



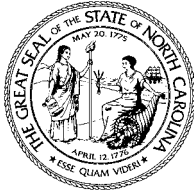
STATE OF NORTH CAROLINA

**FISCAL CONTROL AUDIT REPORT ON THE
ADMINISTRATIVE OFFICE OF THE COURTS
RALEIGH, NORTH CAROLINA**

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

**FISCAL CONTROL AUDIT REPORT ON THE
ADMINISTRATIVE OFFICE OF THE COURTS
RALEIGH, NORTH CAROLINA**

**THE HONORABLE I. BEVERLY LAKE, JR.
CHIEF JUSTICE OF THE SUPREME COURT**



STATE OF NORTH CAROLINA
Office of the State Auditor

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

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
The Honorable I. Beverly Lake, Jr., Chief Justice of the Supreme Court

This report presents the results of our fiscal control audit of the Administrative Office of the Courts. 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 internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources.

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items 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

TABLE OF CONTENTS

	PAGE
BACKGROUND INFORMATION	1
OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS	3
AUDIT FINDINGS AND RECOMMENDATIONS.....	5
DISTRIBUTION OF AUDIT REPORT	11

BACKGROUND INFORMATION

State law establishes the Administrative Office of the Courts as a state agency within the judicial branch of government. The law provides that there shall be a Director appointed by the Chief Justice of the Supreme Court to supervise the agency. The basic responsibility of the Administrative Office of the Courts is to aid in maintaining an efficient court system and provide Statewide administrative support to judicial organizations within the State. The agency's administrative duties include budgeting, financial reporting, purchasing, human resources, information technology, legal, research and planning services.

In the fiscal year ended June 30, 2004, the Administrative Office of the Courts accounted for approximately \$396 million of expenditures in the general fund and \$13 million of expenditures in special revenue funds. The majority of these expenditures were for personal service costs. The primary revenue sources supporting the expenditures were general fund appropriations of nearly \$383 million and fees, licenses and fines of approximately \$167 million.

[This Page Left Blank Intentionally]

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 Administrative Office of the Courts.

The objective of a fiscal control audit is to gather and evaluate evidence about internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources. Our audit does not provide a basis for issuing an opinion on internal control, and consequently, we have not issued such an opinion.

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 from February 1, 2004, through January 31, 2005, and included selected internal controls in the following organizational units:

Financial Services Division

This organizational unit is responsible for the budgeting and general accounting functions for organizations within the judicial branch of government.

Human Resources Division

This organizational unit is responsible for establishing and implementing human resource policies and procedures for organizations within the judicial branch of government. Since judicial organizations are not subject to oversight by the Office of State Personnel, the Division also recommends pay plans and evaluates job classifications for the organizations, except for salaries set by the General Assembly.

During our audit, we considered internal control related to the following accounts and control objectives:

Contributions, Gifts and Grants – The Administrative Office of the Courts reported nearly \$6 million of these revenues for the fiscal year ended June 30, 2004. We examined internal control designed to ensure the revenues were used in accordance with grant restrictions.

OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)

Personal Services – The Administrative Office of the Courts reported over \$238 million in personal services for the fiscal year ended June 30, 2004. These expenditures are primarily salaries for judicial employees. We examined internal control designed to ensure certain salaries were not in violation of statutory amounts and that salary increases were given in accordance with internal policy. Judicial employees are not subject to the State Personnel Act or Office of State Personnel policies.

Accrued Vacation Leave – As of June 30, 2004, the Administrative Office of the Courts reported approximately \$14 million in accrued vacation leave. We examined internal control designed to ensure that leave was properly accounted for and that internal leave policies were followed. Judicial employees are not subject to the State Personnel Act or Office of State Personnel policies.

Contracted Personal Services – For the fiscal year ended June 30, 2004, the Administrative Office of the Courts reported nearly \$80 million in contracted personal services, over \$64 million of which was for indigent legal services. We examined internal control designed to ensure that the Administrative Office of the Courts properly paid and accounted for indigent legal services.

Travel – For the fiscal year ended June 30, 2004, the Administrative Office of the Courts reported over \$4 million in travel expenditures. These expenditures include the travel costs for all judicial employees. We examined internal control designed to ensure that travel advances and subsequent travel costs were properly accounted for and that the advances were processed in accordance with State travel policies.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control, performed tests of control effectiveness, and/or performed direct tests of the accounts and transactions 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.

RESULTS

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Recommendations section of this report.

AUDIT FINDINGS AND RECOMMENDATIONS

1. MILEAGE REIMBURSEMENTS PAID INCORRECTLY

The Administrative Office of the Courts did not pay mileage reimbursements in accordance with regulations. As a result, employees were paid incorrect amounts for travel.

Prior to August 2004, the agency paid 30 cents per mile to employees who used their own vehicle, regardless of whether a State-owned vehicle was available for the trip. In August 2004, the agency established a policy to pay 23 cents per mile to employees based in Raleigh when a State-owned vehicle is available and 33 cents to all others. The State budget manual indicates that employees will be paid at the rate set by the Internal Revenue Service (currently 40.5 cents per mile) if a State-owned vehicle is not available and at the State motor fleet rate (currently 25 cents per mile) if a State-owned vehicle is available and the employee chooses to use his or her personal vehicle.

Certain employees of the Guilford County District Attorney's office were reassigned to work in High Point rather than in Greensboro. The agency has been reimbursing the employees for commuting mileage from their homes to their new duty station. *North Carolina General Statute 138-6* states that no reimbursement shall be made for the use of a personal car in commuting from an employee's home to his duty station in connection with regularly scheduled work hours. The State budget manual reiterates this requirement.

The former chief financial officer was paid for travel miles that were not supported by the travel reports. In several instances, the mileage claimed for particular trips appeared excessive. For example, a round trip from Raleigh to Gastonia was reported as 512 miles when the map used by the agency to estimate actual mileage indicates the round trip distance to be 342 miles. One Internet travel site estimates the round trip mileage at 373 miles. Agency personnel have stated that trips taken by the former chief financial officer often included stops at several locations that may not be on a direct route to the ultimate destination, all of which were for business purposes. If this was the case, the side trips were not presented on the travel report.

Recommendation: The Administrative Office of the Courts should document consideration of whether a State-owned vehicle is available when determining the rate used to reimburse employees for use of their personal vehicles and should use the rate indicated in the State budget manual. Further, the agency should not pay employees for commuting mileage from their homes to their duty stations. Lastly, the agency should review the travel reports, especially the miles claimed, to ensure the costs are properly documented, supported and reasonable.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

Agency's Response: We concur and are modifying our travel policies and procedures to address this and other travel issues identified in the audit findings. We are reviewing duty stations to identify and discontinue reimbursements for commuting.

2. EXCESSIVE TRAVEL ADVANCES PAID TO EMPLOYEES

The Administrative Office of the Courts gave employees travel advances that exceeded the amount needed. This violated provisions in the State budget manual.

We found cases where advances given to employees who regularly travel each month (permanent advances) were excessive. The State budget manual indicates that the amount of these advances should be the average monthly expense incurred, and that the advance amount should be adjusted during the year as actual reimbursements are paid. In our examination of 10 permanent advances, we found five that exceeded the employee's average monthly expenditures by 19% or more. Supervisors are approving the travel advance request but apparently are not consistently requiring that the amount requested be justified.

In addition, during our examination of 38 permanent and temporary advances (for occasional travel), we found six advances that were paid from a copy of a prior advance request form. This often occurred when the agency determined that a temporary advance should have been a permanent advance. In a few instances, the agency issued a permanent advance check while the temporary advance was still outstanding, which resulted in the employee having a total advance that, exceeded the amount allowed by the State budget manual.

Recommendation: The Administrative Office of the Courts should require employees to justify the amount of requested travel advances and supervisors to review justification before approving the request. Monthly expenditures of employees who travel monthly should be monitored to ensure that permanent advances are not excessive. Care should be taken to ensure that the proper type of advance is paid and recorded.

Agency's Response: We concur and now require additional documentation to justify the amount of the advance being requested.

3. TRAVEL ADVANCES PAID TO EMPLOYEES BEFORE NEEDED

The Administrative Office of the Courts often gave employees travel advances before they were needed. This violates provisions in the State budget manual.

The agency has a written policy stating that advances for occasional travel (temporary advances) may be paid up to 30 days in advance of the trip, though employees indicated that in practice the policy was to pay advances no more than two weeks before the travel begins. The State budget manual requires that these advances be given no more than five

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

days prior to the date of departure. The agency does not believe five days is enough lead-time to ensure employees get the money before the travel begins.

In our examination of 28 temporary advances, we noted 14 instances where the advance was paid more than five days prior to the date of departure. We also noted six instances where the advance was paid more than two weeks before the travel, two of which were paid more than 30 days in advance.

In one instance in December 2003, the former chief financial officer approved for himself a \$3,000 travel advance. The actual travel costs used to settle the advance were not incurred until the period April through June 2004, at least four months after the travel advance was paid. In January 2005, the same employee approved for himself a \$300 travel advance. The advance covered travel previously incurred from November 17, 2004, through January 14, 2005. Instead of receiving a travel advance, the employee should have completed a travel reimbursement form for the actual cost of the travel. The travel reimbursement form to settle the advance was not processed until mid-April, over two months after the employee had ceased employment with the agency.

Recommendation: The Administrative Office of the Courts should pay travel advances in accordance with the time restrictions in the State budget manual. If this is impractical, the agency should seek a waiver from the Office of State Budget and Management and establish an alternative limit that is as close to the beginning date of travel as possible.

Agency's Response: Judicial employees are stationed over a wide geographical area, so additional lead time is necessary for payment of travel advances. AOC will establish a feasible time limit while pursuing a waiver of the five day restriction from Office of State Budget and Management.

4. TRAVEL ADVANCES NOT SETTLED TIMELY

The Administrative Office of the Courts did not require employees to settle travel advances promptly and settled other advances incorrectly. This violated provisions in the State budget manual.

In our examination of 38 advances given for travel, we noted eight instances where the travel expense report settling the advance was not filed within 30 days after the travel. The State budget manual requires that advances be deducted from the reimbursement request on the travel expense report and that the report be submitted within 30 days after the travel period or by June 30, whichever comes first.

We also noted that in June 2004, the agency collected outstanding advances from five employees by docking their June paycheck. The agency accidentally docked the employees' pay again the next month. Several adjusting journal entries were made to the travel advance account in an attempt to record and correct the transactions. Due to a lack

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

of explanation and supporting documentation for the entries, it is difficult to ascertain the total effect of the entries.

Recommendation: The Administrative Office of the Courts should require employees to file travel expense reports in accordance with the time restrictions in the State budget manual. Further, the agency should consider whether having the employee repay excess travel advances by check rather than through payroll deduction would simplify the accounting process. This problem would also be alleviated if the agency improved procedures to ensure that travel advances are not excessive.

Agency's Response: AOC will reiterate the existing reimbursement policy for travel and advances. Recoupment through payroll deduction will only be utilized when other collection efforts fail.

5. AUTHORIZATION/JUSTIFICATION FOR PAY RAISES NOT PROPERLY DOCUMENTED

In many cases, the Administrative Office of the Courts did not properly document the authorization or justification for pay raises granted to employees. This increases the risk that an improper pay raise will be given.

The Administrative Office of the Courts is not subject to Office of State Personnel oversight. Therefore, the agency is free to follow whatever personnel policies are deemed reasonable.

We found that for nine of the 29 pay raises examined during our audit, the form used to authorize the pay change was not completed and signed by the appropriate supervisor as required by agency policy. According to personnel records, four of the nine pay raises were granted based on an email sent by a supervisor's administrative assistant and three pay raises were granted based on a phone call from the supervisor. For the other two pay raises without the form, there was no indication of supervisor authorization in the files.

We also noted instances where agency-required criteria for pay raises were not met. In general, agency policy requires that pay raises, other than legislative cost-of-living raises and raises stemming from changes in job duties, be granted only if supported either by a salary study conducted by an assigned human resources employee or by the agency's salary increase schedule based on years of service. We found two instances where pay raises were granted without meeting either of these criteria.

Additionally, we found seven instances where a pay raise was granted to an employee who should have had a performance evaluation in accordance with agency policy, but the employees were not formally evaluated. Lastly, we noted one instance where a pay raise was granted because the employee had assumed broader supervisory responsibility. However, the agency's organizational chart, personnel management information system, and our own observations indicate that the employee is not supervising the employees described in the justification for the pay raise.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

Recommendation: The Administrative Office of the Courts should fully document the justification for pay raises. Senior officials should review such documentation to ensure that pay raises are reasonable and justified. Authorization for pay raises should be clearly documented.

Agency's Response: All authorizations for pay increases will be documented in writing and received directly from the Hiring Authority or their designee. All requests for pay increases must meet the requirements identified by Human Resources policies.

6. FEES FOR INDIGENT DEFENSE SERVICES NOT PROPERLY PAID

The Administrative Office of the Courts did not follow proper procedures when paying fees for indigent defense services. As a result, unauthorized pay rates were used, payments were made more than once, transactions were misclassified in the accounting records and checks were sent to wrong addresses.

In a test of 74 transactions, we noted six instances where payment was made using an unauthorized pay rate. *North Carolina General Statute 7A-458* requires that payments be made using a rate approved by the Office of Indigent Defense Services. In all six of the discrepancies noted, the approved rate was \$65 per hour, but the actual rate paid ranged from \$58 to \$100 per hour. In addition, we found four instances where the documentation supporting the payment was incomplete, and as a result, we were unable to determine the pay rate that was charged.

In a separate test, we examined 60 transactions that had similarities in payees and amounts and found four instances where a fee was paid more than once. There may have been other duplicate payments in the transactions examined; however, the documentation supporting the payment was not conclusive because claim forms do not clearly itemize the services provided.

While examining the potential duplicate payments, we noted that 11 of the 60 transactions were misclassified in the accounting records. The agency has established separate accounts to track the amount spent for each type of case, but due to the misclassifications, the information is not useful to management.

Recommendation: The agency should strengthen procedures to process payments for indigent defense services. Payments should only be made using approved rates. Management may consider whether improvements can be made in claim forms to clearly itemize charges and prevent duplicate payments. Likewise, the claim form and/or process may be amended so that a payment is not mailed prior to verifying a change of address. Finally, procedures for ensuring the proper coding of transactions should be enhanced. Additional supervisory review of transactions may be needed to improve processing.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

Agency's Response: We agree that some payments were made at rates other than rates approved by the Office of Indigent Defense Services (IDS). To address this situation, General Statute 7A-458 was amended to clarify fees should not be ordered at a rate other than the IDS established rate and notified attorneys and Judges of the revised statute. In addition, AOC will send fee applications that violate the amended statute to IDS for review and return to the Judges who granted the fee.

Procedures are also being implemented to help eliminate duplicate payments and recover funds as detected. IDS staff have begun to analyze data to trigger review of payment records that appear atypical.

IDS will also work closely with AOC Financial Services to review the accuracy of coding payments into the accounting system.

7. ADJUSTMENTS TO GRANTS EXPENDITURES NOT EXPLAINED OR REVIEWED

The Administrative Office of the Courts made numerous adjusting journal entries to grant accounts that were not accompanied by an explanation or supporting documentation and were not reviewed and approved by supervisory personnel. As a result, we could not verify whether the adjustments were proper.

We reviewed 15 adjusting journal entry code sheets for several different grants to determine why the adjustments were being made. However, we were unable to discern from the code sheets or supporting documentation the purpose or justification for the adjustments. Supervisor approval of adjusting entries is not required, and in some cases, the accountant that initiates the entry can also code and post the entry to the accounting system.

We also reviewed 11 grants to determine if they were properly closed at the end of their term. In all cases, final cash draw downs were made within the required 60 days after the grant period, but four of the grant accounts stayed open for further adjustments after the final cash was received. It is unclear why the accounting records would need to be adjusted at that point.

Recommendation: The Administrative Office of the Courts should ensure that all adjusting journal entries are accompanied by a clear and complete explanation. Entries should be reviewed and approved by a supervisor indicating that the entry is appropriate.

Agency's Response: We will modify procedures for grant adjustments to require additional supporting documentation and approval. We reviewed those adjustments identified during the audit and are satisfied that the entries were proper.

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.

EXECUTIVE BRANCH

The Honorable Michael F. Easley
The Honorable Beverly M. Perdue
The Honorable Richard H. Moore
The Honorable Roy A. Cooper, III
Mr. David T. McCoy
Mr. Robert L. Powell

Governor of North Carolina
Lieutenant Governor of North Carolina
State Treasurer
Attorney General
State Budget Officer
State Controller

JUDICIAL BRANCH

The Honorable Ralph A. Walker
Mr. Rex Whaley

Director, Administrative Office of the Courts
Chief of Financial Services
Administrative Office of the Courts

LEGISLATIVE BRANCH

Appointees to the Joint Legislative Commission on Governmental Operations

President Pro Tempore
Senator Marc Basnight, Co-Chair
Senator Charles W. Albertson
Senator Thomas M. Apodaca
Senator Daniel G. Clodfelter
Senator Walter H. Dalton
Senator Charlie S. Dannelly
Senator James Forrester
Senator Linda Garrou
Senator Kay R. Hagan
Senator Fletcher L. Hartsell, Jr.
Senator David W. Hoyle
Senator John H. Kerr, III
Senator Ellie Kinnaird
Senator Jeanne H. Lucas
Senator Anthony E. Rand
Senator R. C. Soles, Jr.
Senator Richard Y. Stevens
Senator A. B. Swindell, IV
Senator Scott Thomas

Speaker of the House
Representative James B. Black, Co-Chair
Representative Alma S. Adams
Representative Martha B. Alexander
Representative Harold J. Brubaker
Representative Lorene T. Coates
Representative E. Nelson Cole
Representative James W. Crawford, Jr.
Representative William T. Culpepper, III
Representative W. Pete Cunningham
Representative Beverly M. Earle
Representative Pryor A. Gibson, III
Representative Joe Hackney
Representative R. Phillip Haire
Representative Dewey L. Hill
Representative Lindsey H. Holliman
Representative Julia C. Howard
Representative Howard J. Hunter, Jr.
Representative Margaret M. Jeffus
Representative Daniel F. McComas
Representative Charles L. McLawhorn
Representative Henry M. Michaux, Jr.
Representative Richard T. Morgan
Representative Edd Nye
Representative William C. Owens, Jr.
Representative Deborah K. Ross
Representative Drew P. Saunders
Representative Wilma M. Sherrill
Representative Joe P. Tolson
Representative Edith D. Warren
Representative Thomas E. Wright
Representative Douglas Y. Yongue

Other Legislative Officials

Mr. James D. Johnson

Director, Fiscal Research Division

September 6, 2005

ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

Office of the State Auditor
State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Internet: <http://www.ncauditor.net>

Telephone: 919/807-7500

Facsimile: 919/807-7647