - Use of EMMA mandated since July 1, 2009
  - Notification to Underwriters of Bonds
  - Info Requirements to Other Entities
  - Create universal e-mail address for reporting and noticing
  - Establish an investor website
- Miscellaneous Requirements
  - Security
  - Insurance
  - Financial Covenants
  - Transfer of Property
  - Investments
  - Derivatives

39

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

## Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

**Training for Post Issuance Compliance**  
**Bond Covenants and Agreements Compliance**

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

- ❑ For variable rate bonds include credit/liquidity provider administration
- ❑ Develop internal tickler system from beginning
- ❑ Keep up-to-date
- ❑ Don't reinvent the wheel with every deal; similar reporting requirements are okay and always preferred
- ❑ Keep it simple and consistent as possible

40

---

---

---

---

---

---

---

---

**Training for Post Issuance Compliance –**  
**Disbursement of Bond Proceeds**

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

- ❑ Establish Procedures for Disbursement of Bond Proceeds and Train Staff
  - ❑ Project staff
  - ❑ Finance staff
- ❑ Understand eligible expenditures
  - ❑ Working capital limits
  - ❑ Private Activity limits/restrictions
  - ❑ Use of proceeds
  - ❑ Develop procedures for allocation expenditures of bond proceeds to Projects
- ❑ Bond Project Monitoring

41

---

---

---

---

---

---

---

---

**Training for Post Issuance Compliance –**  
**Investment of Bond Proceeds**

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

- ❑ Principals of good investment management and understanding of inherent risks in investing bond proceeds critical
  - ❑ Establish good guidelines for permitted investments to reduce credit risk – **SAFETY**
  - ❑ Good cash flow estimates mitigate market risk – **LIQUIDITY**
  - ❑ Integration of knowledge of expected and future market conditions with other cash flows to reduce opportunity risk – **YIELD**
  - ❑ Mirror your existing investment policy or modify it

42

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

## Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

### Training for Post Issuance Compliance – Investment of Bond Proceeds

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Initial investment – generally "easier part"
  - ▣ Project cash flows
  - ▣ Capitalized Interest
  - ▣ Debt Service Reserve Fund
  - ▣ Cost of Issuance
- Reinvestment – generally "really hard part"
  - ▣ Develop process to monitor and make reinvestment decisions
  - ▣ Use of cash flow expectations v. reality
  - ▣ Does the cash flow pass the smell test

43

---

---

---

---

---

---

---

---

---

---

### Training for Post Issuance Compliance – Facility/Project Use

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Maintain records of facility use
  - ▣ Follow Record Retention Requirements
- Review all agreements for facility use
  - ▣ Potential impact on tax-exemption
- Everything must be reviewed by bond/tax counsel
  - ▣ Solar panels on roof top or cellular phone receiver on roof top could negatively impact tax-exemption
  - ▣ Operator Agreements for facilities can also impact tax-exemption

44

---

---

---

---

---

---

---

---

---

---

# QUESTIONS

45

---

---

---

---

---


---

---

---

---

---



Session 2

---

DEBT ISSUANCE BEST PRACTICES

46

---

---

---

---

---

---

---

---

---

---

Bay Area Toll Authority Best Practices

---

- o Debt Policy
- o Disclosure Policies and Procedures
- o Post-Issuance Responsibilities
- o Project Monitoring
- o Reporting Ticker System
- o Ongoing Administrative Responsibilities
- o BATA Debt Outstanding

47

---

---

---

---

---

---

---

---

---

---

Debt Policy

---

- o Conforming to the mission of the agency
- o Debt issuance guidelines
  - o Managing risk – credit ratings
  - o Covenants
- o Financing plan
- o Continuing disclosure requirements
  - o SEC Rule 15c2-12
  - o Arbitrage & Rebate
  - o EMMA postings
  - o Dodd-Frank compliance (for derivatives)
  - o CDIAC Reports
- o Internal controls
- o Administration of debt service

48

---

---

---

---

---

---

---

---

---

---



## Disclosure Procedures

- Identify types of disclosures
- Who is responsible for providing disclosures
- Process of submitting each type of disclosure
- Management review to ensure compliance
- Continued training and professional development

---

---

---

---

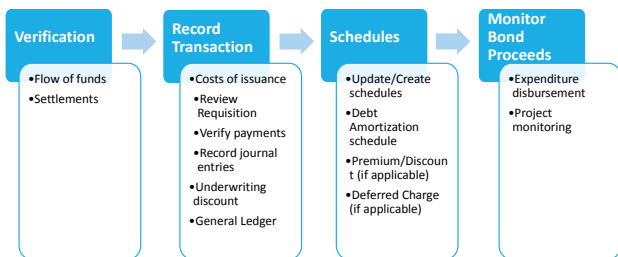
---

---

---

---

## Post-Issuance Responsibilities




---

---

---

---

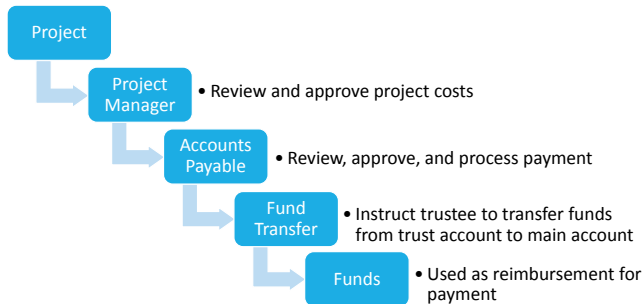
---

---

---

---

## Project Monitoring




---

---

---

---

---

---

---

---

### Reporting Tickler System

- EMMA – Credit Monitoring
- Outlook Calendar
- Excel
  - List of important due dates

---

---

---

---

---

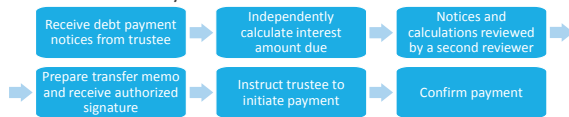
---

---

---

### Ongoing Administrative Responsibilities

#### ○ Debt Service Payments



- Reconciliation
  - Payments to Bank and General Ledger
- Fees & Expenses
  - Arbitrage, trustee, ratings, etc.
- Accounting/Audit
  - Ensure transactions are recorded accurately and in a timely manner
  - Audit trail with supporting documentation
- Staffing
  - Understanding of debt
  - Familiar with financial reporting, accounting, and audit

---

---

---

---

---

---

---

---

### BATA Debt Outstanding

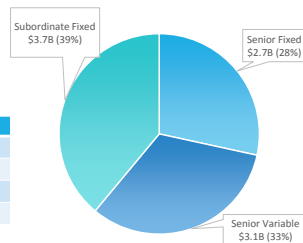
○ BATA's \$9.5 billion of bonds are diversified by lien and type

#### ○ Breakdown by lien and type:

- Senior Lien Bonds - \$5.8 billion (61%)
  - Fixed Rate - \$2.7 billion
  - Variable Rate - \$3.1 billion

BATA Variable Rate Composition	
Variable Rate Demand Bonds (VRDB)	\$400 mm
Index Rate Bonds tied to SIFMA Swap Index	\$971 mm
Index Rate Bonds tied to 70% of 3-month LIBOR	\$156.8 mm
Term Rate Bonds (2022-2027)	\$1.56 b

- Subordinate Lien Fixed Rate Bonds - \$3.7 billion (39%)




---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

ASSOCIATION OF BAY AREA GOVERNMENTS  
 ABAG Finance Authority for Nonprofit Corporations



ABAG

55

---

---

---

---

---

---

---

---

Conduit Issuer

- What is a Conduit Issuer?
- Role of Conduit Issuer
- Conduit Financing Transaction Types
- Risks and Responsibilities
- Continuing Compliance Monitoring
- Fraud Prevention

56

---

---

---

---

---

---

---

---

What is a conduit issuer?

- A conduit issuer is a government agency, usually a joint powers authority (JPA) that issues municipal securities to raise capital for revenue-generating projects where the funds generated are used by a third party (known as the "conduit borrower").
- The conduit financing is typically backed by a combination of the conduit borrower's credit or funds pledged toward the project by outside investors.
- If a project fails, and the security goes into default, the conduit borrower is responsible for all debt service payments

57

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

## Role of Conduit Issuer

- The role of the conduit issuer is to provide access to the market.
- Provides access to tax exempt bond market
- Lowers cost of financing
- Monitor financing activity
- Monitor affordable housing compliance

A conduit issuer is not obligated to make debt service payments on the bonds.

58

---

---

---

---

---

---

---

---

## Conduit Financing Transaction Types

- Health Care facilities
- Private elementary and secondary schools
- Private higher education facilities
- Multifamily rental housing
- Solid waste disposal facilities
- Local furnishing of gas, electricity, and infrastructure
- Certain renewable energy and green technology projects

Conduit Issuer provides access for non-profit entities who would otherwise not have access to low cost tax exempt capital financing.

59

---

---

---

---

---

---

---

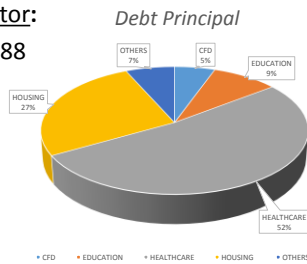
---

## ABAG FAN Portfolio Breakdown

Total Outstanding Debt—Approx. \$2 billion

### Portfolio Breakdown by Sector:

- Healthcare - \$1,008,381,288
- Housing - \$513,678,509
- Education - \$174,824,967
- Communities Facilities Districts - \$106,345,000
- Other Transactions - \$128,706,220
- Total 103 Transactions



60

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

## Borrower Disclosure Obligations

- Audited Financial Statements
- Annual Report of the conduit borrower
- Material Event Notices
- Filing Post Issuance Disclosure
- SEC Rule 15c2-12
- EMMA submission
- IRS Compliance

61

---

---

---

---

---

---

---

---

## Issuer Disclosure Obligations

- Official Statement
- Continuing Disclosure Agreement
- Continuing Program Compliance Monitoring
- Project Status Reports/Certificates of Compliance
- Annual Audit

62

---

---

---

---

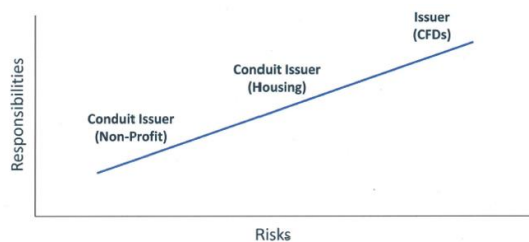
---

---

---

---

## Risks and Responsibilities



Category	Financial Liability	Continuing Disclosure	Regulatory Requirements	Ongoing Monitoring
Conduit Issuer (Non-Profit)				
Conduit Issuer (Housing)			✓	✓
Issuer (CFDs)	✓	✓	✓	✓

63

---

---

---

---

---

---

---

---

### Developing Policies Procedures

- Overall Risk Assessment for Bond Fund Accountability
- Develop Policies, Procedures, and Practices to mitigate risk
- Roles and responsibilities of agency staff for the administration of bond funds before, during, and after issuance
- Internal Controls
- Post Issuance Responsibilities
- Continuing Compliance Responsibilities

64

---

---

---

---

---

---

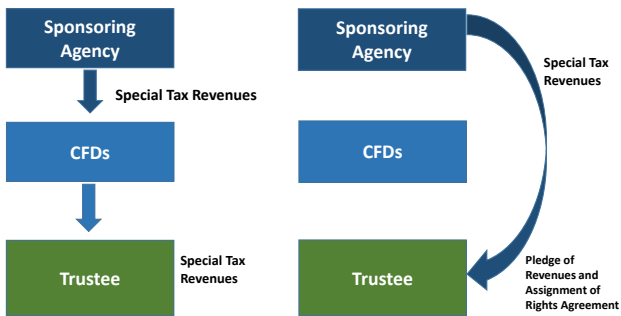
---

---

---

---

### Communities Facilities Districts Flow of Funds



The Communities Facilities Districts (CFD) Flow of Funds is the key to maintaining internal controls. Having funds flow directly to the trustee maintains fiduciary responsibility of the issuer.<sup>65</sup>

---

---

---

---

---

---

---

---

---

---

### Fraud



---

---

---

---

---

---

---

---

---

---



Questions ?

67

---

---

---


---

---

---

---

---



CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

**SESSION 4**  
ONGOING MONITORING AND OVERSIGHT:  
WHEN TO REVIEW AND UPDATE PRACTICES AND PROCEDURES?

---

---

---

---

---

---

---

---

### Learning Objectives

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

During this session we will discuss:

- 1) Who should be involved in the oversight – internal or external.
- 2) Should the audit function be internal or external.
- 3) How often is refresher training needed.

69

---

---

---

---

---

---

---

---



**II Audience Polling**

**Detailed Directions in Program**  
 Link: [b.Socrative.com/login/student](https://b.Socrative.com/login/student)  
 Room Name: CDIAC

**Questions**

- Does your agency have an Oversight Committee?
- Who makes up your Oversight Committee?
- If you attend Oversight Committee Meetings, what is your role?

70

---

---

---

---

---

---

---

---

**Oversight Bodies/Committees**

- Identify oversight bodies/committees
  - Governing Boards or Councils – elected or appointed
    - Oversight and approval
    - Bond Accountability Reporting
  - Capital/Facilities Planning Committee
    - Responsible for planning and project approval
    - Review of financing needs and establishment of budget for capital improvements
    - Ongoing project status updates
  - Best practices may include
    - Pre-issuance accountability reporting
    - Quarterly reporting of bond programs on issuances and spending
    - Citizens Oversight Committee
  - Commissions and other Oversight Agencies
    - Legislative and statutory approval and oversight

71

---

---

---

---

---

---

---

---

**Bond Program Information**

- To be effective, information needs to be reliable and timely
- Options for Dissemination of Information
  - Presentation at governing body meeting
  - Posting on dedicated website
    - Creatively display bond program accomplishments
    - Establish deadlines for periodic reporting and updating
    - Be cognizant of securities laws governing disclosure
    - Example: <https://www.lbcc.edu/facilities-maintenance>
  - Electronic delivery of FAQ's focused on bond program information

72

---

---

---

---

---

---

---

---





### Appropriate Use of Bond Proceeds

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Provide reasonable assurance bond proceeds used for legal and intended purposes
- Provide reasonable assurance bond funds are properly accounted for, managed and safeguarded
- Perform annual audits designed to ensure compliance with legal requirements, best practices and internal controls
- Monitoring of conduit financings requires testing of control functions of the conduit borrower

73

---

---

---

---

---

---

---

---

### Whistleblower or Fraud Hotlines

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Establish Whistleblower or Fraud Hotlines
  - ▣ Website or Telephonic
  - ▣ Anonymous tips provide another layer of oversight
  - ▣ Example: WeTip - [https://wetip.com/?option=com\\_wrapper&view=wrapper&Itemid=159](https://wetip.com/?option=com_wrapper&view=wrapper&Itemid=159)
- Monitoring of conduit financings should include provision of whistleblower or fraud hotlines for the conduit borrower

74

---

---

---

---

---

---

---

---

### Bond Oversight Committees

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Voter approved bond measures frequently include “bond oversight committees”
  - ▣ Citizen oversight
  - ▣ Roles and responsibilities often left to local agency to define after bond sale
  - ▣ Prop. 39 GO Bonds for K-14 Districts require citizens oversight committees

75

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

## Prop. 39 COC Required Representatives

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- ❑ Business organization
- ❑ Taxpayers organization
- ❑ Senior citizens organization
- ❑ Parents and Guardians at K-12 district
- ❑ Student at a community college district
- ❑ Parents active in support of the District, e.g., a member of the PTA or school site council
- ❑ Cannot include an employee, vendor, contractor or consultant of district

76

---

---

---

---

---

---

---

---

---

---

## II Audience Polling

CDIAC

### Detailed Directions in Program

Link: [b.Socrative.com/login/student](https://b.Socrative.com/login/student)

Room Name: CDIAC

### Questions

Does your agency conduct annual audits?  
 What types of audits of your bond program does your agency conduct?

77

---

---

---

---

---

---

---

---

---

---

## Annual Financial Audit

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- ❑ Annual Independent Financial Audit
- ❑ Specific Independent Financial Audit and report of the bond expenditures
- ❑ Citizen's Oversight Committee review of Annual Independent Audit and expenditure/delivery of public projects/facilities

78

---

---

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

## Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

### Policies and Procedures

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Continual Review
- Updates to Policies and Procedures necessary to reflect changes in federal and state law
- Updates to reflect changes in internal processes and procedures
- Documentation critical in era where
  - Constrained staffing resources
  - Staff organizational tenure declining
- Institutional memory needs to and must be documented!

79

---

---

---

---

---

---

---

---

### Internal Audit

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Why Audit?
  - An internal audit plays an important role in helping management to maintain a comprehensive framework of internal controls.
  - An internal audit is defined by the International Institute of Auditors as an: Independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

80

---

---

---

---

---

---

---

---

### Auditing the Internal Controls

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- Periodic review of internal controls
- On going monitoring of the effectiveness of internal control
- Effective information and communication
- Frequent evaluation that internal controls are performed
- Mandatory staff training

81

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

## Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

### Audit Committee

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- The audit committee should:
  - ▣ Provide oversight over the government's system of internal controls;
  - ▣ Monitor controls performed directly by senior management as well as controls designed to prevent or detect senior management override of other controls;
  - ▣ Be formally established by charter, enabling resolution, or other appropriate legal means; and
  - ▣ Be directly responsible for the appointment, compensation, retention and oversight of the work of any independent accountants.

82

---

---

---

---

---

---

---

---

---

---

### Audit Committee - Continued

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

- The audit committee should:
  - ▣ Have access to the services of at least one financial expert;
  - ▣ May have access to internal auditor reports and annual internal audit work plans;
  - ▣ Present annually to the full governing body;
  - ▣ Establish procedures for the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters; and
  - ▣ Be able to meet privately with the independent auditors, as needed.

83

---

---

---

---

---

---

---

---

---

---

## QUESTIONS

84

---

---

---

---

---

---

---

---

---

---



# California Debt and Investment Advisory Commission

## Developing and Administering Internal Controls for Bond Accountability

September 5, 2019

CDIAC  
CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

**SESSION 5**  
USING THE CHECKLISTS:  
WHY THIS IS AN IMPORTANT TOOL?

---

---

---

---

---

---

---

---

**The Checklists**

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

- Debt Issuance and Management Review Checklist
  - Agency's General Debt Profile
  - Use of Bond Proceeds
  - Covenants
- Internal Control Checklist for Bond Requirements
  - Control Environment
  - Risk Assessment
  - Control Activities
  - Information and Communications
  - Monitoring

86

---

---

---

---

---

---

---

---

**The Debt Issuance and Management Review Checklist**

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

- Agency's General Debt Profile
  - Maintain a complete inventory of outstanding debt
  - Identify and review bond covenants
  - Meeting the terms of underlying documents
  - Debt service payments have been incorporated into annual budget
- Use of Bond Proceeds
  - Describe proposed use of the bond proceeds
  - Identify source(s) of repayment
  - Confirm proposed uses of bond funds are included in budget
  - Confirm proposed uses of bond funds are in conformity with bond documents
  - Confirm agency follows GAAP/GASB
  - Maintain detail timelines

87

---

---

---

---

---

---

---

---



**The Debt Issuance and Management Review Checklist**

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

- Use of Bond Proceeds (Cont.)
  - Establish and maintain expenditure schedules
  - Establish a system to track expenditures
  - Establish and follow procedures for disbursements
  - Monitor expenditures for conformity/compliance with bond documents
  - Track progress of projects
  - Regularly review and validate trustee reports
  - If voter approved, certify that the project is in conformity with voter authorization
  - Complete and file tax certificate
  - Identify information to be reported
  - Confirm website contains current debt information

88

---

---

---

---

---

---

---

---

---

---

**The Debt Issuance and Management Review Checklist**

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

- Use of Bond Proceeds (Cont.)
  - Establish procedures to assure proper custody and security of investments/proceeds
  - Establish and maintain a record retention system for related bond documents
  - Regularly monitor the investment of bond proceeds in conformity with the bond documents and state law
  - Regularly schedule audits
  - Prepare reports for the governing board/oversight committee as required
  - Report to trustee, rating agencies, bond insurer, and/or credit enhancer as required
  - Report to trustee, rating agency(ies), bond insurer, and/or credit enhancer

89

---

---

---

---

---

---

---

---

---

---

**The Debt Issuance and Management Review Checklist**

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

- Covenants
  - Complete and file tax certificate
  - Identify information required to comply with CDA
  - Review and update debt information on agency's website
  - If there is a safekeeping requirement in controlling bond documents, establish procedures to assure property custody and security
  - Establish record retention system for bond financing documents
  - Monitor investment of bond proceeds
  - Regularly schedule audits
  - Prepare reports for the governing board and/or oversight committee

90

---

---

---

---

---

---

---

---

---

---



CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### The Internal Control System Checklist

- Control Environment
  - Is there a designated compliance officer
  - Has compliance officer and team participated in training
  - Do you have an inventory of outstanding bonds
  - Do you have written procedures for bond administration
  - Have you adopted a debt policy
  - Is there an audit committee to review compliance
- Risk Assessment
  - Clearly define objectives of the bond administration program
  - Include a summary of these objectives in your debt policy
  - Establish performance measurements to monitor how successfully the agency achieves its objectives
  - Establish risk tolerance relative to each of the objectives of the bond administration program
  - Identify and analyze risks (i.e., not all risks are equal)

91

---

---

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### The Internal Control System Checklist

- Control Activities
  - Same effort should be applied to bond expenditures as it is to other aspects of the organization
  - Regularly review and update inventory of outstanding bonds and related requirements
  - Review and update bond administration procedures
  - Review and update as appropriate your debt policy on an annual basis
  - Confirm compliance with policies, covenants and bond administration procedures
  - Confirm legal requirements of debt sales are met
  - Confirm compliance with financial covenants and other restrictions
  - Confirm compliance with oversight requirements for bond administration activities
  - Confirm compliance with agency records retention policy and procedures
  - Confirm compliance with tax certificate covenants
  - Confirm compliance with continuing disclosure agreement covenants

92

---

---

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

### The Internal Control System Checklist

- Information and Communications
  - Establish process to alert personnel of changes in policies and procedures
  - Establish formal structure of communication within the organization based upon roles and responsibilities
  - Establish ongoing training
- Monitoring
  - Perform period review of bond activities and report results to the governing body
  - Complete Internal Control Checklist and report findings to management

93

---

---

---

---

---

---

---

---

---

---



CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

---

# QUESTIONS

94

---

---

---

---

---

---

---

---

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

## Closing Remarks

---

### Upcoming CDIAC Programs

Details Online: [Treasurer.ca.gov/CDIAC/Seminars](http://Treasurer.ca.gov/CDIAC/Seminars)

**Webinars**

**Green Bonds in the Golden State:**  
**A Practical Path for Issuers**

Free three-part webinar series on fundamental concepts, integrating green finance into projects and policies, and the status of green bonds in the municipal market.

10:00 AM to 12:00 PM on:

August 14, 2019 ✓

September 19, 2019

October 2, 2019

More information on [treasurer.ca.gov/CDIAC/Seminars](http://treasurer.ca.gov/CDIAC/Seminars)

**Seminars**

Bond Buyer Pre-Conference	September 23	San Francisco
Municipal Market Disclosure	October 30	Irvine
Public Funds Investing Workshop	November 19, 20	West Sacramento

95

---

---

---

---

---

---

---

---