SUPERIOR COURTS OF CALIFORNIA

Report to the California State Legislature

VALIDITY OF RECORDED REVENUES, EXPENDITURES, AND FUND BALANCES

July 1, 2016, through June 30, 2019

BETTY T. YEE

California State Controller

April 2021

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California State Controller

April 1, 2021

Members of the California State Legislature
State Capitol Building
Sacramento, CA 95814

Members of the California State Legislature:

I am pleased to present you with the State Controller's Office annual report for the Superior Court Audit Program of California, Validity of Recoded Revenues, Expenditures, and Fund Balances. This report has been prepared pursuant to Government Code section 77206(h)(3).

During this initial reporting period, the State Controller's Office completed 14 audits of Superior Courts with audit periods between July 1, 2016, and June 30, 2019.

The purpose of these audits is to determine whether the Superior Courts complied with governing statutes, rules, and regulations relating to the validity of recorded revenues, expenditures, and fund balances of all material and significant funds under their administration, jurisdiction, and control.

Please direct any questions regarding this report to Michael Reeves, CPA, Acting Chief of our Division of Audits, at (916) 323-5849.

Sincerely,

Original signed by

BETTY T. YEE

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Summary

This report summarizes the results of the State Controller's Office (SCO) audit of the Superior Courts of California (courts) during the period of July 1, 2016, through June 30, 2019. This report has been prepared pursuant to Government Code (GC) section 77206(h)(3).

SCO completed 14 audits of the following courts:

- Amador County Superior Court (fiscal year [FY] 2016-17)
- El Dorado County Superior Court (FY 2017-18)
- Kern County Superior Court (FY 2018-19)
- Merced County Superior Court (FY 2018-19)
- Placer County Superior Court (FY 2017-18)
- Sacramento County Superior Court (FY 2016-17)
- San Joaquin County Superior Court (FY 2017-18)
- San Mateo County Superior Court (FY 2016-17)
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- Stanislaus County Superior Court (FY 2018-19)
- Sutter County Superior Court (FY 2017-18)
- Tehama County Superior Court (FY 2016-17)
- Yolo County Superior Court (FY 2016-17)

The purpose of these audits was to determine whether the courts complied with governing statutes, rules, and regulations relating to the validity of recorded revenues, expenditures, and fund balances of all material and significant funds under their administration, jurisdiction, and control.

We reviewed approximately $273,257,204 in recorded revenues, $26,659,028 in recorded expenditures, and $32,677,375 in recorded fund balances. We found $10,156,695 in cumulative errors.

The reported audit findings are classified as follows:

- Accounting misstatements and errors
- Failure to reclassify unclaimed trust accounts
- Internal control deficiencies
  - Inadequate internal controls over cash handling
  - Failure to promptly deposit cash
  - Noncompliance with procurement and payment policies
  - Lack of supporting documentation (expenditures and payroll)

- Inadequate review and approval of expenditure and procurement processing
- Inadequate segregation of duties

Except for the issues described in the Audit Results, we found that the courts were generally in compliance with the governing statutes, rules, and regulations relating to the validity of recorded revenues, expenditures, and fund balances of material and significant funds under the administration, jurisdiction, and control of each court audited.

Background

The courts are located in each of California's 58 counties and follow the California Rules of Court, established through Article IV of the Constitution of California. The Constitution charges the Judicial Council of California (JCC) with authority to adopt rules for court administration, practices, and procedures. The Judicial Council Governance Policies are included in the California Rules of Court. The courts are also required to comply with various other state laws, rules, and regulations, much of which are codified in GC sections 68070 through 77013, Title 8, The Organization and Government of Courts.

Pursuant to California Rules of Court (CRC) Rule 10.804, the JCC adopted the *Trial Court Financial Policies and Procedures Manual*, which provides guidance and directives for court fiscal management. The manual contains regulations establishing budget procedures, recordkeeping practices, accounting standards, and other financial guidelines. The manual is comprised of an internal control framework that enables courts to monitor their use of public funds, provide consistent and comparable financial statements, and demonstrate accountability. Procurement and contracting policies and procedures are addressed separately in the *Judicial Branch Contracting Manual*, adopted by the JCC under Public Contract Code section 19206.

With respect to court operations, CRC Rule 10.810 provides cost definitions (inclusive of salaries and benefits, certain court-appointed counsel provisions, services and supplies, collective bargaining, and indirect costs), exclusions to court operations, budget appropriations for counties, and functional budget categories. GC section 77001 provides trial courts with the authority and responsibility for managing their own operations.

All court employees are expected to fulfill at least the minimum requirements of their positions and to conduct themselves with honesty, integrity, and professionalism. In addition, they must operate within the specific levels of authority established by courts for their positions.

The JCC requires that courts prepare and submit Quarterly Financial Statements, Yearly Baseline Budgets, and Salary and Position Worksheets. Financial statement components form the core subject matter of our audit.

The Trial Court Trust Fund is the primary source of funding for operations. The JCC allocates monies in the Trial Court Trust Fund to the courts. The

Trial Court Trust Fund's two main revenue sources are the annual transfer of appropriations from the State's General Fund and maintenance-of-effort payments by counties, derived from their collections of fines, fees, and forfeitures.

In FY 2016-17, FY 2017-18, and FY 2018-19, the audited courts generated approximately 78% of the total revenues from Trial Court Trust Fund allocations.

The audited courts employed approximately 3,508 staff members to fulfill the operational and administrative activities necessary to serve each County's population, totaling approximately 6,731,082 in aggregate for all Counties. The courts that we audited incurred $425,507,915 in expenditures for the period of July 1, 2016, through June 30, 2019. Of this amount, approximately 77% represents employee salaries and benefits.

Funds under each court's control include a General Fund, a Special Revenue Non-Grant Fund, a Special Revenue Grant Fund, a Proprietary Fund, and a Fiduciary Fund. All funds that had revenue accounts and expenditure accounts with reported balances at year-end in excess of 4% of total revenues and expenditures, respectively, were considered material and significant.

We performed audits at the request of the JCC, pursuant to Interagency Agreement No. 1034558, dated September 5, 2017, and Interagency Agreement No. 38881, dated May 28, 2019, between the SCO and the JCC.

Audit Authority

We conducted our audits under the authority of GC section 77206(c), which states:

> The Controller, at the request of the Legislature, may perform and publish financial and fiscal compliance audits of the reports of court revenues and expenditures. The Controller shall report the results of these audits to the Legislature and the Judicial Council.

In addition, GC section 77206(h)(3) states, in part:

> Notwithstanding Section 10231.5, the auditing entity shall compile the trial court audit findings and report the results of these audits to the Legislature, the Judicial Council, and the Department of Finance no later than April 1 of each year.

In addition, GC section 12410 states, in part:

> The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment.

Objective, Scope, and Methodology

The objective of our audits was to determine whether the courts complied with governing statutes, rules, and regulations relating to the validity of recorded revenues, expenditures, and fund balances of all material and significant funds under their administration, jurisdiction, and control. Specifically, we conducted these audits to determine whether:

- Revenues were consistent with authorizing Government Code sections, properly supported by documentation, and recorded accurately in the accounting records;
- Expenditures were incurred pursuant to authorizing Government Code sections, consistent with the funds' purposes, properly authorized, adequately supported, and recorded accurately in the accounting records; and
- Fund balances were reported based on the Legal/Budgetary basis of accounting and maintained in accordance with fund accounting principles.

During this initial reporting period, we completed 14 court audits with audit periods between July 1, 2016, and June 30, 2019. To accomplish our objective, we completed the following actions.

General Procedures

- We reviewed the Judicial Council Governance Policies (November 2017), the Budget Act, the *Manual of State Funds*, applicable Government Code and California Rules of Court sections, the *Trial Court Financial Policies and Procedures Manual*, Ninth Edition, June 2018, and other relevant internal policies and procedures to identify compliance requirements applicable to court revenues, expenditures, and fund balances.

Internal Controls

- We reviewed the courts' current policies and procedures, organization, and website, and interviewed court personnel to gain an understanding of the internal control environment for governance, operations, and fiscal management.
- We interviewed court personnel and prepared internal control questionnaires to identify internal accounting controls.
- We assessed whether key internal controls, such as reviews and approvals, reconciliations, and segregation of duties were properly designed, implemented, and operating effectively by performing walk-throughs of revenue and expenditure transactions.
- We reviewed the courts' documentation and financial records supporting the validity of recorded revenues, expenditures, and fund balances.
- We evaluated electronic access controls and data reliability of the courts' financial system.
- We selected revenue and expenditure ledger transactions to test the operating effectiveness of internal controls. Using non-statistical sampling, we selected revenue and expenditure items to evaluate key internal controls of transactions recorded in significant operating

funds and the related fund accounts. We expanded testing on accounts with transactions containing errors to determine the impact of the identified errors. Errors were not projected to the tested population.

We designed our testing to verify the courts' adherence to prescribed accounting control procedures, and to verify that transactions were correctly recorded into the accounting system for financial reporting. Our testing results are summarized in the Audit Results section.

We limited our review of the courts' internal controls to gaining an understanding of the significant internal controls within the context of the audit objective. None of the audits included objectives related to economy and efficiency measures, and we did not audit the courts' financial statements.

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

Audit Results

Summary of Audit Results

We tested revenues, expenditures, and fund balances for each of the 14 trial courts. Below is a collective summary of all 14 trial court audits.

<u>Revenue Testing</u>

We tested approximately 64% of total revenues ($273,257,204 of $428,008,402), and found that some prior-year revenues were misclassified in accounts reported in the courts' financial statements. However, the courts' total reported revenues were not misstated. We also found some inaccuracies with revenues that were recorded at year-end using estimates and not adjusted for the differences in amounts actually received.

<u>Expenditure Testing</u>

We tested approximately 6% of total expenditures ($26,659,028 of $425,507,915), and found an internal control deficiency relating to the assignment of accounts used to classify and record prior-year expenditure transactions. We also found some isolated deficiencies regarding approval of invoice payments for some high-dollar expenditure transactions, cash and mail handling procedures, and missing procurement and personnel documentation.

<u>Fund Balance Testing</u>

We recalculated sampled funds as of June 30, 2017, June 30, 2018, and June 30, 2019, and determined that fund balances for the tested operating General Funds, Grant Special Revenue Funds, and Non-Grant Special Revenue Funds were properly reported. However, we found several courts did not reclassify unclaimed trust accounts that were older than three years.

Audit Results and Findings for Individual Trial Courts

Amador County Superior Court (FY 2016-17)

The court complied with governing statutes, rules, and regulations relating to the validity of recorded revenues, expenditures, and fund balances. However, we found the following weaknesses in the court's administrative and internal accounting control system.

The amount of error was $0.

The court agreed with the findings.

Finding 1—Inadequate internal controls over cash handling

We identified deficiencies in the following areas:

- Cashiers are not adequately safeguarding cash collections. We noted several instances in which cashiers left keys unsecured on their desks or in keyholes while not at their stations, or when leaving the room altogether.
- Cashiers do not verify the identities of customers writing personal checks or using credit cards when payment is made at the public window.
- Only one employee opens the mail, instead of a two-person team. In addition, the mail-opening responsibilities are not regularly rotated among the staff members.
- Payment receipts are not recorded in a log when payment is received through the mail.
- Safes are not secured to the wall and remain open throughout the day.

Finding 2—Failure to promptly deposit cash:

During our review of the court's internal controls, we found that the court does not process payments received through the mail on the day that payments are received. During an interview with a senior clerk, the clerk stated that payments are not always processed the same day they are received; instead, they are left in a cash bag to be processed on the next business day.

Finding 3—Noncompliance with procurement policies:

During our testing of procurement transactions, we found that the court staff did not comply with procurement policies and procedures to ensure effective management controls over the purchase order process.

We tested four procurement transactions initiated during the audit period. For two of the transactions tested, the court did not comply with procurement policies that require the court to obtain at least three bid offers. The court did not document any justification for sole-sourcing its procurement.

El Dorado County Superior Court (FY 2017-18)

Our audit found that the court complied with governing statutes, rules, regulations, and policies for revenue, expenditures, and fund balances. However, in the course of testing, we noted weaknesses in the court's internal controls over its enhanced collection reimbursements, year-end revenue accruals, and expenditure-related procurements and disbursements process.

The amount of error was $19,467.

The court partially agreed with the findings.

Finding 1—Revenues: Internal control deficiencies and accounting errors

As part of our revenue testing, we reviewed the Enhanced Collections Program. We also compared and reconciled the JCC's Trial Court Trust Fund distributions with the court's recorded monthly revenue ledger entries. We noted errors in the calculation and recording of reimbursable enhanced collection program costs. We also found an omitted year-end Trial Court Trust Fund accrual.

These errors resulted from deficiencies in accounting internal controls. Specifically, we found that:

- The court did not apply its indirect cost rate to staff benefit costs when calculating the reimbursable costs for administering its Enhanced Collections Program. Collections performed in the enforcement of court orders for fees, fines, forfeitures, restitutions, penalties, and assessments result in various operating costs to the court. Through the Enhanced Collections Program, the court receives reimbursements to recover related operating and indirect costs.

  Additionally, the court applied an incorrect indirect cost rate to its reimbursable cost calculations. The court's approved indirect cost rate for FY 2017-18 was 20.02%. However, the court applied a lower indirect cost rate of 10% to direct salaries charged to the Enhanced Collections Program. If the court had applied the approved indirect cost rate of 20.02% to both direct salaries and benefits charged to the program, it would have recovered additional reimbursements of $24,078.

- The court did not accrue $339 at year-end for the Trial Court Trust Fund Automated Record Keeping and Micro Graphics (General Ledger [GL] Account No. 812160) from Distribution No. 14. We discovered this minor variance when comparing the Trial Court Trust Fund distributions to the court's ledger entries. The court acknowledged an oversight in recording the distribution.

Finding 2—Expenditures: Internal control deficiencies and accounting errors

During our review and testing of the court's expenditures, we noted internal control deficiencies relating to its procurement and disbursement process. We also noted classification errors in the accounting and recording of invoiced transactions.

Procurement and disbursement internal control deficiencies include the following:

- A purchase order, requisition form, or contract was not provided to support payment terms for two vendor transactions in amounts of $1,781 and $313.
- Services were completed prior to renewal of a vendor contract in the amount of $1,056.
- Services were completed prior to approval of a vendor purchase order in the amount of $1,800.

Expenditures related to prior-year transactions were misclassified in the accounts as current-year operating activities. The testing revealed eight invoices representing services that were rendered in the prior fiscal year (FY 2016-17). Transactions that were not accrued in a prior year, and were paid in the current year, should be recorded in the Prior-Year Expense Adjustment Account (GL Account No. 99910). The combined value of the eight invoices is $3,693. Court staff members indicated that delays in receiving invoices prevented the accrual of expenditures before the June 30 deadline.

It is worthwhile noting that the Prior-Year Expense Adjustment Account is treated as a current-year expenditure (recognized) and not as an adjustment to prior-year financial statements. Therefore, the fund balance is not affected by these misclassification errors. However, correctly classifying prior-year transactions in the Prior-Year Expenses Adjustment Account more closely matches period costs by truing up current-year operating expense accounts, and improves the accuracy of accounting data used for budget and cost management.

<u>Kern County Superior Court (FY 2018-19)</u>

Our audit found that the court complied with governing statutes, rules, regulations, and policies for revenue, expenditures, and fund balances. However, our audit identified instances of internal control deficiencies in which the court selected improper accounts for both recording year-end revenue distributions from the prior-year and, separately, for recording current-year operating expenditures. We also noted an internal control deficiency over the court's authority to approve invoice payments.

The amount of error was $455,094.

The court agreed with the findings.

Finding 1—Revenues: Accounting and recording errors

The court did not utilize adjustment accounts to reclassify and properly record certain prior-year revenues that were received in the current-year. Both revenue exceptions identified below reflect estimated revenues provided to the Court by Trial Court Trust Fund, Distribution No. 14 of the previous year.

Adjustments were not recorded in the following instances:

- The court did not accrue two year-end Court Interpreter (GL Account No. 834010) revenue transactions in the amount of $131,529 and $13,776 in the prior year (FY 2017-18). When the Court received the cash in FY 2018-19, it was recorded as a current- year revenue in the Court Interpreter account, instead of the Prior-Year Revenue Adjustment account (GL Account No. 899910).

- The court did not accrue a transaction in the prior year (FY 2017-18) for the Assembly Bill 1058 Grants account (GL Account No. 838010) totaling $10,844. When the court received the cash in FY 2018-19, it was recorded as a current year revenue in the AB 1058 Grants account, instead of the Prior-Year Revenue Adjustment account (GL Account No. 899910).

Differences can occur because Distribution No. 14 revenues may not be known at year-end, and should be recorded as an adjustment in GL Account No. 899910 – Prior-Year Revenue Adjustment when received. We also noted other differences between amounts accrued in the prior year and amounts received. These differences were trivial and are not described in this report; however, differences between accrual and actual revenues should be also accounted for in the adjustment account. The court indicated that it was not aware of using the Prior-Year Revenue Adjustment account.

The Prior-Year Adjustment account effectively serves to true-up accounting information for financial and budgetary reporting, and isolates prior-year transactions to prevent them from being comingled with current-year operating accounts. Failure to adjust accounts may lead to material financial misstatements.

We conferred with staff from the JCC's Administrative Division regarding trial court accounting procedures for accruals and adjustments. Administrative Division staff provided an extract of recent guidance from a FY 2019-20 year-end accounting manual communicated to trial courts in an effort to clarify the accounting procedures. The guidance is as follows:

> **Automated Accrual Reversal Process**
>
> As previously discussed, most expenditure and revenue accruals are automatically reversed in the new-year by placing Z2 and 07/01/2020 in the last two columns of the ZREVERSAL Journal Entry template. Once period 13 is closed, these adjusting entries will automatically be reversed with a posting date of 07/01/2020.

Note: If an accrual was not recorded at year end or the difference between the accrual amount and the actual amount received/paid is deemed material, then prior-year [adjustment] accounts are to be used in the subsequent year.

The court expressed appreciation for the additional guidance provided by the JCC in 2020. The court noted that such guidance had not been provided in prior years, nor had it been expressed in prior audits performed by the JCC.

Finding 2—Expenditures: Accounting errors and noncompliance with payment policies

During our review of the court's expenditures, we noted the following two internal control deficiencies.

- Accounting and recording errors:

  The court incorrectly classified and entered invoice payments for the progress billings on a project to GL Account No. 922699, Minor Equipment–Under $5,000. The total project cost, billed over four installments, was $298,945. We initially selected one invoice to review in our sample, but upon discovering the error selected the other three invoices related to the project. The court indicated that the transaction should have been recorded in GL Account No. 945207, Security Surveillance, because one of the items purchased was greater than $5,000.

  The cost detail provided by the contractor shows that project costs consisted of materials, labor, and project management/engineering fees. The materials list included approximately 150 items, for a total value of $126,375. One item on the materials list had a value of $11,845. To ensure accurate recording of all project costs, the project should have been considered as a single acquisition.

  Each of the two accounts mentioned are classified into separate financial reporting and budget categories of the financial statements, where GL Account No. 922699, Minor Equipment–Under $5,000, is classified in the "General Expense" category; and GL Account No. 945207, is classified in the "Major Equipment" category.

  Accounts are assigned (coded) when a purchase requisition, quote, or purchase order is prepared, reviewed, and approved. Properly coded purchase documents facilitate correct accounting and financial reporting. The court indicated the misclassification was an oversight. While the misclassification did affect the presentation of account totals, it did not cause a misstatement in the court's overall reported total expenditures and fund balances.

- Failure to follow payment policies:

  In seven out of 47 invoices reviewed, the Chief Executive Officer (CEO) approved payments in excess of the CEO's authorized $50,000 limit. According to the court's Authorization Matrix, the CEO is limited to approving invoice payments up to $50,000; those above $50,000 should be approved by the presiding judge. The invoices were each valued at more than $100,000. Approval for higher cost purchases are similarly limited; we reviewed the underlying purchase records and found appropriate approvals from the presiding judge to make the requested purchases. We did not find any misuse of funds.

This payment-approval issue was previously disclosed in the JCC Audit Services Report of the Superior Court of Kern County, August 2016. We noted that in response to the reported finding, the court revised its authorizations and exceptions to address the purchase and payment approval processes, but retained the $50,000 limit on CEO invoice approvals.

<u>Merced County Superior Court (FY 2018-19)</u>

Our audit found that the court complied with governing statutes, rules, regulations, and policies for revenue, expenditures, and fund balances. However, in the course of testing, we noted weaknesses in the court's internal controls for recording accrual-related accounting adjustments.

The amount of error was $115,166.

The court agreed with the findings.

Finding 1—Revenues: Accounting and reporting errors

The court did not record account adjustments to reclassify certain prior-year transactions that affect balances reported in the current-year revenue operating accounts of the court's Statement of Revenues, Expenditures, and Fund Balances. As part of our revenue testing for the FY 2018-19 audit year, we compared the JCC's Trial Court Trust Fund distribution schedules (monthly allocations) with the court's recorded monthly revenue ledger entries. We noted differences between the Trial Court Trust Fund–Court Interpreter and Trial Court Trust Fund–Court Appointed Counsel accounts. The cumulative revenue reporting error totals $122,725.

Following are instances in which adjustments were not recorded:

- The court accrued revenue of $145,675 in the Trial Court Trust Fund–Court Interpreter, GL Account No. 834010, for the prior fiscal year (FY 2017-18). However, the court received only $22,198 in program distributions during the current year, which resulted in a $123,477 shortfall from the court's expected program revenue and a deficit in the account's current year balance.

  At the beginning of each new fiscal year, the accounting system automatically reverses the previous year's accrual entries and creates a deficit in the account's beginning balance of the current fiscal year. Normally, account deficits are offset by subsequent deposits; however, in the absence of deposits, the deficit remains in the account and understates the balance at year-end, unless it is reclassified through an accounting adjustment.

As the FY 2017-18 accrued revenue was not distributed to the court to offset the reversal, the Trial Court Trust Fund–Court Interpreter revenue account balance was understated by $123,477 for FY 2018-19. The prior year balance for FY 2017-18 is conversely overstated, without enforceable claims or collections. Court staff members informed us that they inquired with the JCC on multiple occasions about distributions and were told they would not receive additional funding for the prior FY 2017-18, but they should continue accruing needed funding for all expenses incurred. Following the instructions, the court accrued another $110,355 toward funding its program costs for the current year, FY 2018-19. Court staff informed us that no funds were subsequently distributed in the following year, FY 2019-20. As a result, the FY 2018-19 revenue account was cyclically inflated and overstated for the same amount of $110,355. We did not include this error amount in the financial schedule of our report because the adjustment should have been made in FY 2019-20, the year following our audited year.

- The court received a $752 revenue distribution for the Trial Court Trust Fund–Court Appointed Counsel (GL Account No. 832012), attributable to the prior year of FY 2017-18, but not accrued at year-end. The court noted that it had accrued only the invoice expense and accounts payable for the costs incurred (and for which this distribution was made), but did not accrue the revenue funding and distribution receivable to offset the expense. If not accrued, unadjusted revenues result in overstating the balances of current-year operating revenue accounts and understating the balances in the prior year. The JCC allocated this revenue in its Trial Court Trust Fund Distribution No. 14, of August 2018. We did not identify the basis on which the JCC allocated the funds.

  Revenues distributed to the court for a prior year, but not accrued, should be reclassified as a prior-year revenue adjustment. For this transaction, the court should have reclassified the revenue out of the Trial Court Trust Fund–Court Appointed Counsel, GL Account No. 832012, and into GL Account No. 899910, Prior Year Revenue Adjustments.

The Trial Court Chart of Accounts describes GL Account No. 899910–Prior-Year Revenue Adjustment as the account used to record revenue that was earned in the prior year but not accrued. Guidance from the JCC also provides that adjustment accounts be used to record adjustments of accrual-related accounting differences. Importantly, the adjustment account is presented in the court's financial statement, but appropriately isolates prior year transactions to prevent them from being comingled with current year operating accounts. Failure to adjust accounts may lead to material financial account misstatements.

We conferred with staff from the JCC's Administrative Division regarding trial court accounting procedures for accruals and adjustments. Administrative Division staff provided an extract of recent guidance from a FY 2019-20 year-end accounting manual communicated to trial courts in an effort to clarify the accounting procedures. The court noted that such guidance had not been provided in prior years, nor had it been expressed in prior audits performed by the JCC. The new guidance follows the year of audit and is as follows:

Automated Accrual Reversal Process

As previously discussed, most expenditure and revenue accruals are automatically reversed in the new-year by placing Z2 and 07/01/2020 in the last two columns of the ZREVERSAL Journal Entry template. Once period 13 is closed, these adjusting entries will automatically be reversed with a posting date of 07/01/2020.

Note: <u>If an accrual was not recorded at year end or the difference between the accrual amount and the actual amount received/paid is deemed material, then prior-year [adjustment] accounts are to be used in the subsequent year.</u>

Finding 2—Expenditures: Accounting and reporting errors

Expenditure accounts were not properly adjusted for prior-year activities. As part of our expenditure testing of the FY 2018-19 current year, we reviewed 25 transactions for the court's contracted services and found three expenditures from the FY 2017-18 prior year that were not accrued at year-end, June 30, 2018; but rather, processed and recorded in the current year's operating accounts instead. As a result, the FY 2018-19 contracted services expense account balance is overstated by $7,559. Details of the transactions are as follows:

- Merced County Behavioral Health and Recovery Services, services of $6,984; invoice dated June 30, 2018, and recorded into Psychiatric Evaluations, GL Account No. 939002, August 3, 2018; and
- West America Bank, fees of $575, statement dated June 29, 2018, and recorded into Banking and Investment Services, GL Account No. 939701, July 25, 2018.

The court indicated that the expenses were overlooked in recording year-end accruals. In processing the previous year's expenses, the court should have recorded the transactions directly in its Prior Year Expense Adjustment account, GL Account No. 999910. The adjustment account is used to record expenses (or expenditures) that were related to prior-year activities, but not accrued in the prior year. It should also be used to adjust accounts for differences between accrued expenses and subsequent payments made in the following fiscal-year, if different.

The Trial Court Chart of Accounts describes GL Account No. 999910–Prior-Year Expense Adjustment as the account used to record expenses related to prior year activities. Guidance from the JCC also provides that adjustment accounts be used to record adjustments of accrual-related accounting differences. The JCC guidance is described in Finding 1 and as similarly noted in Finding 1, the adjustment account is presented in the court's financial statement, but appropriately isolates prior-year transactions to prevent them from being comingled with current year operating accounts. Failure to adjust accounts may lead to material financial account misstatements.

Placer County Superior Court (FY 2017-18)

Our audit found that the court complied with governing statutes, rules, regulations, and policies for revenue, expenditures, and fund balances. However, in the course of testing, we noted a weakness in the court's internal control for recording accrual-related accounting adjustments.

The amount of error was $0.

The Court agreed with the finding.

Finding—Account adjustments not recorded

The court did not record account adjustments to reclassify certain prior-year transactions that affect balances reported in the current-year revenue and expenditure accounts. Following are instances in which adjustments were not recorded:

- We noted differences between revenue accrued in the prior year (FY 2016-17) and amounts actually received in the current year (FY 2017-18). Revenues received were less than amounts accrued. Differences can occur because accruals are estimated at year end and should be recorded as an adjustment in GL Account No. 899910 – Prior-Year Revenue Adjustment. The court indicated that it had not previously entered adjustments for accrual differences after the close of the fiscal year.
- We also noted instances in which expenditure transactions that took place near the close of the prior year were not accrued, but instead were recorded in current-year operating accounts. Recording prior-year transactions in a current year occurs because payment information may not be known in time to accrue the transactions before closing the prior year-end financial ledgers. The court should record invoice payments for the prior year in GL Account No. 999910 – Prior-Year Expense Adjustment.

Because the transactions that we identified produced only a negligible effect on the specific revenue and expenditure account balances, we did not quantify the errors. Both adjustment accounts indicated above are included in the financial statements of revenues and expenditures, but the financial statements appropriately isolate prior-year transactions to prevent them from being comingled with current-year operating accounts. Therefore, neither the revenue differences nor the invoice payment and expenditure amounts were material to the financial statements as a whole.

However, the volume of transactions that we reviewed was limited by sampling, and other transactions may exist that we did not identify. The Prior-Year Adjustment accounts effectively serve to true-up accounting information for financial and budgetary reporting. Failure to adjust accounts may lead to material financial misstatements.

We conferred with staff from the JCC's Administrative Division regarding trial court accounting procedures for accruals and adjustments. The Administrative Division staff provided an extract of recent guidance from a FY 2019-20 year-end accounting manual communicated to trial courts in an effort to clarify the accounting procedures. The guidance is as follows:

> **Automated Accrual Reversal Process**
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> As previously discussed, most expenditure and revenue accruals are automatically reversed in the new-year by placing Z2 and 07/01/2020 in the last two columns of the ZREVERSAL Journal Entry template. Once period 13 is closed, these adjusting entries will automatically be reversed with a posting date of 07/01/2020.
>
> Note: If an accrual was not recorded at year end or the difference between the accrual amount and the actual amount received/paid is deemed material, then prior-year [adjustment] accounts are to be used in the subsequent year.

The Court expressed appreciation for the additional guidance provided by the JCC in 2020. The Court noted that such guidance had not been provided in prior years, nor had it been expressed in prior audits performed by the JCC.

Sacramento County Superior Court (FY 2016-17)

The Court complied with governing statutes, rules, and regulations relating to the validity of recorded revenues, expenditures, and fund balances. However, we found the following weaknesses in the Court's administrative and internal accounting control system.

The amount of error was $6,248,472.

The Court agreed with the findings.

Finding 1—Inadequate internal controls over cash handling

During our review of the court's internal controls, we found that it does not have adequate internal controls over the cash-handling process. The court did not follow its cashiering policies and procedures. Cash collection is one of the major components of reported revenues; therefore, inadequate cash controls could affect the accuracy of reported revenues.

We identified deficiencies in the following areas:

- Court supervisors do not always ensure that cashiers are adequately safeguarding cash. We observed at two cash collection points where staff members did not keep their drawer keys secured with them at all times. There were several instances in which staff members left keys unsecured on their desks or in keyholes while not at their stations, or when leaving the room altogether.
- Unprocessed mail is not secured when same-day processing does not occur. We observed that mail not processed during the day was left unsecured in a filing cart. In addition, management does not provide counter workers the mail payment totals to be processed. Therefore,

no verification and reconciliation occurs between the amount that is received and the amount processed.

- During our review of the cashier overages and shortages report, it was brought to our attention that on June 19, 2017, there was a $480 discrepancy in the amount reported and the amount verified.
- During our cash control interview and observation at the court locations, we found the following:
  - Safe combinations were not changed periodically; and
  - Safes were not secured, and remained open throughout the day.
- We observed that cashiers carry money bags from upstairs to the safe downstairs with no security. The route that the cashiers travel is in plain view of the public and, thus, the potential exists for the money bags to be tampered with or stolen.
- We observed that the barriers between the cashiers and the public are insufficient. Due to the insufficient barriers, the cashier's drawers could be tampered with or stolen from by the public.

Finding 2—Failure to reclassify unclaimed trust accounts

During our review of the aging of the court's trust accounts, we found that the court did not reclassify $6,248,472 of unclaimed trust accounts older than three years.

<u>San Joaquin County Superior Court (FY 2017-18)</u>

Our audit found that the Court complied with governing statutes, rules, regulations, and policies for revenue, expenditures, and fund balances. However, in the course of testing, we noted weaknesses in the Court's internal controls over ledger entry, procurement processing, and human resource employee records.

The amount of error was $0.

The court agreed with the findings.

Finding 1—Revenues: Recording errors

During our review of revenues, we noted an error in the Court's recording of the year-end accrual amount totaling $28,019 for the category of Enhanced Collections Revenue (GL Account No. 821200). The Court's accounting records show that accrual was not posted properly between two sub-accounts totaling $6,365 for Enhanced Collections, Civil Assessments (GL Account No. 821201) and $21,654 for Enhanced Collections, Other (GL Account No. 821202). The entries were incorrectly reversed between the two sub-accounts. Court accounting staff members indicated that they were involved in a physical office move that affected their routine activities, and the misclassification was an oversight. The records that we obtained show sufficient evidence of review by the Court Finance Officer or other accounting management before the amounts were posted to the Phoenix accounting system.

Despite an error in posting to sub-accounts within the Enhanced Collections Revenue account, the account balance in total is correct as presented in the FY 2017-18 financial statement. However, a misclassification of this nature and type may lead to incorrect reporting in other budget and reporting requirements, such as the quarterly Report of Revenue and related state reporting for net civil assessment revenue, which were not reviewed or evaluated in our audit.

Finding 2—Expenditures: Lack of supporting documentation

During our review of expenditure-related internal control tasks, we selected a sample of 40 expenditure transactions to review, and noted that the Court did not provide adequate supporting documentation, such as a purchase requisition or purchase order, for one expenditure transaction totaling $1,800.

We also noted a separate expenditure transaction in which the court did not initiate and approve a purchase order for a contract renewal prior to the vendor's monthly service and billing for $420. The purchase order was signed and dated October 17, 2017; however, the invoice was dated August 15, 2017, and date-stamped as received by the accounting department on August 21, 2017. The expenditure was incurred for charges in an existing, but expired, contract. The court provided evidence of extending the contract for an additional year (FY 2017-18). Although the court renewed the contract, it did not process the direct payment ahead of completing the purchase order. Ultimately, the payment was appropriately approved by the Court Finance Officer and the invoice was paid in a timely manner.

Finding 3—Payroll: Lack of supporting documentation

During our review of payroll transactions, we noted that 30 court employees selected for review did not have personnel-action request forms on file. As a result, we were unable to verify salary and employment for these employees. A personnel-action request form is used to verify the position appointment and the authorization of salary and time-base for resulting payroll-related expenditures. The Court's human resources personnel indicated that they stopped using personnel action forms for step increases when the Court's payroll processing function was moved to an outside vendor, Automatic Data Processing, Inc. We did not notice documentation policies in the records we reviewed at the court; however, such policies may separately exist with the JCC.

Good internal control policies include the maintenance of standardized documentation for all employees that include the employees' position numbers, approved pay rates, salary steps, any stipends, and job descriptions. The personnel action form should be signed by the employee, the appropriate hiring management authority, and the human resources director when the employee is first hired, and upon each change in the employee's pay rate and/or position. The form is used by an appointing authority to report the appointment of an employee, miscellaneous changes, and separation actions. Use of such a form would improve the court's processing of payroll and allow employees to notify their departmental personnel office of erroneous information and verify corrections or changes.

<u>San Mateo County Superior Court (FY 2016-17)</u>

The court complied with governing statutes, rules, and regulations relating to the validity of recorded revenues, expenditures and fund balances. However, we found the following weaknesses in the court's administrative and internal accounting control system.

The amount of error was $3,238,580.

The court agreed with the findings.

Finding 1—Inadequate internal controls over cash handling

During our review of the court Traffic Division's internal controls, we identified deficiencies in the following areas:

- The court maintains no cash receipt log from the prior day verifying the next day opening balance of $150. Both the cashier and the manager must sign and date a cash receipt log for each verification and receipt.
- Management does not always ensure that cashiers are adequately safeguarding cash. We observed two instances in which staff members did not keep their cash drawer keys secured, and left keys unsecured in register keyholes while not at their stations.
- Management does not provide counter workers with the mail payment totals to be processed. Therefore, there is no verification and reconciliation between the amount received and the amount processed.

Finding 2—Failure to reclassify unclaimed trust accounts

During our review of the aging of the court's trust accounts, we found that the court did not reclassify $3,238,580 of unclaimed trust accounts that were older than three years.

<u>Solano County Superior Court (FY 2018-19)</u>

Our audit found that the court complied with governing statutes, rules, regulations, and policies for revenue, expenditures, and fund balances.

There was no error amount and there were no findings.

Sonoma County Superior Court (FY 2016-17)

The court complied with governing statutes, rules, and regulations relating to the validity of recorded revenues, expenditures and fund balances. However, we found the following weaknesses in the court's administrative and internal accounting control system:

The amount of error was $433,982.

The court agreed with the findings.

Finding 1—Inadequate internal controls over cash handling

During our review of the court's internal controls, we found the court does not have adequate internal controls over the cash-handling process.

We identified the following deficiencies:

- The court's safe is opened and closed by finance personnel in the morning and afternoon and is left unsecured during the day. Finance personnel do not remain at the safe until the lead clerk comes to collect and return cash bags into the safe at the start and end of the day. Cash bags are placed on a shelf in the open safe and finance personnel return later in the day to lock the vault.
- Money collected from the court's offsite locations is transported by finance personnel in their personal vehicles between court locations with no security.
- Each clerk is responsible for his or her own lockable bag for cash collections. While the clerk is performing transactions at a transaction window, he or she takes money out of the bag and stores it in a lockable till at the window. Auditors observed instances in which clerks walked away from the transaction window with keys left in the till while performing transactions for customers.
- Only one court employee opens the mail, instead of a two-person team. In addition, the mail-opening responsibilities are not regularly rotated among staff members.

Finding 2—Noncompliance with procurement policies and lack of review

During our review of the court's internal controls, we found that the court staff did not comply with procurement policies and procedures.

We tested two procurement transactions initiated during the audit period. For each transaction, court staff incorrectly keyed data into the Procurement Comparison Spreadsheet. Staff members transposed numbers and added tax to items that already had tax assessed, thereby changing the original numbers submitted by the bidding entity.

Finding 3—Failure to reclassify unclaimed trust accounts

During our review of the aging of court's trust accounts, we found that the court did not reclassify $433,982 of unclaimed trust accounts older than three years.

Stanislaus County Superior Court (FY 2018-19)

Our audit found that the court complied with governing statutes, rules, regulations, and policies for revenue, expenditures, and fund balances.

There was no error amount and there were no findings.

Sutter County Superior Court (FY 2017-18)

Our audit found that revenues, expenditures and fund balances reported by the court complied with governing statutes, rules, regulations, and Judicial Branch policies, and were maintained in accordance with appropriate fund accounting principles. However, in the course of our testing, we identified a few instances in which the court did not record revenues and expenditures correctly. Errors in the recording of revenues caused a cumulative understatement of $65,220 (or approximately 1% of all revenue reported). Similarly, cumulative expenditures were understated by $132,987 (or 2% of reported expenditures). We also noted weaknesses in the court's internal controls for procurement and disbursement processing.

The amount of error was $198,207.

The court agreed with the findings.

Finding 1—Revenues: Reporting deficiencies

We noted inaccuracies and inconsistencies in the recording of transactions during our testing of the court's revenue accounts. We identified the following errors:

- The court's FY 2017-18 financial statements reported $5,121,237 of Trial Court Trust Fund revenues; however, the Trial Court Trust Fund Distribution Schedules that we obtained from the JCC showed Trial Court Trust Fund allocations to the court in the amount of $5,118,367. Reconciling the differences revealed posting errors related to prior-year revenues and accruals. Details are as follows:
    - The court understated Trial Court Trust Fund Operations revenue (GL Account No. 812110) of $6,151 by recording a negative adjustment from the prior year's (FY 2016-17) Trial Court Trust Fund Distribution Schedule No. 14 in the current year. The prior-year revenue negative adjustment should have been recorded in the Prior Year Revenue Adjustment Account (GL Account No. 899910).

   - The court duplicated a journal entry to accrue revenues and receivables at year-end for the Trial Court Trust Fund – Returned Checks (GL Account No. 812152), Civil Assessments (GL Account No. 812159), Child Custody Evaluations (GL Account No. 812162), and Court Appointed Counsel for Children (GL Account No. 812163). Revenue and General Fund balances were thereby overstated by $9,185.
   - The court did not accrue revenue of $164 at year-end from Trial Court Trust Fund Distribution Schedule No. 14 for the Trial Court Trust Fund Automated Record Keeping and Micro Graphics (GL Account No. 812160). Revenue and General Fund balances were understated by $164.

- The court incorrectly recorded prior-year reimbursements of $3,353 for Court Interpreter fees from the FY 2016-17 Trial Court Trust Fund Distribution Schedule No. 14 as current year reimbursements, instead of posting to the Prior Year Revenue Adjustment Account (GL Account No. 899910).

  Additionally, the court did not accrue reimbursements totaling $6,205 from FY 2017-18 Trial Court Trust Fund Distribution Schedule No. 14. As a result, reimbursements for the Court Interpreter Program were understated by $2,852 and the General Fund balance was understated by $6,205.

- The AB 1058 Grant revenue for the Child Support Commissioner and Family Law Facilitator programs was understated by $3,926. The Court incorrectly recorded reductions to prior-year reimbursements as adjustments to current-year revenue. Adjustments to prior year revenues should be recorded in the Prior Year Revenue Adjustment Account (GL Account No. 899910).

- For FY 2017-18, the court did not include all reimbursable costs of administering its Enhanced Collections Program when calculating its full cost recovery. Additionally, we found accounting entries for costs and related reimbursements recorded in different fiscal years. Collections performed in the enforcement of court orders for fees, fines, forfeitures, restitutions, penalties, and assessments result in various operating costs to the court. Through the Enhanced Collections Program, the court receives reimbursements to recover related operating and indirect costs. We calculated that the court should have reported additional cost reimbursements of $68,035. Details are as follows:

   - The court posted reimbursements to an incorrect fiscal period, thereby not matching reimbursements with the related costs of the same fiscal period. Fiscal-year program operating costs of $37,430 for June 2018 were posted in July 2018 of the subsequent fiscal year and recorded as a reimbursement for FY 2018-19.
   - The court did not include $5,469 of direct costs for salaries, benefits, and operating expenses recorded during the year-end adjustment period of FY 2017-18 when calculating the cost recovery reimbursement of its Enhanced Collections Program for the same period.

- The court applied an incorrect indirect cost rate and excluded benefits from indirect cost calculations. The court's approved indirect cost rate for FY 2017-18 was 22.67%. However, the court applied a lower indirect cost rate of 20% to direct salaries charged to the Enhanced Collections Program.

  By applying the approved indirect cost rate of 22.67% to both direct salaries and benefits charged to the program, the court would have recovered $25,136 in additional revenue.

- The court did not transfer expenditures in the amount of $2,455 for program indirect costs in May 2018 from the Trial Court Operations Fund (General Fund) to the Enhanced Collections Fund (Grant Special Revenue Fund); however, the Court correctly included these expenditures when computing the monthly recovery costs. As a result, the error affected only the ledger classification, not the revenue calculation.

- The court incorrectly recorded a prior-year (FY 2016-17) revenue allocation of $12,301 for the State Trial Court Improvement and Modernization Fund reimbursements as current-year revenues (GL Account No. 837011), instead of posting the cash receipt as a prior-year revenue adjustment (GL Account No. 899910).

Finding 2—Payroll: Reporting deficiencies

During our review of the court's payroll system, we noted the following accounting errors and control deficiencies:

- The court's Employee Benefits Liability Account (GL Account No. 374700) had an abnormal (debit) balance of $132,987 as of June 30, 2018. We reviewed the court's General Ledger and noted that the court made payments for employee benefits in excess of accrued liabilities and expenditures. The account had a beginning debit balance of $105,131 as of July 1, 2017. During FY 2017-18, the court made disbursements totaling $1,000,284 from the Employee Benefits Liability Account. However, the court accrued only $972,428 in liabilities during the year. As a result, the General Fund's current-year and prior-year expenditures for Staff Benefits were understated by $27,856, and $105,131, respectively, and the fund balance was overstated by $132,987 at year end.

  We also found that the court paid $717 for medical insurance for one employee, but recorded expenditures totaling $1,863 in the General Ledger. As a result, expenditures and liabilities for employee health benefits were understated by $2,205 for March 2018.

- We were unable to verify supervisory approval of employee timesheets. Although court management informed us that employee timesheets were reviewed and approved each pay period, the court was unable to provide records for the employee sample selection to validate time card approvals. System-generated time reports were provided, but they did not contain any proof (such as a signature) that supervisors had reviewed and approved employee entries.

The court further indicated that it did not maintain a payroll policy and procedures manual documenting internal processing steps and requirements for both time reporting and payroll processing.

Finding 3—Expenditures: Internal control deficiencies

During our review of the court's expenditure transactions, we noted the following deficiencies in the Court's procurement and disbursement process:

- The court did not provide a purchase order, contract, or purchase requisition for six of 40 expenditure transactions selected for review to support payment terms.
- Seven of 40 invoices reviewed did not contain evidence of approval for payment.
- The court incorrectly recorded expenditures totaling $48 for mileage reimbursement paid to court interpreters in Court Interpreter Travel (GL Account No. 938502) instead of Court Interpreter–Mileage (GL Account No. 938509).
- The court did not properly record expenditures for court-appointed counsel. We reviewed three invoices and noted that $1,584 of $2,034 in payments made to vendors were related to services provided in the prior fiscal year as current-year expenditures instead of recorded in the Prior Year Expenditure Adjustment Account (GL Account No. 999910).

<u>Tehama County Superior Court (FY 2016-17)</u>

The court complied with governing statutes, rules, and regulations relating to the validity of recorded revenues, expenditures, and fund balances. However, we found the following weaknesses in the court's administrative and internal accounting control system.

The amount of error was $83,088.

The court agreed with the findings.

Finding 1—Inadequate internal controls over cash handling

During our review of the court's internal controls, we found that the court does not have adequate internal controls over the cash-handling process.

We identified deficiencies in the following areas:

- Only one employee opens the mail, instead of a two-person team. In addition, the mail-opening responsibilities are not regularly rotated among the staff members; and
- One employee from the accounting department makes daily deposits alone.

Finding 2—Failure to reclassify unclaimed trust accounts

During our review of the aging of the court's trust accounts, we found that the court did not reclassify $83,088 of unclaimed trust accounts that were older than three years.

Yolo County Superior Court (FY 2016-17)

The court complied with governing statutes, rules, and regulations relating to the validity of recorded revenues, expenditures and fund balances. However, we found the following weaknesses in the court's administrative and internal accounting control system.

The amount of error was $0.

The court agreed with the findings.

Finding 1—Inadequate internal controls over cash handling

We observed during the walk-through that money bags were unsecured during the cash handling procedure. Management does not routinely monitor the cash controls. Money bags are collected from the safe by management and are left on a table for cashiers to collect, resulting in a break in the chain of custody, and leaving the money bags vulnerable to theft.

Finding 2—Inadequate segregation of duties

Through discussions with Yolo court staff and walk-through testing, we found that the same staff members performed the following conflicting duties:

- Logged and verified payments received in the mail; and
- Posted verified payments into the Court's financial system.

Finding 3—Noncompliance with procurement policies

We tested seven procurement transactions initiated during the audit period. For one of the transactions tested, Yolo court had not obtained three bids for a purchase between $500 and $5,000.

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