

OHIO AUDITOR OF STATE KEITH FABER



Auditor of State
Bulletin 2024-002

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TO: All Public Offices
Independent Public Accountants

FROM: Keith Faber
Ohio Auditor of State

SUBJECT: Clarifying when Governmental Entities are Permitted to Assume Debt
in the Form of Standard Installment Loans from Private Financial
Institutions

Bulletin Purpose

The purpose of this bulletin is to clarify when governmental entities are permitted to assume debt in the form of standard installment loans from private financial institutions.

Implementation Date

Upon issuance.

Background

The Ohio Auditor of State (AOS) has noticed an increase in the number of audit clients executing standard installment loans issued by banks or other private financial institutions without statutory authority. When debt is improperly assumed by governments, the revenue raised by those governments through taxation or other means may be placed at risk. Therefore, issuing a bulletin to address the confusion surrounding when governmental entities are permitted to assume debt in the form of standard installment loans from private financial institutions, became of great importance to AOS.

Please consult with your legal counsel prior to entering into any debt agreements.

Bulletin Detail

I. Governmental Entities are Generally Prohibited from Assuming Debt in the Form of a Standard Installment Loan from Private Financial Institutions Unless Clearly Permitted by Statute.

A standard installment loan agreement, for purposes of this bulletin, is any arrangement involving a private financial institution (usually a bank) that requires the borrower to execute a loan agreement detailing: the amount of money to be loaned (usually as a lump sum), a period of repayment, and the regular intervals (usually yearly or monthly) when part of the principle is expected to be repaid to the lender with interest (usually at a fixed rate). For purposes of this bulletin, the loan agreement is usually either encompassed within - or accompanied by - a promissory note or similar instrument that the borrower must execute to evidence the loan arrangement. A local government borrowing money from a private institution must have authority to both borrow money and provide evidence of the indebtedness (i.e., issue notes or other securities).¹

It is a well-established principle in Ohio Law that most governmental entities are “creatures of statute,” and may only act in accordance with the limited powers conferred upon them by statute or necessarily implied therefrom. Therefore, governmental entities that are created by statute must have clear statutory authority to execute a standard installment loan agreement from a private financial institution.

In addition, the authority to spend money and incur debt is construed strictly under the law – meaning there must be clear, express, statutory authority for a public body to engage in a specific type of financial transaction or assume debt.² Therefore, unless a legal authority (statute, regulation, etc.) clearly authorizes a governmental entity to (1) borrow money from private lenders for its intended purpose(s) and (2) issue evidences of the debt (usually in the form of a promissory note or similar security), such governmental entity is prohibited from obtaining a standard installment loan from a private financial institution.³

¹ It is important to clarify that the private installment loan agreement addressed by this bulletin is not a lease-purchase arrangement. Lease-purchase arrangements allow buyers to rent a piece of property for a few years by paying fixed payments in installments before purchasing the property at a nominal price at the end of the term. An entity entering into a lease-purchase should look for express statutory authority and should follow the requirements in O.R.C. Chapter 133 and other applicable Revised Code provisions with respect to those lease-purchases.

² See generally 2006 Op. Att’y Gen. No. 2006-008 at 2-71 n.3 (“Financial powers given to public bodies are construed strictly, and there must be clear authority to enter into financial transactions.”); see also *State ex rel. Locher v. Menning*, 95 Ohio St. 97, 99, 115 N.E. 571 (1916) (“The authority to act in financial transactions must be clear and distinctly granted, and, if such authority is of doubtful import, the doubt is resolved against its exercise in all cases where a financial obligation is sought to be imposed . . .”); see also 2004 Op. Att’y Gen. No. 2004-005 at 2-44 (“a board of county commissioners may incur debt only if it has clear statutory authority to do so.”); see also 1993 Op. Att’y Gen. No. 93-039, at 2-203 (“The power to borrow money or to incur debt is not necessarily to be implied from the authority conferred upon a board of township trustees to expend funds for particular purposes.”).

³ While there is early case law that concluded the power of governmental entities to borrow money for a particular purpose carried with it an incidental power of executing/delivering such evidence of indebtedness (including

A starting place to look for authority to borrow money and the authority to issue securities is O.R.C. Chapter 133 (“the Uniform Public Securities Law”).⁴ Some examples of entities that may utilize the provisions of O.R.C. Chapter 133 for their security issuances include:

- A board or boards of county commissioners;
- The legislative authority for a municipal corporation;
- The board of education for a school district;
- A board of township trustees for township,
- Any other political subdivision or taxing district or other local public body or agency authorized by the Uniform Public Securities Law or other laws to issue "Chapter 133 securities."

Under O.R.C. §133.01(KK), a “security” includes “bonds, *notes, certificates of indebtedness, commercial paper, and other instruments in writing*, including, unless the context does not admit, anticipatory securities, *issued by an issuer to evidence its obligation to repay money borrowed, or to pay interest, by, or to pay at any future time other money obligations of, the issuer of the securities . . .*” As stated previously, promissory notes are a common debt instrument (a type of security, per O.R.C. Chapter 133) used by private institutions to evidence a borrower’s indebtedness and the borrower’s obligation to repay the bank, usually with interest, when the bank lends money.

One example of a provision in the Revised Code that would permit the taxing authority of a subdivision to both borrow money and issue securities (evidence of indebtedness) is O.R.C. § 133.15, which grants broad authority for the issuance of securities for the purpose of paying all or any portion of the costs of any permanent improvement that the subdivision is authorized to acquire, improve, or construct.

Nearly all the security issuances authorized by and subject to O.R.C. Chapter 133 are detailed/complex and any governmental entity seeking to borrow money from a private financial institution utilizing any provision of O.R.C. Chapter 133 as statutory authority for the loan arrangement should consult its legal counsel before taking any actions.

negotiable bonds, notes, or other securities), later case law on this subject suggests that the power to issue securities is not necessarily incident to a power to borrow money and that generally, both powers must be expressly granted. *Compare State ex rel. Shoemaker v. Trustees of Goshen Tp.*, 14 Ohio St. 569, 1863 WL 53 (1863) (“The grant of power to the trustees to borrow money for the purpose of paying the amount subscribed, carried with it the necessary incidental power of executing and delivering such evidences of indebtedness, as are sanctioned by the known usages of business, in such cases; and it was, therefore, competent for the trustees to issue the negotiable bonds of the township in payment for the stock subscribed . . .”), and *Muskingum County Com'rs v. State*, 78 Ohio St. 287, 302-3, 85 N.E. 562 (1908) (“The power to issue bonds, or other negotiable securities, is not necessarily incident to a power expressly conferred upon a municipal corporation to borrow money, but generally the one power, as well as the other, must be expressly granted.”).

⁴ The “Uniform Public Securities Law” was enacted to: (1) defines key terms related to public securities and bonds; (2) provide authority for the issuance of securities by various political subdivisions and taxing units; and (3) prescribe a uniform procedure for issuing securities including the form(s), content(s), and manner(s) of execution.

While utilizing applicable provisions in O.R.C. Chapter 133 is often the most straight-forward legal authority to obtain a standard installment loan from a private financial institution, there are other provisions, or combinations of provisions, in the Revised Code that governmental entities could rely upon as legal authority to borrow money and issue securities. However, any governmental entity seeking to obtain a standard installment loan from a private financial institution utilizing these other provisions of the Revised Code should consult its legal counsel before taking any actions.

As a final point to consider, while most governmental entities are limited in their capacity to create debt by Constitutional or statutory provisions, there is no uniform debt limitation applying to all types of entities and all types of debt. So, when applicable, an entity should also work closely with its legal counsel to ensure legal debt margins are not exceeded at the time of issuance.

The AOS will evaluate each loan arrangement individually to determine its legality. Any governmental entity with a standard installment loan from a private financial institution should be prepared to present the legal authority it relied upon to both borrow the money and issue securities to evidence the indebtedness.

II. Accounting for the Proceeds/Revenue of a Standard Installment Loan from Private Financial Institution.

Subdivisions who incur debt under a standard installment loan from a private financial institution, as discussed above, should follow the requirements of O.R.C. § 5705.09 and § 5705.10. Unless restricted or otherwise limited to a particular purpose by a law (for example, see O.R.C. § 5705.10(D)), the proceeds/revenue of a standard installment loan from a private financial institution may be placed and accounted for in the recipient entity's general fund.

Subdivisions should be mindful about using proper resources to pay back installment loans that required the subdivision to issue a security. For example, a Bond Retirement Fund would be used to repay the Chapter 133 securities debt in most cases. Proceeds/revenue should be posted as "Loans Issued" or similar receipt description in accounting records and financial reports. Payments on the loans should be posted as "Debt Service: Principal Retirement" and "Debt Service: Interest and Fiscal Charges", as appropriate. See financial statement framework for various entities located on the AOS website within financial statement shells for descriptions: <https://ohioauditor.gov/references/shells.html>

Additionally, entities subject to O.R.C. Chapter 5705 budgetary laws, should evaluate whether they amend their certificate of estimated resources to include the proceeds/revenue of from any debt instrument issued. In addition, they should evaluate whether appropriations must be amended before expending any of the proceeds/revenue.

If a prohibited standard installment loan from a private financial institution has been obtained (meaning the loan was executed without legal authority or contrary to the procedures/parameters set forth by established legal authorities), include a "Non-compliance" footnote disclosure in your year-end financial statements disclosing the violation of legal provisions and actions taken to address such violations.

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Additional guidance for Townships and Villages may be obtained from the Ohio Township Handbook and Village Officer's Handbook located on the AOS website: <https://ohioauditor.gov/publications.html>.

Questions

If you have any questions regarding the information presented in the Bulletin, please contact the AOS Center for Audit Excellence at (800) 282-0370.

A handwritten signature in black ink that reads "Keith Faber". The signature is written in a cursive, flowing style.

Keith Faber
Ohio Auditor of State