



The State Bar of California

OPEN SESSION AGENDA ITEM AUDIT COMMITTEE III.A

DATE: January 15, 2020

TO: Members, Audit Committee

FROM: John Adams, Chief Financial Officer

SUBJECT: Presentation by and Discussion with Macias Gini & O'Connell Regarding the 2019 Fiscal Audit and Schedule

EXECUTIVE SUMMARY

This agenda item is a presentation by the independent external auditor on the 2019 Fiscal Year Audit. The auditor's communication with the Audit Committee is required under Statement on Auditing Standards #114. Results of the audit will be presented to the committee in April and the Board of Trustees on May 14.

BACKGROUND

Business and Professions Code section 6145 provides that the Board of Trustees shall contract with an independent national or regional public accounting firm for an audit of its financial statements for each fiscal year beginning after December 31, 1998. A copy of the audit and financial statement shall be submitted within 120 days of the close of the fiscal year to the Board, the Chief Justice of the Supreme Court, and to the Assembly and Senate Committees on Judiciary.

The Audit Committee is charged with assisting the Board in fulfilling its oversight responsibility as related to the integrity of accounting and financial reporting processes, the system of internal controls, and audit processes. Current audit standards require the independent auditors to meet with the Audit Committee as described under the Statement on Auditing Standards (SAS #114 - The Auditor's Communication with Those Charged with Governance, and under SAS #115 - Communicating Internal Control Related Matters Identified in an Audit). The purpose is to communicate information to those charged with governing the State Bar of California in relation to the audit of financial statements.

Specific items to be communicated include:

- Those charged with governance and management's responsibilities,
- The Auditor's responsibilities under generally accepted auditing standards,
- An overview of the planned scope and timing of the audit, and
- Significant findings from the audit (post audit).

DISCUSSION

Attached for your reference is the Engagement Letter which addresses the items above in more detail (Attachment 1). Additional discussion items are outlined below:

Overview of the planned scope and timing of the audit:

- Interim audit performed August 19-30, 2019, and
- Year-end field work to start March 2, 2020

Scope of audit includes:

Audited Annual Financial Report: As the independent auditor, Macias Gini & O'Connell (MGO) shall issue a two-year report on the fair presentation of the financial statements in conformity with generally accepted accounting principles as of and for the year ended December 31, 2018 and as of and for the year ended December 31, 2019. The auditor shall communicate in a letter to those charged with governance any material weakness or reportable conditions found during the audit, as defined by the generally accepted auditing standards. In addition, the following matters shall be reported to the Board of Trustees:

- The auditor's responsibility under generally accepted auditing standards,
- Significant accounting policies,
- Management judgments and accounting estimates,
- Significant audit adjustments,
- Other information in documents containing audited financial statements,
- Disagreements with management,
- Management consultation with other accountants,
- Major issues discussed with management prior to retention, and
- Difficulties encountered in performing the audit.

Special Examination: In addition to the audit of the State Bar's financial statements, MGO will examine the State Bar's:

1. Legal Services Trust Fund Program Report for the year ended December 31, 2019 and the State Bar's compliance with the provisions Business and Professional Code sections 6210-6222. Under these provisions, interest earned on certain client trust accounts held by California attorneys is forwarded regularly to the State Bar. After the payment of administrative costs, the State Bar distributes eighty-five percent of the funds to

qualified legal service projects and fifteen percent of the funds to qualified legal support. The report consists of an operating statement of the Legal Services Trust Fund, notes, and grant disbursements scheduled presented on a county by county basis.

2. Statement of Expenditures of Mandatory Membership Fees (the Statement) in accordance with generally accepted accounting standards for the years ended December 31, 2018 and December 31, 2019. This is to confirm the State Bar's compliance with the United States Supreme Court's decision on *Keller v. State Bar of California* (1990) 496 U.S. 1, which held that the State Bar cannot use mandatory fees paid by its members for political or ideological activities not related to regulations of the legal profession or improvement of the quality of legal services in California.

The committee will be introduced to new accounting and auditing standards applicable to the State Bar this year. Lastly, the auditor would like to be advised of any areas of concern the committee would like to have addressed during the audit.

FISCAL/PERSONNEL IMPACT

None

AMENDMENTS TO RULES OF THE STATE BAR

None

AMENDMENTS TO BOARD OF TRUSTEES POLICY MANUAL

None

STRATEGIC PLAN GOALS & OBJECTIVES

Goal: None - compliance

ATTACHMENT(S) LIST

- A. Engagement Letter
- B. PowerPoint Presentation



Certified
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Accountants

October 31, 2019

To the Board of Trustees and Management
The State Bar of California
180 Howard Street
San Francisco, CA 94105

We are pleased to confirm our understanding of the services we are to provide the State Bar of California (State Bar) for the years ended December 31, 2019 and 2018. We will audit the financial statements of the State Bar, including the related notes to the financial statements, which collectively comprise the basic financial statements of the State Bar as of and for the years ended December 31, 2019 and 2018. Accounting standards generally accepted in the United States of America provide for certain required supplementary information (RSI), such as management's discussion and analysis (MD&A), to supplement the State Bar's basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. As part of our engagement, we will apply certain limited procedures to the State Bar's RSI in accordance with auditing standards generally accepted in the United States of America. These limited procedures will consist of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We will not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance. The following RSI is required by U.S. generally accepted accounting principles and will be subjected to certain limited procedures, but will not be audited:

- 1) Management's Discussion and Analysis.
- 2) Pension related schedules.
- 3) OPEB related schedules.

We have also been engaged to report on supplementary information other than RSI that accompanies the State Bar's financial statements. We will subject the following supplementary information to the auditing procedures applied in our audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America, and we will provide an opinion on it in relation to the financial statements as a whole, in a report combined with our auditor's report on the financial statements:

- 1) Schedules of Changes in Net Pension Liability and Related Ratios
- 2) Schedule of Plan Contributions – Pension
- 3) Schedule of Changes in Net OPEB Liability (Asset) and Related Ratios
- 4) Schedules of Contribution – OPEB Plan
- 5) Schedule of Funding Progress – OPEB Plan
- 6) Program Funds Schedule of Net Position.

7) Program Funds Schedule of Revenues, Expenses, and Changes in Net Position.

In addition to our audit of the basic financial statements of the State Bar, we will also perform the following:

- Statement of Expenditures of Mandatory Fees for the year ended December 31, 2019 and the State Bar's compliance with the United States Supreme Court's decision in *Keller v. State Bar of California* (1990) 496 U.S. 1, which held that the State Bar cannot use mandatory fees paid by its licensees for political or ideological activities not related to regulation of the legal profession or improvement of quality of legal services in California. Our examination will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Accordingly, the examination will include tests of records and other procedures we consider necessary to enable us to express an opinion as to whether the chargeable program expenditures of State bar are presented, in all material respects, in conformity with the aforementioned requirements.
- Legal Services Trust Fund Program Report for the year ended December 31, 2019 and the State Bar's compliance with the provisions Business and Professional Code sections 6210-6222. Under these provisions, interest earned on certain client trust accounts held by California attorneys is forwarded regularly to the State Bar. After the payment of administrative costs, the State Bar distributes eighty-five percent of the funds to qualified legal service projects and fifteen percent of the funds to qualified legal support. The report consists of an operating statement of the Legal Services Trust Fund, notes, and grant disbursements scheduled presented on a county by county basis.

Audit Objective

The objective of our audit is the expression of opinions as to whether your financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles and to report on the fairness of the supplementary information referred to in the second paragraph when considered in relation to the financial statements as a whole. Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America and will include tests of the accounting records and other procedures we consider necessary to enable us to express such opinions. We will issue a written report upon completion of our audit of the State Bar's financial statements. Our report will be addressed to the Board of Trustees of the State Bar. We cannot provide assurance that unmodified opinions will be expressed. Circumstances may arise in which it is necessary for us to modify our opinions or add emphasis-of-matter or other-matter paragraphs. If our opinions are other than unmodified, we will discuss the reasons with you in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed opinions, we may decline to express opinions or issue reports, or we may withdraw from this engagement.

Audit Procedures—General

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We will plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the government or to acts by management or employees acting on behalf of the government.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, and because we will not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us, even though the audit is properly planned and performed in accordance with U.S. generally accepted auditing standards. In addition, an audit is not designed to detect immaterial misstatements, or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements. However, we will inform the appropriate level of management of any material errors, fraudulent financial reporting, or misappropriation of assets that comes to our attention. We will also inform the appropriate level of management of any violations of laws or governmental regulations that come to our attention, unless clearly

inconsequential. Our responsibility as auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, and may include direct confirmation of receivables and certain other assets and liabilities by correspondence with selected individuals, funding sources, creditors, and financial institutions. We will request written representations from your attorneys as part of the engagement, and they may bill you for responding to this inquiry. At the conclusion of our audit, we will require certain written representations from you about the financial statements and related matters.

Audit Procedures—Internal Control

Our audit will include obtaining an understanding of the government and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. An audit is not designed to provide assurance on internal control or to identify deficiencies in internal control. Accordingly, we will express no such opinion. However, during the audit, we will communicate to management and those charged with governance internal control related matters that are required to be communicated under AICPA professional standards.

Audit Procedures—Compliance

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of the State Bar's compliance with the provisions of applicable laws, regulations, contracts, and agreements. However, the objective of our audit will not be to provide an opinion on overall compliance and we will not express such an opinion.

Other Services

We will also assist in preparing the financial statements of the State Bar in conformity with U.S. generally accepted accounting principles based on information provided by you. We will perform the services in accordance with applicable professional standards. The other services are limited to the financial statement services previously defined. We, in our sole professional judgment, reserve the right to refuse to perform any procedure or take any action that could be construed as assuming management responsibilities.

Management Responsibilities

Management is responsible for designing, implementing, and maintaining effective internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, including monitoring ongoing activities; for the selection and application of accounting principles; and for the preparation and fair presentation of the financial statements in conformity with U.S. generally accepted accounting principles.

Management is also responsible for making all financial records and related information available to us and for the accuracy and completeness of that information. You are also responsible for providing us with (1) access to all information of which you are aware that is relevant to the preparation and fair presentation of the financial statements, (2) additional information that we may request for the purpose of the audit, and (3) unrestricted access to persons within the government from whom we determine it necessary to obtain audit evidence.

Your responsibilities include adjusting the financial statements to correct material misstatements and confirming to us in the management representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

You are responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud affecting the government involving (1) management, (2) employees who have significant roles in internal control, and (3) others where the fraud could have a material effect on the financial statements. Your responsibilities include informing us of your knowledge of any allegations of fraud or suspected fraud affecting the government received in communications from employees, former employees, regulators, or others. In addition, you are responsible for identifying and ensuring that the government complies with applicable laws and regulations.

You are responsible for the preparation of the supplementary information in conformity with U.S. generally accepted accounting principles. You agree to include our report on the supplementary information in any document that contains and indicates that we have reported on the supplementary information. You also agree to include the audited financial statements with any presentation of the supplementary information that includes our report thereon. Your responsibilities include acknowledging to us in the representation letter that (1) you are responsible for presentation of the supplementary information in accordance with GAAP; (2) you believe the supplementary information, including its form and content, is fairly presented in accordance with GAAP; (3) the methods of measurement or presentation have not changed from those used in the prior period (or, if they have changed, the reasons for such changes); and (4) you have disclosed to us any significant assumptions or interpretations underlying the measurement or presentation of the supplementary information. With regard to the electronic dissemination of audited financial statements, including financial statements published electronically on your website, you understand that electronic sites are a means to distribute information and, therefore, we are not required to read the information contained in these sites or to consider the consistency of other information in the electronic site with the original document.

You agree to assume all management responsibilities for financial statement preparation services and any other nonattest services we provide; oversee the services by designating an individual, preferably from senior management, with suitable skill, knowledge, or experience; evaluate the adequacy and results of the services; and accept responsibility for them.

Engagement Administration, Fees, and Other

We understand that your employees will prepare all cash, accounts receivable, or other confirmations we request and will locate any documents selected by us for testing.

The audit documentation for this engagement is the property of Macias Gini & O'Connell LLP (MGO) and constitutes confidential information. However, subject to applicable laws and regulations, audit documentation and appropriate individuals will be made available upon request and in a timely manner to an appropriate regulator or its designee. We will notify you of any such request. If requested, access to such audit documentation will be provided under the supervision of MGO personnel. Furthermore, upon request, we may provide copies of selected audit documentation to an appropriate regulator or its designee. The regulator or its designee may intend or decide to distribute the copies or information contained therein to others, including other governmental agencies.

We expect to begin our audit on approximately August 19, 2019 and plan to issue our reports no later than April 20, 2020. David Bullock is the engagement partner and is responsible for supervising the engagement and signing the reports or authorizing another individual to sign it.

Our fees for these services will be at our quoted hourly rates plus out-of-pocket costs of \$125,000 as outlined in the Financial Audit Agreement between the State Bar and MGO, effective October 9, 2018, plus \$7,000 for the added scope of the Legal Services Trust Fund audit. Our quoted hourly rates vary according to the degree of responsibility involved and the experience level of the personnel assigned to your audit. Our invoices for these fees will be rendered each month as work progresses and are payable on presentation. In accordance with our firm policies, work may be suspended if your account becomes 60 days or more overdue and may not be resumed until your account is paid in full. If we elect to terminate our services for nonpayment, our engagement will be deemed to have

been completed upon written notification of termination, even if we have not completed our report. You will be obligated to compensate us for all time expended and to reimburse us for all out-of-pocket costs through the date of termination. The fees are based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered during the audit. If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs.

Our 2018 peer review report is attached for your reference.

We appreciate the opportunity to be of service to the State Bar and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us.

Very truly yours,

A handwritten signature in black ink that reads "Macias Gini & O'Connell LLP". The signature is written in a cursive, flowing style.

Macias Gini & O'Connell LLP

RESPONSE:

This letter correctly sets forth the understanding of the engagement. I have read this agreement, including the attached Terms and Conditions, and understand its terms. I am authorized to sign this agreement on behalf of the State Bar.

Management signature: _____

Title: _____

Date: _____

Governance signature: _____

Title: _____

Date: _____

Macias Gini & O'Connell LLP

Terms and Conditions

Subpoena and Other Release of Documents

As a result of our services to you, we may be required or requested to provide information or documents to you or a third-party pursuant to a subpoena, court order or other administrative or legal process in connection with governmental regulations or activities, or a legal, arbitration or administrative proceeding, in which we are not a party. You agree that our efforts in complying with such requests or demands will be deemed a part of this engagement and MGO shall be entitled to additional compensation for our time and reimbursement for our out-of-pocket expenditures (including legal fees) in complying with such request or demand.

Use of Electronic Communication and Cloud-based Computing

In the performance of our professional services, we may communicate with each other and/or with others via email transmission. As emails can be intercepted and read, disclosed, or otherwise used by an unintended third party, we cannot guarantee that such email communication will be properly delivered and read only by the addressee. While we will use our best efforts to keep such communications secure in accordance with our obligations under applicable laws and professional standards, you recognize and accept that we have no control over the unauthorized interception of these communications once they have been sent. Therefore, you hereby waive any liability whatsoever for any unintended interception or unintentional disclosure of email transmissions in connection with the performance of our professional services. MGO uses cloud-based computing services, including the storage of data and files, at third party, offsite, secure facilities. In that regard, you agree that we shall have no liability for any loss or damage to any person or entity resulting from the use of email transmissions and cloud-based computing, including any direct or indirect damages that may result from any inadvertent or unanticipated disclosure of confidential or proprietary information, or disclosure through third party criminal conduct (e.g., hackers or hacking activities).

Independence

Professional and certain regulatory standards require us to be independent, in both fact and appearance, with respect to the City in the performance of our services. Any discussions that the City representatives have with professional personnel of MGO regarding employment could pose a threat to our independence. Therefore, you agree to inform us prior to any such discussions so that we can implement appropriate safeguards to maintain our independence.

Hiring of MGO Personnel

If you hire one of our personnel directly from MGO during the performance of our services or within 90 days after the completion of our services, you agree to have the City pay us a fee of 20% of that individual's base compensation at the City 90 days from the first day of employment.

Report on the Firm's System of Quality Control

October 25, 2018

To the Partners of
Macias Gini & O'Connell LLP
and the National Peer Review Committee

We have reviewed the system of quality control for the accounting and auditing practice of Macias Gini & O'Connell LLP (the firm) applicable to engagements not subject to PCAOB permanent inspection in effect for the year ended March 31, 2018. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in a System Review as described in the Standards may be found at www.aicpa.org/prsummary. The summary also includes an explanation of how engagements identified as not performed or reported in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

Firm's Responsibility

The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported in conformity with professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review.



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AUDIT OVERVIEW

State Bar of California

PRESENTED BY:

David Bullock, CPA

Partner

January 15, 2020

Guian Chhim, CPA

Senior Manager

AUDIT COMMITTEE:

State Bar of California



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We are pleased to present our audit plan for the State Bar of California for the year ended December 31, 2019.

We appreciate the opportunity to meet with you to discuss the audit plan, especially as a two-way dialogue can provide valuable information for the audit process. We look forward to working with you!

Your Dedicated Team:



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Caroline Walsh
Technical Review
Partner



David Bullock
Engagement
Partner



Scott Johnson
Advisory Services
Partner



Guian Chhim
Senior Manager



Jasmine Costa
IT Manager



Timothy Chu
Senior Associate

Required Communications

with Those Charged with Governance



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Planning

- Auditor's responsibility under U.S. Generally Accepted Auditing Standards
- Planned scope and timing of audit

Results

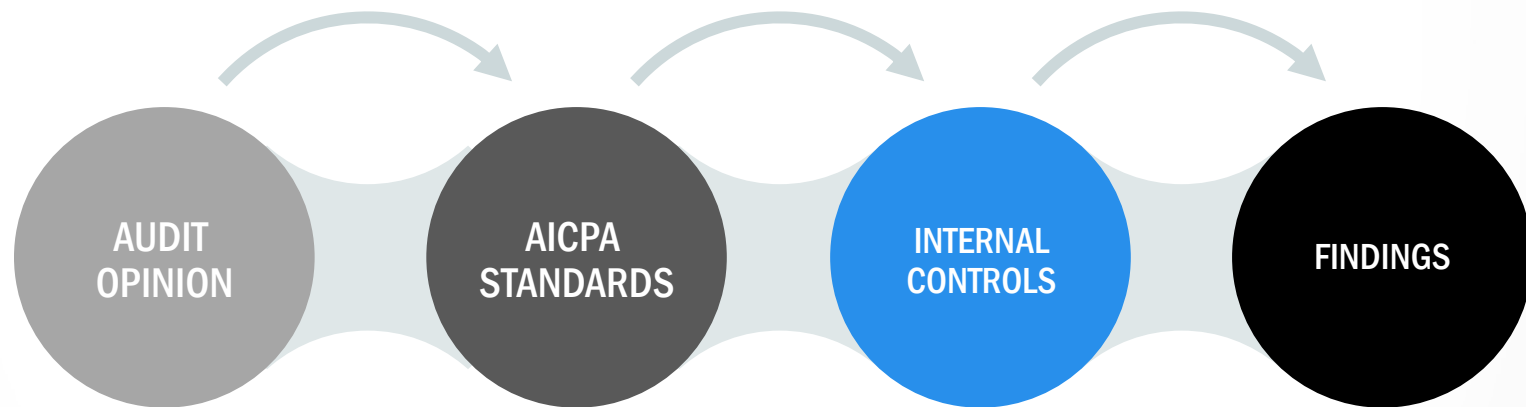
- Significant audit findings
- Qualitative aspects of accounting practices
- Difficulties encountered in performing the audit
- Corrected and uncorrected misstatements
- Management representations
- Management consultations with other independent accountants
- Other audit findings or issues

Our Responsibility



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Our responsibility under U.S. Generally Accepted Auditing Standards.



To express our opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. This does not relieve you or management of your responsibilities.

To perform an audit in accordance with generally accepted auditing standards issued by the AICPA, and to design the audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement.

To obtain an understanding of the State Bar and its environment, including internal controls over financial reporting and compliance, as a basis for designing our audit procedures, but not for the purpose of expressing an opinion on its effectiveness.

To communicate findings that, in our judgment, are relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

The Annual Financial Audit

Audit Plan and Approach

- Tailored to the State Bar
- Risk-based approach
- Identify and research key issues



What is Materiality?



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Materiality

The amount of a misstatement that could influence the economic decisions of users, taken on the basis of the financial statements.

How It's Calculated:

Using certain quantitative (e.g., total assets, total revenues, or other financial information) and qualitative factors (e.g., covenants, expectations, or industry factors)

It's Used To Identify:

- Significant risk areas
- Nature, timing, extent, and scope of test work
- Findings or misstatements

Significant Audit Areas



Financial closing and reporting –including drafting of financial statements and footnote disclosures



Investment valuation and disclosures

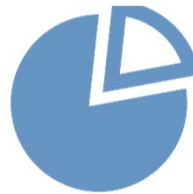


Accounts receivable and accounts payable

Significant Audit Areas (continued)



**Loans payable and
debt covenant
compliance**



**Pension and other post-
employment benefits
(OPEB) accounting,
valuation, and
disclosures**



**Revenue recognition –
fees, donations, and
grants**

Consideration of Fraud



Auditors must consider fraud to “improve the likelihood that auditors will detect material misstatements due to fraud in a financial statement audit.”

How we gather information to identify fraud-related risks of material misstatement:

- Brainstorm with team
- Conduct personnel interviews
- Document understanding of internal controls
- Consider unusual or unexpected relationships identified in planning and performing the audit

Procedures to be performed:

- Examine general journal entries for nonstandard transactions
- Evaluate policies and accounting for revenue recognition
- Test and analyze significant accounting estimates for biases
- Evaluate the business rationale for significant unusual transactions

Deliverables

We will issue the following December 31, 2019 reports:

- Audit report on the basic financial statements of the State Bar of California
- Examination report on the statement of expenditures of mandatory membership fees of the State Bar of California
- Examination report on Legal Services Trust Fund Program
- Report to those charged with governance
 - Communicating required matters and matters related to internal controls and compliance with laws, regulations, contracts and agreements



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Audit Timing



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Accounting Update



New Standards



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GASB Pronouncements

- GASB 83 – Asset Retirement Obligations
- GASB 84 – Fiduciary Activities
- GASB 88 – Debt Disclosures
- GASB 90 – Minority Equity Interests

Future GASB Pronouncements

- GASB 87 – Leases
- GASB 89 – Capitalized Interest

About MGO

One of the fastest growing professional services firms in the U.S., MGO combines deep industry expertise with proven accounting and advisory solutions to deliver tangible results. Our clients range from global aerospace and technology leaders to innovative start-ups and not-for-profit organizations – from the largest government entities in the country, to the biggest names in entertainment.

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MARKETING OVERVIEW

Questions?



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