



Dave Yost • Auditor of State





# Dave Yost • Auditor of State

## INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING AGREED-UPON PROCEDURES

Mahoning Valley Regional Council of Government  
Mahoning County  
7320 North Palmyra Road  
Canfield, Ohio 44406

We have performed the procedures enumerated below, with which the Council members and the management of Mahoning Valley Regional Council of Government (the "Council of Government") agreed, solely to assist the Board in evaluating receipts, disbursements and balances recorded in their cash-basis accounting records for the years ended December 31, 2015 and 2014, and certain compliance requirements related to these transactions and balances. Management is responsible for recording transactions; and management and the Board are responsible for complying with the compliance requirements. This agreed-upon procedures engagement was conducted in accordance with the American Institute of Certified Public Accountants' attestation standards and applicable attestation engagement standards included in the Comptroller General of the United States' *Government Auditing Standards*. The sufficiency of the procedures is solely the responsibility of the parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

This report only describes exceptions exceeding \$10.

### Cash

1. We tested the mathematical accuracy of the December 31, 2015 and December 31, 2014 bank reconciliations. We found no exceptions.
2. We attempted to agree the January 1, 2014 beginning fund balances recorded in the Financial Report by Fund (the "FINSUM") to the December 31, 2013 balances. This was an initial audit so there were no cash balances at that date. We attempted to agree the January 1, 2015 beginning fund balances recorded in the FINSUM report to the December 31, 2014 balances in the FINSUM report. However, the Council of Government closes out the year-end as of June 30; thus, monthly beginning balances were reflective of June 30 instead of December 31.
3. We agreed the totals per the bank reconciliations to the total of the December 31, 2015 and 2014 fund cash balances reported in the FINSUM report. The amounts agreed. However, the ending balance at December 31, 2015 and 2014 per the FINSUM report did not agree to the ending balance in the filed financial statements as of December 31, 2015 and 2014 in the amounts of \$4,956 and \$2,801, respectively. Variances appear to be attributed to State Income Taxes in the first quarter of 2015 not being paid until January of 2016, whereas, the reconciliation included these amounts as paid. In addition, the amount of federal tax withheld and not paid as of December 31, 2015 was listed higher on the reconciliation than the amount reported on the 941 form.
4. We observed the year-end bank balance on the financial institution's website. The balance agreed. We also agreed the confirmed balance to the amount appearing in the December 31, 2015 bank reconciliation without exception.

5. We selected five reconciling debits (such as outstanding checks) haphazardly from the December 31, 2015 bank reconciliation:
  - a. We traced each debit to the subsequent January bank statement. We found no exceptions. In addition, we found the Council of Government was issuing checks to different vendors with check numbers that had already been used.
  - b. We traced the amounts and dates to the check register, to determine the debits were dated prior to December 31. We found the outstanding checks figure on the accounting system's bank reconciliation does not agree to the outstanding check report on the accounting system. In addition, a debit included in the amount of \$36,995 represents a Council of Government's check run that was cut on the Mahoning County Educational Service Center check stock in error. This amount was repaid to the Mahoning County Educational Service Center on December 28, 2016. Finally, we identified several remittances withheld and not paid as of December 31, 2015 but were subsequently paid in 2017 and 2016. Also, amounts listed as withheld and not remitted to the Internal Revenue Service and State of Ohio did not agree to amounts subsequently paid.
  
6. We selected the two reconciling credits (such as deposits in transit) haphazardly from the December 31, 2015 bank reconciliation:
  - a. We traced each credit to the credit appearing in the subsequent January bank statement. We found the accounting system bank reconciliation netted the reconciling debits and credits and a detailed reconciliation was later provided to show the credits. The first reconciling item in the amount of \$3,808 was not rectified until December 12, 2016. The second reconciling item in the amount of \$149 was posted to the Council of Government's December 2016 financial record.
  - b. We agreed the credit amounts to the Receipts Register. The overpayment was not recorded in the accounting system and the deposit in transit agreed to the Receipts Register.

### **Member Contributions**

We haphazardly selected five member contribution cash receipts from the year ended December 31, 2015 and five member contribution cash receipt from the year ended 2014 recorded in the duplicate cash receipts book and determined whether the:

- a. Receipt amount agreed to the amount recorded in the Revenue Ledger. We were unable to agree revenue ledger postings to individual receipts due to the billing and subsequent receipt and recording of the receipt based on the Council of Government's system. We performed alternative procedures and were able to agree five member contributions in 2015 and 2014 to the individual billing and supporting documentation.
- b. Amount charged complied with rates in force during the period. We found the rate charged per day for substitutes and the total rates billed to each client were not approved by the Governing Board. Rates were not specified in each member's contract nor consistently charged amongst the member entities. In addition, the Governing Board's minutes were not available for all meetings and most minutes were not signed. The Council of Government was unable to provide support for the rates charged for services provided to the members. Finally, the Governing Board approved a two percent increase in overhead costs from five percent to seven percent effective July 1, 2015. A review of the member's contracts for this period found the overhead fee had not been amended to reflect the seven percent. The Council of Government was unable to provide a signed addendum showing the members were made aware of and accepted the new rate.
- c. Receipt was posted to the proper fund, and was recorded in the proper year. We found no exceptions, however when comparing revenue amounts posted to the accounting system to those reported in the filed financial statements in 2015 and 2014, we identified variances of \$2,086 and \$1,362, respectively.

**Debt**

1. This is the initial engagement of the Council of Government, thus, there was no debt outstanding as of December 31, 2013.
2. We inquired of management, and scanned the Revenue Ledger Report and Budget Account Information Detail Report for evidence of debt issued during 2015 or 2014 or debt payment activity during 2015 or 2014. We noted no new debt issuances or any debt payment activity during 2015 or 2014.

**Payroll Cash Disbursements**

1. We haphazardly selected one payroll check for five employees from 2015 and one payroll check for five employees from 2014 from the Earnings Register Report and:
  - a. We compared the hours and pay rate, or salary recorded in the Earnings Register Report to supporting documentation (timecard, legislatively approved rate or salary). We identified the Board's approval of employee hirings and pay rates subsequent to the actual start date of the employee.
  - b. We determined whether the fund and account code to which the check was posted were reasonable based on the employees' duties as documented in the minute record. We also determined whether the payment was posted to the proper year. We found no exceptions.
2. For any new employees selected in step 1 we determined whether the following information in the employees' personnel files was consistent with the information used to compute gross and net pay related to this check:
  - a. Name
  - b. Authorized salary or pay rate
  - c. Department(s) and fund(s) to which the check should be charged
  - d. Retirement system participation and payroll withholding
  - e. Federal, State & Local income tax withholding authorization and withholding
  - f. Any other deduction authorizations (deferred compensation, etc.)

We found no exceptions related to steps a. – f. above.

3. We scanned the last remittance of tax and retirement withholdings for the year ended December 31, 2015 to determine whether remittances were timely paid, and if the amounts paid agreed to the amounts withheld, plus the employer's share where applicable, during the final withholding period of 2015. We noted the following:

<b>Withholding (plus employer share, where applicable)</b>	<b>Date Due</b>	<b>Date Paid</b>	<b>Amount Due</b>	<b>Amount Paid</b>
Federal income taxes & Medicare	January 31, 2016	January 19, 2016	\$58,949	\$58,949
State income taxes	January 15, 2016	January 21, 2016	9,619	9,619
SERS retirement	January 30, 2016	December 30, 2015	10,677	15,754
STRS retirement	January 31, 2016	December 30, 2015	21,003	21,455

A scanning of the withholdings identified payments to the United States Department of Treasury and State of Ohio not being paid in a timely manner as federal withholdings were not remitted from July of 2014 until February of 2015 and State of Ohio withholdings were not paid until January of 2016 and 2015 for all of 2015 and 2014, respectively. Finally, the Council of Government had not made payments to several local municipalities for local income tax withheld for employees during the period. Upon being informed of this, the Council of Government remitted payments to the local municipalities in December 2016. A description of each withholding and amounts paid is as follows:

<b>Withholding</b>	<b>Amount Due Per the December 2015 Bank Reconciliation</b>	<b>Amount Paid in 2016 and 2017</b>
Federal income taxes & Medicare	\$60,552	\$60,784
State income taxes	19,027	24,602
SERS retirement	15,754	15,754
STRS retirement	21,473	21,473
Ohio Child Support	532	532
School District Income Tax	101	101
City of Niles	44	44
City of Struthers income tax	5,806	5,806
City of Hubbard income tax	212	212
City of Campbell income tax	3,594	3,594
Pennsylvania income tax	4	4
City of Youngstown income tax	12,829	12,829
City of Canfield income tax	3,135	3,135
Village of Sebring income tax	2,240	2,240
Village of Windham income tax	250	250
United Way	160	160

### **Non-Payroll Cash Disbursements**

1. From the Payment Register Detail Report, we re-footed checks recorded as General Fund disbursements for *salaries* for 2015. We found that although this is an automated system, the COG was not posting to the accounting system in a timely manner. A comparison of expenses posted to the accounting system during 2015 and 2014 to those reported in the filed financial report reflected variances of \$9,842 and \$1,439, respectively. In addition, the Council of Government did not post 2015 and most of the 2014 activity until December of 2016. Finally, a review of the check register identified duplicate checks being issued to vendors with the same check numbers as previously issued checks. These checks with the previously issued check numbers were cashed by the bank.
2. We haphazardly selected ten disbursements from the Check Register Report for the year ended December 31, 2015 and ten from the year ended 2014 and determined whether:
  - a. The disbursements were for a proper public purpose. We found no exceptions except for the disbursements listed in the next paragraph. Additionally, we identified two checks in 2015 and three in 2014 which related to mileage reimbursement and COBRA insurance reimbursements which are not included in the Council of Government's By-Laws or approved by the Board. Each disbursement was properly supported, except for one mileage check in 2014 which did not have mileage records attached.

We noted a disbursement in 2015 to the United States Department of Treasury in the amount of \$13,565 for interest and penalties for failure-to-file, failure-to-pay, and failure to make a proper federal tax deposit. In addition, we scanned 2015 and 2014 state remittances paid in 2016 and 2015 and found the Council of Government paid penalties to the State of Ohio in the amounts of \$222 and \$101, respectively, for failing to make timely payments.

Furthermore, we identified the following interest and penalty amounts assessed by the State Teachers Retirement System:

Year	STRS Penalties Assessed	STRS Amount Paid	Amount Owed At 12/31/15
2015	\$ 331	\$1,934	
2014	2,300	84	
Total	2,631	\$2,018	\$613

We requested the detail of the payments made to the Public School Employees Retirement System (SERS) to determine if interest and penalty amounts were paid but we were not provided the documents or information from the Council of Government or SERS.

Finally, the Council of Government was assessed late fees totaling \$1 by the State of Ohio for late payment of School Income Tax withholdings.

**State ex rel. McClure v. Hagerman, 155 Ohio St. 320 (1951)**, provides that expenditures made by a governmental unit should serve a public purpose. Typically the determination of what constitutes a “proper public purpose” rests with the judgment of the governmental entity, unless such determination is arbitrary or unreasonable. Even if a purchase is reasonable, **Ohio Attorney General Opinion 82-006** indicates that it must be memorialized by a duly enacted ordinance or resolution and may have a prospective effect only. **Auditor of State Bulletin 2003-005** Expenditure of Public Funds/Proper Public Purpose states that the Auditor of State’s Office will only question expenditures where the legislative determination of a public purpose is manifestly arbitrary and incorrect.

The law requires that employers withhold taxes from employees’ paychecks and remit those taxes to the government. The United States Internal Revenue Code, for example, requires employers to deduct from wages paid to employees the employees’ share of FICA taxes and individual income taxes. See 26 U.S.C. 3102(a) and 3402(a). Those withholdings are considered to be held in “a special fund in trust for the United States.” 26 U.S.C. 7501(a). The employer is liable for the withheld portion of the employee’s wages and must pay over the full amount to the government each quarter. See *United States v. Farr*, 536 F.3d 1174, 1176 (10th Circ. 2008). In addition, under Ohio law, employers are required to withhold state income taxes and school district income taxes from employees’ wages and transmit the funds to the state. See Ohio Rev. Code §§ 5747.06 and 5747.07. Under Ohio Rev. Code § 5747.07 E(2), each employer required to withhold any tax is liable for the payment of the amount required to be withheld and the amount shall be deemed to be a special fund in trust for the general revenue fund. The same rule applies with respect to municipal income taxes in Ohio. See Ohio Rev. Code § 718.03. With respect to the State Teachers Retirement System (STRS) and Public School Employees Retirement System (SERS), when an employee is required to contribute to STRS or SERS under state law, the fiscal officer of each local authority is required to transmit to STRS and SERS for each contributor the applicable percent of the employee’s salary at such intervals and in such form as STRS and SERS require.

See Ohio Rev. Code §§ 3307.01 and 3309.23. In addition, each public employer "shall pay" to STRS and SERS an amount that shall be a certain percent of the earnable salary of all contributors to be known as the "employer contribution" and must make such payments into the employers' accumulations fund in monthly installments. See Ohio Rev. Code §§ 3307.01 and 3309.49.

The Board hired Blaise Karlovic as Treasurer. As Treasurer, Mr. Karlovic was the official responsible for withholding and remitting the required income taxes and pension contributions from Council of Government employee earnings. During the audit period, Mr. Karlovic withheld, as required, federal income tax, Medicare, state income tax, local income tax, school district income tax, and STRS and SERS contributions from the earnings of each Council of Government employee. However, Mr. Karlovic failed to transmit all required funds to the appropriate entity, agency, or system, a gross neglect of duty amounting to reckless disregard for the Council of Government. As a result, the Council of Government incurred penalties, late fees, and interest from the federal government, the State of Ohio, and STRS. Specifically, the total amount of penalties paid by the Council of Government to the federal government is \$13,565. The Council paid the State of Ohio penalties and interest totaling \$324. Penalties paid to STRS totaled \$2,018. The penalties and interest by Council of Government serve no proper public purpose and could have been avoided had the funds been remitted as required by law.

In accordance with the foregoing facts and authorities, and pursuant to Ohio Revised Code Section 117.28, a Finding for Recovery for public money that has been illegally expended for failure to remit withheld income taxes and pension contributions resulting in penalties and interest assessed against the Council of Government is hereby issued against Blaise Karlovic, Council of Government Treasurer, in the amount of \$15,907 and in favor of the Council of Government's General Fund. Further, Mr. Karlovic's bonding company, The Cincinnati Insurance Company, will be jointly and severally liable in the total amount of \$15,907 in favor of the Council of Government's General Fund.

On March 22, 2017 check numbers 270902347 and 5932558134 totaling \$15,907 were deposited into the Council's account and credited to the General Fund. The Finding for Recovery issued against Blaise Karlovic, Treasurer, is deemed repaid and resolved.

- b. The check number, date, payee name and amount recorded on the returned, canceled check agreed to the check number, date, payee name and amount recorded in the Check Register Report and to the names and amounts on the supporting invoices. We found no exceptions.
- c. The payment was posted to a fund consistent with the restricted purpose for which the fund's cash can be used. We found no exceptions pertaining to proper fund posting, however, we found one exception in 2014 where an employee was incorrectly issued a nonpayroll check which was charged to a contracted services object code instead of a payroll object code.

#### **Other Compliance**

1. Ohio Rev. Code Section 117.38 requires entities to file their financial information in the HINKLE system formerly known as the Annual Financial Data Reporting System (AFDRS) within 60 days after the close of the fiscal year. The HINKLE system indicated the Council of Government did not file their financial information within the allotted timeframe for the years ending December 31, 2015 and 2014. The Council of Government filed their financial information on October 31, 2016 for the years ending December 31, 2015 and 2014.

We were not engaged to, and did not conduct an examination, the objective of which would be the expression of an opinion on the Council of Government's receipts, disbursements, balances and compliance with certain laws and regulations. Accordingly, we do not express an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of management, those charged with governance, and others within the Council of Government, and is not intended to be, and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Dave Yost". The signature is written in a cursive style with a large, looping "D" and "Y".

**Dave Yost**  
Auditor of State

Columbus, Ohio

March 14, 2017

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**Officials Response:**

In July 2013, the Mahoning Valley Regional Council of Governments (MVR-COG) was created in order to provide member school districts with a valuable resource for sharing services and saving costs. As fiscal agent, the responsibility of building the general accounting, accounts payable/receivable, purchasing and payroll systems from the ground up for a newly formed organization whose operations were completely different from anything previously practiced was done with limited staff because the MVR-COG had no funds available to hire anyone.

On January 1, 2014, MVR-COG employed 25 paraprofessionals to service two districts. In April 2014, MVR-COG grew to 250 employees and serviced 10 districts. From July 2014 through December 2014, MVR-COG added another 147 new employees to bring the total to 397 employees as of December 31, 2014. Only one staff member who already had full time duties servicing MCEC was responsible for processing payroll, new hires, accounts payable, accounts receivable and financial reporting for MVR-COG. During this period, there were no funds available to bring on the appropriate staffing needed to service these growing operations. On November 3, 2014, MVR-COG hired a part time data entry clerk who had no experience with USPS payroll system or AESOP. After several months of training on these systems, a thorough understanding was in place and this helped improve efficiency in the process.

In calendar year 2015, MVR-COG employed another 270 new employees to bring the total count of new employees to 667 as of December 31, 2015. The majority of these new hires occurred prior to June 30, 2015. On July 1, 2015, MCEC hired a payroll bookkeeper to assist the Deputy Treasurer with payroll and accounts payable for MVR-COG since operations had increased 125%. After hiring a full time bookkeeper, all Federal and State income taxes were remitted timely and no penalties occurred.

With any startup company, there are growing pains. There have been growing pains in navigating through the new landscape implemented by MVR-COG. Internal control weaknesses existed due to the entity growing at a much faster pace than the staff available to process operations. The MVRCOG was a brand new entity. No one in the Treasurer's office had ever worked through implementing something so vast in such a short amount of time. However, from 2014-2015, districts saved \$700,000 from the services the MVR-COG provided. Along the way, processes have been analyzed and ways to improve the system were implemented. The MVR-COG grew at a rate of 125% and this was not anticipated. The growth, volume of work and understaffing contributed to weaknesses. These issues have been corrected and controls put in place in 2015 to eliminate these weaknesses.

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**MAHONING VALLEY REGIONAL COUNCIL OF GOVERNMENTS**

**MAHONING COUNTY**

**CLERK'S CERTIFICATION**

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

*Susan Babbitt*

**CLERK OF THE BUREAU**

**CERTIFIED  
APRIL 11, 2017**