



The State Bar of California

OPEN SESSION AGENDA ITEM AUDIT COMMITTEE III.A

DATE: January 20, 2022

TO: Members, Audit Committee

FROM: Aracely Montoya-Chico, Chief Financial Officer

SUBJECT: Presentation by and Discussion with Macias Gini & O'Connell Regarding the 2021 Fiscal Audit and Schedule

EXECUTIVE SUMMARY

This agenda item is a presentation by the independent external auditor on the 2021 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 and the Board of Trustees at the May 2022 meeting.

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. 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. Generally accepted auditing standards require the independent auditor 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 relate 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

The audit engagement letter, which addresses the items above in more detail, is provided as Attachment A.

The scope of the 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 years ended December 31, 2021, and 2020. 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 documentation 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, 2021, and the State Bar's compliance with the provisions described in the California Business and Professions Code, Article 14 Funds for the Provision of Legal Services to Indigent Persons, sections 6210–6228.
2. Statement of Expenditures of Mandatory Membership Fees – MGO shall issue a report on the fair presentation of the statement in conformity with generally accepted accounting principles for the year ended December 31, 2021. 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. The committee will be afforded the opportunity to ensure that MGO is independent with respect to the State Bar. 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

None

AMENDMENTS TO BOARD OF TRUSTEES POLICY MANUAL

None

STRATEGIC PLAN GOALS & OBJECTIVES

Goal: None – compliance

RECOMMENDATIONS

None

ATTACHMENT(S) LIST

- A. Engagement Letter
- B. PowerPoint Presentation



January 12, 2022

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

The following represents our understanding of the services we will provide to the State Bar of California.

You have requested that we audit the financial statements of the State Bar of California (State Bar) for the years ended December 31, 2021 and 2020 and the related notes, which collectively comprise of the State Bar's basic financial statements as listed in the table of contents. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on each opinion unit applicable to those basic financial statements.

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

- Statement of Expenditures and Mandatory Fees for the year ended December 31, 2021 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.
- Legal Services Trust Fund Program Report for the year ended December 31, 2021 and the State Bar's compliance with the provisions described in the California Business and Professions Code, Article 14 Funds for the Provision of Legal Services to Indigent Person, Section 6210-6228 (the Code).

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with auditing standards generally accepted in the United States of America (GAAS) will always detect a material misstatement when it exists. Misstatements, including omissions, can arise from fraud or error and are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

Accounting principles generally accepted in the United States of America, (U.S. GAAP,) as promulgated by the Governmental Accounting Standards Board (GASB) require that certain required supplementary information (RSI) be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB, 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 required supplementary information (RSI) in accordance with auditing standards generally accepted in the United States of America, (U.S. GAAS). These limited procedures will consist primarily of inquiries

of management regarding their methods of measurement and presentation, and comparing the information for consistency with management's responses to our inquiries. We will not express an opinion or provide any form of assurance on the RSI. The following RSI is required by U.S. GAAP. This RSI will be subjected to certain limited procedures but will not be audited:

1. Management's Discussion and Analysis
2. Schedule of Changes in Net Pension Liability and Related Ratios
3. Schedule of Plan Contributions – Pension
4. Schedule of Changes in Net OPEB Liability (Asset) and Related Ratios
5. Schedule of Contribution – OPEB Plan

Supplementary information other than RSI will accompany [Entity Name]'s basic financial statements. We will subject the following supplementary information to the auditing procedures applied in our audit of the basic financial statements and perform certain additional procedures, including comparing and reconciling the supplementary information to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and additional procedures in accordance with U.S. GAAS. We intend to provide an opinion on the following supplementary information in relation to the basic financial statements as a whole:

1. Program Funds Schedule of Net Position
2. Program Funds Schedule of Revenues, Expenses, and Changes in Net Position

Auditor Responsibilities

We will conduct our audit in accordance with U.S. GAAS. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the basic financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the basic financial statements, whether due to fraud or error, misappropriation of assets, or violations of laws, governmental regulations, grant agreements, or contractual agreements.

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 basic financial statements. If appropriate, our procedures will therefore include tests of documentary evidence that support the transactions recorded in the accounts, tests of the physical existence of inventories, and direct confirmation of cash, investments, and certain other assets and liabilities by correspondence with creditors and financial institutions. As part of our audit process, we will request written representations from your attorneys, and they may bill you for responding. At the conclusion of our audit, we will also request certain written representations from you about the basic financial statements and related matters.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk that some material misstatements (whether caused by errors, fraudulent financial reporting, misappropriation of assets, or violations of laws or governmental regulations) may not be detected exists, even though the audit is properly planned and performed in accordance with U.S. GAAS.

In making our risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the basic financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies

or material weaknesses in internal control relevant to the audit of the basic financial statements that we have identified during the audit. Our responsibility as auditors is limited to the period covered by our audit and does not extend to any other periods.

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 on the basic financial statements 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 to issue a report as a result of this engagement.

Compliance with Laws and Regulations

As previously discussed, as part of obtaining reasonable assurance about whether the basic financial statements are free of material misstatement, we will perform tests of 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.

Management Responsibilities

Our audit will be conducted on the basis that *management and, when appropriate, those charged with governance* acknowledge and understand that they have responsibility:

- a. For the preparation and fair presentation of the basic financial statements in accordance with accounting principles generally accepted in the United States of America;
- b. For the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of basic financial statements that are free from material misstatement, whether due to error, fraudulent financial reporting, misappropriation of assets, or violations of laws, governmental regulations, grant agreements, or contractual agreements; and
- c. To provide us with:
 - i. Access to all information of which *management* is aware that is relevant to the preparation and fair presentation of the basic financial statements such as records, documentation, and other matters;
 - ii. Additional information that we may request from *management* for the purpose of the audit;
 - iii. Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.
 - iv. A written acknowledgement of all the documents that *management* expects to issue that will be included in the annual report and the planned timing and method of issuance of that annual report; and
 - v. A final version of the annual report (including all the documents that, together, comprise the annual report) in a timely manner prior to the date of the auditor's report.
- d. For including the auditor's report in any document containing basic financial statements that indicates that such basic financial statements have been audited by us;
- e. For identifying and ensuring that the entity complies with the laws and regulations applicable to its activities;
- f. For adjusting the basic 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 current year period(s) under audit are immaterial, both individually and in the aggregate, to the basic financial statements as a whole; and

- g. For acceptance of nonattest services, including identifying the proper party to oversee nonattest work;
- h. For maintaining adequate records, selecting and applying accounting principles, and safeguarding assets;
- i. For informing us of any known or suspected fraud affecting the entity involving management, employees with significant role in internal control and others where fraud could have a material effect on the financials; and
- j. For the accuracy and completeness of all information provided.

With regard to the supplementary information referred to above, you acknowledge and understand your responsibility: (a) for the preparation of the supplementary information in accordance with the applicable criteria; (b) to provide us with the appropriate written representations regarding supplementary information; (c) to include our report on the supplementary information in any document that contains the supplementary information and that indicates that we have reported on such supplementary information; and (d) to present the supplementary information with the audited basic financial statements, or if the supplementary information will not be presented with the audited basic financial statements, to make the audited basic financial statements readily available to the intended users of the supplementary information no later than the date of issuance by you of the supplementary information and our report thereon.

As part of our audit process, we will request from *management and, when appropriate, those charged with governance*, written confirmation concerning representations made to us in connection with the audit.

Reporting

We understand that your employees will prepare all confirmations we request and will locate any documents or support for any other transactions we select for testing.

If you intend to publish or otherwise reproduce the basic financial statements and make reference to our firm, you agree to provide us with printers' proofs or masters for our review and approval before printing. You also agree to provide us with a copy of the final reproduced material for our approval before it is distributed.

During the course of the engagement, we may communicate with you or your personnel via fax or e-mail, and you should be aware that communication in those mediums contains a risk of misdirected or intercepted communications

Regarding the electronic dissemination of audited financial statements, including financial statements published electronically on your Internet 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.

MGO is owned by professionals who hold CPA licenses as well as by professionals who are not licensed CPAs. Therefore, depending on the nature of the services being provided, non-CPA owners may be involved in providing certain services hereunder. David Bullock, CPA, is the engagement partner for the audit services specified in this letter. Her responsibilities include supervising MGO's services performed as part of this engagement and signing or authorizing another qualified firm representative to sign the audit report.

Our fees are based on the amount of time required at various levels of responsibility plus actual out-of-pocket expenses of \$132,000. Invoices will be rendered every two weeks and are payable upon

presentation. We will notify you immediately of any circumstances we encounter that could significantly affect this initial fee estimate. Whenever possible, we will attempt to use the State Bar's personnel to assist in the preparation of schedules and analyses of accounts. This effort could substantially reduce our time requirements and facilitate the timely conclusion of the audit. Further, we will be available during the year to consult with you on financial management and accounting matters of a routine nature.

During the course of the audit we may observe opportunities for economy in, or improved controls over, your operations. We will bring such matters to the attention of the appropriate level of management, either orally or in writing.

You agree to inform us of facts that may affect the basic financial statements of which you may become aware during the period from the date of the auditor's report to the date the financial statements are issued.

We agree to retain our audit documentation or work papers for a period of at least seven years from the date of our report.

At the conclusion of our audit engagement, we will communicate to those charged with governance the following significant findings from the audit:

- Our view about the qualitative aspects of the entity's significant accounting practices;
- Significant difficulties, if any, encountered during the audit;
- Uncorrected misstatements, other than those we believe are trivial, if any;
- Disagreements with management, if any;
- Other findings or issues, if any, arising from the audit that are, in our professional judgment, significant and relevant to those charged with governance regarding their oversight of the financial reporting process;
- Material, corrected misstatements that were brought to the attention of management as a result of our audit procedures;
- Representations we requested from management;
- Management's consultations with other accountants, if any; and
- Significant issues, if any, arising from the audit that were discussed, or the subject of correspondence, with management.

The audit documentation for this engagement is the property of MGO and constitutes confidential information. However, we may be requested to make certain audit documentation available to agencies and regulators pursuant to authority given to it by law or regulation, or to peer reviewers. If requested, access to such audit documentation will be provided under the supervision of MGO's personnel. Furthermore, upon request, we may provide copies of selected audit documentation to these agencies and regulators. The agencies and regulators may intend, or decide, to distribute the copies of information contained therein to others, including other governmental agencies.

Independence

Professional and certain regulatory standards require us to be independent, in both fact and appearance, with respect to the client in the performance of our services. Any discussions that State Bar 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.

Engagement with MGO Affiliates

If the State Bar has or expects to engage an affiliate of MGO (see list of affiliates below) to perform services during the audit and professional engagement period (as defined below), the State Bar must notify MGO prior to entering into such engagement with the MGO affiliate. In addition, prior to signing this engagement letter, the State Bar must notify MGO of any service an MGO affiliate has performed prior to the audit and professional engagement period in order for MGO to ensure our independence in relation to this engagement. The State Bar will also be required to provide such representation within the management representation letter prior to the issuance of our report.

Audit and professional engagement period includes both:

1. The period covered by any financial statements being audited or reviewed (the “audit period”); and
2. The period of the engagement to audit or review the audit client's financial statements or to prepare a report to be issued (the “professional engagement period”):
 - a) The professional engagement period begins when MGO either signs an initial engagement letter (or other agreement to review or audit a client's financial statements) or begins audit, review, or attest procedures, whichever is first; and
 - b) The professional engagement period ends when the audit client or MGO terminate the engagement and the audit client is no longer a client of MGO.

MGO Affiliates:

1. MGO Group LLC
2. MGO Realty Advisors, Inc.
3. MGO India Private Limited
4. MGO Wealth Advisors, LLC
5. MGO Technology Group, LLC
6. MGO Risk Management Group LLC
7. Cresta Management Services, LLC
8. ELLO LLC
9. ELLO Capital, LLC
10. ELLO Advisors, LLC
11. Fiorello, LLC
12. IntelliBridge Partners LLC
13. Sands Lane Capital Fund I, L.P.
14. Sands Lane Capital GP I, L.L.C

Potential Impact of the Coronavirus (COVID-19) Outbreak

Notwithstanding the unprecedented circumstances resulting from the COVID-19 outbreak, we continue to have a professional obligation to gather sufficient appropriate audit evidence in support of the State Bar's financial statements. Travel restrictions, actual or suspected infections, work from home requirements, changes – such as work force reductions – made to accommodate the current business environments, or other similar matters may result in delays in the State Bar's employees' ability to provide us the necessary audit evidence on a timely basis or at all. Similarly, such matters may impact our own ability to collect or appropriately assess necessary audit evidence on a timely basis or at all.

Should such events occur, the State Bar and MGO will make good faith efforts to complete alternative procedures to gather and assess necessary audit evidence. Such procedures might include, but not be limited to, our respective employees working from home, transferring more audit information via electronic modes (preferably through our secure MGO Exchange portal), and meeting virtually rather than

in-person. As to audit evidence transferred via electronic modes, the State Bar is responsible to ensure that such evidence is authentic, complete, and accurate for the purposes it is meant to serve. MGO will perform, as it deems necessary, incremental procedures to validate the authenticity, completeness, and accuracy of such audit evidence.

Should impacts from the COVID-19 outbreak impede the ability to provide full cooperation and access, the State Bar will instead work with us in good faith to make alternative arrangements to accomplish the objectives of our audit. As necessary, we will notify the State Bar if such alternative procedures require additional efforts and, if possible, an estimate of the additional cost.

Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the basic financial statements including our respective responsibilities.

We appreciate the opportunity to be your financial statement auditors and look forward to working with you and your staff. Our 2018 peer review report is provided for reference.

Respectfully,



Macias Gini & O'Connell LLP

RESPONSE:

This letter correctly sets forth our understanding.

Acknowledged and agreed on behalf of State Bar by:

Name: _____

Title: _____

Date: _____

Signature: _____

Name: _____

Title: _____

Date: _____

Signature: _____



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AUDIT OVERVIEW

State Bar of California

PRESENTED BY:

David Bullock, CPA

Partner

January 20, 2022

Guian Chhim, CPA

Senior Manager

AUDIT COMMITTEE:

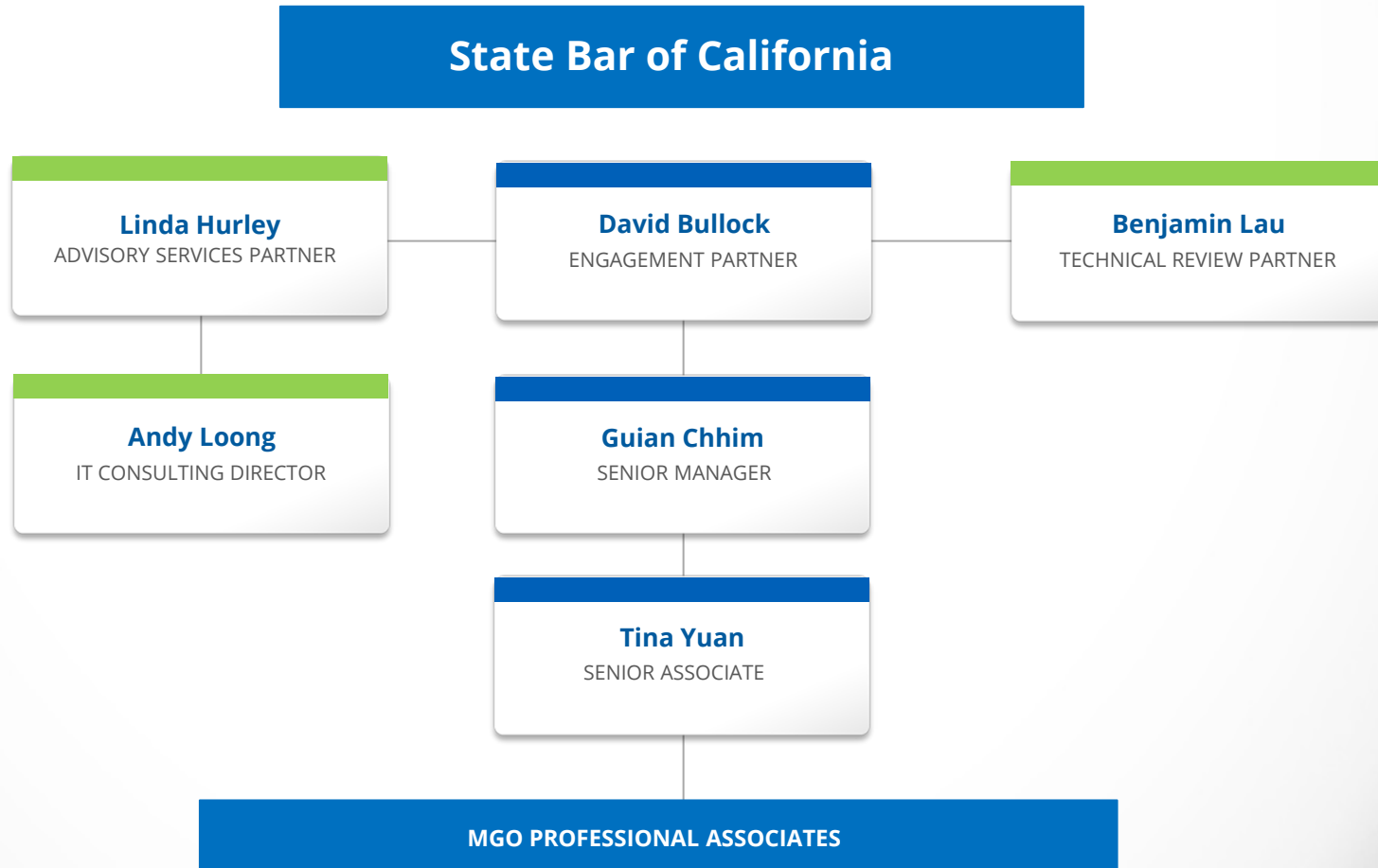
State Bar of California



We are pleased to present our audit plan for the State Bar of California for the year ending December 31, 2021.

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:



Required Communications

with Those Charged with Governance



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Planning

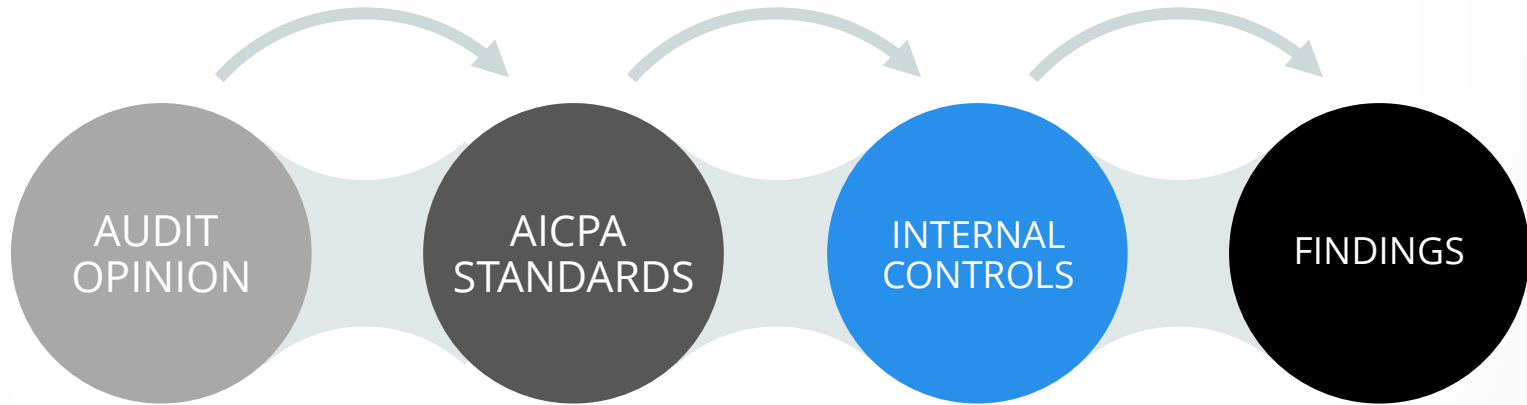
- Auditor's responsibility under U.S. Generally Accepted Auditing Standards
- Planned scope and timing of audit

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

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. 5

The Annual Financial Audit

Audit Plan and Approach

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



What is Materiality?

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



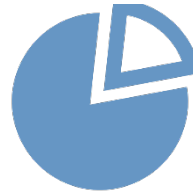
Accounts receivable and accounts payable

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

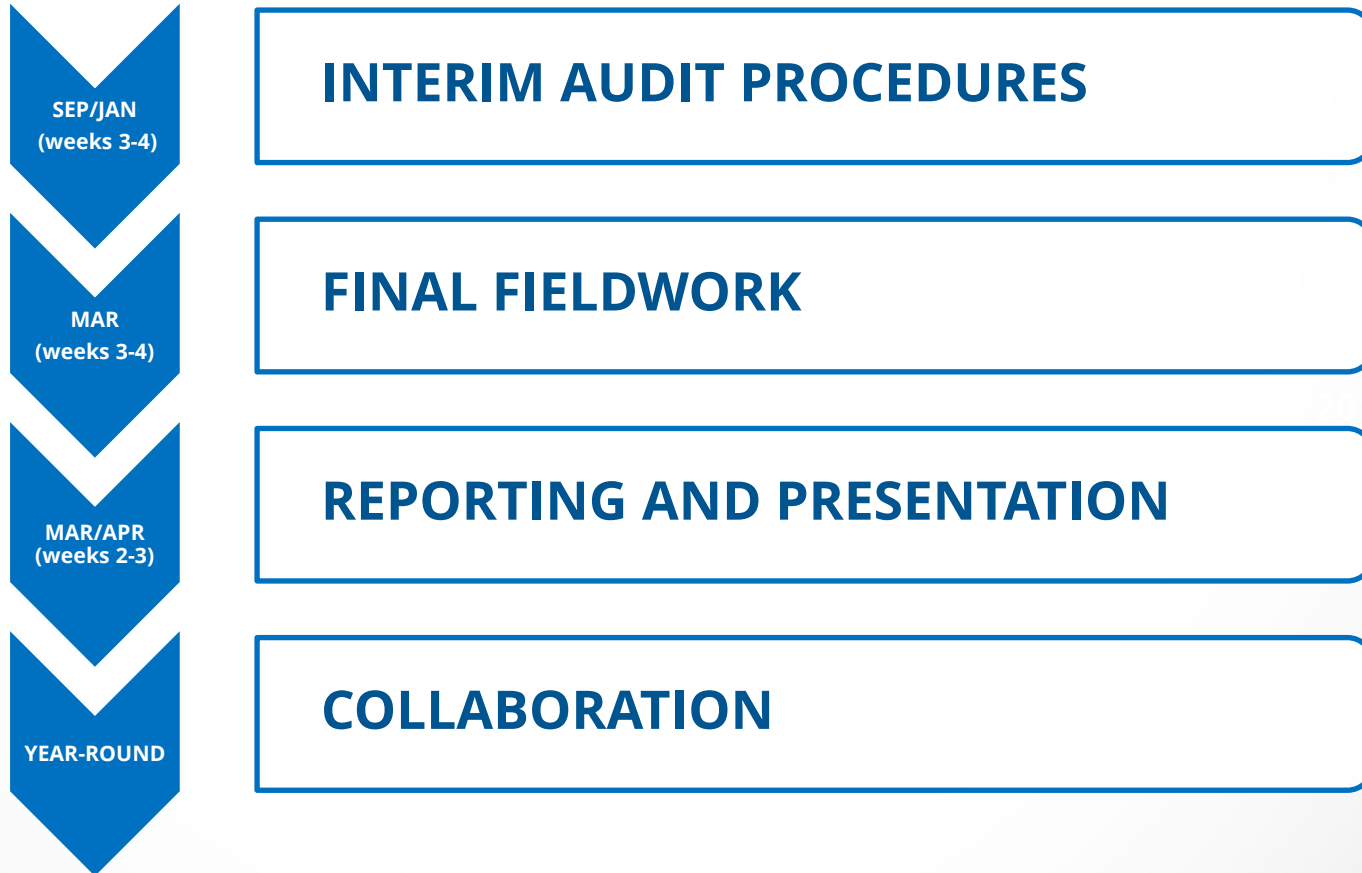
Deliverables

We will issue the following December 31, 2021 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



Audit Timing



Accounting Update



New Standards

GASB pronouncement effective for 2021

- GASB 89 – Accounting for Interest Costs Incurred Before the End of a Construction Period.
- GASB 91 – Conduit Debt Obligations

New Standards



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Future Significant GASB Pronouncements

- GASB 87 – Leases
 - Establishes a single model for lease accounting, whereby all leases are considered financings of the right to use an underlying asset. The State Bar is now required to recognize a lease liability and an intangible right-to-use lease asset, as a lessee, and to recognize a lease receivable and a deferred inflow of resources, as a lessor.

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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