

Audit Report

Judiciary

August 2010



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

August 24, 2010

Karl S. Aro
Executive Director

Bruce A. Myers, CPA
Legislative Auditor

Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Delegate Steven J. DeBoy Sr., Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Judiciary for the period beginning October 1, 2006 and ending October 18, 2009. The Judiciary is established by the State Constitution as responsible for the administration of justice in Maryland and comprises the courts and various other agencies (such as the Administrative Office of the Courts and the State Law Library) that support the administrative and regulatory functions of the Judicial Branch of government.

Our audit disclosed that certain expenditures were not charged to the Real Property Records Improvement Fund at the time incurred causing the Fund's cash balance to be artificially high. As a result, during our audit period, the Fund was credited with excess investment income totaling approximately \$1.3 million that otherwise would have been credited to the State's General Fund.

Our audit also disclosed that the Judiciary did not distribute property transfer tax revenues collected during fiscal years 2007, 2008, and 2009 in accordance with the State law. For example, the Judiciary incorrectly distributed property transfer tax revenues totaling approximately \$1.5 million to the Department of Natural Resources' Program Open Space rather than to the Maryland Agricultural Land Preservation Fund as required. Finally, we noted internal control and record keeping deficiencies relating to corporate purchasing cards and equipment.

An executive summary of our findings can be found on page 5. The Judiciary's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during our audit by the Judiciary.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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* Denotes item repeated in full or part from preceding audit report

Executive Summary

Legislative Audit Report on the Judiciary August 2010

- **Certain expenditures were not charged to the Real Property Records Improvement Fund at the time incurred resulting in the Fund receiving excess investment earnings totaling approximately \$1.3 million.**

The Judiciary, in conjunction with the Comptroller of Maryland and State Treasurer, should determine the amount of investment income improperly credited to the Fund and revert such income to the State General Fund. The Judiciary should also ensure all applicable future expenditures are charged to the Fund at the time such costs are incurred.

- **The Judiciary did not distribute property transfer tax revenues in accordance with State law. For example, the Judiciary incorrectly distributed property transfer tax revenues totaling approximately \$1.5 million to the Department of Natural Resources' Program Open Space instead of to the Maryland Agricultural Land Preservation Fund.**

The Judiciary should ensure that all distributions of property transfer tax revenues are made in accordance with State law and recover the noted overpayments from the Department of Natural Resources and transfer the related funds to the Maryland Agricultural Land Preservation Fund.

- **Deficiencies were noted in equipment and corporate purchasing cards.**

The Judiciary should take the necessary actions to improve internal controls and correct recordkeeping deficiencies in these areas.

Background Information

Agency Responsibilities

The Judiciary is established by the State Constitution as a separate branch of government responsible for the administration of justice in Maryland. The Judiciary comprises the courts and various other agencies that support the administrative and regulatory functions of the Judicial Branch of government.

The courts include the Court of Appeals, Court of Special Appeals, Circuit Courts, and District Court. The Circuit Courts are located in each of the State's 24 local subdivisions. The District Court is divided into 12 geographic districts that contain 34 local courts.

Other agencies included in the Judiciary are the Maryland Judicial Conference, the Administrative Office of the Courts, the State Law Library, and related agencies such as the State Reporter, Commission on Judicial Disabilities, and the State Board of Law Examiners.

According to the State's records, during fiscal year 2009, the Judiciary's operating expenditures totaled approximately \$413 million.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the current status of the twelve findings contained in our preceding audit report dated June 21, 2007. We determined that the Judiciary satisfactorily addressed eleven of these findings. The remaining finding is repeated in this report.

Findings and Recommendations

Real Property Records Improvement Fund

Finding 1

Certain expenditures were not charged to the Real Property Records Improvement Fund balance in a timely manner resulting in the Fund receiving excess investment income totaling approximately \$1.3 million.

Analysis

Certain expenditures were not charged to the Real Property Records Improvement Fund balance at the time incurred resulting in the Fund receiving excess investment income totaling approximately \$1.3 million for a three-year period we reviewed. Specifically, during fiscal years 2007, 2008 and 2009, expenditures applicable to the Fund did not reduce the Fund balance until the end of each year. For example, the Fund's fiscal year 2009 expenditures, which totaled approximately \$24 million, did not reduce the Fund's balance until July 2009. This practice inflated the Fund's month-end cash balances causing the Fund to be credited with investment income that should have been credited to the State General Fund.

In 1991, State law established the Real Property Records Improvement Fund as a special fund within the Judiciary to maintain and modernize equipment at the various Clerk of Circuit Court land records offices. The Fund's revenue is primarily derived from a surcharge of \$20 collected by the circuit courts for recording land record documents, such as mortgages and leases. The law also provides that investment income of the Fund shall be paid into the Fund. According to the Judiciary's records, the Fund balance was approximately \$62.4 million as of June 30, 2009.

Recommendation 1

We recommend that the Judiciary

- a. in conjunction with the Comptroller of Maryland and State Treasurer, determine the amount of investment income that has been improperly credited to the Real Property Records Improvement Fund and revert such income to the State General Fund; and**
- b. ensure all applicable future expenditures are charged to the Fund as such costs are incurred.**

Property Transfer Tax Revenue Distributions

Finding 2

The Judiciary did not distribute property transfer tax revenues collected during fiscal years 2007, 2008, and 2009 in accordance with State law.

Analysis

The Judiciary did not distribute property transfer tax revenues collected during fiscal years 2007, 2008, and 2009 in accordance with State law.

- The Judiciary incorrectly transferred a total of \$1,534,500 to the Department of Natural Resources' (DNR) Program Open Space rather than to the Maryland Agricultural Land Preservation Fund (MALPF) as required. Specifically, the law provides that certain percentages of the total property transfer taxes collected be distributed annually to various programs including Program Open Space and MALPF. However, as a result of certain errors that were made when calculating the required property transfer tax distributions for each of the aforementioned fiscal years, the total taxes available and subject to transfer to MALPF were improperly reduced and excess taxes were distributed to DNR.
- The Judiciary did not distribute property transfer taxes collected during fiscal year 2007 in accordance with the timeframe established by State law. Specifically, as the amount of taxes collected (\$214 million) was less than the related revenue estimate (\$264 million), the Judiciary should have distributed the total taxes collected at fiscal year-end.¹ However, as of June 30, 2007, the Judiciary had distributed only \$3 million of the \$214 million collected. The majority (\$196.5 million) of the amount remaining was not distributed until January 2009, a delay of 18 months. The failure to distribute property transfer taxes in accordance with the law could delay State programs from spending these funds. The distributions for fiscal years 2008 and 2009 were made timely.

Failure to distribute property transfer taxes timely and properly could adversely impact the ability of DNR and MALPF to properly manage their programs. A similar condition was commented upon in our preceding audit report.

¹ According to State law, the circuit courts collect property transfer tax revenues to be distributed to certain State programs. The distribution is based on an annual revenue estimate and, if the revenues collected exceed the estimate, the excess funds are required to be distributed in the second fiscal year following the year during which the excess occurred. If the revenues collected are less than the estimate, the law requires the total revenues to be distributed at the end of the applicable fiscal year.

Recommendation 2

We recommend that the Judiciary

- a. take immediate action to recover the aforementioned \$1,534,500 from the Department of Natural Resources and transfer this amount to the Maryland Agricultural Land Preservation Fund, and**
- b. ensure that all future distributions of property transfer tax revenues are calculated properly and made timely in accordance with State law (repeat).**

Corporate Purchasing Cards

Finding 3

Corporate purchasing card purchases were not adequately monitored.

Analysis

The Judiciary did not ensure that corporate purchasing card transactions were adequately documented and reviewed as required. In addition, numerous cardholders did not use their assigned cards for periods in excess of one year. Specifically, we noted the following conditions:

- Cardholders did not always prepare monthly cardholder activity logs and/or reconcile the transactions included on the related monthly bank statements with the applicable transactions recorded on the activity logs and accompanying vendor receipts. Our test of 34 monthly corporate purchasing card bank statements from calendar years 2008 and 2009, which accounted for purchases totaling approximately \$248,000, disclosed that the related activity logs for 16 of these monthly bank statements totaling \$170,000 were not properly maintained. Specifically, the applicable cardholders did not record all purchases made onto the logs and did not reconcile such purchases to the related bank statements. In addition, supervisory personnel did not review the aforementioned purchases for propriety and approve the related documents (activity logs, bank statements, and vendor receipts) as required.
- As of December 31, 2009, the Judiciary had 33 active purchasing cards that had not been used to make any purchases during the preceding 12 months.

The Judiciary's *Corporate Purchasing Card Program Guide* requires cardholders to record all purchases onto their activity logs and reconcile all such transactions with the monthly bank statement. The *Guide* also requires the cardholder's immediate supervisor to review all such purchases for reasonableness and to

approve the related activity log. In addition, the *Guide* requires that any card having no purchasing activity for an extended period of time be cancelled.

According to the records of the State's purchasing card bank, as of December 31, 2009, the Judiciary had 130 corporate purchasing cards. In addition, according to Judiciary's records, related expenditures totaled approximately \$933,000 during fiscal year 2009.

Recommendation 3

We recommend that the Judiciary comply with the requirements of its *Corporate Purchasing Card Program Guide*.

Equipment

Finding 4

The Judiciary lacked adequate controls over equipment.

Analysis

The Judiciary lacked adequate controls over equipment which, according to its records, totaled approximately \$66.3 million as of June 30, 2009. Specifically, we noted the following conditions:

- Three employees had access to both the inventory warehouse and the automated detail equipment records. In this regard, the Judiciary purchased certain equipment (for example, computer equipment) in large quantities and stored the items in its warehouse until issued. As a result, these employees could potentially misappropriate equipment items located in the warehouse and conceal the related theft by deleting such items from the detail equipment records.
- Reconciliations of the detail equipment records to the control account were not reviewed and approved by a management level employee as required by the Judiciary's *Inventory Control Manual*.

Recommendation 4

We recommend that the Judiciary establish adequate internal controls over equipment. Specifically, we recommend that

- a. employees who have routine physical access to equipment not be able to access and update the related detail records, and**

- b. reconciliations of the control account balance to the aggregate total of the detail records be reviewed and approved by agency management personnel as required by the Judiciary's *Inventory Control Manual*.**

Audit Scope, Objectives, and Methodology

We have audited the Judiciary for the period beginning October 1, 2006 and ending October 18, 2009. The audit was conducted 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.

As prescribed by State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine the Judiciary's financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings included in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit primarily included procurements and disbursements related to operating expenditures, processing of traffic citations and related collections, State grant funds, special funds, payroll, equipment, information systems security, and corporate purchasing cards. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the Judiciary's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

The Judiciary provides certain support services (for example, payroll, processing of invoices, maintenance of budgetary accounting records) on a centralized basis for the Offices of the Clerks of the Circuit Courts. These support services were included in the scope of this audit. We audit the remaining fiscal activities of the Clerks' Offices on an individual basis, and separate audit reports are issued.

Our scope included certain operations of the Judicial Information Systems (JIS). Specifically, our audit included a review of information controls for certain key systems which support the State courts and the Judiciary's Administrative Office of the Courts. These systems included: the Maryland Automated Traffic System, the Uniform Court System, and the Administrative Office of the Court's financial system. Our audit included a review of the internal controls related to production data, programs and transactions and certain general controls over these systems. We also perform a separate audit of JIS which includes reviewing internal

controls over its data center, the related data center software, and the Judiciary's wide area network.

The Judiciary's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations 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.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect the Judiciary's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to the Judiciary that did not warrant inclusion in this report.

The Judiciary's response to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the Judiciary regarding the results of our review of its response.

APPENDIX



ROBERT M. BELL
CHIEF JUDGE
COURT OF APPEALS OF MARYLAND
ROBERT C. MURPHY COURTS OF APPEAL BUILDING
361 ROWE BOULEVARD
ANNAPOLIS, MARYLAND 21401-1699

August 17, 2010

Mr. Bruce A. Myers, CPA
Legislative Auditor
Office of Legislative Audits
301 West Preston Street
Baltimore, MD 21201

Dear Mr. Myers:

We have received the Legislative Auditor's Draft Audit Report pertaining to the audit of the Judiciary for the period beginning October 1, 2006 and ending October 18, 2009. The following are our responses to the audit findings and recommendations in the report:

Finding 1
Real Property Records Improvement Fund

Due to budget decisions enacted by the General Assembly, the Judiciary set up special fund Program Cost Accounts (PCA) that were directly related to the Real Property Records Improvement Fund (RPRIF) in FY 2002, FY 2004, FY 2007 and FY 2009. The PCAs were set up to track various types of RPRIF expenditures and it was presumed that the accounts were linked to the special fund revenue account that the Comptroller uses to calculate interest allocations. It is the cash balance in the revenue account that the Comptroller uses to calculate the interest allocations. Prior to September 2009, the Judiciary was not made aware that such a problem existed and, therefore, presumed the aforementioned links were established appropriately. During this time, land record expenditures were posted correctly by the Judiciary to these special fund PCAs. At the end of each fiscal year, the Judiciary transferred special fund revenue to offset the special fund expenditures in each of these PCAs. This procedure had been used since FY 2002 to establish the rollover balance for the RPRIF revenue account, which is a non-lapsing fund.

- a. It appears that the cash balance used by the Comptroller to allocate interest earnings for the Real Property Records Improvement Fund did not always include all associated expenditures.

In conjunction with the Comptroller's Office and the State Treasurer's Office, an analysis will be performed to determine the amount of interest in question for purposes of transfer of interest income from the special fund to the State General Fund.

- b. In September 2009, the Comptroller's Office made the Judiciary aware that the PCAs were not linked to RPRIF revenue account and that they took action to correct the situation. That action linked the various special fund PCA accounts to the special fund revenue account, such that all relevant special fund expenditures are captured in the cash balance. As a result, the interest allocation provided by the Comptroller's Office has been correct, since September 2009.

Finding 2

Property Transfer Tax Revenue Distributions

The Judiciary again asserts and continues to maintain that it lacks the legal authority to undertake the aforementioned distributions that rightly is the responsibility of the Comptroller's Office. This position is supported with advice from the Attorney General's Office. More practically, the Comptroller's Office is in a far better position to monitor any changes to the distributions as directed by the General Assembly.¹

- a. The Judiciary contacted the Department of Natural Resources to recover the \$1,534,500 and as of June 2010 the amount has been transferred to the Maryland Agricultural Land Preservation Fund.
- b. A revision has been made to the Judiciary's Department of Budget and Finance worksheets to ensure that future distributions made to the Maryland Heritage Areas Authority Financing Fund are funded timely from Program Open Space revenues. This change ensures that the amount transferred to the Maryland Agricultural Land Preservation Fund will be based on the correct revenues.

Finding 3

Corporate Purchasing Cards

The Judiciary's Department of Procurement and Contract Administration is updating the Corporate Purchasing Card Program Guide for redistribution to all corporate purchasing cardholders and their supervisors by September 1, 2010. The Director of Procurement and Contract Administration provided to the executive staff an overview of the requirements of cardholders and their supervisors with respect to maintaining activity logs and receipts for all purchases with the corporate purchasing card and the reconciliation process between the logs and bank statements. In addition, the executive

¹**Auditor's Comment:** Footnote 1 in the audit report was changed based on this response. Nevertheless, we noted that the Judiciary accepted both of our related recommendations.

Mr. Bruce A. Myers
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staff was reminded of the review process and sign-off required by the supervisory personnel.

Based on the updated Guide, official notice will be issued monthly to cardholders who are not in compliance with the Guide for submission of purchasing card transaction logs. Penalties for non-compliance include forfeiture of card privileges.

Of the 34 purchasing cards noted in the finding, 9 cards had been cancelled prior to December 31, 2009. Since January of 2010, an additional 5 cards have been cancelled. After reviewing purchasing card use through the end of the Fiscal Year 2010, another 10 of the 34 purchasing cards were cancelled. In addition, separate from the 34 noted in the finding, an additional 11 cards have been cancelled.

Card activity for remaining cardholders will be assessed monthly to determine if any purchasing cards need to be cancelled based on the revised Guide limiting non-use of purchasing cards to six months. The Judiciary's Department of Procurement and Contract Administration will ensure that all cardholders follow the requirements in the Corporate Purchasing Card Program Guide.

Finding 4
Equipment

- a. As of June 2010, internal control procedures have been implemented that restrict employees that have routine physical access to equipment from having the capability to update detail equipment records.
- b. Beginning with the June 2010 report, the reconciliation of the detail equipment records to the control account is being reviewed and approved by appropriate management personnel as required by the Judiciary's Inventory Control Manual.

We believe we have responded in full to the findings and recommendations in the audit report.

Very truly yours,



Robert M. Bell

cc: Honorable Ben C. Clyburn
Frank Broccolina, State Court Administrator
Faye Gaskin, Deputy State Court Administrator
Ssali S. Luwemba, Director of Internal Audit

AUDIT TEAM

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Audit Manager

Richard L. Carter, CISA
Information Systems Audit Manager

Bekana Edossa, CPA, CFE
Senior Auditor

Edwin L. Paul, CPA, CISA
Amanda L. Roller
Information Systems Senior Auditors

Andrew N. Dobin, CPA, CFE
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