

SUPERIOR COURT OF CALIFORNIA, COUNTY OF MERCED

Audit Report

VALIDITY OF RECORDED REVENUES, EXPENDITURES, AND FUND BALANCES

July 1, 2018, through June 30, 2019



BETTY T. YEE
California State Controller

March 2021



BETTY T. YEE
California State Controller

March 30, 2021

Amanda Toste, Court Executive Officer
Superior Court of California, County of Merced
627 West 21st Street
Merced, CA 95340

Dear Ms. Toste:

The State Controller's Office audited the Superior Court of California, County of Merced (Court) to determine whether the revenues, expenditures, and fund balances under the administration, jurisdiction, and control of the Court complied with governing statutes, rules, regulations, and policies; were recorded accurately in accounting records; and were maintained in accordance with fund accounting principles. The audit period was July 1, 2018, through June 30, 2019.

Our audit found that the Court complied with governing statutes, rules, regulations, and policies for revenue, expenditures, and fund balances. However, we noted weaknesses in the Court's internal controls for recording accrual-related accounting adjustments. These issues are described in the Findings and Recommendations section of our report.

This report is for your information and use. The Court's response to the findings are incorporated into this final report. The Court agreed with our findings and provided a Corrective Action Plan to address the fiscal control weaknesses and recommendations. We appreciate the Court's willingness to implement corrective actions.

If you have any questions, please contact Joel James, Chief, Financial Audits Bureau, by telephone at (916) 323-1573.

Sincerely,

Original signed by

MICHAEL REEVES, CPA
Acting Chief, Division of Audits

MR/as

cc: Keri Brasil, Chief Financial Officer
Superior Court of California, County of Merced
Martin Hoshino, Administrative Director
Judicial Council of California
Millicent Tidwell, Chief Deputy Director
Judicial Council of California
John Wordlaw, Chief Administrative Officer
Judicial Council of California
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Audit Report

Summary

The State Controller's Office (SCO) audited the Superior Court of California, County of Merced (Court) to determine whether the revenues, expenditures, and fund balances under the administration, jurisdiction, and control of the Court complied with governing statutes, rules, regulations, and policies; were recorded accurately in accounting records; and were maintained in accordance with fund accounting principles. The audit period was July 1, 2018, through June 30, 2019.

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. These issues are described in the Findings and Recommendations section of our report.

Background

Superior Courts (trial 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. Trial courts are also required to comply with various other state laws, rules, and regulations, much of which are codified in Government Code (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 trial 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 trial 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 trial 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 trial courts for their positions.

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

The Trial Court Trust Fund is the primary source of funding for trial court operations. The JCC allocates monies in the Trial Court Trust Fund to trial 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 fiscal year (FY) 2018-19, the Court (County of Merced) generated approximately 76% of its total revenues from Trial Court Trust Fund allocations.

The Court employs approximately 135 staff members to fulfill the operational and administrative activities necessary to serve Merced County's population of approximately 280,772. The Court incurred approximately \$17.8 million in expenditures for the period of July 1, 2018, through June 30, 2019. Of this amount, approximately 69% represents employee salaries and benefits.

Funds under the Court's control include a General Fund, Non-Grant Special Revenue Fund, Grant Special Revenue Fund, Capital Projects Fund, and a Fiduciary Fund. The General Fund, Non-Grant Special Revenue Fund, and the Grant Special Revenue Fund had revenue and expenditure accounts in excess of 4% of total revenues and expenditures and were considered material and significant.

We performed the audit at the request of the JCC. The authority is provided by Interagency Agreement No. 38881, dated May 28, 2019, between the SCO and the JCC.

**Objective, Scope,
and Methodology**

The objective of our audit was to determine whether the Court 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 its administration, jurisdiction, and control.

The audit period was July 1, 2018, through June 30, 2019.

Specifically, we conducted this audit 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.

To accomplish our objective, we:

General Procedures

- 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 trial court revenues, expenditures, and fund balances;

Internal Controls

- Reviewed the Court's 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;
- Interviewed Court personnel and prepared internal control questionnaires to identify internal accounting controls;
- 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;
- Reviewed the Court's documentation and financial records supporting the validity of recorded revenues, expenditures, and fund balances;
- Evaluated electronic access controls and data reliability of the Court's financial system; and
- Selected revenue and expenditure ledger transactions to test the operating effectiveness of internal controls. Using non-statistical sampling, we selected 40 revenue items and 40 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 population.

We designed our testing to verify the Court's adherence to prescribed accounting control procedures, and to verify that transactions were correctly recorded into the accounting system for financial reporting. Our testing methodology and results are summarized below:

Revenue Testing

- We tested revenue transactions and account balances in the General Fund, Non-Grant Special Revenue Fund, and Grant Special Revenue Fund to determine whether revenue accounting was consistent with

authorizing Government Code sections, properly supported by documentation, and recorded correctly in the accounting system.

- Our testing included both tests of controls and analytical procedures. We selected all material accounts that exceeded 4% of total revenues and determined that the Trial Court Trust Fund, Court Interpreter, MOU Reimbursements, and Other Miscellaneous accounts were material. We tested at least 98% of these accounts through combined sampling and analytical procedures.
- We tested \$16,402,605 of \$17,996,901, or 91% of total revenues.

We found errors in the recording of transactions resulting from an internal control deficiency over recording accrual-related accounting adjustments. The total amount of error is \$122,725.

Details of our findings are provided in the Findings and Recommendations section of this report.

Schedule 1—Summary of Revenues and Revenue Test Results, presents total revenues by account related amounts tested, and error amounts noted.

Expenditure Testing

- We tested expenditure transactions and account balances in the General Fund, Non-Grant Special Revenue Fund, and Grant Special Revenue Fund to determine whether expenditures were incurred pursuant to authorizing Government Code sections, consistent with the funds' purposes, properly authorized, adequately supported, and accurately recorded in the accounting records.
- We tested all material expenditure accounts that exceeded 4% of total expenditures. We stratified accounts into two groups comprised of personnel services (payroll) and operating expenditures (non-payroll). Material accounts included the payroll Salaries – Permanent and Staff Benefits accounts, and the non-payroll Contracted Services account.
- To test payroll, we selected two pay periods occurring in March and April of 2019 and reconciled the salaries and benefit expenditures shown on the payroll registers to the general ledger. We further selected 30 of 135 employees from the payroll registers and verified that:
 - Employee timesheets included supervisory approval;
 - Regular earnings and other supplemental pay was supported by salary schedules and Personnel Action Forms;
 - Employer retirement contributions and payroll taxes were entered into the general ledger accurately; and
 - Health insurance premiums shown on the payroll register agreed with the employees' benefit election forms.
- To test material non-payroll accounts, we:
 - Selected a sample of 65 expenditure transactions to test both internal controls and the accuracy of recording transactions;
 - Selected 25 expenditure transactions that exceeded \$36,667; and

- Traced expenditures recorded in the general ledger to supporting documents.
- We tested \$706,663 of \$17,841,137, or 4% of total expenditures.

We found errors in the recording of transactions resulting from an internal control deficiency over recording accrual-related accounting adjustments. The total amount of the error is \$7,559.

Details of our findings are provided in the Findings and Recommendations section of this report.

Schedule 2—Summary of Expenditures and Expenditure Test Results, presents total expenditures by account related amounts tested, and error amounts noted.

Fund Balance Testing

- We judgmentally selected the General Fund, Non-Grant Special Fund, and Grant Special Revenue Fund because these funds had significant balances in revenue and expenditure accounts.
- We tested revenue and expenditure transactions in the General Fund, Non-Grant Special Revenue Fund, and Grant Special Revenue Fund to determine whether transactions were reported based on the Legal/Budgetary basis of accounting and maintained in accordance with fund accounting principles (see Schedule 2);
- We verified the accuracy of individual fund balances in the Court's financial supporting documentation; and
- We recalculated sampled funds to ensure that fund balances as of June 30, 2019, were accurate and in compliance with applicable criteria.

We found that fund balances for the tested funds were properly reported.

Schedule 3—Summary of Fund Balances and Fund Balance Test Results, presents by Fund, total balances and changes in fund balances.

We conducted this performance audit under the authority of GC section 77206(h) and in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We limited our review of the court's internal controls to gaining an understanding of the significant internal controls within the context of the audit objective. We did not audit the court's financial statements.

Conclusion

Our audit found that revenues, expenditures, and fund balances reported by the Court complied with governing statutes, rules, regulations, and Judicial Branch policies; were recorded accurately in accounting records;

and were maintained in accordance with appropriate fund accounting principles. However, in the course of testing, we noted weaknesses in the Court's internal controls for recording accrual-related accounting adjustments. These issues are described in the Findings and Recommendations section of our report.

**Follow-up on
Prior Audit
Findings**

This is the first audit performed by SCO at the Court pursuant to GC section 77206(h)(2); therefore, there are no prior audit findings to address in this report. The Court was previously audited by JCC's Internal Audit Services, which issued a report in January 2018. We are not including any follow-up to matters presented in JCC's prior report.

**Views of
Responsible
Officials**

We issued a draft audit report on March 12, 2021. Amanda Toste, Court Executive Officer responded by letter dated March 18, 2021 (Attachment), agreeing with the audit results. This final audit report includes the Court's response.

Restricted Use

This report is solely intended for the information and use of the Superior Court of California, County of Merced; JCC, and SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit the distribution of this report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

MICHAEL REEVES, CPA
Acting Chief, Division of Audits

March 30, 2021

**Schedule 1—
Summary of Revenues and Revenue Test Results
July 1, 2018, through June 30, 2019**

| Revenue Accounts ¹ | Revenues Reported | | Revenues Tested | | Error Amount ² |
|--|-------------------|------------|-----------------|------------|---------------------------|
| | Amount | Percentage | Amount | Percentage | |
| State Financing Sources³ | | | | | |
| Trial Court Trust Fund ⁴ | \$ 13,402,403 | 74.5% | \$ 13,402,403 | 100.0% | \$ 752 |
| Improvement and Modernization Fund | 38,617 | 0.2% | 38,617 | 100.0% | - |
| Judges' Compensation | - | 0.0% | - | 0.0% | - |
| Court Interpreter ⁴ | 965,222 | 5.4% | 965,222 | 100.0% | (123,477) |
| Civil Coordination Reimbursement | - | 0.0% | - | 0.0% | - |
| MOU Reimbursements ⁴ | 1,107,131 | 6.2% | 1,087,056 | 98.2% | - |
| Other Miscellaneous ⁴ | 774,827 | 4.3% | 774,827 | 100.0% | - |
| Subtotal | 16,288,201 | | 16,268,126 | | (122,725) |
| Grants³ | | | | | |
| AB 1058 Commissioner/Facilitator | 699,646 | 3.9% | 73,810 | 10.5% | - |
| Other Judicial Council Grants | 31,767 | 0.2% | 10,180 | 32.0% | - |
| Non-Judicial Council Grants | - | 0.0% | - | 0.0% | - |
| Subtotal | 731,413 | | 83,990 | | - |
| Other Financing Sources³ | | | | | |
| Interest Income | 105,542 | 0.6% | 93 | 0.1% | - |
| Investment Income | - | 0.0% | - | 0.0% | - |
| Donations | - | 0.0% | - | 0.0% | - |
| Local Fees | 341,611 | 1.9% | 960 | 0.3% | - |
| Non-Fee Revenues | 30,102 | 0.2% | 11,021 | 36.6% | - |
| Enhanced Collections | 397,910 | 2.2% | 32,519 | 8.2% | - |
| Escheatment | - | 0.0% | - | 0.0% | - |
| Prior Year Revenue | 135 | 0.0% | 135 | 100.0% | 122,725 |
| County Program - Restricted | 61,715 | 0.3% | 1,235 | 2.0% | - |
| Reimbursement Other | 40,222 | 0.2% | 4,476 | 11.1% | - |
| Sale of Fixed Assets | - | 0.0% | - | 0.0% | - |
| Other Miscellaneous | 50 | 0.0% | 50 | 100.0% | - |
| Subtotal | 977,287 | | 50,489 | | 122,725 |
| Total Revenues | \$ 17,996,901 | 100% | \$ 16,402,605 | 91% | \$ - |

¹ Differences due to rounding

² Revenues over/(under) stated; see Finding 1

³ Tested account internal controls

⁴ Material account

Schedule 2—
Summary of Expenditures and Expenditure Test Results
July 1, 2018, through June 30, 2019

| <u>Expenditure Accounts¹</u> | <u>Expenditures Reported</u> | | <u>Expenditures Tested</u> | | Error |
|---|------------------------------|------------|----------------------------|------------|---------------------|
| | Amount | Percentage | Amount | Percentage | Amount ² |
| <u>Payroll³</u> | | | | | |
| Salaries – Permanent ⁴ | \$ 6,797,147 | 38.1% | \$ 108,862 | 1.6% | \$ - |
| Temp Help | - | 0.0% | - | 0.0% | - |
| Overtime | 30,635 | 0.2% | - | 0.0% | - |
| Staff Benefits ⁴ | <u>5,497,252</u> | 30.8% | <u>61,421</u> | 1.1% | <u>-</u> |
| Subtotals | 12,325,034 | | 170,283 | | - |
| <u>Operating Expenses and Equipment³</u> | | | | | |
| General Expense | 621,547 | 3.5% | 43,576 | 7.0% | - |
| Printing | 22,824 | 0.1% | 894 | 3.9% | - |
| Telecommunications | 165,121 | 0.9% | 19,147 | 11.6% | - |
| Postage | 114,104 | 0.6% | 6,557 | 5.7% | - |
| Insurance | 7,405 | 0.0% | 595 | 8.0% | - |
| In-State Travel | 27,918 | 0.2% | 1,095 | 3.9% | - |
| Out of State Travel | 2,256 | 0.0% | 1,193 | 52.9% | - |
| Training | 7,722 | 0.0% | 1,151 | 14.9% | - |
| Security Services | 3,515 | 0.0% | 1,835 | 52.2% | - |
| Facility Operations | 473,894 | 2.7% | 14,573 | 3.1% | - |
| Utilities | 2,876 | 0.0% | 5 | 0.2% | - |
| Contracted Services ⁴ | 2,525,475 | 14.2% | 64,839 | 2.6% | 7,559 |
| Consulting and Professional Services | 68,040 | 0.4% | 5,955 | 8.8% | - |
| Information Technology | 675,535 | 3.8% | 13,788 | 2.0% | - |
| Major Equipment | 387,240 | 2.2% | 72,972 | 18.8% | - |
| Other Items of Expense | <u>4,060</u> | 0.0% | <u>582</u> | 14.3% | <u>-</u> |
| Subtotals | 5,109,532 | | 248,756 | | 7,559 |

Schedule 2 (continued)

| Expenditure Accounts ¹ | Expenditures Reported | | Expenditures Tested | | Error |
|---|-----------------------|------------|---------------------|------------|---------------------|
| | Amount | Percentage | Amount | Percentage | Amount ² |
| <u>Special Items of Expense³</u> | | | | | |
| Grand Jury | 6,617 | 0.0% | 119 | 1.8% | - |
| Jury Costs | 121,957 | 0.7% | 5,070 | 4.2% | - |
| Judgements, Settlements, Claims | - | 0.0% | - | 0.0% | - |
| Debt Service | 277,997 | 1.6% | 277,977 | 100.0% | - |
| Other | - | 0.0% | - | 0.0% | - |
| Capital Costs | - | 0.0% | - | 0.0% | - |
| Internal Cost Recovery | - | 0.0% | 4,458 | 0.0% | - |
| Prior Year Expense | - | 0.0% | - | 0.0% | (7,559) |
| Subtotals | 406,571 | | 287,624 | | (7,559) |
| Total Expenditures | \$ 17,841,137 | 100% | \$ 706,663 | 4% | \$ - |

¹ Differences due to rounding

² Expenditures over/(under)stated; see Finding 2

³ Tested account internal controls

⁴ Material account

**Schedule 3—
Summary of Fund Balances and Fund Balance Test Results
July 1, 2018, through June 30, 2019**

| <u>Balance¹</u> | <u>General Fund</u> | <u>Non-Grant Special Revenue Fund</u> | <u>Grant Special Revenue Fund</u> | <u>Capital Project</u> | <u>Total</u> |
|---|---------------------|---|---------------------------------------|----------------------------|---------------------|
| Beginning Balance | \$ 447,644 | \$ 420,338 | \$ - | \$ 2,194,028 | \$ 3,062,010 |
| Revenues | 16,320,818 | 590,005 | 731,413 | 354,664 | 17,996,901 |
| Expenditures | (15,699,744) | (640,618) | (1,222,778) | (277,997) | (17,841,137) |
| Transfers In | - | - | 491,364 | - | 491,364 |
| Transfers Out | (491,364) | - | - | - | (491,364) |
| Ending Balance | <u>\$ 577,353</u> | <u>\$ 369,726</u> | <u>\$ -</u> | <u>\$ 2,270,695</u> | <u>\$ 3,217,774</u> |
| <u>Errors Noted²</u> | | | | | |
| Revenues over/(under) stated; see Finding 1 | \$ - | \$ - | \$ - | \$ - | \$ - |
| Expenditures over/(under) stated; see Finding 2 | - | - | - | - | - |
| | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> |

¹ Differences due to rounding

² Classification errors in Findings 1 and 2 did not affect fund balances

Findings and Recommendations

FINDING 1— Revenue 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, General Ledger (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 General Ledger 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 commingled in 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: 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.

CRC Rule 10.804(a) states:

As part of its responsibility for regulating the budget and fiscal management of the trial courts, the Judicial Council adopts The Trial Court Financial Policies and Procedures Manual. The manual contains regulations establishing budget procedures, recordkeeping, accounting

standards, and other financial guidelines for superior courts. The manual sets out a system of fundamental internal controls that will enable the trial courts to monitor their use of public funds, provide consistent and comparable financial statements, and demonstrate accountability.

Trial Court Financial Policies and Procedures Manual, Eighth Edition, Policy No. Fin 5.02, section 3.0 states:

It is the policy of the trial court to establish an accounting system with a chart of accounts and general ledger that enables the court to record financial transactions with accuracy and consistency. All of the trial courts use a single chart of accounts. This single set of accounts ensures that the financial position of all courts is reported consistently and clearly. The actual accounts each court utilizes may vary depending on the complexity of operations.

Recommendation

We recommend that the Court implement accounting procedures to ensure that accounts are adjusted for prior-year transactions and accrual differences, according to the JCC's accounting guidance. We also recommend that the Court continue seeking assistance from the JCC Administrative Division to improve the interagency system of tracking its interpreter program costs and funding requirements.

Court's Response

The Court agrees there was a technical recording error. Notwithstanding that the Court is ultimately responsible for the accounting and reporting of its revenues and expenditures, the Court relies heavily on the Judicial Council of California (JCC) accounting support staff as the Court's Finance Team consists of three people. The Court consulted with JCC during the year-end process and followed the exact recommendations and instructions provided at that time. Judicial Council of California communicated to the Trial Courts in the FY2019-20 Year-End Accounting Manual with additional guidance and clear instructions. With this communication, the Court has followed the amended guidance and instructions.

FINDING 2— Expenditure 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 for \$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 General Ledger 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. As similarly noted, the adjustment account is presented in the Court's financial statement, but appropriately isolates prior year transactions to prevent them from being commingled in current year operating accounts. Failure to adjust accounts may lead to material financial account misstatements.

Finding 1 also includes references to both CRC Rule 10.804(a) and the *Trial Court Financial Policies and Procedures Manual*, Eighth Edition, Policy No. Fin 5.02, section 3.0, which applies equally here. Additionally, Policy No. Fin 5.01, section 6.8.2 (Year-End Expenditure and Related Liability Accruals) states:

During year-end closing, the court must:

1. Accrue expenditures for all open encumbrances for goods and services that have been delivered or rendered, but not paid as of June 30;
2. Review all contracts, including contracts covering more than one fiscal year. Accrue expenditures for services rendered or goods received in the current fiscal year only;
3. Not accrue expenditures for contracts or POs that have a valid, open balance, and the goods or services have not been received by June 30;
4. Accrue expenditures for all direct invoices, not supported through an encumbrance, for which goods or services have been received or rendered, but not paid as of June 30;
5. Prepare and maintain a detailed listing of accruals with actual invoice numbers and amounts noted; and
6. Reverse all expenditure accruals in the first month of the new fiscal year.

Failure to accrue or adjust accounts may lead to material financial misstatements.

Recommendation

We recommend that the Court strengthen its internal controls over the year-end closing process to ensure that expenses are fully recorded and properly accrued in the period in which they occurred, or to ensure that

prior-year expenses that are not accrued in the prior year are properly recorded in the Prior Year Expense Adjustment account, as required.

Court's Response

The Court agrees there was a technical recording error and will continue to follow the FY2019-20 Year-End Accounting Manual.

**Attachment—
Superior Court of California, County of Merced
Response to Draft Audit Report**



**SUPERIOR COURT OF CALIFORNIA
COUNTY OF MERCED**

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AMANDA TOSTE
COURT EXECUTIVE OFFICER
and
JURY COMMISSIONER

March 18, 2021

Mr. Joel James, Chief Financial Audit Bureau
Office of State Controller Betty T. Lee
Division of Audits
P.O. Box 942850
Sacramento, CA 94250

Re: Response to the Audit of the Superior Court of California, County of Merced

Dear Mr. James,

The Court is in receipt of the State Controller's Office (SCO) audit report titled "Superior Court of California, County of Merced, Validity of Recorded Revenues, Expenditures, and Fund Balances" for the period July 1, 2018 through June 30, 2019. Below are the Court's responses to the findings and recommendations contained in the audit report.

FINDING 1 – Revenue 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 FY2018-19 audit year, we compared the JCC's Trial Court Trust Fund (TCTF) distribution schedules (monthly allocations) with the Court's recorded monthly revenue ledger entries. We noted differences between the TCTF-Court Interpreter and TCTF-Court Appointed Counsel accounts. The cumulative revenue reporting error total \$122,725.

- The Court accrued revenue of \$145,675 in the TCTF-Court Interpreter, GL Account No. 834010 for the prior fiscal year (FY2017-18). However, the court received only \$22,198 in program distributions during the current year which resulted in a \$123,477 short fall from the Court's expected program revenue and 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 TCTF-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 TCTF-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 TCTF 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 TCTF-Court Appointed Counsel, GL Account No. 832012 and into GL Account No. 899910, Prior Year Revenue Adjustments.

Court Response: *The Court agrees there was a technical recording error. Notwithstanding that the Court is ultimately responsible for the accounting and reporting of its revenues and expenditures, the Court relies heavily on the Judicial Council of California (JCC) accounting support staff as the Court's Finance Team consists of three people. The Court consulted with JCC during the year-end process and followed exact the recommendations and instructions provided at that time. Judicial Council of California communicated to the Trial Courts in the FY2019-20 Year-End Accounting Manual with additional guidance and clear instructions. With this communication, the Court has followed the amended guidance and instructions.*

FINDING 2 – Expenditure 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:

- o Merced County Behavioral Health and Recovery Services, services for \$6,984; invoice dated June 30, 2018, and recorded into Psychiatric Evaluations, GL Account No. 939002, August 3, 2018; and
- o 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 General Ledger 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, above. As similarly noted, the adjustment account is presented in the Court's financial statement, but appropriately isolates prior year transactions to prevent them from being commingled in current year operating accounts. Failure to adjust accounts may lead to material financial account misstatements.

Court Response: *The Court agrees there was a technical recording error and will continue to follow the FY2019-20 Year-End Accounting Manual.*

The Court also wants to extend our gratitude and thanks to the professional team members for the audit as it is our goal to ensure the court is in compliant with the laws, rules, and regulations for the remittance and distributions of the state, county, and court revenues.



Amanda Toste
Court Executive Officer, Merced Superior Court

cc. Donald J. Proietti, Presiding Judge
Keri Brasil, Chief Financial Officer

**State Controller's Office
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