

LOCAL GOVERNMENT FISCAL EMERGENCY

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Introduction

The Ohio Legislature has established a fiscal accountability system for local governments in order to protect the public from financial mismanagement. This fiscal accountability system is spelled out in Ohio Revised Code Chapter 118 which restricts the power of local governments (municipal corporations, counties and townships) to borrow money, contract debt, and levy taxes and requires reporting and examination of local governments' financial condition and operations to prevent fiscal abuses by those in office.

The below information is intended to provide an overview of Ohio's fiscal accountability system for local governments.

I. State Fiscal Designations

Ohio's fiscal accountability system for Ohio's local governments in fiscal distress moves through three stages: (1) "Fiscal Caution," (2) "Fiscal Watch," and (3) "Fiscal Emergency." Each stage serves to alert local and state administrators to varying degrees of imminent financial disaster, much as the National Weather Service's "watch," "warning," and "emergency" nomenclature warns of an escalating natural disaster. The utility of these fiscal designations is likewise dependent upon the accuracy of a forecast, in this case is provided by the financial audit required of all local governments pursuant to Revised Code Section 117.11. These audits are statutorily required once every two years, but generally completed on an annual basis.

A. Statutory Requirements of each Designation

1. Fiscal Caution

The designation of "Fiscal Caution" warns that unfavorable fiscal conditions have been detected while there is still time to take action to avoid further financial decline. This designation is intended to prompt the local government to identify fiscal practices and budgetary conditions that, if not corrected, could ultimately result in a declaration of fiscal watch or fiscal emergency.¹

When the State Auditor declares a local government to be in Fiscal Caution, the local government is required to provide a written proposal for discontinuing or correcting the fiscal practices or budgetary conditions that prompted the declaration within 60 days. If the local government fails to make reasonable proposals or take action to discontinue or correct the practices or conditions that led to the declaration of Fiscal Caution, the State Auditor *may* upgrade the local government to a state of Fiscal Watch or Fiscal Emergency.

A local government may only be released from Fiscal Caution once the State Auditor has determined that the corrective actions have been or are being implemented and that the Fiscal Caution conditions no longer exist.

¹ R.C. 118.025



Any one of the following factors is needed for the State Auditor to declare Fiscal Caution:

- When the State Auditor declares that a local government's financial records are unauditable, and has issued a letter to the local government indicating the timeframe under which those records must be restored to an auditable condition, and the local government has failed to do so within the timeframe specified.
- When the State Auditor identifies significant deficiencies or material weaknesses over accounting and financial reporting functions, direct and material noncompliance with laws and regulations, or mismanagement which in the opinion of the State Auditor, in the aggregate, have a significant effect on the financial condition of the local government.
- When a deficit fund balance exists at year-end in the general fund that is greater than 2% of that fund's revenue for that year, *and/or* when a deficit fund balance exists at year-end in any other fund that is greater than 2% of that fund's revenue for that year; *and*

There are not sufficient resources in the general fund or any other fund that may be transferred to eliminate the deficit.

- When a low year-end carryover balance exists in the general fund that is equal to or less than an amount representing one month of expenditures, *and/or* when a low year-end carryover balance exists in any other fund that is equal to or less than an amount representing one month of expenditures; *and*

There are not sufficient resources in the general fund or any other fund that may be transferred to subsidize the fund.

- When a local government has not reconciled its accounting journals and ledgers with the treasury/bank for more than three months and is unable to reconcile the records within one month of written notification by the State Auditor.

2. Fiscal Watch

If the State Auditor determines that the local government, while in Fiscal Caution, has failed to make progress on the written proposals and, if necessary to prevent further fiscal decline, the State Auditor *may* determine the local government to be in "Fiscal Watch,"¹ the second state of fiscal distress.

In the alternative, a local government not currently in Fiscal Caution may undergo a "Fiscal Watch" Review to determine whether it is approaching a state of Fiscal Emergency, if the legislative authority or State Auditor has reason to believe so. If the Fiscal Watch Review is prompted by the legislative authority of the local government, the request must be submitted to the State Auditor in writing.

Prior to making a determination of Fiscal Watch, the Auditor will conduct an initial review of the local government's finances. Once the State Auditor has declared the local government to be in Fiscal Watch, the local government has 90 days to submit a financial recovery plan that identifies actions to be

¹ R.C. 118.025



taken to eliminate the conditions causing the Fiscal Watch designation, including a schedule detailing the approximate dates for beginning and completing the action, and a five-year forecast reflecting the effects of the proposed actions. The financial recovery plan must be approved by the State Auditor. The fiscal recovery plan must also evaluate the feasibility of entering into shared service agreements with other political subdivisions.² If the local government fails to timely submit a feasible financial recovery plan the State Auditor **must** declare the local government to be in a Fiscal Emergency.³ The State Auditor, however, is permitted to extend the timeframe to submit a financial recovery plan.

Any one of the following factors is needed for the State Auditor to declare Fiscal Watch:⁴

- The existence of either of the following:
 - All accounts that were due and payable from the general fund for more than 30 days (less the general funds' year-end balance), exceeded 1/12 of the general fund budget for the year; *or*
 - All accounts that were due and payable from all funds for more than 30 days (less the general funds' year-end balance), exceeds 1/12 of the available revenue for the previous fiscal year.
- Total deficit funds, less the total of any balances in the general fund and transferrable special funds, exceeds 1/12 of the total year's general fund budget and receipts to those deficit funds (not counting transfers from the general fund).
- Money and marketable investments, minus outstanding checks, were less than the total positive fund balances of the general fund and special funds, and the deficiency exceeds 1/12 of the total amount of receipts during the preceding fiscal year.
- The State Auditor certifies that the general fund deficit at the end of the current fiscal year will exceed 1/12 of the prior fiscal year's general fund revenue.

3. Fiscal Emergency

"Fiscal Emergency" is the final stage of fiscal distress, the conditions for which are outlined in R.C. 118.03. Upon such a determination, a "financial planning and supervision commission" is created for which the State Auditor serves as the financial supervisor, unless he/she elects to contract out for that function.⁵ A commission has broad powers to monitor the required plan and timetable for fiscal recovery.⁶

Within 120 days after a commission's first meeting, the local government must submit to the commission a detailed financial recovery plan.⁷ Failure to submit such a plan may result in a withholding of all state assistance or the commission limiting the local government's expenditures.⁸ The detailed

² R.C. 118.023(B)

³ R.C. 118.04

⁴ R.C. 118.022

⁵ R.C. 118.05

⁶ R.C. 118.07

⁷ R.C. 118.06(A)

⁸ R.C. 118.06(E)



financial plan, as approved or amended and approved by ordinance or resolution of the legislative authority, must contain the following:

- 1) Actions to be taken by the municipal corporation, county, or township to:
 - a) Eliminate all fiscal emergency conditions determined to exist pursuant to R.C. 118.04;
 - b) Satisfy any judgments, past due accounts payable, and all past due and payable payroll and fringe benefits;
 - c) Eliminate the deficits in all deficit funds;
 - d) Restore to construction funds and other special funds moneys from such funds that were used for purposes not within the purposes of such funds, or borrowed from such construction funds by the purchase of debt obligations of the municipal corporation, county, or township with the moneys of such funds, or missing from the construction funds or such special funds and not accounted for;
 - e) Balance the budgets, avoid future deficits in any funds, and maintain current payments of payroll, fringe benefits, and all accounts⁹;
 - f) Avoid any fiscal emergency condition in the future;
 - g) Restore the ability of the municipal corporation, county, or township to market long-term general obligation bonds under provisions of law applicable to municipal corporations, counties, or townships generally.
- 2) The legal authorities permitting the municipal corporation, county, or township to take the actions enumerated pursuant to R.C. 118.06 (A)(1);
- 3) The approximate dates of the commencement, progress upon, and completion of the actions enumerated pursuant to R.C. 118.06 (A)(1), a five-year forecast reflecting the effects of those actions, and a reasonable period of time expected to be required to implement the plan. The municipal corporation, county, or township, in consultation with the commission and the financial supervisor, shall prepare a reasonable time schedule for progress toward and achievement of the requirements for the financial plan and the financial plan shall be consistent with that time schedule.
- 4) The amount and purpose of any issue of debt obligations that will be issued, together with assurances that any such debt obligations that will be issued will not exceed debt limits supported by appropriate certifications by the fiscal officer of the municipal corporation, county, or township and the county auditor;
- 5) Assurances that the municipal corporation, county, or township will establish monthly levels of expenditures and encumbrances pursuant to R.C. 118.07 (B)(2);
- 6) Assurances that the municipal corporation, county, or township will conform to statutes with respect to tax budgets and appropriation measures;
- 7) The detail, the form, and the supporting information that the commission may direct;
- 8) An evaluation of the feasibility of entering into shared services agreements with other political subdivisions for the joint exercise of any power, performance of any function, or rendering of any service, if so authorized by statute.

⁹ Contrast this provision with R.C. 3316.07(A)(11), the school district counterpart, which expressly permits a commission to make reductions in force to bring the school district's budget into balance, notwithstanding collective bargaining agreements.



For villages and townships with a population of less than 1,000, no commission is required. Instead, the State Auditor serves as the financial supervisor and has all the powers and responsibilities of such a commission.¹⁰

Financial Planning and Supervision Commission

The Financial Planning and Supervision Commission must be composed of the following seven members:

- o Treasurer of State (or office designee)
- o Director of state office of Budget and Management (or office designee)
- o For municipalities, the mayor and presiding officer of municipal legislative authority
- o For counties, the president of the board of county commissioners and the county auditor
- o For townships, a member of the board of township trustees and the county auditor
- o Three appointed members chosen out of five names provided to the governor by the mayor and presiding officer of the municipality's legislative authority; or by the county board of commissioners or board of township trustees. These individuals must be residents of the declared government (by home or office address) with knowledge and experience in financial/business matters.

The State Auditor *must* declare a local government to be in Fiscal Emergency if the local government exhibits any one of the following:¹¹

- Failure to timely submit a feasible financial recovery plan while in Fiscal Watch; *or*
The State Auditor finds that while in a state of Fiscal Watch the local government has not made reasonable proposals or taken action to discontinue or correct the fiscal practices or budgetary conditions that prompted the declaration of Fiscal Watch, and the State Auditor determines a Fiscal Emergency declaration necessary to prevent further decline.
- The existence of either of the following conditions **for at least four months** after the end of the fiscal year:
 - o All accounts that were due and payable from the general fund for more than 30 days (less the general funds' year-end balance), exceeded 1/6 of the general fund budget for the year; *or*
 - o All accounts that were due and payable from all funds for more than 30 days (less the general funds' year-end balance), exceeds 1/6 of the available revenue for the previous fiscal year.
- Total deficit funds, less the total of any balances in the general fund and transferrable special funds, exceeds 1/6 of the total year's general fund budget and receipts to those deficit funds (not counting

¹⁰ R.C. 118.05(L)

¹¹ R.C. 118.023(C)



transfers from the general fund) and persists **for at least four months** after the end of the fiscal year.

- Money and marketable investments, minus outstanding checks, were less than the total positive fund balances of general fund and special funds, and the deficiency exceeds 1/6 of the total amount of receipts during the preceding fiscal year (other than from transfers from the general fund) and persists **for at least four months** after the end of the fiscal year.
- Failure, for lack of funds, to make payroll that continues beyond 30 days, or a period of agreed-upon extension that cannot last more than 90 days from the time payment was originally due.
- Default of payment on any debt obligation for more than 30 days.
- An increase in the inside millage by the county budget commission that results in a reduction for any of the overlapping subdivisions or taxing districts.

Fiscal Emergency Termination

The State Auditor will terminate a Fiscal Emergency designation only after the local government is deemed to be in a state of recovery which is determined on the basis of meeting all of the following conditions:

- An effective financial accounting and reporting system is being implemented to place the local government back on track, with an expected completion of within two years.
- All Fiscal Emergency conditions have been or are in the process of being eliminated, and no new Fiscal Emergency conditions have occurred.
- The financial recovery plan objectives are being met.
- The local government has a five-year financial forecast that the State Auditor determines is "nonadverse."

Only once the aforementioned conditions have been met will the State Auditor release a local government from Fiscal Emergency. In some instances, the local government is unable to meet these conditions in which case the financial supervisor *may* recommend dissolution.

Dissolution of Municipality or Township

Dissolution of a local government, namely a municipality or township, occurs upon petition of the financial supervisor and approval by the commission, if any.¹² The Attorney General thereafter files a court action to dissolve the local government if all of the following conditions apply:

1. The local government has a population of less than 5,000 as of the most recent federal decennial census.

¹² R.C. 118.31



2. The local government has been in Fiscal Emergency for at least four consecutive years.
3. Implementation of the required financial recovery plan cannot reasonably be expected to correct and eliminate all Fiscal Emergency conditions within five years.

The court will hold a hearing within 90 days after the date on which the Attorney General files the legal action requesting dissolution. Notice of the hearing must be filed with the Attorney General, and the fiscal officer of the local government subject to the action. If the court finds that all of the foregoing conditions have been met, it will appoint a receiver. The receiver will then work with the executive and legislative officers of the local government to wind up and dissolve the affairs of the local government.

4. Dissolution of a Village

There are two statutory mechanisms whereby villages may dissolve: (1) R.C. 703.20 provides for dissolution by petition; and (2) R.C. 703.201 provides for forced dissolution.

Dissolution by Petition¹³

A village may surrender its corporate powers upon the petition of at least 40% of the electors (as determined by the number voting at the last regular election) to the legislative authority of the village. The legislative authority must then place the question of dissolution before the voters. If a majority of the voters vote in favor of surrendering the village's corporate powers, the village clerk will certify the result to the Secretary of State and county recorder and the village shall cease to exist.

Forced Dissolution¹⁴

A forced dissolution of a village may occur if the State Auditor finds the presence of the following, as determined by an audit report:

- A population of 150 persons or less (determined either at the last preceding federal decennial census or according to certified population estimates);
- Consists of less than two square miles; and
- That the village meets at least **two conditions for surrendering corporate powers.**

If the above conditions are met, the State Auditor will send a letter to the Attorney General requesting that the Attorney General pursue legal action to dissolve the village. Within 20 days of receipt of the State Auditor's request, the Attorney General *may* file a legal action in the court of common pleas to request the dissolution.

Once a legal action is filed, the court has 90 days to hold a hearing. At the hearing, the court will determine whether the village meets requisite conditions for dissolution and if so, order dissolution.

¹³ R.C. 703.20

¹⁴ R.C. 703.201



Conditions for surrendering corporate powers

- The village has been in Fiscal Emergency for at least three consecutive years with little or no improvement.
- The village has failed to properly follow applicable election laws for at least two consecutive election cycles for any one elected office in the village.
- The village has been declared by the State Auditor to be unauditable in at least two consecutive audits.
- The village does not provide at least two services typically provided by municipal government (e.g., police or fire protection, garbage collection, etc.)
- The village has failed to adopt a tax budget for any fiscal year.
- A village elected official has been convicted of theft in office, at least two times in 10 years.

In recent years, the State of Ohio has experienced an increase in village dissolutions. Since 2005, the following villages have dissolved:

- Lawrenceville, Clark County (2005)
- Alvordton, Williams County (2007)
- St. Martin, Brown County (2011)
- Fort Shawnee, Allen County (2012)
- Uniopolis, Auglaize County (2013)
- Orient, Pickaway County (2013)
- Cherry Fork, Adams County (2015)
- Salesville, Guernsey County (2015)

At the March 2016 primary election, the Villages of Neville (Clermont County), Somerville (Butler County), and Smithfield (Jefferson County), placed before their electorate the question of dissolution. The Village of Somerville's ballot question succeeded, although by a narrow margin. Somerville is currently in the process of winding up its affairs.

The increase in village dissolutions is primarily attributable to a lack of financial resources. The phase out of the tangible personal property tax, the accelerated phase out of tax replacement payments and steady cuts to the Local Government Fund have placed an increasing financial burden on local governments.¹⁵ A lack of state funding has forced local governments to not only cut local services but cut the salaries paid to those serving in elective office. This in turn has created apathy amongst residents to seek election to elective office. Consequently, some villages, like Somerville, have been forced to dissolve by sheer virtue of lacking a legislative authority.¹⁶

¹⁵ Cuts to Cities, Counties Threaten Local Services, Policy Matters Ohio, August 24, 2015, <http://www.policymattersohio.org/localgovt-june2015>

¹⁶ At the end of December 2015, the Village of Somerville ceased to have a legislative authority.



Recent Legislative Changes

The statutory mechanisms spelled out in R.C. 703.20 and 703.201 are great mechanisms for dissolving a village. There are, however, instances where neither one of these mechanisms may be used. This is especially the case for cash-strapped villages lacking residents with a desire to run for election to the legislative authority or fulfill appointments. The processes for dissolution described in R.C. 703.20 and 703.201 are inapplicable in the case where a village's population exceeds 150 people and the legislative authority has ceased to exist.

To address the situation where the legislative authority has disbanded prior to dissolving the village, the Ohio legislature has introduced House Bill 509 which would allow the electors of a village without a legislative authority to certify a petition for dissolution directly to the county board of elections. This legislation is currently pending in the House State Government Committee.

