

**DEPOSITORIES OF PUBLIC FUNDS
AND
PUBLIC INVESTMENTS**

LEGAL COMPLIANCE AUDIT GUIDE

DEPOSITORIES OF PUBLIC FUNDS AND PUBLIC INVESTMENTS

Introduction

A government entity that receives and disburses funds may deposit the funds only in financial institutions designated by its governing body. The governing body may authorize its treasurer or chief financial officer to make such designations. The government entity may deposit funds in amounts that are federally insured or, if it deposits more than this amount, it must either have the depository furnish a bond or assign collateral to protect the excess deposit.

“Government entity” for the purpose of this section means:

- a county;*
- a city;*
- a town;
- a school district;
- a hospital district;
- a public authority;
- a public corporation;
- a public commission;
- a special district;
- a political subdivision; or
- [for depository and collateral provisions only--Minn. Stat. §§ 118A.02 and 118A.03 an American] Indian tribal government entity located within a reservation.

Minn. Stat. § 118A.01, subd. 2. This section does not apply to entities whose investment authority is specified under Minn. Stat. ch. 11A or 356A. *Id.*

“Public funds” for the purpose of this section means all general, special, permanent, trust, or other funds, regardless of source or purpose, held or administered by a government entity, unless otherwise restricted. Minn. Stat. § 118A.01, subd. 4.

If the audited government entity is one of those listed and it has the power to receive and disburse public funds, then complete this section to determine if the government entity has properly invested its funds or deposited its funds in a properly designated depository with appropriate collateral or bond.

In addition, the depository and collateral requirements of Minn. Stat. §§ 356A.06, subd. 8a, and 118A.03 apply to fire relief associations. Parts I and II should be completed for fire relief associations.

OPEB Trusts – The assets of a trust created to pay postemployment benefits (giving rise to a liability under GASB Stmt. 45) to employees or officers after their termination of service shall be invested and held as provided in Minn. Stat. § 471.6175.

*Note: A “city with a population in excess of 200,000 or a county that contains a city of that size” (currently the two largest cities and counties) has additional investment authority. *See* Minn. Stat. § 118A.07.

Minn. Stat. Section	DEPOSITORIES OF PUBLIC FUNDS AND PUBLIC INVESTMENTS	Yes	No	Workpaper Reference
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Part I. Designation of Depository
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§ 118A.02, subd. 1	A. In the case of a government entity:			
	1. Has each depository of public funds been designated by the government entity's governing body, or by its treasurer or chief financial officer, if the governing body has authorized them to make such a designation?			
§ 118A.01, subd. 3	2. Is each depository one of the following:			
	a. a savings association;			
	b. a commercial bank;			
	c. a trust company;			
	d. a credit union; or			
	e. an industrial loan and thrift company?			
§ 356A.06, subd. 8a	B. In the case of a relief association:			
	1. Has each depository for assets, not held by the relief association's custodian bank, been designated by the relief association's governing board?			
	2. Is each depository one of the following:			
	a. a national bank;			
	b. an insured state bank;			
	c. an insured credit union; or			
	d. an insured thrift institution?			

Part II. Insuring or Securing Deposits

§ 118A.03	A. If a government entity desires to deposit an amount in excess of deposit insurance, it must obtain a bond or collateral which, when computed at its market value, shall be at least ten percent more than the amount of the excess deposit at the close of the banking day. For the purpose of this section, "banking day" has the meaning given in Federal Reserve Board Regulation CC, 12 C.F.R. § 229.2(f), and incorporates a financial institution's cutoff hour established under Minn. Stat. § 336.4-108. If irrevocable standby letters of credit from Federal Home Loan Banks are used as collateral, the amount must be equal to the amount of the excess deposit at the close of the banking day.			
	B. Review the following general principles of FDIC coverage and complete the spread sheet in this section to determine the amount of the government entity's funds that is not insured and thus need to be either bonded or collateralized. Deposits held by credit unions are covered by separate deposit insurance rules promulgated by the National Credit Union Administration (NCUA).			

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	<p>General Principles of FDIC coverage:</p> <ol style="list-style-type: none"> 1. Deposits are insured only if the depository is a member of FDIC. 2. Deposits in one depository are insured separately from deposits in another depository which is not a branch of the first one. However, a depository and all of the branches associated with it are treated as a single combined depository, and the funds deposited in the branches are aggregated for purposes of insurance coverage. 3. The aggregate of a government entity's interest bearing accounts, i.e., savings accounts, NOW accounts, and time deposits (CDs), with the same depository are insured up to a total of \$250,000. The aggregate of a government entity's non-interest bearing accounts, i.e., non-interest checking accounts, are insured up to a total of \$250,000 and are insured separately from the government entity's interest-bearing deposits. This separate \$250,000 coverage for non-interest bearing accounts only applies if the depository is in the same state as the government entity. 4. A public authority, public corporation, public commission, or special district receives separate insurance coverage from its parent government entity only if it was created expressly by state statute and funds have been allocated for its exclusive use and control. Subordinate or nonautonomous divisions, agencies, or boards do not receive separate insurance coverage. 5. Funds held for a special purpose and required by law to be paid to bondholders or beneficiaries such as members of pension funds or relief associations are covered up to \$250,000 per bondholder or beneficiary whether the beneficial interest is vested or not. The fiduciary nature must be indicated on the account name in the bank's records. 6. If more than one person is legal or official custodian of funds for a government entity, each custodian is separately insured up to \$250,000. Also, if the same person is the custodian of funds for two separate government entities, the funds for the two government entities are separately insured. 7. Moneys held by a government entity in trust are insured separately from other government entity funds only <u>if</u> the trust is an irrevocable express trust and the account records indicate the name of both the settlor and the trustee. 			

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	<p>The Transaction Account Guarantee Program (TAGP), initiated in 2008, provided unlimited coverage for noninterest-bearing transaction accounts, (including IOLTA (Attorney Trust) accounts and NOW accounts that pay up to 0.5% interest) in participating banks. A list of banks that opted out of the program can be found at: http://www.fdic.gov/regulations/resources/TLGP/optout.html. The unlimited coverage for noninterest-bearing transaction accounts is scheduled to terminate on December 31, 2010.</p> <p>Note: The FDIC Board of Directors issued a final rule to implement the section of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) that provides temporary unlimited coverage for noninterest-bearing transaction accounts at all FDIC-insured depository institutions. The separate coverage for noninterest-bearing transaction accounts becomes effective on December 31, 2010, and terminates on December 31, 2012. See http://www.fdic.gov/news/news/financial/2010/fil10076.html.</p> <p>Like the TAGP, the Dodd-Frank Act provides for unlimited coverage for noninterest-bearing transaction accounts. A noninterest-bearing transaction account is a deposit account where:</p> <ul style="list-style-type: none"> ■ interest is neither accrued nor paid, ■ depositors are permitted to make an unlimited number of transfers and withdrawals, <u>and</u> ■ the bank does not reserve the right to require advance notice of an intended withdrawal. <p>Unlike the TAGP, the Dodd-Frank Act provision includes all FDIC-insured depository institutions. Unlike the TAGP, the Dodd-Frank Act definition of noninterest-bearing transaction accounts does not include either low-interest Negotiable Order of Withdrawal (NOW) accounts or Interest on Lawyer Trust Accounts (IOLTAs). Money Market Deposit Accounts and NOW accounts are not eligible for this unlimited coverage, regardless of the interest rate.</p>			
	C. Has the spreadsheet been completed? (See pages 1-10.)			

Part III. The Bond and Collateral				
§ 118A.03, subd. 1	A. If a bond was furnished by the depository to the government entity, answer the following question:			
	1. Was the bond executed by a corporate surety company authorized to do business in the state?			
§ 118A.03, subd. 2	B. If the depository assigned collateral to the government entity, answer the following questions:			
	1. Was the collateral one of the following:			
	a. U.S. government treasury bills, notes, or bonds;			
	b. issues of a U.S. government agency or instruments that are quoted by a recognized industry quotation service available to the government entity;			

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	c. a general obligation of a state or local government, with taxing powers, rated "A" or better;			
	d. a revenue obligation of a state or local government, with taxing powers, rated "AA" or better;			
	e. unrated general obligation securities of a local government, with taxing powers, pledged as collateral against funds deposited by that same local government entity;			
	f. an irrevocable standby letter of credit issued by a Federal Home Loan Bank accompanied by written evidence that the Federal Home Loan Bank's public debt is rated "AA" or better by Moody's or Standard and Poor's; or			
	g. time deposits insured by any federal agency?			
§ 118A.03, subd. 7	2. Was the collateral placed for safekeeping:			
	a. In a restricted account at the Federal Reserve Bank; or			
	b. in an account at a trust department of a commercial bank or other financial institution not owned or controlled by the depository?			
	3. Did the government entity approve of the selection of the safekeeping entity?			
§ 118A.03, subd. 4	4. Was the collateral assignment in writing?			
	5. Did the assignment provide that, upon default, the depository shall release the collateral pledged to the government entity on demand?			
§ 118A.03, subd. 3	C. Collateral pledged must equal at least ten percent more than the uninsured and unbonded amount on deposit at the close of the banking day. If irrevocable standby letters of credit from Federal Home Loan Banks are used, the amount must be equal to the amount of the excess deposit at the close of the banking day. The depository may, at its discretion, furnish both a bond and collateral aggregating the required amount. For the purpose of this section, "banking day" has the meaning given in Federal Reserve Board Regulation CC, 12 C.F.R. § 229.2(f), and incorporates a financial institution's cutoff hour established under Minn. Stat. § 336.4-108.			
§ 118A.03, subd. 5 [12 C.F.R. § 229.2(f)]	1. If a bond was obtained or standby letters of credit from Federal Home Loan Banks were pledged, was the amount of excess deposit at the close of the banking day (as defined above) equal to or less than the amount of the bond or standby letters of credit?			
§ 118A.03	2. If other collateral was pledged, was the amount of collateral at least ten percent more than the uninsured amount on deposit at the close of the banking day?			
	D. Assignment [Federal Statutory Requirements]			

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[12 U.S.C. § 1823(e)]	1. Was the written assignment approved by the depository's board of directors or loan committee?			
	2. Was the assignment an official record of the depository?			

Part IV. Public Investments				
	A. Were all repurchase agreements and reverse repurchase agreements <u>only</u> entered into with:			
§ 118A.05, subd. 2	1. a financial institution qualified as a depository of public funds;			
	2. any other financial institution which is a member of the Federal Reserve System <u>and</u> whose combined capital and surplus equals or exceeds \$10,000,000;			
	3. a primary reporting dealer in United States government securities to the Federal Reserve Bank of New York; or			
	4. a securities broker-dealer licensed pursuant to chapter 80A, or an affiliate of it, regulated by the Securities and Exchange Commission and maintaining a combined capital and surplus of \$40,000,000 or more, exclusive of subordinated debt?			
§ 118A.06	B. Are all investments held in safekeeping? If so:			
	1. Is the government entity's ownership of all securities in which the fund is invested evidenced by written acknowledgments identifying the securities by:			
	a. the names of the issuers?			
	b. maturity dates?			
	c. interest rates?			
	d. CUSIP numbers or other distinguishing marks?			
	2. Were investments, contracts, and agreements held in safekeeping with:			
	a. a Federal Reserve Bank;			
	b. any bank authorized under the laws of the United States or any state to exercise corporate trust powers, including, but not limited to, the bank from which the investment is purchased;			
	c. a primary reporting dealer in United States government securities to the Federal Reserve Bank of New York; <u>or</u>			
	d. a securities broker-dealer, or an affiliate of it, that			
	(1) Is registered as a broker-dealer under Chapter 80A or is exempt from the registration requirements;			
	(2) is regulated by the Securities and Exchange Commission; <u>and</u>			

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	(3) maintains insurance through the Security Investor Protection Corporation (SIPC) or excess insurance coverage in an amount equal to or greater than the value of the securities held? [Note: To test safekeeping on or before December 31, 2009, use the 2009 version of this Legal Compliance Audit Guide question.]			
	C. Were the securities sold or pledged under the repurchase agreement or reverse repurchase agreement permissible direct investments under Minn. Stat. § 118A.04 (see L and M below)?			
	D. Were all reverse repurchase agreements only entered into:			
§ 118A.05, subd. 2	1. for a period of 90 days or less; and			
	2. only to meet short-term cash needs and not to generate cash for investments?			
	E. Were all securities lending agreements (including custody agreements) entered into only with:			
§ 118A.05 subd. 3	1. a financial institution qualified as a depository having an office in Minnesota; or			
	2. a financial institution which is a member of the Federal Reserve System <u>and</u> whose combined capital and surplus equals or exceeds \$10,000,000, <u>and</u> which has an office in Minnesota?			
	F. Did the custodian or entity operating the securities lending program only enter into securities lending transactions with those entities identified in Part IV.A. (above)?			
	G. Were all guaranteed investment contracts or agreements only entered into with an issuer or guarantor:			
§ 118A.05, subd. 5	1. that was a U.S. commercial bank, a domestic branch of a foreign bank, a U.S. insurance company, or its Canadian subsidiary, or the domestic affiliates of any of the foregoing; or			
	2. whose credit quality for long-term and short-term unsecured debt was rated in one of the highest two categories by a nationally recognized rating agency?			
	H. Did all guaranteed investment contracts give the public entity withdrawal rights in the event the issuer's or guarantor's credit quality was downgraded below "A"?			
	I. Did the government entity only invest in shares of a Minnesota joint powers investment trust whose investments were restricted to securities described in Minn. Stat. §§ 118A.04 and 118A.05?			
§ 118A.05, subd. 4	J. Mutual Funds - Did the government entity only invest in shares of an investment company that met the criteria in either 1 or 2 below:			
	1. a. registered under the Federal Investment Company Act of 1940;			
	b. whose shares were registered under the Federal Securities Act of 1933;			

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	c. whose fund received the highest credit rating;			
	d. that was rated in one of the highest risk rating categories by at least one nationally recognized statistical rating organization; <u>and</u>			
	e. that only invests in financial instruments with a final maturity no longer than 13 months?			
	2. a. registered under the Federal Investment Company Act of 1940;			
	b. which holds itself out as a money market fund meeting the conditions of SEC rule 21-7; <u>and</u>			
	c. is rated one of the two highest rating categories for money market funds by at least one nationally recognized statistical rating organization?			
§ 118A.05, subd. 4	K. Did the government entity only invest in units of a short-term investment fund:			
	1. established and administered pursuant to regulation 9 of the Comptroller of the Currency; and			
	2. in which investments are restricted to securities described in Minn. Stat. §§ 118A.04-.05?			
	L. Were all other funds invested in instruments which met at least one of the following criteria:			
§ 118A.04	1. In governmental bonds, notes, bills, mortgages, and other securities, which were direct obligations or are guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of Congress, excluding mortgage-backed securities defined as “high risk” (see Section M - Mortgage-Backed Securities);			
	2. In a general obligation of a state or local government with taxing powers which was rated “A” or better by a national bond rating service;			
	3. In a revenue obligation of a state or local government with taxing powers which was rated “AA” or better by a national bond rating service;			
	4. In a general obligation of the Minnesota Housing Finance Agency which was a moral obligation of the State of Minnesota and is rated “A” or better by a national bond rating service;			
	5. In commercial paper issued by a United States corporation or its Canadian subsidiary and that:			
	a. was rated in the highest quality category by at least two nationally recognized rating agencies, and			
	b. matures in 270 days or less;			
§ 118A.04, subd. 5	6. In time deposits fully insured by the Federal Deposit Insurance Corporation;			

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§ 118A.04, subd. 5	7. In bankers' acceptances issued by United States banks; or			
§ 118A.04, subd. 7	8. In its own temporary obligations issued under Minn. Stat. §§ 429.091, subd. 7 (special assessments), 469.178, subd. 5 (tax increment bonds), or 475.61, subd. 6?			
§ 118A.04, subd. 8	Note: A debt service fund can purchase any issue payable from the fund.			
	M. Mortgage-Backed Securities			
§ 118A.04, subd. 2	Government entities may only purchase mortgage-backed securities that are direct obligations or guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of Congress.			
	Mortgage-backed securities purchased shall not be "high risk." Minn. Stat. § 118A.04, subd. 6, states, "high risk mortgage-backed securities" are:			
§ 118A.04, subds. 2 & 6	1. interest-only or principal-only mortgage-backed securities; and			
	2. any mortgage derivative security that:			
	a. has an expected average life greater than ten years; or			
	b. has an expected average life that:			
	(1) will extend by more than four years as the result of an immediate and sustained parallel shift in the yield curve of plus 300 basis points, or			
	(2) will shorten by more than six years as the result of an immediate and sustained parallel shift in the yield curve of minus 300 basis points; or			
	c. will have an estimated change in price of more than 17 percent as the result of an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.			
	3. Were all mortgage-backed securities purchased by the government entity after August 1, 1993, not "high risk?"			
Part V. Broker Acknowledgement Certification				
§ 118A.04, subd. 9	A. Annually, prior to completing an initial investment transaction with each broker, did the government entity provide to that broker a written statement of investment restrictions?			
	B. Did the broker acknowledge receipt of the investment restrictions and agree to handle the government entity's account in accordance with the restrictions?			
	C. Did the government entity retain documentation of compliance with A and B above?			
Part VI. Audit Conclusion				

