THE STATE BAR OF CALIFORNIA

Report to the Board of Governors

For the Year Ended December 31, 2008

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For the Year Ended December 31, 2008

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The Board of Governors
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) for the year ended December 31, 2008, 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 our auditing procedures for the purpose of expressing our opinion on the 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.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, we consider the deficiency described as item 2008-01 in the Current Year Recommendations section to be a significant deficiency in internal control over financial reporting. We also noted other matters and recommendations that we believe warrant your consideration in improving controls.

A *material weakness* is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses.

The State Bar's written responses to the findings identified in our audit are described in the Current Year Recommendations section. We did not audit the State Bar's responses and, accordingly, we express no opinion on them. In addition, we would be pleased to discuss the recommendations in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing these recommendations..

In addition, we have included in this letter a summary of communications with the Board of Governors as required by auditing standards generally accepted in the United State of America. We would also like to thank State Bar management and staff for the courtesy and cooperation extended to us during the course of our engagement.

The accompanying required communications, comments and recommendations are intended solely for the information and use of the Board of Governors, State Bar management and others within the State Bar and are not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & O'Connell LLP

Certified Public Accountants

Walnut Creek, California
April 24, 2009

THE STATE BAR OF CALIFORNIA

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REQUIRED COMMUNICATIONS

Professional auditing standards require auditors to communicate with the audit committee, or its equivalent, on a number of subjects. The following information satisfies these requirements, and is solely for use of the State Bar of California (State Bar) Board of Governors and management.

I. Our Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our audit plan dated November 21, 2008, our responsibility, as described by professional standards, is to express an 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. Our audit of the financial statements does not relieve you or management of your responsibilities.

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of the State Bar. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

II. Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our audit plan dated November 21, 2008.

III. Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the State Bar are described in Note 3 to the financial statements. As described in Note 3 to the financial statements, the State Bar changed accounting policies related to other postemployment benefits and pension benefits by adopting Statements of Governmental Accounting Standards (GASB Statements) No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, No. 45, *Accounting and Financial Reporting by Employers for Postemployement Benefits Other Than Pensions,* and No. 50, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, in 2008. Accordingly, the cumulative effect of the accounting change as of the beginning of the year is reported in the Statement of Revenues, Expenses and Changes in Net Assets. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

REQUIRED COMMUNICATIONS (Continued)

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Depreciation estimates for capital assets, including depreciation methods and useful lives assigned to depreciable assets;
- Accrual of sick leave and vacation payable; and
- Accrual and disclosure of pension and other postemployment benefits.

Management's estimates were based on the following:

- Useful lives for depreciable assets were determined based on the nature of the capital asset. The State Bar uses the straight-line method of depreciation.
- Sick leave and vacation payable is based on unused employees sick leave and vacation and the employees' pay rates at year-end.
- The liabilities for pension and other postemployment benefits were based on actuarial evaluations using historical financial information and other data.

We evaluated the key factors and assumptions used to develop these accounting estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were pension benefits, other postemployment benefits, and contingencies. The disclosures of pension benefits and postemployment benefits in Note 7 and Note 8 to the financial statements, respectively, are based on actuarial evaluations. The disclosure of contingencies in Note 9 to the financial statements is based on management and legal counsel judgment about the ultimate outcome of claims.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

REQUIRED COMMUNICATIONS (Continued)

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated April 24, 2009.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the State Bar's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the State Bar's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

CURRENT YEAR RECOMMENDATIONS

Significant Deficiency #1
2008-01 Rental Income

Observation:
In September 2008, the State Bar management discovered a suspected fraud in which the former Director of Real Property misappropriated tenant rental and related payments. Internal and external investigations concluded that the embezzlement occurred over a period of approximately 9 years, beginning in January 2000, affected multiple tenants, and resulted in an estimated loss of $655,000, of which $80,450 related to fiscal year 2008. The fraud was a result of a lack of segregation of duties over the rental income cash collection process, where the former Director of Real Property was responsible for negotiating with and contracting tenants and collecting security deposits and rental payments.

During our audit we noted that the Office of Finance implemented the recommendations of the consultant hired to evaluate the cause of the fraud, confirm management's estimate of the losses, and recommend improvements to the internal controls over the rental payment transactions. We also noted that the consultant was further engaged to evaluate the controls over other cash collection processes and made additional recommendations for improvements to mitigate the risk of fraud.

Recommendation:
We recommend that the State Bar management implement the recommendations made by the consultant and develop procedures for monitoring implemented controls to ensure risks of errors and fraud are mitigated.

Management Response:
We agree with this recommendation. Finance and Operations staff have completed all the recommendations included in the internal audit of rental billing and collection procedures performed by the consultant Kevin W. Harper, CPA.

The Audit Committee of the State Bar has also contracted with Kevin Harper to assist the State Bar in identifying and implementing a process for State Bar personnel to 1) assess and monitor risks, 2) assess the adequacy of related controls, and 3) identify efficiencies and inter-departmental coordination for each of the State Bar's major processes (receipts, procurement/disbursements, payroll, budgeting, grants, treasury and financial reporting). Through this process, key personnel will receive training in identifying risks to the organization, understanding how internal controls help the State Bar manage those risks, and understanding their role in those control procedures.

CURRENT YEAR RECOMMENDATIONS (Continued)

Other Matter #1
2008-02 Employee Termination Process

Observation:
During our assessment of internal control, we noted that the Human Resource Department (HR) generates a weekly activity report informing the Information Technology Department (IT) of new hires and terminations. However, we also noted that IT does not maintain a master list of the user access rights of the State Bar employees. It is the responsibility of management of each individual department to notify IT of what systems and access levels a terminated employee had, which is currently an informal process.

Recommendation:
We recommend that the State Bar develop a formal process to immediately notify IT of an employee's termination. We also recommend that IT, with the assistance of department management, develop and maintain a master list of employee user access rights for all systems. This list should be used to efficiently facilitate the complete removal of access to all systems for terminated employees. Finally, the weekly activity report generated by HR should be used as a monitoring tool to ensure the termination process was effective.

Management Response:
We agree with this recommendation. HR will work with IT to implement this recommendation.

Other Matter #2
2008-03 Client Security Fund

Observation:
Due to the sensitive nature of the activity of the Client Security Program, disbursements made from this program are not subject to the same controls as all other disbursements made by the Office of Finance. Though control sheets are provided to the Office of Finance authorizing the disbursement, detailed documentation supporting these disbursements is maintained decentrally by the State Bar's office in Los Angeles, California, and is not provided to the Office of Finance for review. After the checks are prepared by the Office of Finance, they are sent to the Los Angeles office to be logged and mailed to the recipients. Our evaluation of this process indicates a potential deficiency in segregation of duties due to the decentralized operation and limited control the Office of Finance has over these disbursements, which amount to approximately $5 million per year. In addition, there is a potential risk that checks could get lost in transit from the State Bar's San Francisco office to its Los Angeles office.

Recommendation:
To mitigate a potential conflict in segregation of duties and risk of lost checks, we recommend that the State Bar's Office of Finance log and mail the Client Security Program payments directly to the recipients.

Management Response:
We agree with this recommendation. Effective May 11, 2009, Client Security Program staff will provide the Office of Finance with claimant addresses and supporting documentation for all claim payment requests. Claim payment checks will be mailed directly from the Office of Finance. Finance staff will keep a log for returned and voided claim payment checks, and a monthly reconciliation of claim payments to the closed claim report will be continued.

CURRENT YEAR RECOMMENDATIONS (Continued)

Other Matter #3
2008-04 Intangible Assets
(Informational)

Observation:
In June 2007, the Governmental Accounting Standards Board (GASB) issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets,* to establish accounting and financial reporting guidance related to amortization of intangible assets to reduce inconsistencies, thereby enhancing the comparability of the accounting and financial reporting of such assets among state and local governments. This Statement requires that all intangible assets, unless specifically excluded by its scope, be classified as capital assets. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets and guidance on determining the useful life of intangible assets when the length of their life is limited by contractual or legal provisions.

The State Bar will be required to retroactively report intangible assets, except for those considered to have indefinite useful lives as of the effective date of this Statement and those that would be considered internally generated.

Recommendation:
We encourage the State Bar take the following steps prior to the effective date of this statement:

- Identify intangible assets that are impacted by the new rules;
- Determine the useful life of the intangible assets, if the length of life is limited by any means; and
- Determine the amortization of such assets identified.

The State Bar is required to implement GASB Statement No. 51 for the year ending December 31, 2010. Early implementation is encouraged by GASB.

Management Response:
We agree with the recommendation. Finance staff will develop processes and procedures to identify intangible assets, including consultant fees and in-house IT staff costs for future computer software development, implementation and upgrades. Finance staff will also review all assets to identify any such assets that will be impacted by this statement prior to end of the year.

STATUS OF PRIOR YEAR RECOMMENDATIONS

Reference	**2007-01 Risk Assessment and Monitoring over Financial Reporting**
Recommendation	We recommend that the State Bar expand upon its existing internal control assessment process and formalize a comprehensive risk assessment plan, which includes monitoring the adequacy and effectiveness of internal control procedures. This risk assessment should be evaluated at least annually to consider changes in the State Bar's operating environments.
Status	In progress. Beginning in February 2009, the State Bar initiated a comprehensive risk assessment project that is being facilitated by Kevin Harper, CPA. This project will encompass an evaluation of all the State Bar's major control procedures. Any improvements to the control environment will be documented and a process will be established to ensure that internal controls are regularly evaluated.

Reference	**2007-02 Logical Security – Automatic Timeout**
Recommendation	We recommend the State Bar institute and enforce a policy of automatically locking a user out of the network or ending the financial application session after a set period (five to ten minutes) of inactivity. The automatic lock function in Windows prevents unauthorized users from unlocking the system and viewing or accessing any open files or programs. Only the authorized user or the system administrator can unlock the current session by pressing Ctrl+Alt+Delete to input the correct username and password. This requirement will also increase security by preventing certain virus programs that masquerade as a system logon program to retrieve usernames and password information that the writer of the virus program can later use to break into the system.
Status	Implemented.

Reference	**2007-03 Allowance for Doubtful Accounts Methodology**
Recommendation	We recommend that the State Bar revisit its current policies for establishing the allowance for doubtful accounts to develop an adequate methodology in accordance with U.S. generally accepted accounting principles. The State Bar may use historical collection experiences to determine the net realizable value of its receivable balance at year-end. The policies should be clearly documented and used to analyze and adjust this balance during the annual financial reporting process.
Status	Implemented.

Reference	**2007-04 Client Security Fund Claims Liability**
Recommendation	We recommend that the State Bar revisit its current methodology to analyze the impact of IBNR claims. Management should review historical claims experience to analyze the number and amount of claims reported after the year of occurrence to estimate IBNR for reporting purposes.
Status	Analysis completed. A Client Security Fund actuarial study was completed in 2008 to review historical claims experience and provide an estimate of IBNR. At the completion of the study, staff determined that reporting IBNR in the Bar's financial statements was not necessary due to the discretionary nature of the program.

STATUS OF PRIOR YEAR RECOMMENDATIONS (Continued)

Reference	**2007-05 Comprehensive Business Continuity Plan**
Recommendation	We recommend that the State Bar finalize and adopt the business continuity plan to document polices and procedures to be followed when disruptions occurs to mitigate the impact of disruptive events on essential business processes and network functions and to lower costs or losses arising from such events. The business continuity plan should also include the method of operations to be followed while the system is inoperable, how data should be collected during system down time for later recovery and what steps the users must follow once the system is operational to ensure all data collected is accurately entered and the system brought up to date. Once adopted, the business continuity plan should be clearly communicated to all management and staff to demonstrate a clear commitment to establishing and maintaining an effective business continuity planning process. The individuals involved in the critical path should be fully trained and informed on the significance and extent of the recovery operation and the tasks for which they are responsible to ensure that those critical activities receive the highest priority. Furthermore, management should evaluate and test plan procedures periodically with the results of the tests incorporated as updates to the plan to address changes in business operations.
Status	In progress. In 2007, the Legislature gave the State Bar the authority to charge members $10 each year for three years. Information Technology is using this money for a complete refresh and redesign of its service configuration. In prior years, there was sufficient capacity and infrastructure between the Los Angeles site and the San Francisco site to provide some level of service continuity between the sites. With the pace of the dramatic technology changes that have been implemented, Information Technology will be taking a fresh look at IT services continuity that better correlates to the new infrastructure. The State Bar determined that it would be a waste of effort to update a continuity plan that could not reflect the operational realities of our changing infrastructure. To date, IT has implemented a new AS-400, new desktop PCs and has completed about 40% of a new consolidated and virtualized server environment. This new environment requires a fresh and alternative look at Business Continuity. The Business Continuity plan will need to be refreshed to reflect the significant changes in the operating environment. The State Bar will be engaging an outside consultant in the fall of 2009 to assist with both the IT component of a Business Continuity Plan as well as to assist the Business Units in their piece of such a plan.

STATUS OF PRIOR YEAR RECOMMENDATIONS (Continued)

Reference	**2007-06 Postemployment Health Care Benefits**
Recommendation	We encourage the State Bar take the following steps prior to the effective date of these new rules: • Consult with the State Bar's actuary to quantify the potential impacts of the new rules; • Research opportunities to reduce costs; and • Start/continue dialogue between affected parties (e.g., finance, benefits staff and governing board). GASB No. 45 is effective for the year ending December 31, 2008. The State Bar is currently working with its actuary on its implementation strategy.
Status	Implemented.

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SCHEDULE OF UNCORRECTED MISSTATEMENTS

Account Description	Debit	Credit
Outside Printing Expense	$ 84,818	
Beginning Net Assets		$ 84,818
(To record current year expense that was incorrectly accrued in prior year.)		
Interest Receivable – LAIF	$251,544	
LAIF		$251,544
(To reclassify cash/cash equivalents to interest receivable for current year LAIF interest received after year-end.)		