

# 2022 Local Government Training Conference

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## Legal Compliance Update

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# Compliance Manual Changes

- ▶ In the “Depositories of Public Funds and Public Investment” sections of the Cities, Towns, Counties, Volunteer Firefighting Relief Associations and Other Political Subdivisions Audit Guides, the following question was added:
- ▶ “If the [Public entity] used a sweep account, did the timing of the sweep take place so that all amounts on deposit at the end of the banking day were protected by deposit insurance, bond or pledged collateral?”
- ▶ Changes found on Page 1-5 of the Cities, Towns, Counties, and Other Political Subdivisions sections and Page 2-4 in the VFRA section.

# Sweep Accounts

- ▶ Various types of sweeps
- ▶ Can be Internal or External sweeps.
- ▶ If External, the sweep or transfer must take place before or contemporaneously with the end of the banking day.
  - ▶ Required by Minn. Stat. § 118A.03, Subd. 3, any amount on deposit in excess of deposit insurance at the end of the banking must have 110% of the uninsured amount collateralized.
  - ▶ If not transferred custodial credit risk present. See Comprehensive Implementation Guide Q&A 1.30.17

# Sweep Accounts

- ▶ How can one determine when the sweep occurs?
- ▶ Check sweep account agreement
- ▶ Check when funds received by outside entity

# Sweep Accounts

- ▶ Internal sweeps
- ▶ If the sweep involves an investment all of the requirements for public investing apply:
  - ▶ Only permissible investments can be purchased in the sweep
  - ▶ Broker Certification must be signed
  - ▶ Broker defined as any broker or “agent of a government entity, who transfers, purchases, sells, or obtains securities for or on behalf of a government entity.
  - ▶ If by agreement the bank can only obtain a specific permissible investment for the depositor, that agreement may be sufficient for broker certification.

# Sweep Accounts

- ▶ **Safekeeping Acknowledgement** -Bank must provide acknowledgement required by Minn. Stat. § 118A.06 (b) which states :

“The government entity's ownership of all securities under paragraph (a) must be evidenced by written acknowledgments identifying the securities by the names of the issuers, maturity dates, interest rates, CUSIP number, or other distinguishing marks.”

Key is that the acknowledgement must sufficiently identify the security.

# Sweep Accounts

- ▶ Conclusion:
- ▶ For External sweeps make sure the funds leave the bank before or contemporaneously with the end of the banking day.
- ▶ For Internal sweeps that involve investments, make sure all of the statutory investment requirements are fulfilled including permissibility (118A.04 and .05), safekeeping (118A.06), and broker certification form (118A.04, Subd. 9). Further, if the counterparty (bank) is holding the security, custodial credit risk may be present.

# Gift Cards

- ▶ Legal Issues arise from statutory authority and restrictions on:
  - ▶ 1) How public funds are disbursed
  - ▶ 2) Purposes for which public funds are disbursed

# Gift Cards

- ▶ When a public entity purchases a gift card it is not disbursing public funds. This is true because the gift card is a cash equivalent and the public entity is retaining possession of the gift card. It is only when the gift card is transferred to a third party that the disbursement of public funds occurs.

# Gift Cards

- ▶ Cities, counties and towns are authorized to disburse public funds in only the following ways:
- ▶ Negotiable instruments including checks, warrants, orders (Minn. Stat. §§ 412.271, Subd. 1, 384.13, 385.31, and 367.18)
- ▶ Imprest funds (Minn. Stat. §412.271, Subd. 5, 375.162, and 366.01, Subd. 12, ), and
- ▶ Electronic or wire funds transfer (Minn. Stat. §§ 471.38 and 471.381).

# Gift Cards

- ▶ Note that cities, counties and towns are also authorized to use credit cards to make purchases. Minn. Stat. §§ 471.382 and 375.171 However, presenting a credit card at the point of sale does not cause the disbursement of public funds. That occurs only after the credit card company presents its bill as a claim and that claim is processed and approved by the government entity.

# Gift Cards

- ▶ We have not been able to identify a statute that would authorize cities, counties or towns to disburse public funds using gift certificates.

# Gift Cards

- ▶ Further, for many public entities, public funds must be in the custody of the treasurer. For cities, counties, school districts and towns only the treasurer is authorized to receive, have custody of and disburse the entity's funds. Minn. Stat. §§ 412.141 (Statutory cities), 385.05, 385.07, 384.13 (Counties), 367.16 (Towns) and 123B.96 (School districts).
- ▶ Gift cards as cash equivalents must be in the custody of the treasurer.

# Gift Cards

- ▶ So even if there existed authority to use gift cards, any gift cards purchased by a public entity would have to be in the custody of the treasurer.

# Gift Cards

- ▶ Proposed uses of Gift Cards include “thanking” employees, volunteers or citizens participating in programs, serving on boards or focus groups
- ▶ All expenditures of public funds need authority
- ▶ Authority exists to compensate persons providing services to the public entity. Compensation for employees, officers, persons serving on boards is provided for by statute. In those situations, where compensation is authorized, payments should be handled through the district’s payroll or claim process, with tax withholding as appropriate, not with cash or gift cards handed to the individuals involved.

# Gift Cards

- ▶ The Minnesota Attorney General has long held that “gifts” lack consideration and hence lack public purpose. Ops. Att’y Gen. 107-a-3 (Jan. 22, 1980), 270-D (Aug. 12, 1977), and 59a-22 (Dec. 4, 1934).

# Gift Cards

- ▶ Generally public entities are authorized to disburse public funds for one of two purposes: 1) to pay claims or 2) to make statutorily authorized appropriations.
- ▶ Most proposed gift card uses do not involve claims. Very few statutes authorize public entities to appropriate public funds to an outside individual or group.

# Gift Cards

- ▶ Grant programs and gift cards received by the public entity
- ▶ Accounting and internal control issues with gift cards.
- ▶ Statement of Position on Gift Cards from OSA

# Examination of Public Accounts

- ▶ Minn. Stat. § 574.23 requires thorough examination of accounts upon:
  - ▶ The filing of an official bond,
  - ▶ Expiration of a term of office,
  - ▶ Death, resignation or removal of officer
- ▶ Any shortage or irregularity notify officer and surety

# Examination of Public Accounts

- ▶ Examination may be conducted by the governing board itself, or officers and employees of government entity or outside auditors.
- ▶ If outside auditor is used, the examination need not be a full GAAP audit.
- ▶ Purpose of the examination is to enable timely notice to surety companies of claim under surety bond.

# Examination of Public Accounts

- ▶ Examination may be conducted by the governing board itself, or officers and employees of government entity or outside auditors.
- ▶ If use outside auditor, the examination need not be a full GAAP audit.
- ▶ Examination required by statute should enable timely notice to surety companies of claim under surety bond.

# Attendance Check

# Fraud - Theft in a small city - First Example

- ▶ OSA Investigative Report revealed **\$134,639** in apparently improper payments to the former Clerk/Treasurer.
- ▶ Fraud: Checks issued to former Clerk/Treasurer - erroneous supporting documentation. For example:
  - ▶ multiple payments for the same dates
  - ▶ “incentive” pay added in support documents
  - ▶ Checks for non-business purposes.
  - ▶ Other payments without support

# Fraud - Theft in a small city - First Example, (cont.)

- ▶ Additional problem - Pattern of payments for future work hours, expenses and benefits - sometimes over 30 days in advance.
- ▶ This violates legally required payroll practices for statutory cities - **Minn. Stat. § 412.271, subd. 2:**
  - ▶ The city clerk “shall keep a payroll giving the name of each employee and the number of hours or days worked by each,” and
  - ▶ A supervisor (or other officer or ‘ee) “having knowledge of the facts shall sign a declaration that the facts recited on the payroll are correct to the best of the declarant's information and belief,” and
  - ▶ When any claim for wages listed on a payroll is paid, the employee shall sign a declaration, which may be a part of the payroll, to the effect that the employee has received the wages and done the work for which wages have been paid.

# Fraud - Theft in a small city - First Example, (cont.)

- ▶ Fillmore County Attorney - 26-count amended complaint - (23-CR-19-671):
  - ▶ 15 counts of felony theft
  - ▶ 5 counts of felony embezzlement of public funds,
  - ▶ 5 counts of felony receiving stolen property
  - ▶ 1 count of felony public officer permitting false claims

# Fraud - Theft in a small city - Second Example

- ▶ OSA Review requested by another city with the same City Auditor/Treasurer
- ▶ OSA Investigative Report revealed \$13,770 in apparently improper payments.
  - ▶ City funds paid to former Clerk/Treasurer w/no legitimate public purpose or for which support was contradictory. These claims excluded from “bills due” list provided to City Council.
  - ▶ City funds were paid for employee share of IRS, MNDOR, and PERA, but not withheld from the former Clerk/Treasurer’s pay.
  - ▶ Additional payments for expenses were not approved by the City Council and lacked sufficient detail.
  - ▶ Checks for non-business purposes. (cell phone, gas, ice, ink, printer, AC charger, etc.) These claims excluded from “bills due” list provided to City Council.

# Fraud - Theft in a small city - Second Example (Cont.)

- ▶ Problem: Pre-signed checks. The Mayor signed the total number of checks approved at the meeting and the former Clerk/Treasurer filled in the payment information later.
  - ▶ Minn. Stat. § 412.271, subds. 1, 3, require multiple signatures on checks (Mayor, Clerk and Treasurer). To be an effective control, checks should be completely filled in, including payee and amount before each person signs.
  - ▶ In general, claims for payment (other than payroll) must be itemized, and approved by the City Council.

# Fraud - Theft in a small city - Second Example, (cont.)

- ▶ Fillmore County Attorney - 23-count amended complaint - (23-CR-21-130):
  - ▶ 15 counts of felony theft
  - ▶ 3 counts of felony embezzlement of public funds,
  - ▶ 5 counts of felony receiving stolen property

# Fraud - Theft in a Small City - Conviction and Sentence - March 2022.

- ▶ The former Clerk/Treasurer pleaded guilty to:
  - ▶ a felony charge of theft by swindle (Case No. 23-CR-19- 671) and
  - ▶ a felony charge of embezzlement of public funds (Case No. 23-CR-21-130).

## Sentence:

- ▶ 120 days in jail,
- ▶ up to 10 years of supervised probation, and
- ▶ to perform 50 hours of community work service.

She was also ordered to pay a combined \$79,554 in restitution.

# Check Writing Procedures

- ▶ Do not pre-sign checks or deposit slips
- ▶ Obtain all required signatures on checks (> 1) (e.g., Minn. Stat. § 412.271)



# Reconcile Bank Statements

- ▶ Each month (or more frequently), someone not involved with writing checks/making payments should reconcile the bank statement to records of claims approved.
  - ▶ Amount altered?
  - ▶ Proper payee?
  - ▶ Void check cashed?
  - ▶ Checks out of sequence?
  - ▶ Unauthorized payments?

# Reconcile Bank Statements

- Review bank statement and canceled checks (optical images) by someone not involved with check writing.
  - ▶ Amount altered?
  - ▶ Void check cashed?
  - ▶ Unauthorized checks written?
  - ▶ Checks out of sequence?
  - ▶ Checks without required signatures ?
- ▶ Compare with claims approved
- ▶ In small cities, involve mayor or city council members
- ▶ Your review must be prompt. Minn. Stat. § 336.4-406 (When the bank sends a statement, the burden shifts to the customer to promptly notify the bank of unauthorized payments.)

# Fraud - HRA Theft - Recent Conviction in Federal Court

- ▶ The HRA provides affordable housing. The fraud involved theft from rental payments and actions to conceal the theft.
- ▶ In cooperation with the Albert Lea Police Department, the OSA reviewed HRA financial records.
- ▶ Based on this review, the OSA prepared an Investigative Report, finding a cash shortfall of at least \$201,986.17 in apparently diverted tenant rent payments.

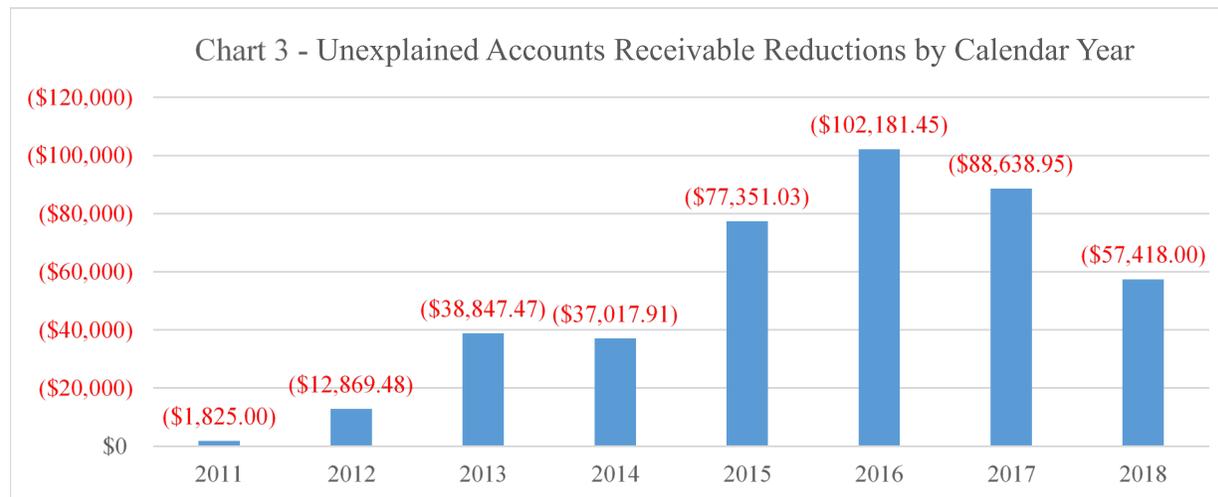
# Fraud - HRA Theft - Recent Conviction in Federal Court (Cont.)

- ▶ The OSA performed a detailed comparison of cash receipts to deposits for a 31-month period. We found:
  - ▶ Receipt books for 7 of the 31 months were missing and unavailable for review.
  - ▶ A cash shortfall of at least \$201,986 over the 24 months for which receipt books were available.
  - ▶ Unexplained accounts receivable reductions totaled \$248,238.
  - ▶ Instances in which:
    - ▶ Tenants documented they made rent payments,
    - ▶ The rent payments were not credited to the tenant's account, and
    - ▶ The amount due was instead reduced with an accounts receivable adjustment.
  - ▶ These findings indicated a possible accounts receivable skimming scheme that may have diverted money from the HRA.

# Fraud - HRA Theft - Recent Conviction in Federal Court (Cont.)

- ▶ The OSA also performed analytical procedures regarding HRA records for the period 2011 - 2018. These procedures disclosed that -
- ▶ Although rent due remained relatively consistent over this eight-year period, the electronic tenant records demonstrate marked increases in unexplained accounts receivable reductions.

The OSA aggregated the unexplained accounts receivable reductions by calendar year in the Chart 3:<sup>1</sup>

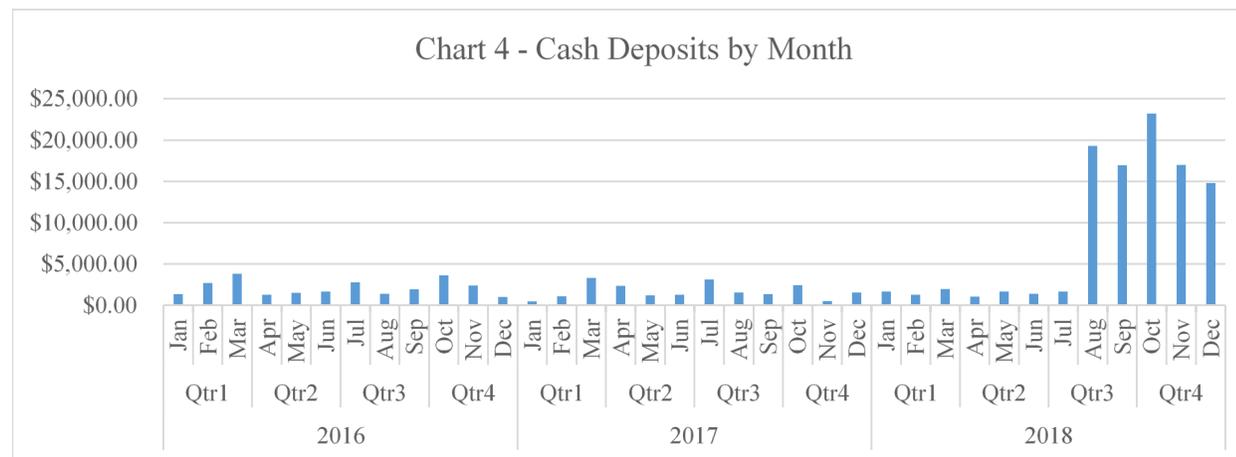


The OSA observed that these entries were not made before May of 2011 and were minimal throughout the rest of 2011 (7 entries totaling \$1,825). However, unexplained accounts receivable reductions increased drastically, and remained elevated before completely stopping on July 18, 2018.

# Fraud - HRA Theft - Recent Conviction in Federal Court (Cont.)

Also, average monthly cash deposits for the period Jan. 1, 2016, through Dec. 31, 2018, increased from \$1,806 to \$18,239 (over nine times) after July 18, 2018.

The HRA's cash shortfall can be most clearly seen by comparing deposits made before and after July 2018. In Chart 4 below, the OSA totaled cash deposits according to the HRA's bank by month.<sup>1</sup>



This chart shows a sharp contrast between the amount of cash deposited monthly by the HRA before and after July 18, 2018. On average, cash deposits made before and after July 2018 were \$1,806 and \$18,239 per month respectively.

# Fraud - HRA Theft - Recent Conviction in Federal Court (Cont.)

- ▶ The OSA provided its Investigative Report to the Albert Lea Police Department and the Freeborn County Attorney's Office in 2019, for their use in possible further criminal investigation and pursuit of prosecution.
- ▶ Subsequently, on August 16, 2022, federal prosecutors brought theft charges against the HRA's former bookkeeper in federal court, alleging theft of more than \$213,000 from the HRA.
- ▶ On October 12, 2022, the former bookkeeper pleaded guilty in U.S. District Court to one count of Theft from Program Receiving Federal Funds.
- ▶ The October 12, 2022, plea agreement includes information on possible sentences and reflects an agreement that the former bookkeeper should be ordered to pay restitution of \$213,217 to the HRA.

# Contact Info

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