



# Dave Yost • Auditor of State

## **Senate Government Oversight and Reform Committee**

**Dave Yost, Auditor of State**

**House Bill 103**

**June 28, 2017**

Chairman Coley, Vice-Chair Uecker, Ranking Member Yuko and members of the Senate Government Oversight and Reform Committee, thank you for allowing me to testify today in support of HB 103, the companion bill to SB 88. This body voted in unanimous support of SB 88. HB 103 is identical to SB 88.

HB 103 would make much needed changes to R.C. §118 which outlines the fiscal emergency process for local governments. As a point of reference, entities can be placed in three different categories of fiscal distress—fiscal caution, fiscal watch, and fiscal emergency. Currently in Ohio, we have nine entities in fiscal caution, one in fiscal watch, and 22 in fiscal emergency. On average, local governments spend approximately 5 years in fiscal emergency.

R.C. §118 was originally enacted in 1978 as a response to the Cleveland debt crisis. The fiscal distress process acts as both a deterrent and a remedy when a local government is facing financial hardship, which we recognize is not always of its own making. An entity in fiscal emergency must develop and implement a financial recovery plan to get back on solid financial footing. The entity is held accountable by a Financial Planning and Supervision Commission who approves or disapproves of the plan. The commission is given broad powers to enforce the plan and ensure the entity is taking the correct path towards financial solvency.

Although the process has worked well since its inception, there are times when commissions become stalled, stonewalled, or otherwise are prevented from doing their work. By comparison, we have observed that school districts spend a year less, on average, in fiscal emergency than other local governments. In short, school district commissions function well; local government commissions sometimes do not.<sup>1</sup> Although we have not imported the entire commission framework for schools, this legislation is an attempt to apply what works well from that statute and strike a balance between local influence and outside oversight. The legislation also contains some of our own recommendations to help entities begin the recovery process faster and ultimately implement their recovery plan.

### **Composition of the Financial Planning and Supervision Commission**

First, the bill addresses the make-up of the Financial Planning and Supervision commission. Under current law the commission is made up of seven members, four ex-officio members and three at-large members. HB 103 does not change the number of ex-officio or at-large members on the commission. Rather, the bill preserves the influence of local officials to fix local problems and speeds up the seating of the commission to begin their work. Under current law local officials can exercise complete control over the commission since they hold four or five of the seven votes. At times, this consolidated power structure may operate to the detriment of the entity, preventing any progress or implementation of a plan. HB 103 brings greater objectivity to the commission – local governments retain control over three of the seven seats, with the remaining votes going to individuals outside the entity.

Attached to my testimony is a table which identifies the current make-up and our proposed make-up of the commission.

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<sup>1</sup> Under R.C. §3316.05(B)(1), school district commissions consists of: two ex officio members: the director of budget and management and the superintendent of public instruction, and three appointed members, one by the governor, one by the superintendent of public instruction, and one by the mayor of the municipal corporation with the largest number of residents living within the school district.

## **Appointment Process for Local Members**

The bill also speeds up the appointment and selection process of the commission. Currently the appointment process can take a year or longer to properly seat a commission. The local leaders submit five names to the governor who then approves and appoints three of the five. There is no deadline to submit names to the Governor nor is there a deadline for the Governor to make his selection from the names provided to him. This stands in contrast to the process with school districts where the commission is organized quickly. In the school district fiscal emergency section, the locally appointed members are appointed within 15 days of the declaration of fiscal emergency. HB 103 imports the school district language requiring all appointments to be made in 15 days. To give an example, under current law, with a city, the mayor and council make a recommendation of five people to the Governor's office who must then select three of those members to be placed onto the commission. The process being proposed in HB 103 allows local governments to directly appoint two members to the commission while also retaining the Governor's authority to appoint one member to the commission.

## **Content of the Financial Recovery Plan**

We have found that local governments sometimes choose not to access funds that could otherwise allow them to be released from fiscal emergency sooner. For instance, the City of Wellston has a "Permanent Investment Fund" that was set up over 20 years ago with the sale of the City's electric plant. The City Council at that time restricted expenditures to "interest only" and also did not allow for any other expenditures of the monies without the vote of the electorate. The City Council could have rescinded the provision requiring the "vote of the electorate" and the "spending of interest only," but opted not to. If the commission was given the power to include these items in the recovery plan and was granted the ability to limit funding and expenditures until

the items were implemented, in Wellston's case, several funds could have been restored to positive balances and allowed the city to be released from fiscal emergency sooner. The bill addresses this problem by encouraging a local government in fiscal emergency to use all funds that are not restricted by state law or the state Constitution, to help them get out of fiscal emergency. Failure to use these kinds of funds would result in the enforcement of the 85% of expenditures rule, which requires the local government to spend 85% of what they spent during the same month of the previous calendar year from the general fund. Our experience with the 85% of expenditures rule (as found in current law) is that it acts as an effective means of helping entities make the tough decisions needed for fiscal recovery.

### **Additional Powers Granted to the Financial Planning and Supervision Commission**

This legislation requires local governments to provide accurate and timely financial data and reports to the financial supervisor. The Auditor of State is designated as the financial supervisor to these commissions and is tasked with creating monthly financial reports to be given to the commission for their consideration. Late or inaccurate financial data or reports can delay the important work of the commission. HB 103 puts a time limit on the submission of financial data or reports to the Auditor of State, and allows the commission to approve or disapprove of the financial data or reports. Disapproval of the financial data or reports by the commission may result in the commission electing to enforce the 85% of expenditures rule as explained earlier in my testimony.

### **Escalation from Fiscal Watch to Fiscal Emergency for Failure to Implement Plan**

HB 103 codifies a provision enacted under HB 64 of the 131<sup>st</sup> General Assembly which enables the Auditor of State to escalate an entity from fiscal watch to fiscal emergency if they fail to act upon or implement

their financial recovery plan within 90 days of the declaration of fiscal watch. Although such escalation existed for caution to watch, no such provision was in place for watch to emergency. As a result, a local government under fiscal watch could adopt a plan with no intention of actually implementing the plan, leaving our office with no enforcement mechanism. Entities in fiscal watch can continue to operate for years in a condition of fiscal watch until they eventually meet the conditions for fiscal emergency, proving the old adage “you can lead a horse to water, but you can’t make it drink.” Codifying this provision will cure an error in the code and help enforce the requirement that entities implement their recovery plan.

### **Financial Health Indicators**

In closing, I’d like to make note of an important tool we introduced several months ago to prevent financial crises – Financial Health Indicators (“FHI”). This tool helps cities and counties better assess their financial health and make informed budgetary decisions to avoid future fiscal stress. While the fiscal emergency process is reactive in nature, FHI is a proactive tool to help Ohio’s 247 cities and 88 counties gauge their fiscal health. This system looks at 17 indicators using data from the previous 4 years to provide each entity their own personalized fiscal physical. No single indicator can determine the outlook of an entity, but all 17 paint a financial forecast. Depending on the data, each indicator is designated as either having a “critical outlook”, “cautionary outlook”, or a “positive outlook.” The FHI report can be used to determine early warning signs of fiscal distress so an entity can take corrective action and avoid a fiscal distress designation altogether. I did want to make the committee aware that we will be issuing our newest FHI report over this summer and would be happy to provide copies of the report should you so please.

The bill before you is the product of more than two years of internal vetting and work with outside stakeholders, including the County Commissioner’s Association (“CCAO”), the Ohio Township

Association (“OTA”), and the Ohio Municipal League (“OML”). We appreciate the valuable feedback and revisions these groups have provided to make this a better bill.

I would like to thank Representative Reineke for HB 103 along with Senator Terhar and President Obhof for their leadership on this issue in the Senate. Thank you Chairman Coley and members of the committee; I would be happy to answer any questions you may have at this time.