STATE OF NORTH CAROLINA

LINCOLN COUNTY CLERK OF SUPERIOR COURT

FISCAL CONTROL AUDIT

LINCOLNTON, NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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THE HONORABLE FRED HATLEY

CLERK OF SUPERIOR COURT

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Office of the State Auditor

Beth A. Wood, CPA
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

May 26, 2011

The Honorable Beverly Eaves Perdue, Governor
The General Assembly of North Carolina
The Honorable Fred Hatley, Clerk of Superior Court

This report presents the results of our fiscal control audit at the Lincoln County Clerk of Superior Court. 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 performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The objective of a fiscal control audit is to identify improvements needed in 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 instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Responses 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.

Beth A. Wood

Beth A. Wood, CPA
State Auditor

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OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS

OBJECTIVES, SCOPE, AND METHODOLOGY

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a fiscal control audit at the Lincoln County Clerk of Superior Court. There were no special circumstances that caused us to conduct the audit, but rather it was performed as part of our effort to periodically examine and report on the financial practices of state agencies and institutions.

The objective of a fiscal control audit is to identify improvements needed in 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 rendering 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.

To accomplish our audit objectives, we gained an understanding of internal control over matters described below and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that may reveal significant deficiencies in internal control. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records, and examining documentation supporting recorded transactions and balances. Whenever sampling was used, we applied a nonstatistical approach but chose sample sizes comparable to those that would have been determined statistically. As a result, we were able to project our results to the population but not quantify the sampling risk.

As a basis for evaluating internal control, we applied the internal control guidance contained in *Internal Control Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As discussed in the framework, internal control consists of five interrelated components, which are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit scope covered the period June 1, 2010 through November 30, 2010. During our audit, we considered internal control related to the following accounts and control objectives:

> *Cash and Cash Equivalents* - This classification includes change funds and cash on deposit with private bank accounts. We examined internal controls designed to ensure that the Clerk properly safeguards and accounts for these assets. As of November 30, 2010, the Clerk had $419,042.35 in cash and cash equivalents.
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> *Investments* - This classification includes pooled investments, certificates on deposit, savings accounts, and money market accounts. We examined internal controls designed to ensure the Clerk properly safeguards and accounts for these assets. We also examined evidence to support compliance with finance-related laws and regulations over these assets. These laws and regulations set limits on authorized investments, set timing requirements for investing funds, provide for the Clerk to receive a fee for administering the investments, and provide for allocation of interest to the beneficial owner or owners of the funds. As of November 30, 2010, the Clerk had $2,006,162.65 in investments.
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> *Trusts* – This classification includes funds held by the Clerk for minors, incapacitated adults, and others according to the terms of a court order, will or deed. We examined internal control designed to ensure the Clerk properly safeguards and accounts for these accounts. We also examined evidence to support compliance with finance-related laws and regulations. These laws and regulations set guidelines for the receipt, administration, and disbursement of these accounts. As of November 30, 2010, the Clerk had $2,028,451.42 in trust accounts.

RESULTS

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under generally accepted government auditing standards. These items are described in the Audit Findings and Responses section of this report.

AUDIT FINDINGS AND RESPONSES

1. INADEQUATE SEGREGATION OF DUTIES

The Clerk's Office has assigned job functions that are incompatible with adequate segregation of duties. As a result, there is an increased risk that an error or misappropriation of assets could occur and not be detected in a timely manner. Our audit identified the following deficiencies:

- The head cashier closes out the cash register, prepares the daily deposit, and makes the daily deposit at the bank.
- The head bookkeeper prepares the bank reconciliations and also makes disbursements in the Financial Management System.
- The estate clerk handling investment trusts receives parent's petitions, prepares court orders for partial withdrawals, and approves the payment authorization forms disbursing the funds. There is no review or approval function in the process.

The *Clerk of Superior Court Financial Policies and Procedures Manual* contains guidance on segregation of duties. Adequate segregation of duties involves assigning responsibilities for transactions such that the duties of one employee automatically provide a cross-check on the work of other employees.

Recommendation: The Clerk's Office should assign duties to achieve proper segregation of duties as described in the *Clerk of the Superior Court Financial Policies and Procedures Manual*.

Clerk Response: Subsequent to the audit period the Clerk's office has taken the following steps to achieve proper segregation of duties.

- An additional employee, whose duties **do not** include cash receipting or bookkeeping, regularly assists with closing out the cash register, preparing deposits and carrying monies to the bank. Steps are being taken to ensure that these duties are not performed by the same person in the same day.
- The head bookkeeper continues to prepare the monthly bank reconciliations as trained by the Administrative Office of the Courts. All bank account reconciliations are reviewed and approved by the Financial Management Analyst assigned to our county.
- Concerning the handling of investment trusts, any activity in established investments must now be approved by the High Clerk and all payment authorizations require the High Clerk's approval and signature.

The Clerk's Office continues to work diligently to achieve proper segregation of duties as much as possible under the current working conditions, which include increasing workloads and decreased staffing.

2. DEFICIENCIES NOTED IN PARTIAL WITHDRAWAL PAYMENTS MADE ON THE BEHALF OF MINORS

Our audit identified deficiencies in the Clerk's processing of partial withdrawal payments disbursed on the behalf of minors. As a result, there is an increased risk that payments could have been made that were for unallowable purposes. In total, we identified payments totaling $62,752 that were either not documented as to the reason for the disbursement or the necessity of the disbursement appeared questionable.

According to *North Carolina General Statute 7A-111(a)*, the Clerk is authorized to receive, administer, and disburse funds on the behalf of minors under 18 years of age. The disbursement of funds prior to the minor obtaining the age of 18 is considered a partial withdrawal and should only occur "at such time or times as in his judgment is in the best interest of the child, except that the clerk must first determine that the parents or other persons responsible for the child's support and maintenance are financially unable to provide the necessities for such child, and also that the child is in need of maintenance and support or other necessities, including, when appropriate, education." The Clerk's Office is required to obtain receipts or paid vouchers to support that the monies disbursed were for the exclusive use and benefit of the child.

We examined three minor's files that were active during the audit period, with partial withdrawal payments totaling $6,514, and noted the following deficiencies:

- Receipts or paid vouchers were not maintained to support the withdrawals.
- Documentation was not available to provide sufficient evidence that the disbursements were either necessary for the maintenance and support of the child or for the exclusive benefit of the child.
- We identified an instance where the required petition from the parent/guardian was not on file.

Due to the deficiencies noted during the original audit period, we expanded our testing to include all partial withdrawal payments for minors made during the last seven years. Our tests covered additional partial withdrawal payments totaling $107,424, of which payments totaling $56,238 were identified as having similar deficiencies to those noted above. We noted an additional 18 instances where petitions or court orders were not on file. In addition, we noted disbursements for furniture, a hot tub, an all-terrain vehicle, a vehicle engine, the purchase of a house, and other expenditures that appear to be questionable uses of the funds when compared to the statutory requirements.

Recommendation: The Clerk's Office should strengthen internal control over partial withdrawal payments on behalf of minors. Specifically, the Clerk's Office should ensure that adequate documentation is maintained to support that the partial withdrawal payments are necessary and for the exclusive use and benefit of the child.

Clerk Response: As required by *North Carolina General Statute 7A-111(a)*, the Clerk's Office requires the proper petitions, receipts, vouchers and sufficient documentation before disbursements are made from minor trusts.

The audit review only included a total of four cases, all of which have since been closed. The majority of the errors were found in one specific case. Strict guidelines are now in place to insure that **all** future withdrawals from trust accounts will be properly documented and submitted to the High Clerk for approval.

The Clerk's Office will continue to provide superior service to holder's of accounts to which they are assigned. We take this responsibility very seriously and continue to improve our efforts.

3. DEFICIENCIES IN INTERNAL CONTROL OVER INVESTMENT AND TRUST REQUIREMENTS

We identified deficiencies in the internal control procedures related to investment and trust account requirements. As a result, there is an increased risk of statutory noncompliance and accounting errors. During our audit, we noted the following deficiencies:

- The Clerk's Office has not monitored its accounts to ensure that they were invested timely as required by law. According to *North Carolina General Statute 7A-112(b)*, "When money in a single account in excess of two thousand dollars ($2,000) is received by the clerk by virtue or color of his office and it can reasonably be expected that the money will remain on deposit with the clerk in excess of six months from date of receipt, the money exceeding two thousand dollars ($2,000) shall be invested by the clerk within 60 days of receipt." We examined nine accounts and identified three, with balances totaling $7,482, that were expected to be held longer than six months and were not invested within the required 60-day period.
- There was no process in place for the review and approval of the recorded commission rate. According to *North Carolina General Statute 7A-308.1(2)*, a fee equal to five percent (5%) of each fund shall be assessed and collected on funds invested by the clerk pursuant to *North Carolina General Statute 7A-112*. For one of eight cases reviewed, we noted that the five percent commission rate was not properly calculated. An amount of $826 should have been taken to meet the 5% commission fee requirement; however, the actual commission fee taken was $500.

- There was no process in place to ensure that the final payout of the trust was properly calculated. According to *North Carolina General Statute 7A-308.1(2)(d),* any fees charged in excess of the cumulative investment earnings on an account shall be refunded and all investment earnings in excess of the prescribed fee shall be remitted to the beneficial owner or owners when all funds in that account are finally withdrawn and distributed by the Clerk's Office. For one of eight cases closed during the audit period, we noted that the beneficial owner of the investment was underpaid by $94.
- We noted that documentation was not on file to support one of seven journal entries tested related to the recording of interest income.

Recommendation: The Clerk's Office should strengthen internal control over investment and trust requirements. Specifically, internal control procedures should ensure that accounts are invested timely in accordance with requirements, proper fees are assessed and collected, final trust payout amounts are properly determined, and all journal entries to record interest earnings are appropriate and recorded timely and accurately.

Clerk Response: The Clerk's Office strives to monitor its accounts to ensure that they are invested in a timely manner per the General Statute. Two of the three cases mentioned in the audit report were monies paid as deposits in lawsuits and both were closed out in the first quarter of 2011. Under the current economic conditions, the Clerk's checking account draws interest equivalent to or less than **.10% less** than typical investment accounts authorized for clerks. The other account was invested shortly after the 60 day limit. Other errors pointed out were simply human errors that have since been resolved.

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

Telephone: 919/807-7500

Facsimile: 919/807-7647