



# The State Bar of California

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## **OPEN SESSION AGENDA ITEM JULY 2023 AUDIT COMMITTEE III.A**

**DATE:** July 20, 2023

**TO:** Members, Audit Committee

**FROM:** Aracely Montoya-Chico, Chief Financial Officer

**SUBJECT:** Discussion of 2022 Internal Controls Review Results

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### **EXECUTIVE SUMMARY**

The attached report describes the results of the State Bar's Internal Controls review performed by our independent consultants, Macias Gini & O'Connell LLP (MO).

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### **BACKGROUND**

In accordance with the provisions outlined in the Audit Committee Charter, the internal control review is conducted on a five-year cycle. The review encompasses various business process areas and information technology (IT) processes. The primary objective is to verify the existence and effectiveness of adequate processes and controls, ensuring their adherence within the respective offices.

### **DISCUSSION**

The results and recommendations from MGO's review have been documented in the accompanying report and are discussed by business process area. The portion of the report pertaining to IT processes was previously reviewed in closed session at the May 2023 Audit Committee meeting due to confidential information.

### **FISCAL/PERSONNEL IMPACT**

None

**AMENDMENTS TO RULES**

None

**AMENDMENTS TO BOARD OF TRUSTEES POLICY MANUAL**

None

**STRATEGIC PLAN GOALS & IMPLEMENTATION STEPS**

None – core business operations

**ATTACHMENT LIST**

- A. Internal Controls Review Report



To the Audit Committee and the  
Board of Trustees of the State Bar of California  
San Francisco, California

In planning and performing our audit of the basic financial statements of the State Bar of California (State Bar), as of and for the year ended December 31, 2022, in accordance with auditing standards generally accepted in the United States of America, we considered the State Bar's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State Bar's internal control. Accordingly, we do not express an opinion on the effectiveness of the State Bar's internal control over financial reporting.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We did not identify any deficiencies in internal control that we consider to be material weaknesses. However, as discussed below, we identified certain significant deficiencies and other matters involving internal control and operations that are presented for your consideration. This letter does not affect our report dated April 28, 2023, on the financial statements of the State Bar. Our comments and recommendations, all of which have been discussed with appropriate members of management, are intended to improve internal controls or result in operating efficiencies. Our comments and recommendations are summarized in the accompanying Recommendations and Management Responses section.

We believe that the implementation of these recommendations will provide the State Bar with a stronger system of internal control while also making its operations more efficient. We will be happy to discuss the details of these recommendations with you at your convenience.

This communication is intended solely for the information and use of management, Audit Committee and the Board of Trustees, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully,

April 28, 2023

Our consideration of internal controls was organized in the following categories:

1. Accounts Payable and Cash Disbursements
2. Accounts Receivable, Cash Receipts and Licensee Billings
3. Fixed Assets
4. Investments
5. General Accounting and Financial Reporting
6. Payroll
7. Travel Cash Advance and Travel and Business-Related Expense
8. Procurement and Purchasing Cards
9. Information Technology Security Program and System Access Administration

On the following pages, we describe our observations and recommendations, State Bar's management responses (if applicable) and the internal controls identified for each subject. The tables of controls for each subject include a column to identify whether the control is automated or not. Automated controls are operations that are programmed to occur within an information technology (IT) system, either without human intervention or after a human triggered an operation to be performed, such as the clicking of a submit button. For example, the IT system automatically sends the timesheet to a supervisor to review and approve when an employee clicks the submit button.

## **1. Accounts Payable and Cash Disbursements**

### **Observations**

- Accounts payable and cash disbursements policies and procedures were updated during calendar year 2022.
- Check requests, purchase requisitions, and expense reports are automated forms reviewed and approved through workflow in Oracle.
- Supervisory review and approval is automated and documented through the use of workflow in Oracle.
- Finance performed monthly reconciliations of the payments recorded in the General Ledger (GL) to the closed Client Security Fund (CSF) cases. Supervisory review was not documented.

### **Recommendation**

The State Bar should consider documenting the supervisory review of the reconciliation of payments recorded in the GL to the closed CSF cases.

### **Management Response**

The State Bar agrees and will implement this recommendation to ensure supervisory review is clearly documented.

## Recommendations and Management Responses

Controls for Accounts Payable and Cash Disbursements		
#	Automated Control (Yes or No)	Controls
1	N	Checks in amounts of \$75,000 or above require the manual signatures of any two of the positions listed on the Financial Resolution 50-2 (July 2021).
2	N	All purchases require a purchase order except for items exempted in the Procurement Manual.
3	N	Any non-routine ACH payments not processed through Oracle need to be requested through the Office of Finance in writing.
4	N	Only the Finance Manager, Controller, or CFO are authorized to initiate non-routine ACH.
5	N	At the end of every month, the Finance representative receives a report of the AS400 data from the Client Security Fund (CSF) Program Supervisor and reconciles the payments recorded in the GL to the closed CSF cases.
6	Y	Oracle flags expenses and processes all outstanding expense reimbursement checks automatically during a system check run.
7	Y	Positive pay file is automatically generated and sent to the bank in order to pay the checks.
8	Y	ACH batch payment requires two approvers from the office of Finance. Authorized approvers are Finance Manager, Controller, CFO.
9	Y	There are 3 authorization levels: L1 Staff/Supervisor - Up to \$14,999; L2 Manager - \$15,000 to \$49,999; L3 Director/Executive - \$50,000 and above. Approval groups are setup and maintained in Oracle.
10	Y	The approver on a check request cannot be the payee or the requestor of the check request.
11	Y	The Oracle System automatically flags any duplicate entries to a single invoice number.
12	Y	Checks are automatically pre-numbered in sequence in the accounting system.
13	Y	All check requests must follow the Oracle organization approval flow in order to be issued.
14	Y	Check request approvers should be obtained at least one level higher than the check requestor in the department.
15	Y	Invoices/request for payment over the PO amount cannot be paid.
16	Y	Credits posted in Oracle must be approved by the AP Specialist to post.
17	Y	Access to the accounting application is restricted to end user by assigning security roles set in the accounting system.

## Recommendations and Management Responses

### 2. Accounts Receivable, Cash Receipts and Licensee Billings

#### Observations

- Accounts receivable, cash receipts and licensee billings policies and procedures were updated during calendar year 2022.
- Supervisory review and approval of bank reconciliations is documented through the use of workflow in Oracle.
- One instance of an accounts receivable write-off recorded during 2022 was not approved by the Chief Financial Officer (CFO). Per policy, accounts receivable write-offs should be approved by both the program director, Controller and CFO.

#### Recommendation

The State Bar should ensure that all three required approvers, the program director, Controller, and CFO, authorize accounts receivable write-offs in accordance with the established policies and procedures, otherwise, consider revising the policies and procedures to limit the authorization to either the "Controller or CFO", if that is deemed to be an appropriate level of oversight.

#### Management Response

The State Bar agrees and will implement this recommendation by revising its policies and procedures for accounts receivable to specify authorization for write-offs is required by either the Controller or CFO.

Controls for Accounts Receivable, Cash Receipts and Licensee Billings		
#	Automated Control (Yes or No)	Control
1	N	The Office of Finance performs independent reconciliations of the receivables billed and collected by Cushman & Wakefield (C&W) on a monthly basis and review monthly aging reports.
2	N	Accounts receivable write-offs should be approved by both the program director, Controller and Chief Financial Officer.
3	N	Licensee Billing & Collections department (LBC) staff reconciles the Wells Fargo bank statement with the deposit and creates the daily Journal Entry (JE) in ORACLE.
4	N	LBC supervisor does quarterly audits to ensure manual payments are posted in the KOALA Billing Application and the associated check deposited in the Wells Fargo Cash account.
5	Y	Once received by Lockbox, these checks are credited to the specific GL account associated with the lockbox via an automated reconciliation process between Wells Fargo Bank and ORACLE.
6	Y	LBC supervisors approves all JEs entered by LBC staff in Oracle.

## Recommendations and Management Responses

### 3. Fixed Assets

#### Observations

- Fixed assets policies and procedures were updated during calendar year 2022.
- No physical inspection was conducted in FY 2022 or in the past 3 – 5 years, as required by policy.
- For one disposal tested, written authorization was not obtained from the Office of Finance prior to disposition of capital assets, as required by policy.

#### Recommendations

The State Bar should consider:

- Ensuring physical inspections are conducted in accordance with policy and documented.
- Ensure staff are aware that written authorization is obtained from the Office of Finance prior to disposition of capital assets.

#### Management Response

The State Bar agrees and will ensure that staff in the Offices of Finance, I.T. and General Services work closely together to ensure Finance is aware of any disposition of assets and documentation is retained.

Controls for Fixed Assets		
#	Automated Control (Yes or No)	Control
1	N	All capital purchases should require advance written approval by authorized personnel and should be included in the capital budget.
2	N	Annual physical inspections are performed to confirm the existence of assets and to determine that all items are properly accounted for, any differences should be investigated in a timely manner. The Office of Finance will ensure that a physical inspection of State Bar assets is conducted every 3 to 5 years.
3	N	Written authorization should be obtained from the Chief Financial Officer prior to disposition of capital assets.
4	N	Detailed listings of the office's property and equipment should be reviewed and updated for any additions or deletions in a timely manner. Office heads should conduct periodic reviews of the list to ensure accuracy.
5	N	Useful life depreciation is straight line.

## Recommendations and Management Responses

### 4. Investments

#### Observations

- The Investments policy was updated during calendar year 2022.
- Supervisory review and approval of the custodian bank reconciliations is documented through the use of workflow in Oracle.
- The Office of Finance obtained a letter from the investment manager, Wells Fargo, related to SOC1 reports. No review of the letter or reports referenced in the letter were documented.
- The procedures and internal controls were included in State Bar's *Internal Control on Investments Memo*, November 1, 2022, which is a separate document from the Office of Finance's Investment Policy. The Investment Policy does not reference the documented procedures or internal control memo, and the internal control memo does not reference the Investment Policy.
- The State Bar's *Internal Control on Investments Memo*, November 1, 2022, did not include procedures and internal controls related to preparing and supervisory review of the quarterly report to the Board of Trustees.

#### Recommendations

State Bar should consider:

- Documenting the review of the SOC1 reports or related letters from the custodians and investment managers.
- Adding a statement in the Investment Policy to reference the separate document with procedures and internal controls.
- Include procedures and internal controls for preparing and supervisory review of the quarterly report to the Board of Trustees.

#### Management Response

The State Bar agrees with these recommendations. Management will revise the investment procedures memo to add reference to the Investment Policy. Further, the memo will incorporate additional details on the procedures and controls for preparing and reviewing the quarterly report to the Board.

Controls for Investments		
#	Automated Control (Yes or No)	Control
1	N	The State Bar shall annually obtain and review the System and Organization Controls (SOC1) reports of custodians and investment managers each year to ensure reliability of data and reports received.
2	N	The Chief Financial Officer will make quarterly reports to the Board of Trustees on the status of the State Bar's Investment portfolio.
3	N	Senior Financial Analyst prepares the quarterly report, supervisor approves and then CFO reviews and approves.
4	N	At the month-end, the Senior Financial Analyst reconciles the investment purchase or sale to the bank statement.



## Recommendations and Management Responses

Controls for Investments		
#	Automated Control (Yes or No)	Control
5	N	Purchase or a sale of security, the Financial Analyst or the Senior Financial Analyst prepares a Trade Settlement Letter. For the purchase or sale of money market fund, the Trade Settlement Letter is not required.

### 5. General Accounting and Financial Reporting

#### Observations

- The General Accounting and Financial Reporting policies and procedures were updated during calendar year 2022.
- Supervisory review and approval is automated and documented through the use of workflow in Oracle.

#### Recommendations

No recommendations noted.

Controls for General Accounting and Financial Reporting		
#	Automated Control (Yes or No)	Control
1	N	All bank reconciliations are reviewed and approved by the General Ledger (GL) Supervisor or the Controller.
2	N	The State Bar conducts a periodic review of its chart of accounts. The account listing is reviewed by the Finance Management Team, which consists of the CFO, the Controller, the Finance Manager and Principal Financial Analysts.
3	N	New accounts and cost centers are requested via email by the Finance Manager or the Controller to the Principal Financial Analyst. The Principal Financial Analyst confirms creation to the Finance Manager or Controller in writing. The Finance Manager or the Controller maintains a log of created cost centers, business units and accounts.
4	Y	Only the Office of Finance and the Admissions Fiscal Service Specialist have access to enter journal entries into the Oracle system.
5	Y	Staff does not have access to post or reverse their own journal entries in the Oracle system without supervisor approval.
6	Y	Journal Entry batches created by Financial Analyst are reviewed by the Senior Financial Analyst or the Principal Financial Analyst or the Controller. Batches created by the Senior/Principal Financial Analyst are reviewed by the Controller, the Finance Manager or the CFO.
7	Y	All journal entries must be signed by both the preparer and appropriate approver from the business unit and department involved.

## Recommendations and Management Responses

Controls for General Accounting and Financial Reporting		
#	Automated Control (Yes or No)	Control
8	Y	Monthly adjusting entries must be approved by either a Finance Supervisor, the Controller or the Finance Manager. The accounting system provides evidence of review once the Journal Entry batch is approved for posting.
9	Y	Quarterly close - the review of all recorded transactions is evidenced by signing off in Oracle at the level that the review occurred. For instance, the Senior Financial Analyst or Principal Financial Analyst signs off on Journal Vouchers prepared by the Financial Analyst and the Controller signs off on review of Journal Vouchers prepared by the Principal Financial Analyst.
10	Y	Year-end adjustments must be reviewed and approved by either the GL Supervisor, the Controller or the Finance Manager. They evidence the review by approving the journal entries for posting in Oracle.
11	Y	New accounts and cost centers can only be added by Principal Finance Analysts in the Oracle System.
12	Y	All Journal Vouchers submitted to the Office of Finance must be reviewed by the GL Team prior to entering the accounting system.
13	Y	Once an accounting period is closed in the Oracle GL module, it will not be reopened.
14	N	Journal voucher that is incomplete, incorrect, has inappropriate approval, or insufficient information and supporting documentation, will be returned to the preparer for correction.

## Recommendations and Management Responses

### 6. Payroll

#### Observations

- The Payroll policies and procedures were updated during calendar year 2022.
- Supervisory review and approval is automated and documented through the use of workflow in Oracle.
- The Payroll policies and procedures do not reference or describe the monthly payroll bank account reconciliations that are performed.
- For two samples tested, documentation of the Controller's or CFO's approval to remit payroll was not provided. Per policy, a screenshot of the written approval from the Controller or CFO to remit payroll is saved to the Final Analysis excel sheet as support.
- For terminated employees, Human Resources (HR) changes the employees' status to inactive in the HCM module of Oracle. Per policy, HR cancels terminated employees' direct deposit account after their last paycheck.

#### Recommendations

The State Bar should consider:

- Adding the monthly bank reconciliations to the policies and procedures.
- Ensuring documentation is maintained of the Controller's or CFO's approval to remit payroll.
- Updating the policies and procedures to change the information about canceling direct deposit for terminated employees to changing their status to inactive.

#### Management Response

The State Bar agrees with these recommendations. Management will revise the payroll policies to include reference to reconciliations. In addition, Finance management will ensure documentation is always maintained as proof of approval to remit payroll. HR management will update its policies and procedures to reflect the process of changing terminated employees' status to inactive.

Controls for Payroll		
#	Automated Control (Yes or No)	Control
1	N	Any data change in the payroll system must be substantiated by necessary documentation.
2	N	All changes in employment status (additions and terminations), salary and wage rates and employee deductions should be properly authorized, approved and documented in writing by Office of Human Resources (HR).
3	N	Final Activity Report is sent to the Controller or the CFO for final review and payroll remittance approval. Once reviewed, a written approval from the controller or the CFO is sent back to the Payroll Team authorizing to submit the payroll. A screenshot of the written approval is saved to the Final Analysis excel sheet for support.
4	N	HR reviews the activity report for any changes or adjustments.
5	N	The GL Senior Financial Analyst or Financial Analyst performs monthly bank reconciliation.

## Recommendations and Management Responses

Controls for Payroll		
#	Automated Control (Yes or No)	Control
6	N	Completed tax reconciliation sheet is sent to the Controller or CFO for review and written approval.
7	N	For those employees with direct deposit, the direct deposit account is canceled after the last paycheck to ensure the money cannot be deposited into a terminated employee's account.
8	Y	All employees must submit timecards to their department supervisor or managers, to reflect hours worked for the pay period, on a bi-weekly basis.
9	Y	All timecards and payroll change forms must be approved prior to any payroll processing by the supervisors, managers or the Office of Human Resources.
10	Y	When an employee is absent and has not submitted his timecard, the manager tries to contact the employee and prepares a substitute timecard for that employee. If the supervisor is unable to contact the employee, the Manager fills out the timecard based on the employee's schedule.
11	Y	The employee's manager or his designee reviews and approves the time entries in Oracle. Manager's timecards are reviewed by the Manager's supervisor.
12	Y	If the approving manager is out of the office, timecard(s) will be approved by the next line manager.
13	Y	Finance's Payroll folder with restricted access only to the payroll financial analyst, the senior payroll financial analyst, the controller and the chief financial officer.
14	Y	Changes to the Employee Master File must be processed and approved by HR.
15	Y	Salary changes are entered into Oracle by the Office of Human Resources.
16	Y	Payroll physical checks are signed by the printer using a signature plate of the bank's authorized signer.

### 7. Travel Cash Advance and Travel and Business-Related Expense

#### Observations

- The Travel Cash Advance Policy and Procedures was not dated.
- The Travel and Business-Related Expense Policy was dated January 2, 2021.
- Expense reports are automated forms reviewed and approved through workflow in Oracle.
- Supervisory review and approval is automated and documented through the use of workflow in Oracle.

#### Recommendations

No recommendations noted.

## Recommendations and Management Responses

Controls for Travel Cash Advance and Travel and Business-Related Expense		
#	Automated Control (Yes or No)	Control
1	Y	All travel advances must be approved by General Services in Oracle.
2	N	Traveler is responsible for submitting an approved Expense Report, showing the per diem claimed, as well as the other expenses involved in the settlement of the advance.
3	Y	Cash advances must be approved by traveler's immediate supervisor, manager or other authorized designed for that cost center.
4	Y	For cash advances, expenses and Purchasing Card charges, employees must submit an expense report through Oracle and approved by employee's direct reporting hierarchy within their area.
5	N	Expense reports and receipts audited by Procurement.

### 8. Procurement and Purchasing Cards

#### Observations

- The General Procurement Manual was updated March 24, 2021.
- Purchase requisitions and expense reports are automated forms reviewed and approved through workflow in Oracle.
- Supervisory review and approval is automated and documented through the use of workflow in Oracle.
- The requisition form was automated within Oracle during calendar year 2022. However, the General Procurement Manual was not updated until February 2023.
- For two purchasing card transactions greater than the \$5,000 purchasing limit, the temporary increases were not approved by the Chief Administrative Officer (CAO). Per policy, credit limits over \$5,000 require approval of the cardholder's Department Head and CAO.

#### Recommendations

The State Bar should consider ensuring all credit limits over \$5,000 are approved by the CAO or adding procedures for temporary increases to purchasing card limits that do not require approval from the CAO.

#### Management Response

The State Bar agrees with this recommendation. Temporary increases to accommodate special, one-time purchases over \$5,000, as opposed to an ongoing credit limit over \$5,000, were processed based on approval from the cardholders' office directors. Going forward these one-time requests will also be sent for approval by the CAO.

## Recommendations and Management Responses

Controls for Procurement and Purchasing Cards		
#	Automated Control (Yes or No)	Control
1	N	Purchase Orders are issued by Procurement only after the receipt of a valid completed Procurement Requisition. Users must complete the electronic version online and print a single copy for authorization before sending to Procurement. The Procurement Requisition form must be completed and delivered with supporting documents to Procurement. Purchase Orders will not be issued and contracts will not be signed until all requirements are met.
2	N	Procurement card (pcard) purchases will be limited to \$5,000 for most cardholders. Credit limits over \$5,000 require approval of the Chief Administrative Office in addition to the cardholder's Department Head.
3	Y	Pcard transactions must be reviewed and reconciled in Oracle. Pcard Expense Reports must be verified for accuracy and properly approved by the responsible approver, during the designated approval period at the end of each billing cycle.
4	N	Procurement will audit [pcard] statements for senior management, as well as for those Pcard users who have had reported audit issues from previous periods, on a monthly basis. Statements for all others will be audited on a random sampling basis. Procurement will report any audit issues to cardholders, department heads, and the Executive Director for resolution. (Open Audit Issues report)
5	Y	Procurement requisitions must be approved by the requestor's supervisor/manager based on Signature Authorization on file. (There are 3 authorization levels: L1 Staff/Supervisor - Up to \$14,999; L2 Manager - \$15,000 to \$49,999; L3 Director/Executive - \$50,000 and above. Approval groups are setup and maintained in Oracle.)
6	Y	Procurement requisitions must be approved by: If sole source exemption is requested - Chief Administrative Officer.
7	N	Procurement requisitions must be approved by: If capital asset (equipment > \$5,000) – Finance Director or designee.
8	Y	Procurement requisitions must be approved by: If computer hardware, computer software, or telecommunications equipment – IT Director or designee.
9	N	Procurement requisitions must be approved by: If furniture, building furnishings, electrical appliances - General Services Director or designee.
10	Y	Procurement requisitions must be approved by: For custom contracts, legal review (if necessary) – General Counsel Attorney (as assigned).

Pages 13-15 of the report have not been publicly posted as they contain confidential information.