

# **OKLAHOMA MUNICIPALITIES AND THEIR PUBLIC TRUSTS**

By Michael A. Crawford, CPA

## **1. Why were municipal public trusts created in Oklahoma?**

Article 10 § 26 of the Oklahoma Constitution prohibits a municipality from incurring long-term debt unless the debt is authorized by a vote of the people, and limits that long-term debt primarily to the form of general obligation bonds secured by the municipality's ability to levy a property tax to pay the debt service on the bonds. Public trusts (also referred to as authorities) were initially created in 60 O.S. § 176 of the Oklahoma Statutes to serve as an alternative funding mechanism for authorized municipal/public functions and purposes, including the ability to borrow funds (normally in the form of tax-exempt revenue bonds) without voter approval and to operate certain revenue-producing municipal functions, such as utilities, hospitals, airports, recreation facilities and the like.

## **2. What are the presumptions and conditions for the creation of a municipal public trust?**

60 O.S. § 176.1(A) states that any public trust created in accordance with these statutory provisions are presumed to:

- Exist for the public benefit;
- Exist as a legal entity separate and distinct from the settlor/trustor (which is generally the governmental entity that is its beneficiary); and
- Act on behalf and in the furtherance of a public function(s) for which it is created even though facilities financed or owned by the public trust may be operated by private persons or entities pursuant to contract.

In addition, these public trusts must satisfy the following conditions:

- The trustees are to be appointed by the governing body of the beneficiary (for trusts created after July 1, 1992);
- The trust delivers annual audit reports to the governing body of the beneficiary;
- The function or enterprise in which the public trust is engaged is or could be authorized by state law to be performed by the beneficiary; and
- All long-term indebtedness incurred by the public trust is approved by the governing body of the beneficiary.

## **3. How are municipal public trusts created?**

The creation of an express public trust by a municipality requires the development and approval of a Declaration of Trust (trust indenture) which serves as a contract or covenant between the

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trustees of the trust and the beneficiary municipality governing body, as trustor. The trust indenture essentially serves as the governing document that prescribes the fiduciary nature of the trust and includes such information as the name of the trust, the trust beneficiary, the trust's purpose(s), its powers, duration, and limitations and how the trust will operate, be governed and terminate. Generally, Oklahoma municipal public trusts do not require a vote of the people of the beneficiary municipality to be created and are established through the signing of the declaration of trust by the trustor and trustees and by the acceptance of its beneficial interest in the trust by the municipal beneficiary through a resolution adopted by the municipal governing body. 60 O.S. § 176(A) requires approval of two-thirds (2/3) of the membership of the governing body of its beneficiary for the creation of the trust.

Once a municipal public trust is created by a municipality, generally its operations begin with the leasing of certain existing property on a long-term basis to the trust by the municipality for the trust to maintain and operate. This property and related operations are generally associated with revenue-producing municipal activities, such as electric, water, wastewater and sanitation utilities, hospitals, airports, golf courses, other recreation facilities and the like. These are common functions for municipal public trusts because these activities produce specific net revenue that can be pledged as security for revenue bonds commonly issued by these trusts, without the need to create a general obligation to or pledge of the full faith and credit of the beneficiary municipality.

In 1953 the Internal Revenue Service ruled that an Oklahoma municipal public trust acts "on behalf" of its beneficiary municipality and is therefore a special kind of local government entity under the IRS Code that is exempt from income tax and authorized to issue tax-exempt revenue debt on behalf of the municipality. The IRS has not made it clear as to whether public trusts must have a separate and unique taxpayer identification number from that of the beneficiary municipality. Practice has shown that some trusts do have their own separate taxpayer identification number, while other trusts operate using the municipality's tax ID.

#### **4. What is the legal relationship between a municipal public trust and its beneficiary municipality?**

Oklahoma municipal public trusts are created as separate legal entities from their beneficiary municipality in the form of an express trust governed by a trust indenture. State law and related court cases have held that a public trust is separate and apart from and not merged with its municipal beneficiary – see 60 O.S. § 176.1(a)(2); *Woodward v. City of Anadarko*, 351 P.2d 292 (OK 1960). Trusts are not considered a branch or division of the municipality, but are instead separate legal entities that have powers separate from that of the municipality. For example,

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because the trust is a separate legal entity from the municipality, it is not governed by the constitutional debt limitation applicable to its municipal beneficiary. In addition, many of the state laws applicable to municipalities are not expressly applicable to these municipal public trusts. Contracts and other official documents related to the trust activities are generally executed under the name of the trust, rather than in the name of the beneficiary municipality, by its trustees within the powers and limitations of the trust indenture.

However, although municipal public trusts are separate legal entities, Oklahoma law still contemplates and requires certain control of the trust by its municipal beneficiary. For example, 60 O.S. § 176(F) prescribes that any long-term debt or obligation to be entered into by the trust shall first have two-thirds (2/3) approval of the governing body of its beneficiary (or three-fifths 3/5 of the governing body in municipalities with fewer than 7 members). Also, pursuant to 60 O.S. § 176(H), public trusts must file annually with their beneficiary, copies of financial documents and reports sufficient to demonstrate the fiscal activity of the trust, including such documents as budgets, financial reports, bond indentures and audit reports.

Some additional guidance on the independent legal status of public trusts from their beneficiary municipality can be found in Oklahoma Attorney General Opinion No. 86-131.

## **5. What are some of the constitutional and statutory similarities and differences between a municipal public trust and its beneficiary municipality?**

**Similarities:** Like the beneficiary municipality, a municipal public trust is subject to the open meeting act and open records act, subject to the competitive bidding state laws applicable to municipal construction contracts, and have the power of eminent domain. Also, regardless of how broad or narrow the trust indenture defines the trust purposes, a municipal public trust is generally limited to furthering the authorized public purposes of the beneficiary municipality and is prohibited from engaging in functions or activities that the municipality is unauthorized to do (with the exception of issuing revenue debt).

**Differences:** Subject to the provisions of the trust indenture that created the trust, a municipal public trust and its municipal beneficiary generally differ in the following significant respects:

- Public trusts generally borrow money through the issuance of revenue bonds or other revenue secured debt, without voter approval; while municipalities issue general obligation bonds that require voter approval
- Public trusts generally use net revenues from their operations to pay revenue bonded debt; while municipalities generally use property tax levies to pay the debt service on general obligation bonds

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- Public trusts are generally free to develop a budget in a format that best meets the needs of the trust and are not governed by the budget laws applicable to municipalities
- Budgets of public trusts merely serve as financial estimates and plans without legal spending limits; while municipal budgets establish legal spending limits in the form of appropriations
- Public trusts have additional competitive bidding requirements beyond those applicable to construction contracts of municipalities and trusts; and statutory conflict of interest provisions, exemptions and disclosures are different for municipalities and their public trusts
- Sales tax exemptions on public contracts entered into by a municipality may be passed on to contractors who may make purchases on behalf of the municipality free of sales tax; however, the Oklahoma Tax Commission regulations have not extended that same sales tax exemption pass-through to contractors representing public trusts
- Investment limitations, if any, for public trust monies are commonly found within the trust indenture, while municipality investments are limited to certain investment instruments by applicable state law

## **6. Are a municipal public trust's trustees separate and apart from the governing body of the beneficiary municipality?**

Yes from a legal perspective, but not necessarily from a physical perspective. From a legal perspective, the trustees of the public trust are considered a separate governing body from that of the beneficiary municipality governing body. The trustees of each public trust are identified in the trust indenture and they may or may not be the same members of the beneficiary municipality's governing body. While it is common for the trustees of many Oklahoma municipal public trusts to be identified in the trust indenture as the same members of the governing body of the beneficiary municipality, when these same individuals meet and transact trust business, it is done under a separate public meeting from that of the beneficiary municipality and the business or actions are transacted as trustees of the trust and not as town board, city council or city commission members. Although it is more common to see public trust trustees as the same individuals that serve as the beneficiary municipality's governing body, the trust indenture may provide for a different makeup or composition of the Board of Trustees which could include partial membership from the municipal governing body, or completely separate trustees.

## **7. Are the operational activities of the public trust to be handled separately from those of the beneficiary municipality?**

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60 O.S. § 176.1(D) states that unless otherwise provided for in the trust indenture or other law, the affairs of the public trust shall be separate and independent from the affairs of the beneficiary in all matters or activities authorized in the trust indenture, including but not limited to the trust's budget, expenditures, revenues, and general operation and management of the trust facilities or functions; provided, that either the public trust or the beneficiary may make payment of money to the other unless prohibited by the trust indenture or by existing state law.

For economy and efficiency reasons, most municipalities in Oklahoma use the same management and employees, banking, investments, accounting and information systems, facilities and equipment that serve both the public trust and the beneficiary municipality. While the same individuals may serve both legally separate entities, they do so in different and separate capacities. For example, in a Council/Manager form of municipal government, the City Manager may also be retained by the trust to serve as Trust Manager, the City Treasurer may also be used as the Trust Treasurer, and City departmental employees may also work as employees of the trust, and so on. Technically, these individuals are serving in different capacities when handling the business of the different legal entities. How these dual-capacity employees are compensated between these separate legal entities is matter of agreement between the entities and is most often determined in the budget process.

Likewise, while the municipality and public trust may use the same systems (such as pooled banking and investments, and the same accounting and information systems), their revenues, expenditures, assets, debts and fund balances are all maintained separately within these systems to ensure that trust resources are accountable separate and apart from those of the municipality. Accounting systems used in governments are based on the concept of fund accounting where funds represent separate and distinct accounting entities with their own ledger accounts separate from those of other funds. Public trusts are commonly accounted for separately within the same accounting system as their beneficiary municipality through the use of these fund accounting techniques. It is also common for the bank accounts and investments of municipal governments and their public trusts to be combined through a pooled account or pooled investment portfolio by a common Treasurer, with the fund(s) of each separate entity having an ownership share of the banking or investment pool; thereby maintaining separate accountability for each legal entity.

## **8. Can resources be transferred between a municipal public trust and its beneficiary municipality?**

60 O.S. § 176.1(D) states a public trust or the beneficiary may make payment of money to the other unless prohibited by the trust indenture that created the trust or by existing state law.

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This statute sets the overall tone in providing for the authorization of transfers of resources between these separate legal entities. Transfers of resources between municipalities and their public trusts for operating, capital and debt subsidies is a common occurrence and can be governed by applicable state laws, trust indenture provisions, bond indenture provisions and local ordinances or resolutions.

**Municipality Transfers to the Public Trust:** 60 O.S. § 176(A)(4) requires express approval of the beneficiary municipal governing body before municipal funds may be used for trust purposes. Therefore, any transfer of the beneficiary municipality's resources to its public trust or use of municipal-derived funds for trust purposes must be expressly approved by the municipal governing body, such as through budget adoption or other governing body action. For example, it is common for municipalities to pledge the proceeds of municipal sales tax revenue as part of the security for the repayment of public trust revenue bonds. Pursuant to state statute, for this to be a proper pledge and transfer of resources, the municipal governing body must take express action to approve such pledge and transfer, generally by adopting an ordinance or resolution for the pledge and by budgeting for the transfer.

**Public Trust Transfers to the Municipality:** With regard to transfers from the public trust to the beneficiary municipality, the trust indenture should be reviewed to determine if there are any limitations or constraints within the indenture as to the transfer of resources between the public trust and its beneficiary municipality. Absent any trust indenture limitations or constraints, public trust resources may be transferred to the beneficiary municipality. It is common practice for public trusts to pay money to the beneficiary municipality in the form of reimbursement of costs incurred for trust purposes paid by the municipality, payments in lieu of taxes, and transfers in the form of a return of profit to the beneficiary.

## **9. May a municipal public trust's financial statements be audited in conjunction with the audit of the financial statements of its beneficiary municipality?**

Yes. Generally accepted accounting principles applicable to municipal governments prescribe that a state or local government's financial statements are to be prepared based on the concept of a governmental "financial reporting entity." These accounting principles provide that the financial reporting entity should include not only the funds and activities of the beneficiary municipal government (referred to as the primary government), but should also include the funds and activities of all public trusts/authorities and other separate legal entities for which the municipal government's elected officials are financially accountable or which are significant to the primary government (referred to as component units). In Oklahoma, these component units are most often found in the form of public trust/authorities for which the municipality is

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beneficiary. Although the governmental reporting entity's financial statements will include the financial information of multiple separate legal entities (i.e. the municipality and each of its component unit public trusts), each separate legal entity's funds and activities are generally separately reported and identifiable within these combined financial statements.

In Oklahoma law, the annual financial statement audit requirements applicable to municipalities and public trusts are found in different state statutes. Municipality audit requirements are found in 11 O.S. §17-105 through 17-113, while public trust annual audit requirements are found in 60 O.S. § 180.1 through 180.3. Although located in different state statutes, these audit requirements are similar in terms of audit standards to be followed and audit report deadline.

Because of this financial reporting entity concept that results in the combining of the financial statements of the primary government (i.e. the municipality) and its component units (i.e. public trusts/authorities), it is acceptable and common practice, for economy and efficiency reasons, to engage the same auditor to audit the financial statements of the entire reporting entity (the municipality and all its component units). However, it is also acceptable practice for one or more component unit public trusts to issue separate stand-alone financial statements and/or engage a different auditor to audit the statements of that separate entity. Any audited stand-alone component financial statements would then be combined with the audited financial statements of the primary government to comprise the audited financial statements of the entire reporting entity.

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