

OPINION NO. 86-056**Syllabus:**

1. Provided that a municipal corporation complies with applicable statutory provisions and any applicable rules of the Auditor of State, it may, in the reasonable exercise of discretion under R.C. 743.04-.06, establish more than one account for moneys collected for waterworks purposes and designate the purposes of such accounts.
2. R.C. 743.05 does not authorize the expenditure of municipal waterworks moneys for purposes other than those listed in R.C. 743.05.
3. Pursuant to R.C. 9.34, the question whether a surplus exists under R.C. 743.05 is to be determined annually, on the basis of the municipality's fiscal (calendar) year.
4. Assuming that there are no applicable rules to the contrary, R.C. 743.05 and 743.06 permit a municipality to establish an accounting procedure under which water rents that have been placed in an account for the purposes of repairing, extending, and enlarging the waterworks system are not available for the purposes of operating and managing the waterworks system.

To: Thomas E. Ferguson, Auditor of State, Columbus, Ohio
By: Anthony J. Celebrezze, Jr., Attorney General, July 29, 1986

I have before me your request for an opinion concerning the management and use of waterworks moneys under R.C. 743.04-.06. Your questions are as follows:

- (1) Can a municipality establish more than one

account for moneys collected for waterworks purposes? If so, must these accounts expend their moneys for similar purposes (i.e., conducting and managing the waterworks system)?

- (2) Assume that a municipality has two waterworks accounts. Both derive their income from water rentals. One account A, is used to expend moneys to conduct and manage the waterworks system. The other account, B, is used exclusively for repairing, extending and enlarging the waterworks plant. Whenever account A is projected to require extra funding, a rate hike is passed rather than a transfer made from account B to account A. Under Sections 743.05-743.06 of the Ohio Revised Code, can such an accounting procedure be legally set up?
- (3) Under Section 743.05 of the Ohio Revised Code, when can a municipality legally determine when a surplus of funds [exists]? Can a surplus only be determined at the end of a fiscal period?

It is my understanding that your questions relate to a municipality that is operating under the statutory scheme established by R.C. 743.04-.06 and that has not attempted to alter that scheme by the adoption of local provisions.¹ See R.C. 743.02. See also R.C. 735.29 (granting the board of trustees of public affairs of a village the authority to exercise powers and duties under, inter alia, R.C. 743.05-.06).

Ohio Const. art. XVIII, §4 authorizes any municipality to "acquire, construct, own, lease and operate...any public

¹ The validity of provisions, such as those now appearing in R.C. 743.05, which restrict the expenditure of funds derived from municipal waterworks, has been upheld as an exercise of the power of the General Assembly under Ohio Const. art. XVIII, §13, to limit the power of municipalities to levy taxes. See City of Cincinnati v. Roettinger, 105 Ohio St. 145, 137 N.E. 6 (1922). The theory behind that holding is that charges which exceed the cost of the service constitute taxes. See State ex rel. Waterbury Development Co. v. Witten, 58 Ohio App. 2d 17, 387 N.E.2d 1380 (Lucas County 1977), aff'd, 54 Ohio St. 2d 412, 377 N.E.2d 505 (1978); Giesel v. City of Broadview Heights, 14 Ohio Misc. 70, 236 N.E.2d 222 (C.P. Cuyahoga County 1968). The validity of this theory was questioned by my predecessor in 1952 Op. Att'y Gen. No. 1533, p. 446, in light of City of Niles v. Union Ice Corp., 133 Ohio St. 169, 12 N.E.2d 483 (1938), which states, with reference to an electric light and power system, that a rate charged by a city for a public utility service or product is not a tax, even if it is in excess of the cost of producing the service or product. I am, in this opinion, presuming the constitutionality of R.C. 743.04-.06. See R.C. 1.47(A). I am not considering whether, or to what extent, a municipal corporation might be able to vary the provisions of those sections by local action. See generally Ohio Const. art. XVIII, §§2, 3, 7; Dies Electric Co. v. City of Akron, 62 Ohio St. 2d 322, 405 N.E.2d 1026 (1980); State ex rel. McCann v. City of Defiance, 167 Ohio St. 313, 148 N.E.2d 221 (1958); Pfau v. City of Cincinnati, 142 Ohio St. 101, 50 N.E.2d 172 (1943); 1985 Op. Att'y Gen. No. 85-034.

utility the product or service of which is or is to be supplied to the municipality or its inhabitants." See also Ohio Const. art. XVIII, §§5, 6, 12. A waterworks constitutes such a public utility. See Ohio Const. art. XVIII, §6; 1981 Op. Att'y Gen. No. 81-098. A statutory scheme for the collection and expenditure of waterworks receipts by a municipality appears in R.C. 743.04-.06. The existence of such a scheme has been found to be constitutional. See City of Cincinnati v. Roettinger, 105 Ohio St. 145, 137 N.E. 6 (1922). See generally note 1, supra.

Your first question is whether, under R.C. 743.04-.06, a municipality may establish more than one account for moneys collected for waterworks purposes. R.C. 743.04 relates to the assessment and collection of water rents or charges. It states, in part:

For the purpose of paying the expenses of conducting and managing the water works of a municipal corporation, including operating expenses and the costs of permanent improvements, the director of public service or any other city official or body authorized by charter may assess and collect a water rent or charge of sufficient amount and in such manner as he or it determines to be most equitable from all tenements and premises supplied with water. (Emphasis added.)

R.C. 743.05 contains provisions governing the manner in which waterworks funds are to be accounted for and expended. It states:

After payment of the expenses of conducting and managing the water works, any surplus of a municipal corporation may be applied to the repairs, enlargement, or extension of the works or of the reservoirs, the payment of the interest of any loan made for their construction, or for the creation of a sinking fund for the liquidation of the debt. In those municipal corporations in which water works and sewerage systems are conducted as a single unit, under one operating management, a sum not to exceed ten per cent of the gross revenue of the water works for the preceding year may be taken from any surplus remaining after all of the preceding purposes have been cared for and may be used for the payment of the cost of maintenance, operation, and repair of the sewerage system and sewage pumping, treatment, and disposal works and for the enlargement or replacement thereof. Each year a sum equal to five per cent of the gross revenue of the preceding year shall be first retained from said surplus as a reserve for waterworks purposes.

The amount authorized to be levied and assessed for waterworks purposes shall be applied by the legislative authority to the creation of the sinking fund for payment of any indebtedness incurred for the construction and extension of water works and for no other purposes; provided, where such municipal corporation does not operate or maintain a water works or a sewage pumping, treatment, and disposal works, any or all such surplus may be transferred to the general fund of the municipal corporation in the manner provided for in sections 5705.15 and 5705.16 of the Revised Code. (Emphasis added.)

The first paragraph of R.C. 743.05 relates to amounts collected

from water rents and charges, and the second paragraph relates to property taxes levied for waterworks purposes. See R.C. 743.22; City of Cincinnati v. Roettinger.

R.C. 743.06 states, in part: "Money collected for water-works purposes shall be deposited weekly with the treasurer of the municipal corporation, and shall be kept as a separate and distinct fund." Pursuant to this provision, all amounts collected for waterworks purposes are to be kept in a separate fund. See also R.C. 743.22.

The word "fund" is used generally to mean "[a] sum of money or other liquid assets set apart for a specific purpose, or available for the payment of debts or claims." Black's Law Dictionary 606 (5th ed. 1979). Accord, Webster's New World Dictionary 565 (2d college ed. 1978) (defining "fund" as "a sum of money set aside for some particular purpose"). "Account" is defined as: "[a] statement in writing, of debts and credits, or of receipts and payments," Black's Law Dictionary 17 (5th ed. 1979), or as: "a record of the financial data pertaining to a specific asset, liability, income item, expense item, or net-worth item," Webster's New World Dictionary 9 (2d college ed. 1978). The Revised Code contains the following definitions, applicable to R.C. Chapters 113, 117, 123-127, and 131 and to "any statute that uses the terms in connection with state accounting or budgeting":

(A) "Account" means any record, element, or summary in which financial transactions are identified and recorded as debit or credit transactions in order to summarize items of a similar nature or classification.

(B) "Accounting procedure" means the arrangement of all processes which discover, record, and summarize financial information to produce financial statements and reports and to provide internal control.

(C) "Accounting system" means the total structure of records and procedures which discover, record, classify, and report information on the financial position and operations of a governmental unit or any of its funds, balanced account groups, and organizational components.

....
(L) "Fund" means an independent fiscal and accounting entity with a self-balancing set of accounts recording cash or other resources, together with all related liabilities, obligations, reserves, and fund balances which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special rules, restrictions, or limitations.

R.C. 131.01. As is evident from the foregoing, funds and accounts are procedural devices for keeping financial records. See, e.g., 8 Ohio Admin. Code 117-5-07 ("[to] further identify where moneys in an individual fund were derived, each village shall use the following account (revenue) code which is a sub-classification of the source code"); 1981 Op. Att'y Gen. No. 81-035, at 2-135 ("[a] 'fund' is conceptualized as a convenient business device which 'amounts to no more than assigning a name to a segregated portion of an agency's monies [and a]ttaching words to a fund does not authorize its expenditure for purposes for which the constituent monies could not be spent.' 1957 Op. Att'y Gen. No. 772, p. 287, 289"); 1937 Op. Att'y Gen. No. 1465, vol. III, p. 2447 at 2451 ("[f]unds are merely bookkeeping devices, but indispensable perhaps under our form of government"). See generally 1985 Op. Att'y Gen. No. 85-085.

The statutory scheme set forth in R.C. 743.04-.06 provides for a separate and distinct waterworks fund, R.C. 743.06, and also for a sinking fund for the liquidation of debt incurred in the construction of waterworks, R.C. 743.05. See generally R.C. 5705.09 (setting forth funds which a subdivision must establish); R.C. 5705.12 (authorizing the taxing authority of a subdivision, with the approval of the Auditor of State, to establish such funds other than those provided for by R.C. 5705.01-.13 as may be desirable). Under R.C. 743.04-.06, waterworks moneys may, in appropriate circumstances, be used for a number of different purposes, among them the payment of the expenses of conducting and managing the waterworks; the costs of repairs, enlargement, or extension of the waterworks or reservoirs; the payment of interest on construction loans; the payment of costs relating to a sewage system which is conducted as a single unit with the waterworks; and the transfer to the general fund of the municipal corporation. No statutory direction is given regarding the number or type of accounts that a municipality may establish within the waterworks fund to hold its waterworks moneys.

R.C. 117.43 authorizes the Auditor of State to "prescribe by rule, requirements for accounting and financial reporting for public offices other than state agencies." See 8 Ohio Admin. Code Chapter 117-5 (villages); 8 Ohio Admin. Code Chapter 117-6 (cities). See also Ohio Const. art. XVIII, §13 ("[l]aws...may require reports from municipalities as to their financial condition and transactions, in such form as may be provided by law, and may provide for the examination of the vouchers, books and accounts of all municipal authorities, or of public undertakings conducted by such authorities"); 1927 Op. Att'y Gen. No. 1418, vol. IV, p. 2594; note 1, supra. As long as a municipality complies with applicable statutory provisions and any applicable rules of the Auditor of State, it appears that the municipality may exercise its discretion in establishing an accounting system to carry out the purposes of R.C. 743.04-.06. See generally 1927 Op. No. 1418. I am aware of no reason why the establishment of more than one account for moneys collected for waterworks purposes would, in itself, be inconsistent with the scheme established by R.C. 743.04-.06, provided, of course, that moneys are expended only as permitted by law.

Accounts holding waterworks moneys may, consistent with R.C. 743.04-.06, have purposes which differ from one another, provided that the purposes are permitted by law and are designated in accordance with applicable provisions. R.C. 743.05 does not authorize the expenditure of waterworks moneys for purposes other than those listed in R.C. 743.05. See City of Franklin v. Harrison, 171 Ohio St. 329, 170 N.E.2d 739 (1960); Hartwig Realty Co. v. City of Cleveland, 128 Ohio St. 583, 192 N.E. 880 (1934); City of Cincinnati v. Roettinger; In re Transfer of Funds of the City of Athens, 3 Ohio Op. 215 (C.P. Athens County 1935). See generally State ex rel. Lloyd v. Hurd, 1 Ohio App. 2d 447, 205 N.E.2d 116 (Trumbull County 1964); 1952 Op. Att'y Gen. No. 1533, p. 446; note 1, supra.

For ease of discussion, I turn now to your third question, which also concerns a matter of accounting: over what time period may a municipality determine under R.C. 743.05 whether a surplus of funds exists? Under R.C. 743.05, water rents and charges must first be applied to payment of the expenses of conducting and managing the waterworks. Any surplus existing after the payment of such expenses may be applied to repairs and construction, to payment of interest, or for the creation of a sinking fund to liquidate debt. After all those purposes

have been cared for, a municipal corporation that operates its waterworks and sewage systems as a single unit may take from any remaining surplus an amount that is not more than ten percent of the gross revenue of the waterworks for the preceding year, and use such amount for sewage system purposes. No such moneys may, however, be applied to sewage system purposes unless a sum equal to five percent of the gross revenue of the preceding year is first retained from the surplus as a reserve for waterworks purposes. See generally 1955 Op. Att'y Gen. No. 5137, p. 203.

With respect to property taxes levied for waterworks purposes, R.C. 743.05 states that the amount authorized to be levied and assessed for waterworks purposes shall be applied to the creation of a sinking fund for the payment of indebtedness incurred for the construction and extension of waterworks. It provides further that, where a "municipal corporation does not operate or maintain a water works or a sewage pumping, treatment, and disposal works, any or all such surplus may be transferred to the general fund of the municipal corporation in the manner provided for" in R.C. 5705.15 and 5705.16. R.C. 5705.16 sets forth the procedure to be followed in seeking such transfer, including the passage of a resolution by the taxing authority of the political subdivision, the preparation of a petition addressed to the court of common pleas, the approval of the petition by the Tax Commissioner, and notice of a hearing on the petition.

"Surplus" is defined generally as: "[t]hat which remains of a fund appropriated for a particular purpose; the remainder of a thing; the overplus; the residue." Black's Law Dictionary 1294 (5th ed. 1979). See also 1980 Op. Att'y Gen. No. 80-003 at 2-26 (overruled, in part, on other grounds by 1985 Op. Att'y Gen. No. 85-072) ("'[s]urplus' is...generally understood to mean a fund or amount which is no longer needed for a particular purpose" (citation omitted)); Webster's New World Dictionary 1433 (2d college ed. 1978) (defining "surplus" as "a quantity or amount over and above what is needed or used; something left over; excess"). In order to determine what amount is left over, it is necessary to select a time period and to calculate the amount left unused as of a particular date.

While R.C. 743.05 does not state expressly when a municipality may determine whether a surplus of funds exist, it is implicit in the statutory scheme that such a determination is to be made on an annual basis. The first paragraph of R.C. 743.05 states that the amount of surplus authorized to be transferred to the sewage system is to be based upon the gross revenue of the waterworks for the preceding year; the implication is that the amount that may be transferred is to be calculated yearly. The first paragraph of R.C. 743.05 states further that "[e]ach year," before any moneys are applied to sewage system purposes, a certain percentage of the gross revenue of the preceding year must be retained as a reserve for waterworks purposes. Since the amount to be retained is established on an annual basis, it appears that the determination as to whether a surplus exists is also to be made on an annual basis.

Pursuant to R.C. 9.34, the fiscal year of a municipal corporation is the calendar year, and it is this year to which R.C. 743.05 apparently applies. R.C. 9.34 states, in part: "Except as otherwise provided for school districts, all laws relating to the levying of taxes, the collection, appropriation, or expenditure of revenues, or the making of financial reports or statements for a fiscal year or other year

refer and apply to the fiscal year as defined in this section." I conclude, therefore, that, pursuant to R.C. 9.34, the question whether a surplus exists under R.C. 743.05 is to be determined annually, on the basis of the municipality's fiscal (calendar) year.

The conclusion that, under R.C. 743.05, the question whether a surplus exists is to be determined on the basis of the fiscal year is supported by the fact that R.C. 743.05 appears to permit applications of surplus moneys to be permanent in nature; there is no indication that amounts of surplus moneys expended for particular purposes must be reimbursed. Cf. Op. No. 80-003 at 2-26 ("surplus' may mean anything that is not currently needed for a particular purpose, although it may be needed at some time in the future, i.e. a 'temporary surplus'" (citation omitted)); 1975 Op. Att'y Gen. No. 75-087 (finding that a statute contemplated determination of a temporary surplus where there was a requirement that the fund be reimbursed); 1930 Op. Att'y Gen. No. 2407, vol. II, p. 1542 at 1543 (overruled, in part, on other grounds, by Op. No. 75-087) ("the word 'surplus', as used in [a particular] statute, does not mean an excess of moneys requisite to meet the entire liabilities, both present and future, of a fund, but merely more than sufficient moneys for present needs. In other words, it means a temporary surplus, hence the requirement to reimburse the fund"). See generally R.C. 5705.15-.16. This conclusion is consistent with the fact that a reserve for waterworks purposes must be retained from any surplus before moneys may be applied to sewage system purposes.

I turn now to your second question, which asks, in essence, whether R.C. 743.05 and 743.06 permit a municipality to establish an accounting system under which certain receipts from water rentals are reserved for the costs of repairing, extending, and enlarging the waterworks plant, rather than being available for costs of conducting and managing the waterworks system. The objection that has been voiced to such an arrangement is that rate increases are passed to cover management costs even though moneys are available in the account reserved for repair and construction costs. I find nothing in R.C. 743.05 that prohibits such a result.

As discussed in connection with your first question, assuming that there are no rules to the contrary, R.C. 743.05 permits a municipal corporation to establish two waterworks accounts holding moneys derived from water rentals. In your example, account A holds moneys for conducting and managing the waterworks system, and account B is used exclusively for repairing, extending, and enlarging the waterworks plant. Whenever account A is in need of additional funds, a rate hike is passed. Amounts in account B are reserved for the purposes of that account, and are not transferred to account A to meet its needs.

Under the scheme set forth in R.C. 743.05, when water rents are received, they must be used first to pay the expenses of conducting and managing the waterworks. Only if a surplus exists may moneys derived from water rents "be applied to the repairs, enlargement, or extension of the works or of the reservoirs." R.C. 743.05. Thus, in order for moneys derived from water rents to properly be in account B, those moneys must have been determined at a particular time to constitute a surplus. I believe that the process of finding that a surplus exists and transferring surplus funds to account B may be found to constitute the application of such funds to the "repairs, enlargement, or extension" of the waterworks, so that the

moneys so transferred are no longer available for paying the expenses of conducting and managing the waterworks. See Black's Law Dictionary, 91, 93 (5th ed. 1979) (defining "apply" as meaning "[t]o use or employ for a particular purpose; to appropriate and devote to a particular use, object, demand, or subject matter. Thus, to apply payments to the reduction of interest"; defining "appropriate" as meaning "[t]o prescribe a particular use for particular moneys; to designate or destine a fund or property for a distinct use, or for the payment of a particular demand"); Random House Dictionary of the English Language 73 (unabridged ed. 1973) (defining "apply" as meaning "to use for or assign to a specific purpose: He applied a portion of his salary each week to savings"). R.C. 743.05 appears to permit a scheme under which surplus water rents are considered to have been applied to purposes of repair, enlargement, or extension when they are transferred to account B, even though they may not yet have been expended for those purposes. Once so applied, they need not be made available for the purposes of account A. Rather, appropriate steps--such as increases in water rates--may be taken to meet the needs of account A. See generally City of Cincinnati v. Roettinger, 105 Ohio St. at 151, 137 N.E. at 7-8 (under G.C. 3959 [now R.C. 743.05] "such authorities have the discretion either of applying the surplus in the manner therein stated or carrying it as a surplus, thereby permitting a reduction of the rates and charges in future years. That is to say, they 'may' either do nothing whatever with the surplus, which would automatically and necessarily operate to bring about a reduction of rates and charges, or maintain the rate and apply the surplus thus produced to extensions, new construction, or interest and principal of debts").

It is therefore, my opinion, and you are hereby advised, as follows:

1. Provided that a municipal corporation complies with applicable statutory provisions and any applicable rules of the Auditor of State, it may, in the reasonable exercise of discretion under R.C. 743.04-.06, establish more than one account for moneys collected for waterworks purposes and designate the purposes of such accounts.
2. R.C. 743.05 does not authorize the expenditure of municipal waterworks moneys for purposes other than those listed in R.C. 743.05.
3. Pursuant to R.C. 9.34, the question whether a surplus exists under R.C. 743.05 is to be determined annually, on the basis of the municipality's fiscal (calendar) year.
4. Assuming that there are no applicable rules to the contrary, R.C. 743.05 and 743.06 permit a municipality to establish an accounting procedure under which water rents that have been placed in an account for the purposes of repairing, extending, and enlarging the waterworks system are not available for the purposes of operating and managing the waterworks system.