

# JUDICIAL COUNCIL OF CALIFORNIA

Audit Report

## FISCAL COMPLIANCE AUDIT

*July 1, 2015, through June 30, 2016*



**BETTY T. YEE**  
California State Controller

October 2017



**BETTY T. YEE**  
California State Controller

October 18, 2017

Honorable Tani Cantil-Sakauye, Chief Justice  
Judicial Council of California  
455 Golden Gate Avenue  
San Francisco, CA 94120-3688

Dear Chief Justice Cantil-Sakauye:

The State Controller's Office performed an audit of revenues, expenditures, and fund balances of the Judicial Council of California (Council) staff. The audit was conducted to assess Council staff's compliance with governing statutes, rules, regulations, and policies for all significant funds under the jurisdiction of the Council staff for the period of July 1, 2015, through June 30, 2016.

Our audit found that Council staff complied with statutes, rules, regulations, and policies for revenues, expenditures, and fund balances. Our audit also identified weaknesses in the Council staff's administrative and internal accounting controls system, described in the Internal Control Observations section of this report, which should be addressed and corrected by Council staff.

The enclosed report is for your information and use. The Council's response to the report observations is incorporated into this final report. The Council agreed with our observations and provided a detailed Corrective Action Plan addressing the fiscal control weaknesses and recommendations. We appreciate the Council's willingness to implement corrective actions. This report will be posted on our website.

If you have any questions regarding this report, please contact Jim Spano, CPA, Assistant Division Chief, by telephone at (916) 323-5849 or by email at [jspano@sco.ca.gov](mailto:jspano@sco.ca.gov).

Sincerely,

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

JVB/rg

Honorable Tani Cantil-Sakauye,  
Chief Justice

-2-

October 18, 2017

cc: Martin Hoshino, Administrative Director  
    Judicial Council of California  
Jody Patel, Chief of Staff  
    Judicial Council of California  
John Wordlaw, Chief Administrative Officer  
    Judicial Council of California  
Daniel Alvarez, Secretary of the Senate  
    Office of the Secretary of State  
E. Dotson Wilson, Chief Clerk  
    California State Assembly, Office of the Chief Clerk  
Diane F. Boyer-Vine, Legislative Counsel  
    Office of Legislative Counsel  
Amy Leach, Journal Clerk  
    California State Assembly, Office of the Chief Clerk  
Zlatko Theodorovic, Chief Financial Officer and Director of Finance  
    Judicial Council of California  
Grant Parks, Internal Audit Manager  
    Judicial Council of California

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# Audit Report

## Summary

The State Controller's Office (SCO) audited the Judicial Council of California (Council) staff's compliance with governing statutes, rules, regulations, and policies for revenues, expenditures, and fund balances for all material and significant funds under the administration, jurisdiction, or control of Council staff for the period of July 1, 2015, through June 30, 2016 (fiscal year 2015-16).

Our audit found that Council staff complied with governing statutes, rules, regulations, and policies relating to the revenues, expenditures, and fund balances. Our audit also identified the following internal control weaknesses:

- Inadequate segregation of duties related to payroll functions;
- Deficiency of collection on past-due employee payroll accounts receivable; and
- Lack of a reconciliation process for employee accounts receivable.

## Background

The Council is the policymaking body of the state court system that oversees superior courts in 58 counties, six appellate courts, and the California Supreme Court. The Council sets the direction for improving the quality of justice and advancing the consistent, independent, impartial, and accessible administration of justice for the benefit of the public.

Council staff implements council policy and provides administrative support to judicial branch entities. Specifically, Council staff administers accounting, auditing, budgeting, contracting, human resources, procurement, and information technology services. Other responsibilities include facilitating court construction, issuing and renewing court interpreter licenses, providing training and education services to new judicial officers, and performing budgeting and administrative services for the courts.

We conducted this audit under an Interagency Agreement with the Council.

## Objectives, Scope, and Methodology

We conducted this audit to determine whether the Council complied with governing statutes, rules, regulations, and policies for revenues, expenditures, and fund balances for the period of July 1, 2015, through June 30, 2016.

Government Code (GC) section 77206(i) and (j) requires the SCO to audit Council staff's compliance with governing statutes, rules, regulations, and policies for revenues, expenditures, and fund balances for all material and significant funds under the administration, jurisdiction, or control of Council staff on or before December 15, 2013, and biennially thereafter.

The objectives of our audit were to determine whether:

- Revenues are accurately reported, are properly supported, and comply with applicable laws, regulations, and policies;
- Expenditures are accurately reported, are properly supported, and comply with applicable laws, regulations, and policies; and
- Fund balances are accurately reported, contain sufficient documentation, and comply with applicable laws, regulations, and policies.

To accomplish our objectives, we:

- Evaluated the Council's formal written internal policies and procedures;
- Gained an understanding of the key internal controls related to revenues, expenditures, and fund balances by interviewing key personnel and reviewing documents that support the transaction flow;
- Identified computer-processed data to be used during the audit and prepared a data reliability assessment;
- Conducted interviews with Council staff and observed the Council's business operations for the purpose of evaluating council-wide administrative and internal accounting controls;
- Reviewed the Council's documentation and supporting financial records;
- Judgmentally selected a non-statistical sample of 79 revenue transactions from all eight funds in which revenues were recorded; and in one of the funds for remittances to the State of California, randomly selected two counties each month and tested three revenue accounts. We performed the following procedures:
  - Traced revenues from the general ledger to supporting documentation; and
  - Verified that the selected revenues are allowable in accordance with applicable laws, regulations, and other criteria, such as the State of California Manual of State Funds;
- Judgmentally selected a non-statistical sample of 235 expenditure transactions for all 17 funds (46 accounts) in which expenditures were recorded. We performed the following procedures:
  - Traced expenditures from the general ledger to supporting documentation; and
  - Verified that the selected expenditures are allowable in accordance with applicable laws, regulations, and other criteria, such as the State of California Manual of State Funds; and

- Performed the following procedures on all nine funds administrated by Council staff:
  - Performed an analytical review of fund balances to identify unusual balances or transactions;
  - Verified that fund balances are accurate by recalculating and tracing amounts from Council financial statements to supporting documentation; and
  - Reviewed fund balance transfers to supporting documents to ensure that transfers were allowable in accordance with applicable criteria, such as Executive Orders and California statutes.

We did not discover any errors in the samples tested.

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

We limited our audit to evaluate compliance of revenues, expenditures, and fund balances for material and significant funds under the administration, jurisdiction, or control of Council staff. We did not audit the Council staff's accounting records for the Supreme Court, Court of Appeal, or the Habeas Corpus Resource Center, as the review and approval authority for these transactions remains with those programs. We did not audit the Council's financial statements.

## **Conclusion**

Our audit found that Council staff complied with statutes, rules, regulations, and policies for revenues, expenditures, and fund balances. This report also identified weaknesses in the Council staff's administrative and internal accounting controls system, described in the Internal Control Observations section of this report, that should be addressed and corrected by Council staff.

## **Views of Responsible Officials**

We issued a draft audit report on September 15, 2017. Martin Hoshino, Administrative Director of the Judicial Council of California, responded by letter dated September 27, 2017 (Attachment A), agreeing with the audit results.

## **Follow-up on Prior Audit Findings**

The Department of Finance issued the prior audit report on August 25, 2015, for the period of July 1, 2013, through June 30, 2014. Findings noted in the previous report have been satisfactorily resolved by Council staff with the exception of Finding 2 in this report, as summarized in Appendix A, Status of Prior Audit Findings.

**Restricted Use**

This final report is solely intended for the information and use of the Judicial Council of California, and the 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](http://www.sco.ca.gov).

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

October 18, 2017

# Internal Control Observations

## **OBSERVATION 1— Inadequate segregation of duties within payroll functions**

Council staff lacked adequate internal control procedures to ensure segregation of duties within the payroll and benefits unit related to payroll transactions.

GC sections 13400 through 13407 require state agencies to establish and maintain internal controls, including proper segregation of duties and an effective system of internal review. Adequate segregation of duties reduces the likelihood that fraud or error will remain undetected by providing for separate processing by different individuals at various stages of a transaction and for independent reviews of work performed.

Through discussions with Council payroll staff and walkthroughs of payroll processes, we found that the same Council payroll staff members performed the following conflicting duties:

- Entered timesheets into the State payroll system;
- Reconciled payroll information from the State payroll system to source documents and reporting payroll exceptions; and
- Authorized previously entered timesheet information in the payroll system.

Council staff failed to demonstrate that it had implemented compensating controls to mitigate risks associated with the lack of segregation of duties.

Adequate segregation of duties provides a stronger system of internal control, as the functions of each employee will be subject to review by another employee.

The lack of adequate segregation of duties and compensating controls has a pervasive effect on the Council payroll process, and impairs the effectiveness of other controls by rendering their design ineffective or by keeping them from operating effectively. This control deficiency represents a material weakness in internal control over the payroll process. A reasonable possibility exists that a material misstatement in financial information or noncompliance with provisions of laws, regulations, or contracts will not be prevented, or detected and corrected in a timely manner.

### Recommendation

We recommend that Council staff establish internal control procedures:

- To separate conflicting payroll function duties related to authorizing, recording, and reconciling transactions; and
- For performing and documenting compensation controls, if it is unable to segregate payroll functions fully and appropriately.

**OBSERVATION 2—  
Deficiency of  
collection on  
outstanding employee  
accounts receivable –  
Repeat Finding**

Council staff does not have adequate internal control procedures to collect and write off aging employee accounts receivable.

Our audit identified a net balance of \$24,448 in employee accounts receivable over 90 days in General Fund 0001, Account 1319, ranging from October 4, 2002, through June 22, 2015. Council staff did not provide documentation supporting that any efforts were made to collect on these accounts during the audit period.

SCO's Payroll Procedural Manual, sections I 007 through I 180, identifies collection provisions and procedures for recouping salary overpayments made to an employee. Failure to collect receivables in accordance with these procedures increases the risk that transactions will be processed incorrectly and that money due the Council will not be collected.

GC section 13402 states that:

Agency heads are responsible for the establishment and maintenance of a system or systems of internal control, and effective and objective ongoing monitoring of the internal controls within their state agencies. This responsibility includes documenting the system, communicating the system requirements to employees, and ensuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

Recommendation

We recommend that Council staff establish policies and procedures to collect on aging employee accounts receivable. If the collection efforts do not result in payment, we recommend that the Council submit an application for discharge of accountability to the SCO to write off the aging employee accounts receivable.

**OBSERVATION 3—  
Lack of reconciliation  
process for employee  
accounts receivable**

Council staff does not have adequate control procedures related to the reconciliation of outstanding employee accounts receivable balances.

Our audit found that reference and clearance numbers from the accounting records did not always match source documents provided by the Council Human Resources Department. Based on discussions with the Council Human Resources and Accounting General Ledger groups, we noted that the two departments do not perform reconciliations of outstanding employee receivable balances. The lack of reconciliations of outstanding employee accounts receivable balances may cause employee accounts receivable to be incorrectly stated in the general ledger.

GC section 13401(a)(5) states, "Systems of internal control are necessarily dynamic and must be routinely monitored, continuously evaluated, and, where necessary, improved." The development and implementation of internal control procedures will improve the integrity of financial reporting and help Council staff work more effectively in complying with governing statutes, policies, and procedures.

Recommendation

We recommend that Council staff establish policies and procedures related to the reconciliation of outstanding employee accounts receivable balances to ensure that amounts are accurate and traceable to source documents.

## Appendix A— Status of Prior Audit Findings

The Department of Finance (DOF), Office of State Evaluations, performed the previous fiscal compliance audit for July 1, 2013, through June 30, 2014. The report was dated August 24, 2015. The previous findings and status is as follows:

DOF Finding	Description of Previous Audit Finding	Finding Corrected?	Comments
1	Employee receivables and payables were not cleared timely.	No	Repeat Finding --See Internal Control Observations 2
2	Vendor payments duties were not adequately segregated.	Yes	Implemented
3	Deposits were not always allocated timely.	Yes	Implemented
4	Reconciliations were not properly reviewed.	Yes	Implemented
5	Some policies and procedures were not documents.	Yes	Implemented

**Attachment A—  
Judicial Council’s Response to Draft Audit Report**

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## JUDICIAL COUNCIL OF CALIFORNIA

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TANI G. CANTIL-SAKAUYE  
Chief Justice of California  
Chair of the Judicial Council

MARTIN HOSHINO  
Administrative Director

September 27, 2017

Mr. Jeffrey V. Brownfield, CPA  
Chief, Division of Audits  
State Controller's Office  
P.O. Box 942850  
Sacramento, California 94250-5874

Dear Mr. Brownfield:

I am in receipt of your draft audit report, dated September 15, 2017, pertaining to the State Controller's Office (SCO) review of the revenues, expenditures, and fund balances of all material funds under the administration, jurisdiction, or control of the Judicial Council of California under Government Code section 77206(i). The Judicial Council appreciates the professionalism of the State Controller's audit staff and is pleased with your report's primary conclusion that "Council staff complied with governing statutes, rules, regulations, and policies."

The draft audit report also contains three internal control observations, noting opportunities where the Judicial Council can improve its processes. The Judicial Council will work toward addressing your report's observations, as noted below.

***Observation 1—Segregation of duties over payroll functions***

Although current staffing of the Judicial Council's Human Resources office prevents segregating each payroll function, Human Resources staff are in the process of developing for the Payroll and Benefits unit written procedures that will include monthly reviews by supervisors of payroll-

related transactions. Human Resources expects to formalize these written procedures by December 31, 2017, which will entail the following:

- *Monthly review of personnel/payroll transactions keyed into the State Controller's Office (SCO) system.* A Human Resources analyst or supervisor will review the personnel/payroll transactions monthly and ensure that they are keyed into the system accurately based on the internal, approved requests. Evidence of these reviews will be documented by maintaining a log of reviewed documents.
- *Quarterly audits of personnel/payroll data within SCO system.* Human Resources began auditing and comparing SCO personnel/payroll data with internal Judicial Council HR systems data in 2015. This review, which is ongoing, provides an extra auditing tool to ensure the accuracy and consistency of the data within both the Judicial Council and SCO systems. Results of these reviews are currently maintained in an Excel file that accessible to management.
- *Monthly review of overtime transactions.* Every month, a Judicial Council Human Resources analyst or supervisor will review overtime transactions for consistency based on the Judicial Council's policies and procedures. These reviews will be maintained in an Excel file identifying issues and resolutions and will be stored in a shared directory.

A Human Resources analyst or supervisor will periodically review the documented results of these reviews and identify any systemic errors that may highlight the need for additional staff training.

***Observation 2—Collections on employees' accounts receivable***

Human Resources has developed written procedures regarding the collection of outstanding employee accounts receivables. These policies describe the requirements for various collection approaches, such as payroll deductions or payments made by check directly from the employee.

Branch Accounting and Procurement staff, along with staff from Human Resources, have also developed new procedures describing how their staff will jointly review employee accounts receivable no less frequently than monthly to ensure ongoing collection activity. In addition, accounting staff will review account balances quarterly to identify those accounts eligible for discharge.

***Observation 3—Reconciliation of employees' accounts receivable***

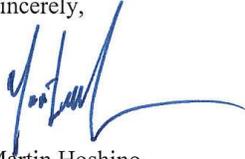
Branch Accounting and Procurement has drafted policies, with the input of Human Resources, to ensure that employee accounts receivable amounts are consistently identified and reported to the State Controller's Office. The policy identifies Human Resources as responsible for initially

Mr. Jeffrey V. Brownfield, CPA  
September 27, 2017  
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identifying amounts owed by an employee and reporting those receivables to the State Controller's Office via *Payroll Adjustment Notice—Accounts Receivable (A/R)*, form STD. 674 A/R. Once the SCO records the receivable in its records, it will then notify the Judicial Council's accounting staff, who will then record the receivable within the Oracle financial system.

The Judicial Council appreciates the State Controller's audit, which serves not only as a tool to improve our existing practices, but also as a means to demonstrate our financial accountability over the public's funds. Please feel free to contact Principal Manager Grant Parks, Audit Services, at 916-263-1321, should you require any additional information pertaining to this response.

Sincerely,



Martin Hoshino  
Administrative Director  
Judicial Council

MH/GP

cc: Jody Patel, Chief of Staff, Judicial Council  
John Wordlaw, Chief Administrative Officer, Judicial Council  
Doug Kauffroath, Director, Branch Accounting and Procurement, Judicial Council  
Aurora Rezapour, Director, Human Resources, Judicial Council  
Grant Parks, Principal Manager, Audit Services, Judicial Council

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