



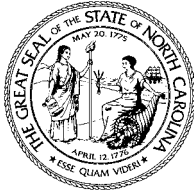
STATE OF NORTH CAROLINA

**FISCAL CONTROL AUDIT REPORT ON
DURHAM COUNTY CLERK OF SUPERIOR COURT
DURHAM, NORTH CAROLINA
FOR THE PERIOD MAY 1, 2004 THROUGH OCTOBER 31, 2004**

**OFFICE OF THE STATE AUDITOR
LESLIE W. MERRITT, JR., CPA, CFP
STATE AUDITOR**

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THE HONORABLE ARCHIE L. SMITH, III



Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
The Honorable Archie L. Smith, III, Clerk of Superior Court

This report presents the results of our fiscal control audit of the Durham County Clerk of Superior Court for the period May 1, 2004, through October 31, 2004. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The objective of a fiscal control audit is to gather and evaluate evidence about selected internal control policies and procedures designed to ensure: (1) reliable financial accounting and reporting and/or (2) compliance with finance-related laws and regulations. Should any information arise during the audit indicating that significant abuse may have occurred, the audit objective may be extended to include internal control designed to prevent abuse and to determine whether the abuse did in fact occur and its impact. Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice.

The results of our audit disclosed a deficiency in internal control and an instance of noncompliance that are considered reportable under *Government Auditing Standards*. These matters are described in the Audit Findings and Recommendations section of this report.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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BACKGROUND INFORMATION

The office of the Clerk of Superior Court is created by the North Carolina Constitution which mandates that there be a Clerk of Superior Court for each county. Under the constitution, it is the responsibility of the General Assembly to prescribe jurisdiction and the powers of the Clerk. Laws of the General Assembly regarding clerks must be uniformly applied in every county in the State.

Voters of each county elect the Clerk of Superior Court to a four-year term. Clerks are paid by the State, with their salaries scaled in accordance with the population of their counties. The Clerk appoints the assistants, deputies and employees in his or her office. The number of assistants and deputies that each clerk may employ varies from county to county depending on the volume of business. Assistant and deputy clerks are paid on a salary schedule fixed by the Administrative Office of the Courts based on education and years of service in the Clerk's office; the maximum and minimum salaries within that scale are fixed by the General Assembly.

The responsibilities of the Clerk are numerous and varied. The Clerk, as a judicial officer of the Superior Court, has judicial responsibilities. The Clerk is judge of probate; that is, the Clerk handles the probate of wills (proceedings to determine if a paper writing is a valid will) and the administration of estates of decedents, minors and incompetents. The Clerk also hears a variety of special proceedings such as adoptions, incompetency determinations and partitions of land and is empowered to issue arrest and search warrants and to exercise the same powers as a magistrate with respect to taking pleas of guilty to minor littering, traffic, wildlife, boating, marine fisheries, alcoholic beverage, State park recreation and worthless-check offenses.

The Clerk is also responsible for all clerical and record-keeping functions of the Superior Court and District Court. The Clerk operates a unified record-keeping system for all civil actions, special proceedings, estates, criminal actions, juvenile actions, minutes of the court, judgments, liens, lis pendens, and numerous other records required by law. The Clerk maintains the judgment docket, is custodian of evidence in civil and criminal trials, and issues civil summons and subpoenas. In addition, the Clerk invests money received and held by his or her office in trust and receives and administers insurance or other money on behalf of minors and incapacitated adults.

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OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS

OBJECTIVES

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes* and in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we have conducted a fiscal control audit at the Durham County Clerk of Superior Court.

The objective of a fiscal control audit is to gather and evaluate evidence about selected internal control policies and procedures designed to ensure: (1) reliable financial accounting and reporting and/or (2) compliance with finance-related laws and regulations. Should any information arise during the audit indicating that significant abuse may have occurred, the audit objective may be extended to include internal control designed to prevent abuse and to determine whether the abuse did in fact occur and its impact. Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

SCOPE

Our audit scope covered the period May 1, 2004, through October 31, 2004, and included selected internal controls in the following areas:

General

Control Environment - The control environment consists of the actions, policies, and procedures that reflect the overall attitude of top management about control and its importance to the entity. The control environment sets the tone of the organization, influencing the control consciousness of its employees.

Information System Controls - Information system controls include activities that relate to many computerized information system applications and support the effective functioning of application controls. Information system controls include access and end-user controls.

Financial Accounting and Reporting

Cash and Investment Cycle - The cash and investment cycle generally consists of the activities associated with the custody of cash and investments. Financial statement accounts typically impacted by the cycle include cash, certificates of deposit, and other investments.

OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONTINUED)

Cash Receipts Cycle – The cash receipts cycle generally consists of the activities associated with the receipt of cash. All financial statement accounts are impacted by this cycle.

Cash Disbursements Cycle – The cash disbursements cycle generally consists of the activities associated with disbursing cash for items other than operating and payroll costs. All financial statement accounts are impacted by this cycle.

Finance-Related Compliance

Listed below are the compliance areas with one or more examples of the criteria for each.

Cash Management and Investments – Laws and regulations set limits on authorized deposits and investments. Moneys are required to be deposited in approved depositories and invested in specific investment types. Accounts must be protected with adequate insurance and collateral. Also, disbursements that are unclaimed by payees for a prescribed time period are often required to be remitted to the State Treasurer in accordance with the State of North Carolina's Escheats and Abandoned Property Program.

Deposit of Receipts – Laws and regulations require deposit of moneys as soon as possible in order to safeguard assets and to enhance the cash management and investment program. Receipts over a specified amount are required to be deposited on a daily basis.

Annual Financial Reporting – Laws and regulations require preparation of annual financial report information in a prescribed format and within a prescribed timeframe. Financial statement information is required to be filed with the Administrative Office of the Courts timely after year-end.

Case File – Laws and regulations set record maintenance and security requirements. Records are required to be filed in a secure location using a uniform indexing system.

Costs and Fees – Laws and regulations set costs and fees to be charged. Uniform costs and fees are required to be charged as established by State law.

Special Provisions – Laws and regulations impose specific requirements on particular entities or activities. Partial payment collections are required to be distributed in the order prescribed by State law. Other special provisions include the investment of accounts greater than \$2,000, record retention requirements, property held for safekeeping procedures, and review procedures over monthly aging reports.

OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control, performed tests of control effectiveness, and performed corroborating direct tests of the accounting records, reports, and/or compliance as we considered necessary in the circumstances. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records, and examining documentation supporting recorded transactions and balances. Our procedures were more limited than would be necessary to give an opinion on internal control, and accordingly, we do not express such an opinion.

RESULTS

The results of our audit disclosed a deficiency in internal control and an instance of noncompliance that are considered reportable under *Government Auditing Standards*. These matters are described in the Audit Findings and Recommendations section of this report.

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Accounting, Reporting, or Compliance

The following findings and recommendations were identified during the current audit and represent a significant deficiency in internal control over financial accounting and reporting or compliance with finance-related laws and regulations. Finding number 1 was also reported in a prior audit.

1. INVESTMENT OF FUNDS NOT MADE TIMELY

The Clerk is not investing funds in a timely manner as required by law. In a sample of eighteen cases, we noted sixteen that were not invested timely. North Carolina General Statute 7A-112(b) states in part that an account in excess of \$2,000 that is reasonably expected to remain on deposit in excess of six months shall be invested by the Clerk within 60 days of receipt.

Recommendation: We recommend that the Clerk assign a responsible employee to monitor the funds as they are received and to review aging reports to assist in identifying accounts that may require investing. If these accounts meet the requirements of General Statute 7A-112(b), they should be invested.

Clerk's Response: The Bookkeeping Division of the Durham County office of the Clerk of Superior Court makes every effort to invest funds in a timely manner as required by law. NCGSGA-7A112 (b) requires that funds that remain with the Clerk's office in excess of 6 months be invested within 60 days or sooner. This same statute also requires that the Clerk's office make a subjective value judgment in regard to these funds as to which funds would be "REASONABLY EXPECTED to remain on deposit in excess of 6 months".

Sometimes funds are claimed within a few days of deposit. Sometimes months may go by before funds are claimed. Sometimes funds are never claimed and escheat to the State. The "reasonably expected" standard requires a judgment call (i.e. "a guess"), which can work to the detriment of the public.

There are occasions when funds are received on behalf of a minor whose 18th birthday will occur slightly more than 6 months from the date of receipt of the funds by the Clerk's office. In these instances, income from invested funds give rise to the production of a 1099, which is forwarded to a minor and his or her parent, but the benefits of invested funds are not realized by the beneficiary. This typically occurs when the funds are invested and the Clerk's commission is not exceeded by the income from the invested funds. If the income is not more than the Clerk's commission, the Clerk's office

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

refunds the difference. However, the beneficiary still has to pay tax on the interest, which was earned and retained, by the Clerk's office as a commission. The beneficiary loses money in this situation. Blind adherence to the 6 month deadline works a hardship on the public in cases like these.

From time to time, the Clerk's office finds itself the recipient of surplus funds from tax foreclosures arising under the provisions of NCGS45-21.31 (b). Although this statute requires the person making the tax foreclosure sale to distribute the funds to those persons who are entitled thereto (if they can be ascertained), the excess surplus funds are almost always deposited with the office of the Clerk of Superior Court. Those persons conducting the proceedings under NCGS45-21.31 are usually attorneys who have conducted a title examination on the foreclosed real property. Among its other attributes, a title examination reveals the true owners of record of the subject real property. These are the parties to whom the surplus funds belong and to whom the funds should be sent in the first place.

As a result of the liability, which they may incur from disbursing the funds, the person making the sale would rather pay the funds over to the clerk. Insofar as tax foreclosures are civil actions under the jurisdiction of the Superior Court division, the Clerk has no authority to decline to accept these funds when such is ordered by a Superior Court Judge at the request of the party conducting the sale. The Clerk is then the arbitrary recipient of these funds. Thereafter the only means by which these funds can be claimed and distributed is by way of a motion in the cause (which in this instance the Clerk can hear) or by way of a special proceeding for surplus funds. It would be much preferred were these funds to be distributed at the time the original proceeding is concluded.

The only sure means by which the Durham County office of the Clerk of Superior Court can avoid any negative audit findings in this area in the future is to remove any subjective standard or criteria from the interpretation of 7A-112 (b). We will invest all accounts in excess of \$2,000 within 60 days of receipt.

2. WITHDRAWALS FROM MINOR'S ACCOUNTS WITHOUT SUPPORTING DOCUMENTATION

The Clerk is not requiring documentation to assure that withdrawals from minor's investment accounts are for authorized purposes. Withdrawals are permitted for necessities that the parent or guardian cannot afford. In a sample of sixteen cases, we noted seven cases where there was no documentation in the file to support the withdrawal.

Recommendation: We recommend that the Clerk require supporting documentation be provided prior to authorizing withdrawals from minor's investment accounts. The supporting documentation should be receipts when possible, or at a minimum, a signed statement from the parent or guardian setting forth the purpose of the withdrawal.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

Clerk's Response: The Durham County office of the Clerk of Superior Court has implemented a policy which requires written documentation for withdrawal from minor's investment accounts for necessities for the child which the parent or guardian cannot afford. These documents shall be receipts when possible and/or statements as to the necessity for the fund withdrawal from a school, physician, counselor or other person or agency involved in matters pertaining to health, education and welfare of said child or, at the minimum, a written, signed statement from the parent or guardian of the child setting forth the necessity for such withdrawal.

DISTRIBUTION OF AUDIT REPORT

In accordance with General Statutes 147-64.5 and 147-64.6(c)(14), copies of this report have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press, and the general public upon request.

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The Honorable Ralph A. Walker
Mr. Rex Whaley

Durham County Clerk of Superior Court
Director, Administrative Office of the Courts
Chief of Financial Services
Administrative Office of the Courts

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Director, Fiscal Research Division

April 13, 2005

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