



Report of the Vermont State Auditor

October 22, 2008

ORANGE COUNTY

Results of a Review of Internal Controls over the Disbursements Process and Related Policies and Procedures

Thomas M. Salmon
Vermont State Auditor
Rpt. No. 08-9

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**THOMAS M. SALMON
STATE AUDITOR**



**STATE OF VERMONT
OFFICE OF THE STATE AUDITOR**

October 22, 2008

The Honorable Gaye Symington
Speaker of the House of Representatives

The Honorable Peter D. Shumlin
President Pro Tempore of the Senate

The Honorable James Douglas
Governor

Dear Colleagues,

We conducted an audit of Orange County's internal controls over disbursement and related policies and procedures after being contacted by concerned citizens and County personnel about possible financial misconduct and inappropriate use of employee benefits which allegedly were injurious to the County and to the public's confidence in County government.

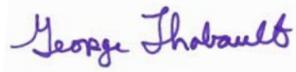
In our opinion, many financial transactions of the County are not being handled in a fiscally prudent manner, putting the County at risk for inappropriate expenditures and financial reporting misstatements. We have recommended a variety of actions to improve the internal controls and financial competence of the organization, including implementing segregation of duties, instituting clearly written comprehensive policies and procedures, utilizing accounting expertise and improving the monitoring of the financial transactions of the County. Within the scope of our review we did not find any evidence indicating fraudulent financial reporting or misappropriation of assets, although some documentation and reconciliations could not be provided.

We are sharing this audit report with Assistant Judges in each County so that they may examine their own policies and procedures, and implement any necessary changes.

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Please feel free to contact us if you have questions about this report.

Sincerely,



George Thabault
Deputy State Auditor

cc: Judge Maurice A. Brown, Orange County Assistant Judge
Judge Prudence Pease, Orange County Assistant Judge
Vermont Association of Assistant Judges
Lee Suskin, Vermont Court Administrator
Jim Reardon, Commissioner, Department of Finance & Management

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Abbreviations

CPA	Certified Public Accountant
FY 2007	Fiscal Year Ending January 31, 2007
FY 2008	Fiscal Year Ending January 31, 2008
FY 2009	Fiscal Year Ending January 31, 2009
SAO	State Auditor's Office
VISION	Vermont Integrated Solutions for Information and Organizational Needs (General Ledger)
V.S.A.	Vermont Statutes Annotated

Introduction

The state is divided into 14 counties, including the County of Orange (the County), Vermont, which was organized in 1781. The County receives the majority of its revenues from taxes assessed upon the equalized grand lists of municipalities located within the County. Under statute, two elected Assistant Judges of the Superior Court have the care and superintendence of the County's administration. The Assistant Judges are responsible for the annual preparation and approval of the County's budget. The County budget including the courthouse, Sheriff's Department, debt service and reserve account for FY 2007 and 2008 totaled \$558,048 and \$672,316, respectively. In addition, the County collects certain County Court fees on behalf of the State.

The State Auditor's Office (SAO) received concerns from citizens of the State and County personnel relating to possible improper handling of funds, inappropriate use and approval of benefits, the proposed budget, poor internal communications and inefficient operations.

In consideration of these concerns, our objectives were to 1) review the design and implementation of internal control systems that are in place for the disbursement process, 2) assess whether compensation and benefits received by County employees and Assistant Judges were in accordance with established policies and procedures, 3) review a sample of disbursements to determine the appropriateness of the transactions and adherence to business procedures, 4) assess compliance with relevant laws, rules and regulations pertaining to County's accounts, disbursements and financial reporting and 5) make necessary recommendations which could help the County be managed in a more fiscally sound manner.

Highlights: Report of the Vermont State Auditor

Orange County: Results of a Review of Internal Controls over the Disbursements Process and Related Policies and Procedures

(October 22, 2008, Rpt. No. 08-9)

Why We Did This Audit

Orange County receives the majority of its revenues from taxes assessed upon the equalized grand lists of municipalities located within Orange County. During fiscal years 2007 and 2008 the County had budgeted expenditures of \$558,048 and \$672,316, respectively.

Because of allegations by County personnel and concerns of the public related to potential inappropriate expenditures, State Auditor Tom Salmon, CPA, initiated an audit in May 2008.

We reviewed the design and implementation of internal control systems that were in place over the disbursement process. In addition, we reviewed a sample of disbursements and benefits received by County Clerk employees to determine the appropriateness of the transaction and assess if they were in accordance with established policies and procedures.

What We Recommend

We recommended that the County develop clearly written comprehensive policies and procedures, direct the Treasurer to sign all checks, establish a process to ensure that the Assistant Judges are reviewing and approving all County disbursements and underlying support, develop a schedule which clearly and concisely tracks employees' earned time, proactively monitor employee earned time, reconcile and review all bank accounts monthly and adhere to applicable State statutes requiring timely deposit reporting, proper retention of records and financial reporting.

Summary of Findings

We found many deficiencies related to the County's internal controls over disbursements, personnel policies and procedures, bank reconciliations and accounting schedules, internal communications and adherence to statutory requirements. Specifically we noted the following findings:

- There is inadequate administration by the Assistant Judges, leading to deficient internal controls and inadequate internal communications.
- The County has not established comprehensive accounting and personnel policies and procedures.
- There is a lack of segregation of duties and insufficient review of County disbursements.
- Employee earned benefits were not accounted for sufficiently. Significant earned compensatory and sick time could not be substantiated, several unusual transfers of compensatory time were observed and other unreconciled differences were noted on the earned time accrual schedule.
- One employee was compensated for more hours than reported on the time sheet and was overpaid on a retroactive pay adjustment. Several employees owe the County for dental insurance benefits extended to their families.
- The County bank accounts are not being adequately reconciled. Significant unreconciled differences were noted during our review of the primary and sweep bank accounts.
- The County does not have sufficient accounting expertise in-house.
- The County has failed to perform certain duties required under State law.

Background

As required by 24 V.S.A. §133, the Assistant Judges are responsible for the preparation and approval of the County's budget. The Assistant Judges shall prepare a proposed budget of the County for the ensuing year. The proposed budget, consisting of expenditures for the courthouse, Sheriff's Department, debit service and reserve, shall be made available to the public for discussion prior to approval. After public comments are considered, the Assistant Judges approve the proposed budget for the ensuing year and the County Clerk sends property tax bills to the County towns. Refer to Appendix I: County Operations Flow Chart for further details on County operations.

The responsibilities of the County Clerk and Deputy Clerk involve managerial, administrative, supervisory and public relations duties for both the County and Superior Court, including maintaining custody of the County's financial records, processing County disbursements, deposits and tax filings, preparing routine financial reports, managing the caseload of the Court and County functions, and maintaining accurate Court records.

The County Treasurer's responsibilities have been limited to reviewing the approved disbursements prior to signing the checks.

Internal control can be broadly defined as a process affected by an entity's governance structure, management, and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.

Internal control is an integral part of managing an organization. Such controls comprise the plans, methods, and procedures used to meet missions, goals, and objectives. In addition, internal controls serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud.

Scope and Methodology

The scope of our audit was limited to a review of the design and implementation of the County's disbursement process to assess whether compensation and

benefits were awarded to County employees appropriately and to assess compliance with all relevant laws, rules, regulations pertaining to disbursements and financial report.

As part of our review of the design and implementation of the County's disbursements process, policies and procedures, and compliance with statutes we interviewed key County personnel to enhance our understanding of the disbursement process.

Our review of the disbursement process included a review of payroll, invoice and debit card transactions. To corroborate the design and implementation of the County's disbursement process, we selected 30 disbursements paid during FY 2007 and 2008. For these disbursements we examined corresponding invoices, approval sheets, copies of cancelled checks, bank statements and other relevant correspondence.

We also reviewed the bank reconciliations for the County's primary and sweep accounts for the months of February, April, August and November 2006 and March, June, August and December 2007. Our review consisted of examining the bank account reconciliations for any unusual reconciling items, verifying the balances per the bank account and ledger and reviewing the cleared checks to determine the check signer.

To assess whether compensation and benefits received by County employees were in accordance with established policies and procedures we reviewed the policies and procedures established and practiced during FY 2007 and 2008. To establish a baseline for such policies and procedures we reviewed the 2004 and 2007 Orange County Superior Court Guidelines and the November 2007 Orange County Employee Benefit Package policies. In addition we examined various time sheets, pay stubs and withholding reports, employee checks, reimbursements and other documentation.

We reviewed payroll registers and other reports to assess that only eligible employees received health and dental benefits. We reviewed the health and dental reimbursements to determine if payments made to employees were in accordance with policies and procedures. We also examined the employees' and County's portion of retirement withholdings and contributions to assess if they were appropriately paid to the State's retirement system.

We reviewed the earned time benefit schedules prepared by the County Clerk for the Deputy Clerk and Administrative Assistant for FY 2007 and 2008. Our examination of the earned time benefits schedules included a review of the vacation, compensatory, personal and sick time. We validated the time reported

on these schedules to the actual approved time sheets for all pay periods during FY 2007 and 2008. In addition, we recalculated the employees' earned time accrued and used as well as reviewed any transfers of time.

We reviewed the compensation paid to the Deputy Clerk, Administrative Assistant and Assistant Judges during FY 2007 and 2008. For the Deputy Clerk and Administrative Assistant, we verified they received proper compensation by validating the hours paid to approved time sheets, verifying pay rates to approval documentation and recalculating amounts paid based on approved time sheets and rates. For the Assistant Judges, we reviewed payroll registers, financial statements and the approved budgets. In addition, we reconciled the quarterly Federal Form 941 filings to the County financial statements for FY 2007 and 2008.

We assessed the County's compliance with statutes relating to the budget preparation, duties of the Treasurer, publishing County financial statements and the required reporting of the deposits. We reviewed the State's annotated statutes and confirmed the County's compliance through observation, corroborating inquiries and inspection of key documents.

Irina Aylward, Staff Auditor, and Jeffrey Kellar, CPA, Audit Supervisor, performed this audit under the supervision of George Thabault, Deputy State Auditor, between May and July 2008 in Chelsea and Montpelier.

Findings

Our overall assessment is that the financial operations of the County lacked adequate internal controls.

We found there was a general lack of policies and procedures to guide the decision-making process; inadequate internal communications; insufficient segregation of duties; lack of documented processes and accounting expertise; inadequate record-keeping; significant unreconciled differences in the bank statement reconciliations; limited adherence to statutory requirements; and other deficiencies which support this general opinion.

The discussions below detail our most significant findings and concerns.

Finding No. 1 - Inadequate Administration by the Assistant Judges

We observed numerous instances of inadequate administration by the County's Assistant Judges, including poor internal communications, lack of established

policies and procedures, insufficient review of County disbursements and lack of segregation of duties. These elements are described in more detail in the subsequent findings.

It is imperative to financial and operational well being of the County that the Assistant Judges be strong administrative stewards of the County. The County Judges are required under Vermont guidelines to discharge their administrative responsibilities without bias or prejudice and to maintain professional competence in judicial administration, and should cooperate with other judges and court officials in the administration of court business. Based on our observations, the Assistant Judges are not meeting their administrative responsibilities and as a result have put the County at risk for significant financial and operational losses.

Strong internal controls, including a well-established and effective control environment¹ as well as properly designed and implemented control activities² are critical to the financial and operational well-being of an organization. The County is deficient in both of these critical elements of internal controls, thus fostering an internal business environment of uncertainty, inefficiency and higher risk of misuse of County resources.

Inadequate internal communications within the County have significantly contributed to the inefficient County operations and have weakened the County's internal controls. The County Clerk and an Assistant Judge often refuse to communicate verbally. Most communications between the two are in the form of lengthy, inefficient and often unnecessary memorandums. The County's most recent staff meeting convened in October 2007. The current situation does not foster effective or efficient operations of the County. We learned of frequent misunderstandings that led to significant internal mistrust, prompting County officers to secure a number of the County records at their personal residences.

These conditions have had a negative impact on internal efficiencies of systems, contribute to low employee morale and frustration and ultimately jeopardize the County's financial future.

¹ The control environment sets the tone of the Organization and influences the effectiveness of internal controls within the Organization. The control environment is the foundation for all other components of internal control, providing discipline and structure and encompassing both technical competence and ethical commitment.

² Control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives.

Finding No. 2 - Lack of Adequate Policies and Procedures

Documentation of policies and procedures is critical to the daily operations of an organization. These documents set forth the fundamental framework and the underlying methods and processes all employees rely on to do their jobs. They provide specific directions and help form the basis for decisions made every day by employees.³ The resulting documentation can also serve as a useful training tool for staff. The Government Finance Officers Association recommends that every government should document its accounting policies and procedures⁴.

The County has not established comprehensive personnel policies and procedures that have been formally approved by the Assistant Judges; the County does not have a mechanism for policy review and adoption. In 2004 the County Clerk drafted basic personnel guidelines addressing earned time benefits. These guidelines were circulated to the Assistant Judges but were not developed further or formally approved. For much of FY 2007 and 2008, the County operated using the informally adopted personnel guidelines established in 2004, which inadequately addressed employee work hours, overtime, vacation and sick benefits. In September of 2007, the County updated the 2004 guidelines to include language on the use of personal time. In November of 2007 and February of 2008, the County established policies on employee health and retirement benefits. The guidelines and policies established by the County are loosely written and lacked many critical elements such as explicit policies governing employee conduct, personnel records, confidentiality, harassment, merit increases, holiday pay, etc. Further, their legitimacy is undermined by the fact that we found no evidence they were approved by the Assistant Judges.

Without clearly written, comprehensive policies and procedures which are sufficiently communicated to and understood by employees, conflicts can occur, poor decisions can be made and serious harm can be done to the County's reputation and financial well-being. Further, the efficiency and effectiveness of operations can be adversely affected⁵.

³ *Internal Control Standards: A Guide for Managers* (Department of Finance & Management).

⁴ *Government Finance Officers Association, Recommended Practice: Documentation of Accounting Policies and Procedures (2002 and 2007)*.

⁵ *Internal Control Standards: A Guide for Managers* (Department of Finance & Management).

Finding No. 3 - Lack of Segregation of Duties and Insufficient Review of County Disbursements

The County Clerk's office is responsible for much of the administration of the Orange County Superior Court, including processing deposits and disbursements. The following are examples of some duties performed within the Orange County Superior Court.

- The County Clerk's office opens the mail for the Orange County Superior Court, including vendor invoices, bank statements, cash receipts and other correspondence.
- All County disbursements are initiated by the County Clerk's office. The Deputy Clerk processes all disbursements, including vendor invoices and employee payroll information.
- The Clerk and Deputy Clerk are the custodians of the County's accounting records including the general ledger and check stock.
- The Deputy Clerk opens the bank statements and prepares the bank reconciliations which are reviewed by the County Clerk.
- The County Clerk, Deputy Clerk and Treasurer are authorized check signers.
- The Assistant Judges review and approve most disbursements biweekly.
- The County Treasurer reviews and signs most checks biweekly.

In general, we found many deficiencies related to lack of segregation of duties, override of controls and insufficient review of disbursements. Specifically we noted the following findings during our review of the County's disbursements cycle:

- Segregation of duties is the division of key duties and responsibilities among different people to reduce the risk of error or fraud and is an essential internal control standard in a well-run organization. In general, our review of the internal controls over the disbursement cycle indicated the County does not have adequate segregations of duties. The County Clerk and Deputy Clerk maintain custody of accounting records, have access to check stock, open all bank statements, prepare bank account reconciliations and are authorized check signers. These employees have

the opportunity to control all key aspects of the disbursements process which increases the risk that improper behavior would be undetected. No one individual should control or have the ability to control or perform all key aspects of a transaction or event⁶.

- The current design of the internal controls over the disbursements process provides that disbursements are processed by the County Clerk's office and approved by the Assistant Judges and checks are then reviewed and signed by the County Treasurer. During our review of select disbursements we observed many instances when the disbursements approval process was not operating as designed. For example, the Assistant Judges did not approve many disbursements or the disbursement checks were not signed by the County Treasurer as intended. Overall, we examined 30 disbursements from FY 2007 and 2008, consisting of 21 invoices and nine debit card payments. Of the 21 invoice disbursements we examined, two disbursements were not approved by an Assistant Judge and eight disbursements were paid with checks signed by the County Clerk and not the County Treasurer. Of the two invoice disbursements not approved by an Assistant Judge, one was paid with a check signed by the County Clerk.

The County Clerk maintains custody of a debit card to make purchases on behalf of the County. Of the nine debit card disbursements we examined, five of the transactions made by the County Clerk were not approved by an Assistant Judge. See Table 1 for the summary results of our disbursements testing.

In addition, during our review of the County's bank statements we observed that the County Clerk signed 250 or 25 percent of the 1,021 checks that cleared the bank statements during the months we examined. According to advice from the Office of the Attorney General, the County Treasurer is the official authorized to draw all checks assigning County funds⁷. The relevant statutes contemplate a three-step process providing segregation of duties. First, the Assistant Judges must assess a claim to determine whether it will be allowed. Second, the County Clerk shall draw an order upon the County Treasurer. Third, upon receipt of the County Clerk's order, the County Treasurer pays the claim from the

⁶ *Internal Control Standards: A Guide for Managers* (Department of Finance & Management)

⁷ Under 24 V.S.A. § 213 and as cited in a confidential memorandum from the Office of the Attorney General, July 15, 2008, *Assignment of County Funds; Assistant Judge Compensation*.

County treasury. It is the advice of the Office of the Attorney General that the County Treasurer should sign all checks disbursing County funds. The County Clerk does not have the statutory authority to sign County checks. Refer to Appendix I: County Operations Flow Chart for further details on County operations.

Since the County Clerk maintains custody of the accounting records, check stock, debit card and is an authorized check signer, the County Clerk has the capability and opportunity to bypass the disbursements approval and check signing process, increasing the risk that an inappropriate transaction is processed.

Subsequently, we have been informed by the County Clerk, as of July 28, 2008, that the County has cancelled its debit card. In addition, the County has begun using formal pre-numbered payment authorization forms to process its disbursements.

Table 1: Summary results of disbursements testing.

Disbursement Type	Total	Instances of Approval by			Instances of Check Signed by		
		Both Assistant Judges	One Assistant Judge	Neither	County Treasurer	County Clerk	Neither
Invoice	21	16	3	2	13	8	N/A
Debit Card	9	4	0	5	N/A	N/A	9
Total	30	20	3	7	13	8	9

- Monitoring is a basic management duty included in routine financial and program activities such as ongoing supervision, reconciliations, comparisons, performance evaluations, and status reports. Internal control systems should generally be designed to ensure that ongoing monitoring occurs in the course of normal operations. Proper monitoring ensures that controls continue to be adequate and function properly⁸.

There were deficiencies in the monitoring of the disbursements of the County by the Assistant Judges and County Treasurer. We observed several instances of payments that were approved by the Assistant Judges

⁸ *Internal Control Standards: A Guide for Managers* (Department of Finance & Management).

and paid by the County Treasurer without sufficient underlying documentation or were paid for an incorrect amount. For example, the Deputy Clerk was paid for approximately 213 hours or \$3,648 of compensatory earned time during FY 2007 and 2008 which could not be substantiated (Refer to Appendix I for the Summary of Questioned Costs). In addition, the Assistant Judges do not receive sufficient information to allow them to ensure they are approving all disbursements. A good monitoring procedure for the Assistant Judges to ensure all disbursements are approved would be to reconcile the check register to the individual disbursements as they are being approved. Any unaccounted-for disbursements should be investigated. Moreover, we noted that the Assistant Judges had not been diligently monitoring the employee earned time accrual schedule and were not aware the schedule was compiled inadequately to track employee earned time. A good measure to ensure that earned time is appropriately paid would be for the Assistant Judges to periodically review the earned time accrual schedule for accuracy and consistency with established policies and to validate that the earned time accrued and used per the schedule agrees to employee time sheets.

In addition, the County Treasurer's financial role has been limited to reviewing the disbursements for proper approvals prior to signing the checks.

Finding No. 4 - Employee Earned Time Benefits Not Sufficiently Accounted for and Monitored

The County Clerk tracks employee earned time benefits for eligible employees, including vacation, compensatory, personal and sick time, by hand, using unlined sheets of paper. Overall, our review of these schedules noted significant discrepancies between the earned benefits accrual schedule and time sheets, significant compensatory and sick time that could not be substantiated, and several unusual transfers between compensatory, vacation and sick time for one employee. Generally, we observed that the earned time accrual schedule is difficult to follow and insufficient to adequately track employee benefits.

Our review of the Deputy Clerk's earned time accrual schedule noted 225 hours of earned compensatory time, of which 213 hours or \$3,648 could not be substantiated by supporting documentation such as calendars, e-mails or time sheets. Only 12 hours of compensatory time were reported on the employee's time sheets. The County Clerk did, however, note that she had been tracking compensatory time earned on her calendar and other notes but that these records could not be located as result of a breach of the filing cabinets in her office that occurred in January 2008. The County Clerk initially stated that she had prepared

an incident report and reported the matter to the Orange County Sheriff. The Orange County Sheriff neither recalled any related incidents, nor could he find any records of such an incident in the County and the State Police databases. At a later date, the County Clerk informed us that she did not report the incident directly to the County Sheriff, but rather brought this matter to the immediate attention of an Assistant Judge and since then has been securing personnel records in the County's safe.

For the pay period ending March 17, 2006, 33 hours were transferred from the Deputy Clerk's earned compensatory pool to cover her earned vacation deficit. In addition, 54 hours were transferred from the Deputy Clerk's earned compensatory pool to cover an earned sick time deficit for the pay period ending November 25, 2007. Moreover, we noted a 31-hour difference between the total sick time reported on the earned time accrual schedule compared to the Deputy Clerk's time sheets for FY 2007 and 2008.

We also observed the County Clerk's schedule under-accrued the Deputy Clerk and Administrative Assistant's earned vacation and sick time for FY 2007 and 2008 by 59 hours. This was the result of employees' accruing vacation and sick time at a rate of 7.38 hours per month versus 3.69 hours per biweekly pay period which was the informal guideline.

Generally, we found only minor differences noted in our review of the Administrative Assistant's earned time accrual schedule, notwithstanding the under accrual of vacation and sick benefits noted above.

Our review of the Deputy Clerk's vacation usage indicated a substantial amount of vacation time was used prior to being earned. The amount of the vacation time used from October 25, 2005, through January 31, 2006, exceeded vacation time earned by 122 hours or \$1,880. The Deputy Clerk's vacation time was approved by the County Clerk and Assistant Judges. Without a policy that clearly stipulates the usage of employee earned time and the period monitoring of employee earned time, the County increases the risk that employees will inappropriately receive earned time benefits.

In an exit conference on September 19, 2008, the Deputy Clerk agreed that her compensatory time was not documented, but maintains that all hours she was compensated for were appropriately earned and approved by the County Clerk and Assistant Judges. Since our audit, the County Clerk has informed us that new procedures have been implemented to more thoroughly account for employee earned time.

Finding No. 5 - Review of County Compensation

We reviewed the compensation paid to County personnel during FY 2007 and 2008. Generally, we found that most of the transactions we reviewed were appropriately approved, recorded and paid. We did however note several transactions that did not appear to be appropriately paid. We found discrepancies related to the following:

- The pay rate approval process;
- A merit pay increase received by an employee;
- Several differences between hours reported and approved on time sheets and actually paid;
- The required Federal withholding deposits for August 2007 were not deposited timely, resulting in penalties;
- Differences reported on the Federal Form 941 reconciliation; and
- Many payroll checks were signed by the County Clerk and not the Treasurer.

According to the personnel policies as practiced by the Orange County Clerk's office, the County employees' compensation is proposed by the County Clerk, approved by the Assistant Judges and formalized through the adoption of County's the annual budget.

Judges' Compensation

As part of our review of County employee compensation we reviewed the compensation calculations and rate approvals for several County employees. We also reviewed the compensation paid to the Assistant Judges. The Assistant Judges approve the County personnel salaries in the County budget annually, including their own salaries and benefits without effective limitation and without the approval of voters or higher authority. Because the Assistant Judges are also paid by the State under a *per diem* rate we sought advice from the Office of the Attorney General as to the authority of the Assistant Judges to receive additional pay and benefits from County funds. The Office of the Attorney General advised us that the Assistant Judges could be paid with County funds for performing their official administrative duties, but not for their judicial duties.

The County does not have a well-designed policy in place for paying compensation to the Assistant Judges. Currently the Assistant Judges submit their

requests for payment at will throughout the year. Compensation may be paid to the Assistant Judges in advance of being earned. For example, an Assistant Judge who left the County during 2007 received advanced compensation of approximately \$1,200 which was not repaid. Without a clearly written policy outlining compensation payment protocol, the County is at risk of overpaying the Assistant Judges.

Approving Employee Pay Rates

Although the County employees' salaries are approved by the Assistant Judges annually, no documentation could be provided validating the Assistant Judges approval of the County Employees' hourly rates. The County Clerk did issue a memo to the Assistant Judges, dated March 8, 2007, outlining the pay increases for County employees, requesting documentation of the Assistant Judges approval. In the absence of documented approvals of County employee pay rates by the Assistant Judges, we validated the County employees' actual compensated pay rates to the rates documented in the County Clerk's memo dated March 8, 2007. We noted no discrepancies in our review.

Retroactive Pay Adjustment

On May 16, 2006, the County Clerk issued a memo to the Assistant Judges requesting a retroactive pay increase for the Deputy Clerk for "exemplary" performance from October 24, 2005, through May 12, 2006. On May 31, 2006, the Assistant Judges issued a memo approving a payment totaling \$654 for the Deputy Clerk's retroactive pay increase from February 1, 2006, through May 12, 2006. On January 31, 2007, a check signed by the County Clerk was issued to the Deputy Clerk in the amount of \$992 for the balance of the Deputy Clerk's retroactive pay increase from October 24, 2005, through January 31, 2006. No documentation could be provided to substantiate the Assistant Judges' approval of the \$992 payment. The County and Deputy Clerk have claimed that this payment had been verbally approved by an Assistant Judge.

In addition, both retroactive payments were calculated assuming the Deputy Clerk worked 40 hours per week during the retroactive period. We recalculated both payments using the actual hours and determined the Deputy Clerk was overpaid by \$333 for the period from October 24, 2005, through January 31, 2006, and \$191 for the period from February 1, 2006, through May 12, 2006, totaling \$523.

Management and staff are currently working on resolution on this matter.

Hours Paid in Excess of Actual Hours Reported

We verified the total hours paid to the Administrative Assistant and Deputy Clerk to the respective time sheets. We found one discrepancy during our review. For the pay period ending November 25, 2005, the Deputy Clerk was paid for 80 hours but only 59 hours were reported on the time sheet, resulting in \$324 of questioned costs. The County Clerk indicated she made an error processing the payroll while filling in for the Deputy Clerk who was out on sick leave.

Federal Employment Tax Deposits

We also noted the County did not make timely deposits of federal income taxes due August 15, 2007. The amount due, totaling \$1,899 was paid in September and October 2007. A penalty of \$173 was waived by the Internal Revenue Service. In general, an employer must deposit federal income taxes withheld and both the employer and employee Social Security and Medicare taxes plus or minus any prior period adjustments to the tax liability. Under the semi-weekly deposit schedule, the County must deposit employment taxes for payments made on Wednesday, Thursday and/or Friday by the following Wednesday or deposit taxes for payments made on Saturday, Sunday, Monday and/or Tuesday by the following Friday⁹.

Reconciliation of County Wages

We reconciled the County wages reported on the quarterly Federal Form 941 to County financial statements for FY 2007 and 2008. We found no significant unreconciled differences for the reconciliation of FY 2008. For the reconciliation of FY 2007 we noted two reconciling differences. The first reconciling difference related to \$720 payment to the County Clerk for custodial services she provided during the year. This amount was included in the County's financial statements as salary expense but was not included in the Federal Form 941 or Form W-2 and the appropriate federal employment taxes were not withheld. Wages subject to federal employment taxes generally include all pay that an employer gives to an employee for services performed¹⁰. The second reconciling difference related to \$2,899 of wages paid to the County's Administrative Assistant during January 2006 which was included in Federal Form 941 and W-2 but was not included in the County's financial statements. This amount could not be reconciled by the County.

⁹ *Department of the Treasury, Internal Revenue Service: Publication 15 (Circular E), Employer's Tax Guide.*

¹⁰ *Department of the Treasury, Internal Revenue Service: Publication 15 (Circular E), Employer's Tax Guide.*

Finding No. 6 - Review of Other County Benefits

One of the objectives of our audit was to verify that the administration of County benefits was made in accordance with the County policies, procedures and/or practices. Overall, we found the County does not have clearly written comprehensive policies and procedures to provide sufficient administration and application of the County's benefits. In addition, we found deficiencies related to the following:

- An overpayment of an employee's health insurance benefit.
- An employee's health and dental benefit eligibility.
- Overpayments made to employees for dental benefits extended to their families.
- Estimated retirement contributions withheld from employee checks.

Health and Dental Insurance Benefits Eligibility

Under the practices of the County, only full-time employees who work 32 or more hours per week or Assistant Judges are eligible to receive health and dental benefits from the County. Eligible employees not choosing to enroll may elect to take a cash benefit equal to their actual out-of-pocket health care insurance premium costs for themselves and family members. The total health benefits were not to exceed the amount of the County's current monthly individual premium cost. Full-time employees may choose to enroll in the dental plan offered by the County. The County will pay 100 percent of the individual's enrollment premium cost. If the individual wishes to extend dental coverage to their spouse or family they may do so at their own expense.

During FY 2007 and 2008 there were seven County employees who received health and dental benefits. Generally, we found these employees to be eligible to receive County health and dental benefits under the established County practices. Our review of the Deputy Clerk's hours indicated there were seven months during FY 2007 and 2008 in which she averaged working either slightly more than or somewhat less than 32 hours per week. During FY 2007 and 2008, the Deputy Clerk worked on average 30.5 and 34.3 hours per week, respectively. Without clearly written benefits policies, which precisely outline eligibility criteria, it is difficult to determine employee eligibility for health and dental benefits. Under the practices in place during FY 2007 we cannot assess the eligibility of the Deputy Clerk for health and dental benefits because some weeks the Deputy Clerk worked fewer than 32 hours.

Cash Payments in Lieu of Health Insurance Benefits

Three employees elected to take the cash benefit payment in lieu of accepting the County's health insurance benefit. We reviewed these reimbursement payments to verify there was sufficient supporting documentation and the amounts were appropriately paid in accordance with the County's practices. Generally, we found the reimbursements for health insurance benefits to be appropriately paid. We did, however, note one instance where an amount was overpaid. The Deputy Clerk was reimbursed twice for the April 2006 health insurance reimbursement, resulting in an overpayment of \$416. This was offset by several underpayments totaling \$92. The Deputy Clerk was overpaid a net amount of \$324 for health insurance reimbursements. In addition, the monthly invoices submitted to support the reimbursements did not always match the period being sought for reimbursement. As of the report date, the Deputy Clerk has reimbursed the County for this overpayment.

Dental Benefits Extended to Family Members

Three employees elected to extend dental coverage to their family at their own expense. We reviewed the periods these employees elected for this benefit and examined the related dental withholdings. We found that two employees did not withhold or pay enough to cover the cost of the premiums extended to their families. These employees owe the County a total of \$638. Assistant Judge Pease and the Deputy Clerk owe the County \$456 and \$182, respectively for dental reimbursements. As of the report date, Assistant Judge Pease and the Deputy Clerk have reimbursed the County for the overpayments.

Participation in the Vermont State Retirement System

For many years the County has elected to participate in the Vermont State Retirement System Group F retirement plan. According to statutes, all employees of a local government who have elected to participate in the Vermont State Employees' Retirement System and who meet the eligibility requirements¹¹ must participate as a condition of employment.¹² Our review noted that eight County employees were required to participate in the Vermont State Retirement System Group F retirement plan but only two actually participated. Failing to meet the requirements of the plan may jeopardize the County's future participation in the plan and may cost County employees significant benefits.

¹¹ Under 3 V.S.A. §481 an eligible "employee" shall mean any regular officer or employee who is employed for not less than forty calendar weeks in a year.

¹² 3 V.S.A. §482.

For the two employees who participated in the Vermont State Retirement System Group F retirement plan, we examined the quarterly retirement plan reports submitted by the County to the Vermont Office of the State Treasurer. The reports calculated the employee and employer portions due to the State retirement plan. We validated the payroll information included in the County's retirement plan reports to the underlying documentation, recalculated the employee and employer portions due and compared the employee and employer amounts withheld and paid to the amounts calculated. Overall, the County properly administered the retirement benefits paid to the State. We did note some differences between the actual amount due and the amounts withheld from employees each pay period. This was the result of estimates being used each pay period for the retirement withholdings. During FY 2007 and 2008, the County over-withheld employee retirement contributions by \$335.

Finding No. 7 - Bank Account Reconciliations

Orange County maintains five bank accounts. These accounts consist of a primary checking, sweep, reserve, county fees and court fees. All accounts are maintained with Mascoma Savings Bank. The primary checking account is used for the majority of the County's disbursements and deposits. The sweep account is integrated with the primary checking account and used to earn interest at a higher rate on primary checking funds. Funds are transferred automatically between the accounts daily by the bank. The Deputy Clerk and County Clerk are responsible for the preparation and review of the County's bank account reconciliations. We reviewed the internal controls over the bank reconciliation process for the primary and sweep accounts, including reviewing reconciling items, bank and ledger balances for selected months. Overall, we found the County's internal controls over the bank reconciliation to be significantly deficient. Moreover, we found inadequate segregation of duties, untimely reconciliation, significant unreconciled differences, and insufficient monitoring. In order to properly safeguard public funds, it is essential for the County to establish sound internal controls over cash and the bank reconciliation process. These controls should include segregation of duties, and timely and complete preparation and review of bank reconciliations. One way to ensure strong internal controls is to establish formal accounting policies and procedures, assigning employees to various functions, and regularly monitoring the compliance with established procedures.

As previously noted, the Deputy Clerk maintains custody of accounting records, has access to check stock, opens all bank statements, prepares bank account reconciliations and is an authorized check signer. In the absence of a sufficient review of bank reconciliations, this employee has the opportunity to control all key aspects of the bank reconciliation process which increases the risk that

improper behavior could be undetected. No one individual should control or have the ability to control or perform all key aspects of a transaction or event.

We reviewed several bank primary and sweep bank account reconciliations. The County's bank accounts have not been sufficiently reconciled or reviewed. Many significant differences were noted. The following are examples of some of the deficiencies observed from our review of the primary checking and sweep bank reconciliations:

- The ledger balance per the February 2006 primary checking bank reconciliation did not agree with the financial statements. A difference of \$15,717 was noted.
- The April 2006 primary checking bank reconciliation contained \$35,417 of uncleared deposits in transit which were more than 60 days old.
- The August and November 2006 and March, June, August and December 2007 primary checking bank reconciliations contained \$55,417 of uncleared deposits in transit which were significantly aged.
- The December 2007 primary checking bank reconciliation contained uncleared checks totaling \$21,444 which are more than 570 days old.
- The August and November 2006 and March, June, August and December 2007 sweep account bank statements were not reconciled until May 2008 after we brought these differences to the attention of the County Clerk. The unreconciled differences ranged from \$23,740 to \$28,273 which was mostly the result of the County not recording interest income.

We recognize that the County Clerk has made progress in the reconciliation and bookkeeping of the County's financial records since the conversion from Quicken to QuickBooks in January 2005, but believe the County Clerk should continue working to improve the reconciliation process. The County Clerk should work closely with the County's auditors to ensure that all audit entries are posted promptly and the County's ledger is reconciled to the audited financial statements.

Monitoring is a basic management duty included in routine financial and program activities such as ongoing supervision, reconciliations, comparisons, performance evaluations, and status reports. Internal control systems should generally be designed to ensure that ongoing monitoring occurs in the course of normal operations. Proper monitoring ensures that controls continue to be adequate and

function properly¹³. A review of the bank reconciliations by the County Clerk, consisting of a review of reconciling items and validation of bank accounts and ledger balances to source documents should have identified these deficiencies. Our review indicated that proper monitoring of the County's bank reconciliations was not being performed by the County Clerk.

Finding No. 8 - Statutory Requirements

We assessed compliance with the statutory requirements relating to the required reporting of deposits, duties of the County Treasurer, publishing County financial statements and bonding of the County Clerk. Overall, the County was not in compliance with many of these statutes, some of which pertain to State, not County funds.

According to 24 V.S.A. §182, each County Clerk shall return quarterly to the Commissioner of Finance & Management an itemized statement, verified by oath, of all fees which have accrued to the State during the three months preceding. The County's quarterly deposit reports are due by the 30th of the month following the end of the quarter. In addition, monthly deposit packets are expected to be filed at the Department of Finance & Management by the 15th day of the following month. The County is also expected to make State bank deposits at least once a week and enter them into VISION, the State's accounting system, within 24 hours of deposit. The County has not been filing complete and timely quarterly reports to report the collection of State funds or has not been making timely deposits and entries into VISION. For example, the financial reports for the quarter ending June 30, 2007 were only partially filed. The escrow summary and supporting documents were not received timely. Deposits for March, April and May 2007 were entered into VISION in June 2007. Similar instances of non-compliance were noted during the quarter ended June 30, 2008 as well.

According to 24 V.S.A. §213, §221 and §223 the County Treasurer shall keep proper entries of monies received and paid out, under appropriate accounts, so that the revenue of the County and the disbursements shall appear in detail. The County Treasurer shall deliver to the Assistant Judges of the County a statement of accounts exhibiting the orders accepted and paid by the County Treasurer, detailing basic disbursement information, the amount of interest paid thereon, and the amount of indebtedness of the County. The Assistant Judges shall compare such statement with the record of the County Clerk of orders drawn upon the County Treasurer for such year, and after correcting errors therein shall cause the same to be recorded in the office of the County Clerk.

¹³ *Internal Control Standards: A Guide for Managers* (Department of Finance & Management).

The County is not meeting the requirements of these statutes. These statutes have been written to support separation of duties and monitoring of County finances. Currently, the County Treasurer's role has been limited to reviewing the County's orders for proper approvals prior to signing the checks and periodically reviewing the County's financial statements. The County Treasurer does not retain copies of records after approving orders and signing checks. A statement of accounts has not been prepared by the County Treasurer or reviewed by the Assistant Judges. Without adequate segregation of duties and monitoring, the County increases its risk that an inappropriate event will occur.

According to 24 V.S.A. §224, within 14 days after the receipt of the statement of accounts from the County Treasurer, the Assistant Judges shall publish annually such a summary as will show the source and amount of the income of the County, the items and amount of expenditures by the Treasurer for the year, together with the indebtedness of the County, and such other facts as to the financial condition of the County as they deem important. Such publication shall be made in not more than three newspapers in the County, or if a newspaper is not published in the County, in some newspaper having general circulation therein. The Assistant Judges did not publish the County's financial summary reports in a general circulation newspaper for FY 2007 and 2008.

Under 24 V.S.A. §175, the County Clerk shall become bound to the County in the sum of \$3,000, with sufficient sureties, by way of recognizance, before two of the judges of the Superior Court, or give a bond to the County executed by principal and sureties in like sum to be approved by two of the judges of the Superior Court, conditioned for the faithful performance of the County Clerk's duties. Such bonds of County Clerks shall be taken biennially in the month of February and recorded in the office of the County Clerk. The insurance policies could not be provided by the County Clerk and therefore we could not validate if proper bonding was obtained for the County Clerk. The insurance renewal policies were provided for FY 2009, which did indicate that sufficient insurance coverage was obtained for that period.

Conclusions

Although the County has some internal controls which appear to be properly designed, we observed many internal controls that were not properly designed or missing. Strong internal controls improve the likelihood that the County is positioned to achieve effectiveness, efficiency and reliability of financial operations and compliance with laws and regulations. There were a number of areas in which improvements can be made, particularly as related to:

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- Establishing clearly written comprehensive policies and procedures.
 - Developing segregation of duties.
 - Improving the monitoring of County disbursements and benefits.
 - Reconciling and reviewing the County's bank accounts.
 - Reporting all employee hours accurately on time sheets and maintaining documentation of employee overtime.
 - Improving internal communications.
 - Complying with State statutes.

These improvements are expected to remediate existing deficiencies and further enhance the County's internal controls and ensure reliability of its financial reporting.

Recommendations

Finding No. 1 - Inadequate Administration by the Assistant Judges

We recommend that the Assistant Judges, as elected managers of County government:

- Take appropriate steps to improve management, internal controls (as indicated in the subsequent recommendations) and internal communications, foster a respectful working environment, and institute procedures to better handle employee personnel and other matters.

Finding No. 2 - Lack of Adequate Policies and Procedures

We recommend that the Assistant Judges, as elected managers of County government:

- Work in conjunction with the Association of Assistant Judges and other counties to develop a clearly written comprehensive personnel policies and procedures manual. The manual should address personnel matters, accounting and approval processes, and should be communicated promptly to all County personnel.

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- Develop a mechanism for policy review, approval and adoption.
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Finding No. 3 - Lack of Segregation of Duties and Insufficient Review of County Disbursements

We recommend that the Assistant Judges, as elected managers of County government:

- Remove the County Clerk and Deputy Clerk as authorized check signers.
- Direct the County Treasurer to sign all County checks. Designate an alternate check signer who is not involved with drawing or approving the County orders.
- Institute a system of having the Assistant Judges alternate opening and reviewing the bank statements and investigate all unusual transactions promptly.
- Establish a process to ensure that the Assistant Judges are reviewing and approving all County disbursements.
- Review the underlying documentation supporting all significant disbursements.

Finding No. 4 - Employee Earned Time Benefits Not Sufficiently Accounted for and Monitored

We recommend that the Assistant Judges, as elected managers of County government:

- Report all employee hours accurately on time sheets, including regular hours worked, overtime and earned compensatory time. Maintain documentation outlining the nature of employee overtime.
- Develop a schedule that clearly and concisely tracks employee accrued and used earned time in accordance with established County personnel policies and procedures. Update this schedule each pay period and reconcile it to approved time sheets.
- Review the updated earned time accrual schedule in conjunction with their review of employee time sheets and approval of pay checks.
- Monitor employee earned time to ensure that it is taken in accordance with established County policies and procedures.

Finding No. 5 - Review of County Compensation

We recommend that the Assistant Judges, as elected managers of County government:

- Develop and codify guidelines for establishing Assistant Judges' compensation and benefits paid with county funds.
- Review underlying support and approve all disbursements, including unique disbursements such as retroactive pay adjustments.
- Monitor employee payroll checks to ensure that only approved hours worked are paid.
- Approve and document County employee pay rates.
- Reconcile the quarterly Federal Form 941 filings to the County's financial statements.
- Process all payments made to employees for services performed through the County payroll and withhold the appropriate federal employment taxes.
- Monitor federal employment taxes to ensure timely deposits.

Finding No. 6 - Review of Other County Benefits

We recommend that the Assistant Judges, as elected managers of County government:

- As previously mentioned, develop clearly written comprehensive personnel policies and procedures.
- Review the underlying support for all benefits payments to ensure that payments are appropriately made and benefits are not overpaid.
- Direct employees to pay what is owed, immediately or withhold the appropriate amount from employees' pay to recoup the cost of benefits owed to the County.
- Immediately enroll all employees into the Vermont State Retirement System Group F retirement plan who meet the plan eligibility requirements.

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- Withhold retirement benefits based on actual amounts due to the State's retirement plan.

Finding No. 7 - Bank Account Reconciliations

We recommend that the Assistant Judges, as elected managers of County government:

- Institute a process to reconcile and review all bank accounts monthly.
- Segregate the reconciliation and review functions.
- Perform a more robust review of the bank account reconciliations, including a review of reconciling items and a tie out of the bank and ledger balances to the bank and financial statements. Investigate any unusual or aged items promptly.
- Reconcile the County's ledger to the audited financial statements.
- Record interest income monthly.

Finding No. 8 - Statutory Requirements

We recommend that the Assistant Judges, as elected managers of County government:

- File quarterly deposit reports timely and completely by the 30th of the month following the end of the quarter in accordance with requirements established by the Department of Finance & Management.
- File monthly deposit packets with the Department of Finance & Management by the 15th of the following month.
- Make bank deposits of State funds at least once a week and enter the transactions into VISION within 24 hours of deposit.
- Direct the Treasurer to retain records of orders signed during the year and deliver to the Assistant Judges a statement of accounts reporting the orders accepted and other key financial information. Require the Assistant Judges to reconcile this information to the records maintained by the County Clerk.
- Publish annually in not more than three newspapers a summary of the County's financial information as required under statute.

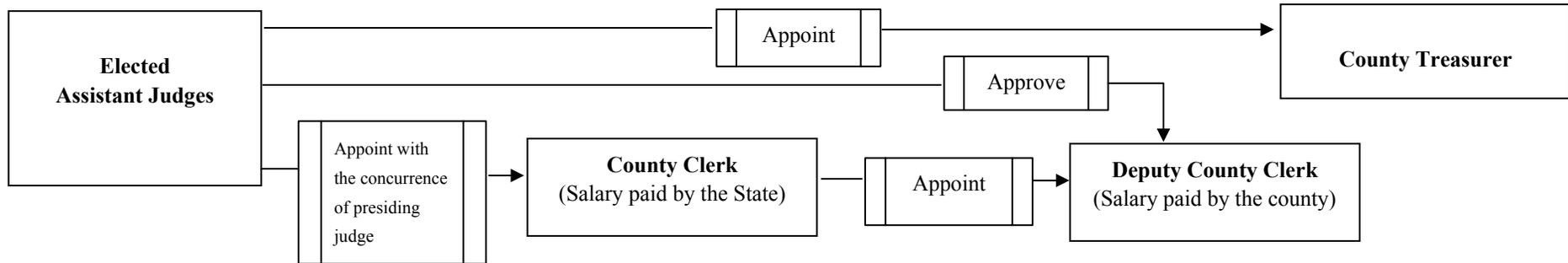
Management's Comments and Our Evaluation

On October 17, 2008, the Assistant Judges provided comments on the draft of this report. In general, the Assistant Judges concur with our recommendations. Their comments broadly address the actions that they plan to take in response to our findings and have been reprinted in their entirety in Appendix III. Prompt and comprehensive actions to our findings are critical to healthy operations of the County.

In accordance with 32 V.S.A. §163, we are also providing copies of this report to the Secretary of the Agency of Administration, Commissioner of the Department of Finance and Management, and the Department of Libraries. In addition, the report will be made available at no charge on the State Auditor's web site, <http://auditor.vermont.gov/>.

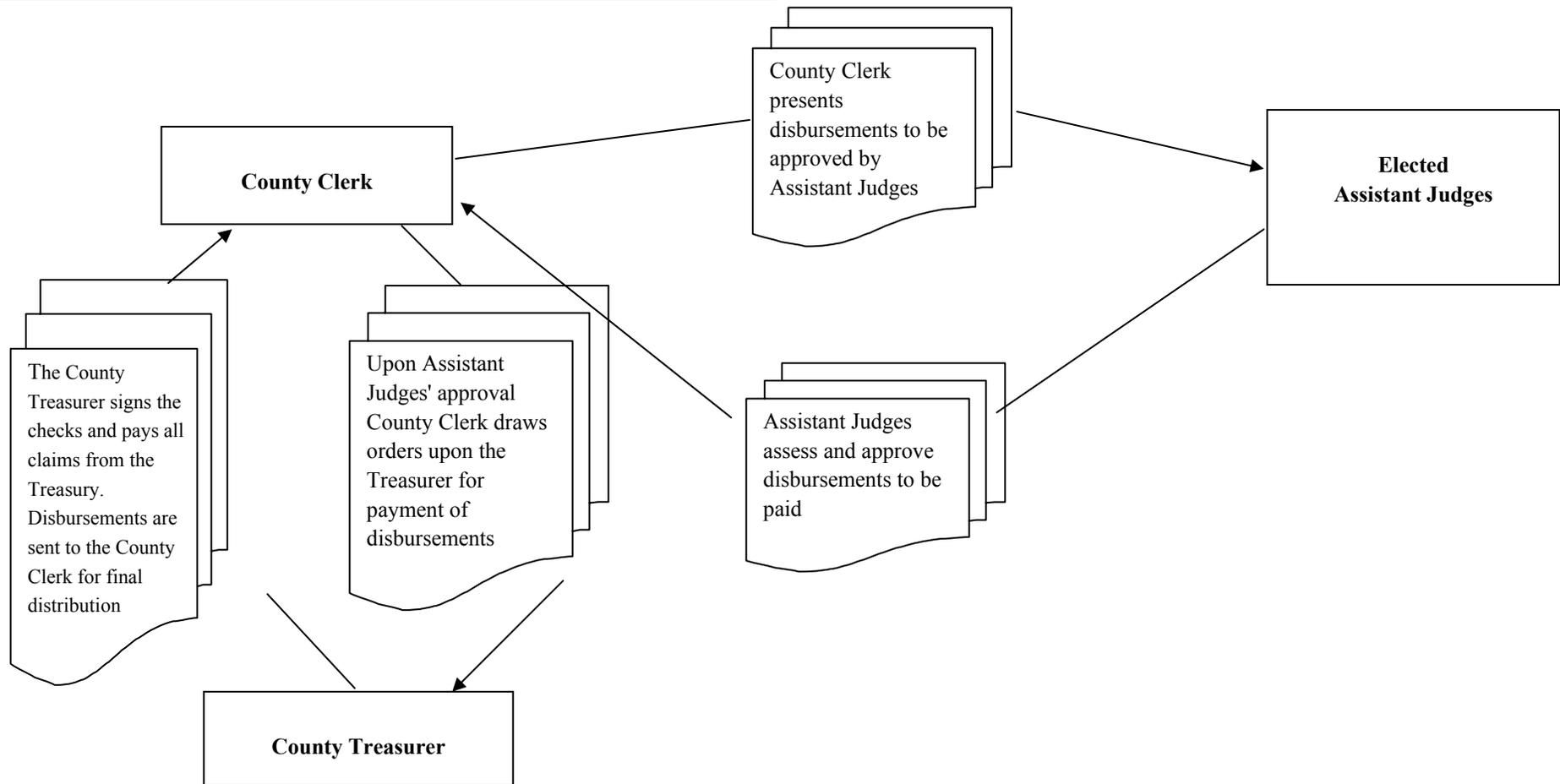
Appendix I: County Operations Flow Chart

Assistant Judges Appointment of County Clerk and Treasurer:



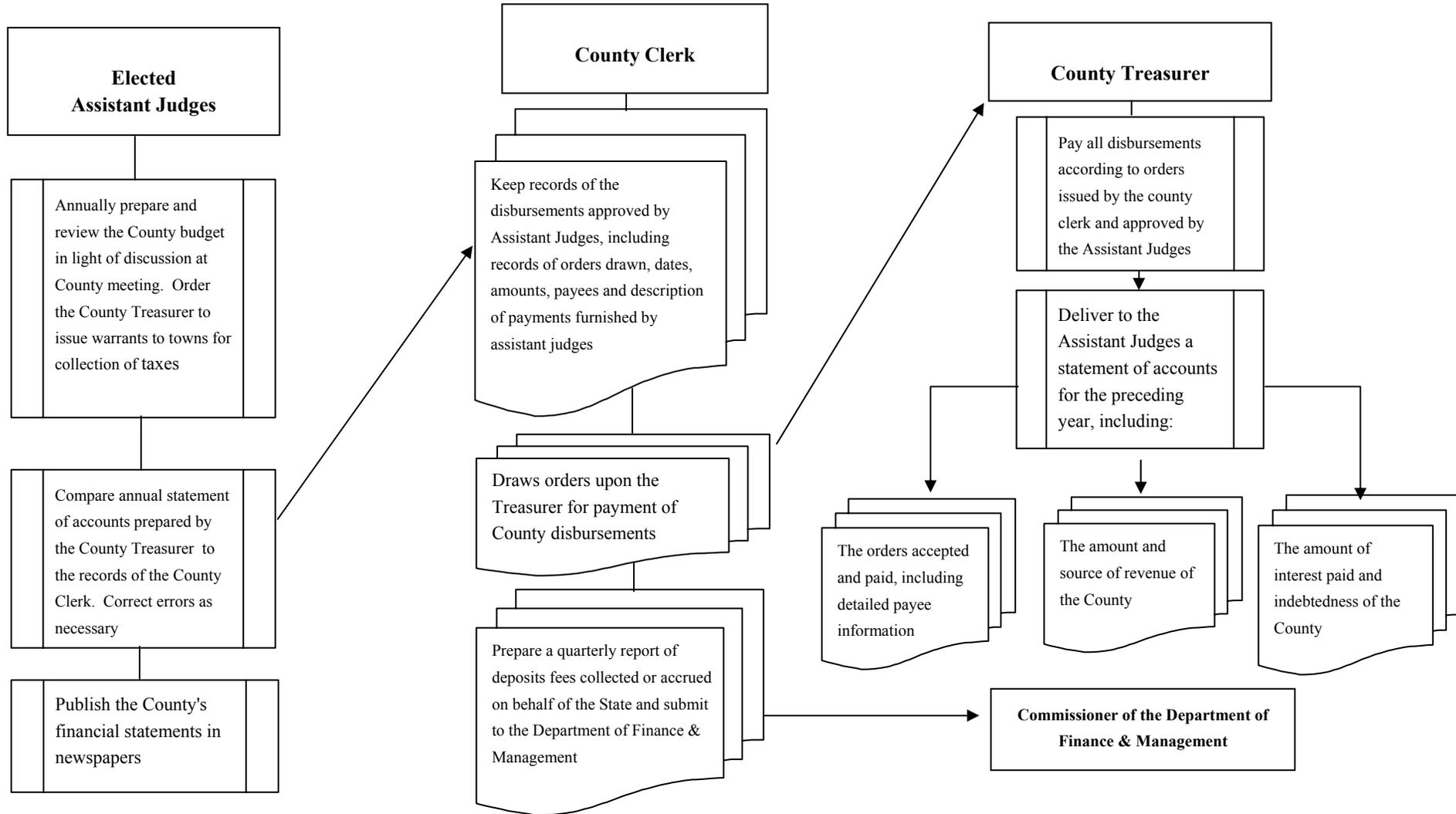
Appendix I: County Operations Flow Chart

County Disbursement Approval Process as Designed Under Statute:



Appendix I: County Operations Flow Chart

Summary of Other Accounting Duties of the Assistant Judges, County Clerk and County Treasurer Under Statute:



Appendix II: Summary of Questioned Costs

Summary of Questioned Costs		
Description	Questioned Cost	Report Page
Unsubstantiated compensatory time.	\$ 3,648	12
Unearned vacation time used.	1,880	13
Retroactive pay adjustment.	523	14
Discrepancies between hours reported on the time card and hours paid.	324	15
Health insurance premium payment to an employee.	324	17
Family dental plan premiums due from employees.	638	17
Total Questioned Costs	\$ 7,337	

Appendix III: Response by the Assistant Judges, October 17, 2008

By facsimile 802.828.2198 and first class mail

Mr. George Thabault
Deputy State Auditor
132 State Street
Montpelier, VT 05633-5101

RE: Orange County Audit

Dear Mr. Thabault:

Please consider this the formal response of Orange County through its Assistant Judges to the draft report, "ORANGE COUNTY Results of a Review of Internal Controls over the Disbursements Process and Related Policies and Procedures," hereinafter "the Draft Report," and "ORANGE COUNTY Results of a Review of Internal Controls over the Disbursements Process and Related Policies and Procedures REVISED DRAFT," hereinafter "the Revised Draft Report." The Assistant Judges address each finding, item by item:

Finding No. 1 - Inadequate Administration by the Assistant Judges

The Assistant Judges acknowledge that steps need to be taken to improve the general management of the County. Toward that end, the Assistant Judges will review county fiscal management and implement appropriate financial controls. The Assistant Judges will strive to encourage a working environment that is conducive to the conduct of County and judicial affairs.

Finding No. 2 - Lack of Adequate Policies and Procedures

The Assistant Judges will develop comprehensive personnel policies and procedures which shall include procedures for policy adoption, review, and amendment.

Finding No. 3 - Lack of Segregation of Duties and Insufficient Review of County Disbursement

The Assistant Judges will implement promptly a fiscal management procedure which is consistent with the recommendations contained in the Audit Report.

Finding No. 4 - Employee Earned Time Benefits Not Sufficiently Accounted for and Monitored

The Assistant Judges will implement promptly a personnel management system which accurately monitors employee duties, hours, and compensation consistent with County policies. Since receipt of the Revised Draft Report, the Assistant Judges have adopted new forms to keep track of sick and vacation time.

Appendix III: Response by the Assistant Judges, October 17, 2008

Finding No. 5 - Review of County Compensation

The Assistant Judges will develop and implement procedures for the compensation of Assistant Judges and establish systems for the approval of disbursements to Assistant Judges. The Assistant Judges will develop and implement procedures to ensure that proper state and federal employment deposits and tax returns are made in an accurate and timely manner.

Finding No. 6 - Review of Other County Benefits

The Assistant Judges will take steps to implement and monitor its personnel policies. Since the receipt of the Revised Draft Report, all eligible employees are participating in the State Retirement System.

Finding No. 7 - Bank Account Reconciliations

The Assistant Judges will oversee the implementation of the recommendations contained in the Audit Report.

Finding No. 8 - Statutory Requirements

Since the receipt of the Revised Draft Report, the County Clerk and Deputy County Clerk have met with the Department of Finance and Management and are current with the entry of transactions into VISION. In addition, the Assistant Judges will oversee the implementation of the recommendations contained in the Audit Report.

Other

The Assistant Judges are pleased that the audit of the County did not reveal evidence of fraudulent financial reporting or misappropriation of assets. The Assistant Judges accept generally the findings of the Audit Report and look forward to working with the Department of Finance and Management, the Office of Court Administrator, the Vermont Association of County Judges, private sector accountants and its legal counsel to improve upon the fiscal and general management of the affairs of the County.

Very truly yours,

Prudence Pease
Assistant Judge

Maurice Brown
Assistant Judge

cc: Jeffrey P. Kilgore, Esquire