



REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500
525 PARK STREET
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
state.auditor@osa.state.mn.us (E-mail)
1-800-627-3529 (Relay Service)

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Avoiding Pitfalls – Protecting Special Fund Assets

By Rebecca Otto, State Auditor

The Office of the State Auditor (OSA) works with and oversees volunteer fire relief associations and other units of local government. Recently we saw an instance in which a bank allowed unauthorized checks to be drawn on a local government's bank account even though the signatures on the checks were not those of the authorized or required signers on the account. In one case a check was not signed at all and was allowed to be drawn on a local government's account.

A clause in the agreement made between the bank and the local government had required the local government to promptly report any unauthorized payments. In general, Minnesota law provides that once a bank sends the bank statement to a customer, the customer must notify the bank within a reasonable time of any unauthorized payments that the customer should have discovered. Despite the lack of proper signatures on the checks in the instance above, the bank did not replace the money it allowed to be drawn from the local government's account.

Protecting Special Fund Assets

Protection of fund assets is a fundamental fiduciary duty of a relief association's board of trustees. To prevent the unfortunate loss of those assets, which can occur in a situation like the one described, a relief association needs to have basic internal controls in place such as the monthly review of bank statements and prompt reporting to its bank of any unusual activity discovered.

This type of unfortunate situation can be prevented by basic internal controls that all relief associations should have in place to protect their special fund assets. Another important control which is required by statute is that a relief association have multiple signatures on its checks -- the treasurer and another trustee. When more than one person

is required to sign a check, each person is verifying that the relief association's board of trustees has approved the check for payment.

In this article we'll show why these and other important steps should be taken to protect a relief association's pension assets from theft, misuse, or misappropriation.

Special Fund Signature Requirements

A volunteer fire relief association's special fund holds its restricted pension assets. Minnesota law requires multiple signatures on checks written by a relief association from the special fund as a protection of these assets.

Minnesota law requires special fund disbursements paid by check to be signed by the relief association treasurer and by at least one other trustee who is designated as a signer by the board of trustees. Electronic or wire funds transfers are also permitted if internal control policies and procedures are established and approved by the board of trustees that provide for authentication of the electronic disbursements by the relief association treasurer and at least one other trustee.

Other Important Internal Control Measures

The OSA encourages each relief association to consider the following additional internal control measures that can be taken to protect special fund assets:

1. **Positive Pay** – Many financial institutions offer this service. The account holder supplies a list of approved payments. When checks are presented to the financial institution for payment, the financial institution compares them to the list, and pays only the checks on the list.
2. **Timely Reviews and Reconciliations** – A relief association should review its monthly bank statements promptly upon receipt. If available, electronic access to account information may be helpful in facilitating timely monitoring of financial accounts. The relief association should compare the items in the monthly bank statement with the claims authorized for payment by the relief association's board of trustees. The board of trustees should report exceptions and unusual activity to the relief association's financial institution as soon as possible. Ideally, someone other than individuals who sign relief association checks should perform the review.
3. **Regular Review of the Relief Association's Designated Depository** – A relief association should, whenever feasible, choose a financial institution that will include the multiple signature requirement in the depository agreement. When that's not feasible, the relief association should make their financial institution aware that relief association checks require multiple signatures. In addition, the relief association should annually review its agreement with the

financial institution which has been designated as the relief association's depository. The review should take a look at the required timeline for reporting unauthorized payments. The review should include assistance from a representative of the financial institution as needed.

4. **Insurance Coverage** – A relief association can discuss fraud risks with its insurance carrier to determine what coverage is available to the relief association. Although this measure will not prevent a falsified check scheme, it may aid in the recovery of losses.

Additional Information

The OSA has a Statement of Position (SOP) titled “The Importance of Internal Controls” that provides additional information regarding internal controls and the types of control procedures that should be implemented. To find the SOP, go to the OSA website at www.auditor.state.mn.us. Once there, choose the “For Local Officials” menu option, then select “Statements of Position.” On that page, under the “Internal Controls” heading, choose “The Importance of Internal Controls”.