



THE STATE BAR OF CALIFORNIA

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Date: July 2, 2009 **Item IV. A**
To: Audit Committee
From: Office of Finance
Subject: Implementation of Recommendations in Risk Scan Internal Control Assessment - Update

Background:

In November 2008, the Audit Committee contracted with the firm of Kevin Harper, CPA & Associates to perform an independent high level scan for weaknesses in the Bar's internal controls over its major financial processes. Mr. Harper presented the results of his review to the Committee at its May 2009 meeting. Staff also presented management's comments and proposed action plan to address the recommendations outlined in Mr. Harper's report.

Following the presentation, the Committee voted to accept certain changes and clarifications that Mr. Harper proposed to management's action plan. This memo will provide the Committee with management's revised action plan and an update on its implementation of the risk scan's recommendations.

Revisions to Management's Action Plan:

Several additional tasks and clarifications have been added to management's action plan. By category, these revisions include:

Policies and Procedures (page 7 of management's action plan):

- 5b. *The Executive Director's office will index existing administrative advisories into an administrative manual that will be available on the Bar's intranet. The addition of this task fully addresses Mr. Harper's recommendations that the Bar's policies and procedures are available to all employees on the Bar's intranet site.*

Risk Assessment (page 8 of management's action plan):

- 6b. *The Senior Executive Team has global responsibility for performing a risk assessment and will work together to identify key risks to the Bar, match controls to mitigate those risks, and identify areas of potential exposure to*

the Bar. This item has been added to clarify the approach that management will take to perform this overall risk assessment.

Internal Audit (page 10 of management's action plan)

- 8a. *The Audit committee has adopted an outsourced internal audit function.* This change acknowledges the Committee's decision to adopt an outsource internal audit function rather than adopt management's proposal to use business process re-engineering approach.

Business Expense Accounts (page 12 of management's action plan)

- 11b. *Finance will establish a regular reporting cycle for business expense costs. The Deputy Executive Director and the Chief Financial Officer will regularly review business expense.* This task identifies the individuals who will be responsible for reviewing business expenses.

Segregation of Duties (page 13 of management's action plan)

- 12b. *Finance will review employee access to the Bar's financial systems and verify that proper segregation of duties exists.* This is an additional task recommended by Mr. Harper.

Status of Recommendations:

Target dates have been established for the 41 individual tasks identified in management's action plan. To date, management is on track to complete the tasks within their individual target date. The specific tasks and the status of each begin on page 25 of the action plan.

Next Steps:

Staff will provide regular updates of the status of management's action plan at each Audit Committee meeting.

The State Bar of California

RiskScan Internal Control Assessment

Management Comments & Action Plan

5/1/2009

Updated: 7/1/2009

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INTRODUCTION

On December 22, 2008, the Board of Governors of the State Bar of California contracted with Kevin Harper & Associates, Inc. (hereafter KHA) to perform an independent, high-level scan for significant weaknesses in the State Bar's internal controls over its major financial processes (cash receipts, cash disbursements and procurement, payroll, budgeting, grants, treasury, and financial reporting). In conducting the RiskScan, KHA operated under the direction of the Audit Committee of the Board of Governors, independent of State Bar management.

On March 5, 2009, KHA presented the draft "Internal Control Assessment" report to the Audit Committee. The Audit Committee subsequently directed State Bar management to prepare a response to the draft report, including comments on the draft's findings and proposed actions on the draft's recommendations. This document represents management's response.

This document is organized to mirror the structure of the KHA draft report. The draft report contains two major sections, titled "Findings and Recommendations" and "Other Control Issues," each of which is further sub-divided into more specific topics. This document parallels these sections and sub-divisions, making it easy to read the draft report and the response side-by-side.

In addition, management's proposed actions, which are discussed throughout this document in conjunction with the KHA recommendations, are collected and summarized in a concluding section titled "Action Plan."

**RESPONSES TO
FINDINGS & RECOMMENDATIONS**

1. Mailed Cash Receipts

KHA Recommendation: “The State Bar should consider centralizing the opening of mail. Mailroom employees should open all mail, remove all checks and make a log of incoming checks. The log should be made available on a shared drive or intranet site so that all divisions can see checks. Prior to centralizing, a test should be performed to determine what information is needed on the check log to allow proper account coding of cash receipts. It may be necessary to scan or photocopy all checks to assure proper account coding, or for research or audit trail reasons. If the State Bar decides not to centralize opening of mail in the mailroom, then each division should be required to centralize their own mail opening, with the same procedures as described herein.”

Managements Comments: The State Bar receives a large volume of mail on a daily basis, and a only relatively small fraction contains checks. Moreover, as noted in the KHA draft, checks directly mailed to the State Bar account for a relatively small share of a typical day’s revenue collections. From a cost-benefit standpoint, we believe that decentralized mail opening, supplemented with tighter procedures as recommended, is the preferable approach. In addition, we believe that tightened procedures should be focused on the relatively small number of offices which frequently receive checks. Finally, we hope to further diminish the scope of this risk by continuing to move in the direction of accepting more payments electronically and online.

Management’s Proposed Actions:

- 1a Finance is currently working with State Bar departments to identify and document the specific offices which receive a meaningful volume of mail-in checks (in terms either of quantity or total dollar amount).

Status: Underway
Target: July 31, 2009

- 1b Finance will provide each office thus identified with a written procedure for the opening of mail, including (i) restrictive endorsement of checks, (ii) logging of checks, (iii) prompt transmittal of checks to Finance for deposit, and (iv) any additional control measures necessary and appropriate to the particular office and types of payments involved. The procedure will ensure that individuals handling inbound checks do not have the ability to modify corresponding accounting records (see Recommendation #12).

Status: Pending completion of 1a

Target: September 30, 2009

- 1c Senior executives will confirm that the mail handling procedures have been implemented within their respective areas of responsibility.

Status: Pending completion of 1b

Target: October 30, 2009

2. Budget

KHA Recommendation: "State Bar management should define and communicate the level of budgetary control managers are responsible for meeting. Divisions should be held accountable for budget compliance by monitoring their budget to actual results on a regular basis. Since costs for salaries and benefits are monitored and managed on a State Bar-wide level, division managers and business unit managers should be accountable for non-personnel costs. The Office of Finance should establish budget blocks and a mechanism to link purchase orders to the budget. The Office of Finance should conduct training for all managers on budget vs. actual analysis and accessing reports available in the PeopleSoft system"

Management Comments: We fully agree that budgetary compliance requirements should be duly communicated and monitored on a regular basis. At the same time, we continue to regard the ability of a responsible manager to hold authorized positions vacant and to use the savings thus achieved to meet appropriate program objectives as a normal part of the exercise of managerial discretion. Managers should not be required to spend money on full-time staff if it can be better used in other ways.

System-imposed budget "blocks" can tighten the budgetary control mechanism very effectively, but also have costs in terms of implementation effort and ongoing administrative requirements. Some cost-benefit balancing is therefore needed to ascertain whether the desired degree of control can be met cost-effectively through enhanced reporting and training, or whether fully automated "blocks" are required.

Management's Proposed Actions:

- 2a Finance will prepare a written budget control policy specifying the level of budgetary control managers are expected to meet and the scope of their discretion, for adoption by the Senior Executive Team (SET).

Status: To Do

Target: July 31, 2009

- 2b Finance and IT will review and consider the feasibility and cost-benefit implications of implementing encumbrance accounting or other method of tracking commitments (such as contracts and purchase orders) against budgets.

Status: Underway
Target: September 30, 2009

- 2c Finance will be provided with the name of a budget liaison from each department. Finance, in cooperation with IT as needed, will provide the designated liaisons with training on the use of existing PeopleSoft reports and inquiry tools.

Status: To Do
Target: December 31, 2009

- 2d Finance, in cooperation with IT, is currently investigating the feasibility of alternative reporting tools to prepare more user-friendly budget reports.

Status: Underway
Target: December 31, 2009

- 2e Finance will investigate the implementation of automated budget “blocks” and report on the matter to the Senior Executive Team. SET will determine whether the added benefits outweigh implementation and ongoing administrative costs and direct subsequent implementation actions as needed.

Status: Pending completion of 2a
Target: October 31, 2009

3. Payroll System

KHA Recommendation: “The State Bar should invest sufficient resources to identify and fix the PeopleSoft payroll system errors. Alternatively, the State Bar should perform a cost/benefit analysis related to outsourcing of payroll. Benefits of outsourcing may include saving a significant portion of the consultant’s costs and immediate access to a sophisticated, reliable and user friendly system. Costs of outsourcing may include integrating the payroll provider’s information into the PeopleSoft financial system.”

Management Comments: The State Bar is currently in the process of identifying and remedying implementation issues related to the PeopleSoft system. However, the need will likely be for an ongoing process of tracking, testing and deploying Electronic Software Upgrades (“ESUs”) as they become available from Oracle in the context of our implementation environment, rather than for a one-time “fix.”

It should be noted that the consultant currently working in the HR area is primarily a business analyst working to implement HR best practices in the State Bar – which leverage the related capabilities of our system – rather than working on system maintenance *per se*.

Management's Proposed Actions:

3a IT, Finance and Human Resources will continue to work together to identify known issues in the payroll system and execute an action plan for their resolution.

Status: Underway
Target: June 30, 2009
Update: Complete

3b IT, Finance and Human Resources are currently developing an ongoing maintenance plan for the existing payroll system, identifying the roles and responsibilities of staff in those departments. The plan encompasses the full cycle of monitoring the availability of ESUs, testing, evaluation, and application of ESUs, and an estimate of the resources necessary in each area to support the cycle.

Status: Underway
Target: July 31, 2009

3c IT, Finance and Human Resources are assessing the feasibility of partial or full outsourcing of the software support for payroll and HR functions, paying due attention to the operational needs of both HR and payroll functions and the issue of data integration with the State Bar's remaining in-house systems.

Status: Underway
Target: December 31, 2009

4. Travel and Expense Reimbursements

KHA Recommendation: "Sections should be required to comply with the State Bar's travel and business expense reimbursement policy. Alternatively, State Bar management should develop and the Board of Governors should adopt a separate policy related to Sections travel and expense reimbursement. In addition, the State Bar should consider providing to Section members periodic financial reports showing how Sections members' voluntary fees are used."

Management Comments: The Sections foster the professional development of their members by providing both educational programs and networking opportunities. This dual mission should be borne in mind when evaluating whether particular events and expenditures are properly business-related. Attorneys are not required to become Sections members; they do so because they find that the events and services delivered are appropriate and valuable. Therefore, some modifications in the State Bar's travel and expense policies as applied to the Sections would appear reasonable, particularly in combination with enhanced accountability to Sections' members.

Management's Proposed Actions:

- 4a Member Services, with the assistance of the Office of General Counsel, will prepare modified travel and expense reimbursement policies applicable to the Sections, to be reviewed and adopted by the Senior Executive Team, and will define a format and a mechanism for periodic reporting of expenditures to Sections Members.

Status: Underway
Target: July 31, 2009

5. Policies and Procedures

KHA Recommendation: "The State Bar should prepare an electronic version of both a financial policies and procedures manual (including procurement) and an administrative manual. These manuals should be made available on an intranet site or shared drive to all employees and publicize their availability; the shared drive should include a table of contents and search capabilities to make them user friendly. Training should be provided to employees on all policies, procedures and advisories that are key to their responsibilities. Existing financial policies and procedures should be inventoried and supplemented as necessary."

Management Comments: Finance is working with the State Bar's Web Editor to consolidate all Finance materials that are currently available on the intranet under one Finance heading. This includes electronic finance forms, purchasing card materials, Travel and Business-Related Expense policy, and the Wells Fargo P-card link. Finance policies & procedures relating to accounts payable, cash receipting, financial reporting, fixed assets, procurement and travel advances will also be posted under this heading.

Beginning in February 2009, the Bar initiated a comprehensive risk assessment project that is being facilitated by Kevin Harper CPA. Employees from departments throughout the Bar are participating in workshops, discussing internal control procedures of the significant accounting functions, and gaining a shared understanding of the Bar's financial policies and procedures. These workshops are excellent opportunities for employees whose job responsibilities include maintaining internal controls in their individual departments. To date four work sessions relating to cash receipting have been conducted.

Management's Proposed Actions:

- 5a Finance is working with the State Bar's Web Editor to re-structure the State Bar's intranet to include a consolidated "Finance" heading under which financial policies and procedures can be accessed. This project is expected to be completed in May 2009.

Status: Underway

Target: May 29, 2009
Update: Completed

- 5b The Executive Director's Office will codify existing administrative advisories into an administrative manual that will be available on the Bar's intranet.

Status: To Do
Target: December 31, 2009

- 5c Finance (in conjunction with KHA) will continue to conduct Bar-wide workshops on its cash receipts control function. Training sessions will be conducted on all the Department's policies and procedures throughout the remainder of the year.

Status: Underway
Target: December 31, 2009

6. Risk Assessment

KHA Recommendation: "The State Bar's senior management should perform an identification and assessment of all the key risks affecting the State Bar's ability to meet its business objectives, safeguard its assets, operate efficiently and effectively, and comply with laws and regulations. They should implement a process to monitor the effectiveness of related controls and identify new risks as they arise. Major risks to be considered may include State oversight of regulatory vs. professional association activities, fraud loss, backlog of discipline cases and expenses growing faster than revenue increases authorized by State."

Management Comments: The Senior Executive Team meets weekly to discuss opportunities to improve operations and business practices while at the same time identifying risks facing the State Bar. We recognize the value of adopting a more formalized approach to guide and document this current and ongoing risk assessment practice.

Management's Proposed Actions:

- 6a The Executive Director has designated the State Bar's Director of Operations to act as the organization's Risk Management Officer, with responsibility for both traditional risk management (e.g. insurance and loss control) and for raising risk-related issues within the Senior Executive Team on an ongoing basis.

Status: Completed
Target: n/a

- 6b The Senior Executive Team has global responsibility for performing a risk assessment and will work together to identify key risks to the Bar, match controls to mitigate those risks, and identify areas of potential exposure to the Bar.

Status: To Do
Target: June 30, 2010

7. Code of Conduct

KHA Recommendation: “The State Bar should develop a written code of conduct that is applicable to all employee levels and aligned with existing policies and procedures. The Agency should also implement training or a process for communicating ethical behavior to employees.”

Management Comments: The State Bar is in the process of culling from its existing union agreements, rules of procedure and conduct, Administrative Advisories, and other sources the principles that constitute the code of conduct at the State Bar. This will be supplemented and issued in a stand-alone code of conduct in conformity with this recommendation.

Management’s Proposed Actions:

- 7a Human Resources is assembling a stand-alone written code of conduct based upon the State Bar’s existing union agreements, administrative advisories, and other sources, supplemented as appropriate, for review and adoption by the Senior Executive Team.

Status: Underway
Target: August 31, 2009

- 7b Human Resources will work with the Bar’s webmaster to publish the State Bar’s code of conduct on the Bar’s intranet, with or linked to its financial policies and procedures.

Status: Pending completion of 7a
Target: September 30, 2009

- 7c Human Resources will include the State Bar’s code of conduct in the State Bar’s annual management and supervisorial training materials.

Status: Pending completion of 7a
Target: December 31, 2009

8. Internal Audit

KHA Recommendation: "The State Bar should establish an internal audit function, which should report directly to the Audit Committee. An internal audit mission and procedures should be developed. The State Bar should determine whether to hire or outsource the internal audit function."

Management's Proposed Actions:

8a The Audit Committee has adopted an outsourced internal audit function.

Status: Underway
Target: Ongoing

9. Training

KHA Recommendation: "The State Bar should develop a formal training program for all its employees. This program should include for each employee:

- Assessment of the skills and knowledge needed to perform his/her job at a high level of competency
- Assessment of the current skills of the individual
- Identification of various development opportunities in the areas needed, including self-study, internal training, external conferences, college courses, personal development seminars, etc.
- Commitment between individual and mentor on which development opportunities will be scheduled
- Adequate funding of the training program
- Tracking of the individual's training progress
- Positive feedback and/or reward to individuals fully participating in the program

The staff training program should also ensure that more than one employee is trained for each key job in the event of turnover or other unavailability of employee.

The Offices of Finance, Information Technology and Human Resources should work together to develop and deliver to the divisions meaningful training related to use of administrative resources. Such training should include procurement, handling cash receipts, expense reimbursement, budgeting and accessing PeopleSoft.”

Management Comments: Management agrees that adequate and appropriate training is an important factor in enhancing organizational performance and ensuring proper internal controls. Management recognizes the importance of cross-training in particular, and, within the practical limits of budget and collective bargaining agreements, will work to enhance training opportunities.

Management’s Proposed Actions:

9a Within the limits of the budget and existing union agreements, Human Resources will support the development and effectuation of departmental training plans.

Status: Underway
Target: Ongoing

10. Decentralized Billing

KHA Recommendation: “As much as possible, billing of State Bar revenues should be centralized by preparing the invoices online using the PeopleSoft billing module. All invoices must have instructions to mail payments only to the State Bar address shown on the invoice. Note that certain programming and training will be required to make the billing module usable in a decentralized manner.

The Office of Finance should identify all invoicing that is being done by operating divisions (e.g., sales of member lists, CalBar Journal classified ads). The Office of Finance should develop written billing policies and procedures for operating divisions. An audit of the divisions’ billing procedures should be conducted periodically to ensure they are being followed.”

Management Comments: Management agrees with these recommendations.

Management’s Proposed Actions:

10a Operations will work with Finance to centralize invoicing of retail and office tenants.

Status: Completed
Target: n/a

- 10b Finance will survey the departments and prepare a complete list of all invoices and bills issued by the State Bar outside of Finance, along with the usual quantity of invoices and amounts (to assist in the evaluation of significance and priorities).
- Status: To Do
Target: August 30, 2009
- 10c Finance will recommend centralizing receivables and cash receipting where feasible.
- Status: Pending completion of 10b
Target: September 30, 2009
- 10d Finance will prepare a written invoicing policy governing any remaining decentralized invoicing, to be reviewed and adopted by SET. This policy will be published on the State Bar's intranet alongside other financial policies.
- Status: Pending completion of 10b
Target: October 31, 2009

11. Business Expense Accounts

KHA Recommendation: "The State Bar should refrain from using 'business expense' accounts or other purchasing mechanisms that do not provide definitive guidance related to inappropriate expenditure of public funds. If the need for these accounts is determined to be necessary, the State Bar should expand the existing policies and procedures to describe the types of disbursements allowed and unallowed, maximum amounts per transaction and per year, and distribution of related expenditure reports to the Chief Executive Officer, Chief Financial Officer and Audit Committee."

Management Comments: Management continues to believe that the business expense mechanism imparts a valuable flexibility – within well defined limits – to the State Bar's travel and expense reimbursement policies. That said, management agrees with the recommendation to expand the existing policy statement to provide more definitive guidance regarding the limits on the use of funds budgeted for business expenses.

Management's Proposed Actions:

- 11a The Office of General Counsel will enhance existing policy statements governing the expenditure of business expense funds, establishing appropriate limits and making clear that expenditures must be reasonably related to the State Bar's business or functions sponsored by the State Bar. The policy will be reviewed and adopted by the Senior Executive Team.

Status: Underway
Target: September 30, 2009

- 11b Finance will establish a regular reporting cycle for business expense costs. The Deputy Executive Director and the Chief Financial Officer will regularly review business expenses.

Status: Pending completion of 11a
Target: December 31, 2009

12. Segregation of Duties

KHA Recommendation: “The Office of Finance should identify all cases wherein State Bar employees have access to both assets and accounting records. In each of these cases, such duties should be adequately segregated. If, due to the State Bar’s relatively small staff size, duties cannot be fully segregated by division, then it is important to assure that (1) duties are segregated by individual within the division and (2) the lack of full segregation is communicated to division management, the Chief Executive Officer, the Chief Financial Officer and the Audit Committee.”

Management Comments: Management agrees with the importance of proper segregation of duties, and, in particular, that the State Bar should avoid situations in which an employee who physically handles payments (unendorsed checks) has the ability to modify the corresponding accounting records. (However, the mere ability to modify records *unrelated* to the payments handled does not necessarily constitute a significant risk in our view.) In general, we believe that this recommendation raises substantially the same issue as Recommendation #1, pertaining to handling of incoming mail.

Management’s Proposed Actions:

12a (see Management’s Proposed Actions 1b, above)

- 12b Finance will review employee access to the Bar’s financial systems and verify that proper segregation of duties exists.

Status: To Do
Target: December 31, 2009

13. Client Security Fund

KHA Recommendation: “Policies and procedures over CSF payments should be developed. Checks prepared by the Office of Finance should be mailed instead of returned to the requesting division. If it is determined that check requests should continue without providing settlement agreements to the Office of Finance, then a recurring internal audit of CSF payments should be scheduled.”

Management Comments: While substantial compensating controls have been implemented in this area to mitigate the risk, management agrees that it would be preferable for CSF checks to be mailed from Finance based upon copies of the signed orders.

Management’s Proposed Actions:

- 13a The Office of Chief Trial Counsel, the Office of General Counsel, and the CSF program director will review the issues impeding implementation of the this recommendation to ascertain whether they still apply or have become obsolete.

Status: Underway
Target: June 30, 2009
Update: Completed

- 13b If the restrictions no longer apply, CSF will work with Finance to implement the recommended procedure, under which CSF checks would be mailed directly by Finance to recipients, rather than being returned to the CSF program staff.

Status: Pending completion of 13a
Target: September 30, 2009
Update: Completed

RESPONSES TO OTHER CONTROL ISSUES

14. Control Environment

KHA Observations:

- (i) Most mission-critical IT applications are on AS400, which is no longer supported by the vendor
- (ii) The shared drive is not used to share information across all divisions because it is not organized
- (iii) There is no prioritized list of systems improvement requests from the Office of Information Technology that user divisions can monitor
- (iv) IT has no business analysts to help divisions understand and coordinate implementation of technology improvements
- (v) An IT strategic plan has been developed, but not yet adopted and funded
- (vi) There is no transparent link between administrative overhead divisions pay and the services they receive
- (vii) Administrative services departments do not proactively provide customer service to other divisions
- (viii) The Office of Information Technology is the only administrative services division that conducts customer service surveys. Other surveys should include purchasing, accounting, payroll, human resources and budgeting
- (ix) There is inconsistent interpretation of what reviews should be performed before signing as approver (e.g. for authorizing purchasing card reports, travel expense reimbursement requests, timesheets, cash balancing forms)
- (x) There is no record retention policy

Management Comments:

- (i) The IBM "i-Series" platform, the successor to the AS/400, continues to be supported by IBM and is in use in a wide variety of businesses worldwide. The State Bar's applications were migrated to the i-Series in 2008.
- (ii) Currently, the preferred approach to organization-wide information sharing is via the State Bar's intranet, because it offers superior administrative control and information-organization capabilities. In addition, the State Bar has an electronic document management system and a technology to support collaborative work on documents ("Collaboration Workroom"). The State Bar uses "shared drives" where appropriate, typically for department-level data sharing.
- (iii) IT does have a work request tracking system; it is expected that the system will be enhanced this year to allow user-department IT contacts to monitor the status and progress of their requests.
- (iv) As part of the 2009 Information Technology Strategic Planning process, the role of the Business Analyst was identified as a critical need for the Bar. Rather than a skilled Information Technologist, we view the business analyst as a key player within the department that can work with the department to identify business reengineering and improvement opportunities and bridge to IT to help craft solutions to meet them.
- (v) The IT Strategic Plan is in process, and funding remains a long-term issue. The immediate needs of the "technology refresh," as laid out in the plan, are being funded with the \$10/member special assessment and will be completed in early 2011 or before. The Business Systems Applications initiatives will be funded using some of the various funding strategies at the Bar's disposal possibly including but not limited to some self-funding, some additional membership assessment, and use of the existing Discipline fund and Technology Fund.
- (vi) The State Bar is in the process of revising its indirect cost allocation methodology, with the assistance of a consulting firm widely recognized in the field. This process is expected to improve the transparency and "explicability" of the indirect cost allocation.
- (vii) We believe that most internal service departments strive to strike an appropriate balance between being responsive to user requests and undertaking pro-active initiatives.
- (viii) Feedback from user departments is, of course, received on a daily basis by most internal service departments. However, management recognizes the value of more formal user surveys, subject to the usual balancing of costs and benefits.
- (ix) We expect that broader publication of finance-related policies via the State Bar's intranet, supplemented with management training, will help to resolve any inconsistencies of interpretation.
- (x) In 2008, the State Bar retained the services of ITAG to assist with the development of an overall State Bar records retention policy. This policy will cover both the physical document retention and more importantly the management of the logical record retention issues. We are working with each department to begin the process of implementing the Bar's record retention policy.

Management's Proposed Actions:

14a Finance will complete the update of the State Bar's indirect cost allocation plan in 2009.

Status: Underway
Target: December 31, 2009

- 14b IT will work with management of the Bar's operating departments to develop an effective organization-wide approach to the "business analyst" issue – i.e. the organization's capability to use technology effectively for business process improvement.

Status: Underway
Target: Ongoing

15. Cash Receipts

KHA Observations:

- (i) Cash in San Francisco is picked up by courier for deposit to the bank only twice per week
- (ii) Member Billing procedures don't cover waivers and amendments
- (iii) The employee in the Office of Information Technology who knows how to maintain Member Billing's Koala system does not have a backup
- (iv) Checks that the lockbox cannot process are not restrictively endorsed

Management Comments:

- (i) Beginning in May of 2009, the State Bar expects to install equipment which will allow daily electronic deposit of scanned checks, largely obviating the use of courier service and eliminating the delay in making deposits.
- (ii) There are procedures in these areas; coverage of these topics in written procedures is being improved.
- (iii) There are currently three individuals within the department of Information Technology that have the skills, training, and experience to maintain the Koala system.
- (iv) The State Bar is investigating alternative procedures (such as having the lockbox deposit checks it cannot process, while sending copies to Finance for resolution).

Management's Proposed Actions:

- 15a Finance will install equipment needed to scan and electronically deposit checks in San Francisco and Los Angeles.

Status: Underway
Target: June 30, 2009
Update: Completed

- 15b Member Billing will clarify written procedures pertaining to waivers and amendments.

Status: Underway
Target: August 28, 2009
Update: Completed

15c Finance will investigate alternative lockbox procedures which could eliminate "round-tripping" of checks.

Status: Underway
Target: September 30, 2009

16. Cash Disbursements/Procurement

KHA Observations:

- (i) Vendor checks are sometimes returned to requester instead of being mailed to vendor by the Office of Finance
- (ii) Duplicate payments are possible if divisions submit duplicate receipts under both purchasing card and travel reimbursement or purchase order process
- (iii) Division employees are not clear when they should use a purchase order, contract or purchasing card
- (iv) A new Procurement Manual has been written but not approved and distributed
- (v) The purchasing card program has not been audited even though this is a Recommended Practice by the Government Finance Officers Association
- (vi) There is inadequate automation (purchase requisitions and travel reimbursements are manual, are circulated for approval through interoffice mail, and require duplicate data entry)
- (vii) Division employees are generally unfamiliar with how to see status of purchase requisitions online and don't know they can go online to see the status of a vendor payment or employee reimbursement
- (viii) Ten vendor contracts have been negotiated, purchase orders issued, purchases made, without the contract yet executed by the vendor
- (ix) There is evidence of employees working around the requirement for higher levels of authorization for purchase requisitions above limits of \$5,000, \$15,000 and \$50,000. For example, during 2008, there were 17 purchase orders in the amounts of either \$4,999 or \$4900; there were 4 in the amount of \$4,999 and one at \$49,999
- (x) Three contractors in Office of Operations are allowed to purchase building maintenance parts and supplies; they are not issued a purchasing card, but share one issued in the name of the director
- (xi) There is no standard boilerplate vendor contract pre-approved by General Counsel
- (xii) Divisions do not consistently use the State Bar's travel agent

- (xiii) Employees and volunteers frequently don't attach adequate documentation to purchasing card and travel reimbursement requests
- (xiv) Accounting for multiple member bills paid on one check cannot be processed by lockbox
- (xv) For vendors that won't accept purchasing cards, divisions use purchase orders even for small amounts

Management Comments:

- (i) Finance will end the practice of providing checks to requesters on a "special request" basis by the end of 2009. (Regarding the related issue of CSF payments, see response to Recommendation #13, above.)
- (ii) As of February 1, 2009, Finance implemented a requirement that reimbursement requests be supported by original receipts; it is expected that this will largely eliminate opportunities for duplicate payments.
- (iii) Finance will seek to clarify policies regarding the uses of P-cards and purchase orders. (See response to Recommendation #5, above.)
- (iv) Management expects to finalize and disseminate the updated procurement manual in the near future. (See response to Recommendation #5, above.)
- (v) Purchases carried out by means of the Bar's P-cards are reconciled, reviewed and approved on a transaction-by-transaction basis at several levels of management, with overall oversight provided by the Procurement manager.
- (vi) Electronic forms for purchase requisitions and travel reimbursement exist; paper copies are still needed because original signatures are required.
- (vii) Familiarization with the status inquiry features of the State Bar's purchasing system will be included in the Bar's training program. (See Management's Proposed Action 2c, above.)
- (viii) Currently there are 5 pending contracts signed by the State Bar but not fully executed. Two of those 5 are revenue-neutral or revenue-generating which require no payments to be made.
- (ix) A review of the purchase orders in question shows little indication of systematic "unbundling" of contracts to evade bid thresholds. In only one instance did the actual expenditures on a contract exceed a bid threshold, and in only two instances were vendors awarded multiple contracts. In all three instances, the purchasing manager concluded that there were valid special circumstances and no evasion of competitive bidding requirements. In more general terms, the purchasing manager reviews all contracts and purchase orders and, if unbundling is suspected, asks department management to provide additional justification or to consolidate the purchases and apply the relevant bidding procedures.
- (x) Our policy prohibits non-employees from being issued State Bar credit cards. In this case, a special-purpose card has been issued to a State Bar manager for repair supplies, emergency materials and routine maintenance needs for the physical plant. All charges

which post to this card are supported by original receipts and are reviewed by a department employee and then by the approving official before monthly submission to the Procurement department. Each transaction is verified during the monthly audit process and results reported back to the approvers and senior management each month.

- (xi) Beginning in 2003, OGC has provided templates, which are form contracts that clients and Procurement may complete and process without legal review. These templates are updated annually and today there are 28 such form contracts. Procurement Department statistics show that more template contracts than custom contracts are being used now in the procurement process.
- (xii) It is often more cost-effective to book airfare directly with the airlines using e-fares online and bypassing the agent booking fees. Southwest Airlines is routinely the cheapest north/south California carrier and is not part of the state-contracted airfare agreement. Effective 1/27/09, the threshold requirement for employees and volunteers to use the State Bar travel agent was raised to \$400. For roundtrip flights under \$400, travelers may use their discretion to determine whether to use the State program or to book tickets directly with the airline. For round-trip flights over \$400, travelers may book tickets directly with the airlines or other travel agency, but the rate booked must be as good as or better than the travel city pair published as available from Giselles Travel, the state booking agent.
- (xiii) As of February 1, 2009, Finance implemented stricter review practices to ensure that reimbursement requests are only paid if fully documented (see also ii above).
- (xiv) The State Bar is investigating alternative procedures (such as having the lockbox deposit checks it cannot process, while sending copies to Finance for resolution).
- (xv) The State Bar is reviewing the implications, risks and benefits, of implementing a blanket dollar threshold below which purchase orders are not required, even for non-P-card purchases.

Management's Proposed Actions:

16a Finance will cease accommodating "special requests" to return checks to requesters instead of mailing them direct to vendors.

Status: Underway
Target: December 31, 2009
Update: Completed

17. Payroll

KHA Observations:

- (i) Employees submit time on manual timesheets which requires duplicate entry by payroll employees

- (ii) There is inconsistent calculation and lack of written policy regarding compensation for employees in circumstances that are not addressed in the bargaining agreements (e.g., holiday pay to employees on leave of absence, over-time for employees with alternative work schedule, vacation and sick accrual for part-time employees)
- (iii) The PeopleSoft payroll system does not generate a single report that provides all the information necessary for reporting to CalPERS and Standard Reliance Insurance Company.
- (iv) Consistent late submission of timesheet revisions risks calculating payroll incorrectly or missing bank direct deposit deadlines.

Management Comments:

- (i) The State Bar is in the process of implementing online time entry through its PeopleSoft system.
- (ii) Due to varying legal and contractual standards based on employee status, there are legitimate variations in these calculations. Human Resources is working with Payroll to address areas of potential ambiguity.
- (iii) CalPERS is in the process of revising its reporting requirements. When the CalPERS requirements are finalized, the Bar will explore options to produce the required report from its payroll system.
- (iv) Human Resources and Finance continue to work with operating departments to remind them of the importance of meeting payroll-related deadlines.

Management's Proposed Actions:

- 17a Human Resources will draft procedures to address areas of ambiguity in the State Bar's pay practices.
 Status: Underway
 Target: September 30, 2009
- 17b Human Resources, Finance, and IT will work together to implement online time entry.
 Status: Underway
 Target: October 31, 2009
- 17c Finance will monitor the CalPERS requirement revision process. When requirements stabilize, Finance will work with Human Resources and IT to obtain necessary reports from the Bar's applications.
 Status: Pending CalPERS requirement revisions
 Target: December 31, 2009

18. Budget

KHA Observations:

- (i) The budget is prepared at the business unit (i.e. cost center) level and there are 299 business units
- (ii) Some budget transfers and adjustments are prepared at the business unit level but not needed
- (iii) Definitions of general ledger accounts are not clear enough to assure consistent account coding

Management Comments:

- (i) The majority of active Cost Centers (170 in the 2009 budget) pertain to the Sections and the Education Foundation, where they are used to segregate the costs of the different Sections from one another, to segregate costs charged to the Education Foundation from costs charged to the Sections *per se*, and to segregate different activities within individual Sections (e.g. to segregate newsletter costs from meeting costs).
- (ii) Departments may not be required to adjust their detailed line-item budgets during the year to precisely reflect actual spending experience, but managers may find it useful to update their budgets in this fashion, and Finance accommodates these requests (within existing budget limits).
- (iii) In the past, department have been given wide latitude to adapt the chart of accounts to their operation needs. However, management recognizes the value of consistent account coding across the organization and will investigate opportunities to clarify and harmonize coding practices.

Management's Proposed Actions:

- 18a Finance will draft an "Account Codes Manual," providing standardized definitions of revenue and expense account codes, accommodating, to the degree possible, existing departmental practices.

Status: To Do
Target: March 30, 2010

19. Financial Reporting

KHA Observations:

- (i) Journal entries are appropriately authorized but the accuracy of data input is not reviewed

- (ii) The PeopleSoft report writing tool is not easy to understand, so it is not being used to generate reports useful to management

Management Comments:

- (i) Finance has implemented tightened review procedures to ensure that journal entries are verified correct.
- (ii) Finance is investigating supplemental reporting tools and working with an outside contractor to develop new reports in key areas.

Management's Proposed Actions:

19a (See Management's Proposed Action #2d, above.)

20. Treasury

KHA Observations:

- (i) The Accounting Manager is an authorized signer for authorizing purchases and sales of securities (two signatures are required)
- (ii) No cash flow projections are prepared

Management Comments:

- (i) Management believes that the signatures currently required (those of the CFO and of the Accounting Manager) are the appropriate ones for this purpose.
- (ii) Management agrees that cash flow management is an important element of financial management. However, given the relatively limited portfolio of investment alternatives and maturities from which the Bar must choose (in accordance with state law and its own investment policies), there is limited scope for improvement in results via more careful analysis of week-to-week and month-to-month cash flow variations. Cost and benefit balancing applies here as elsewhere.

ACTION PLAN

The following section re-caps management's actions outlined above in connection with KHA's recommendations and observations. There are 41 specific action items. (The number/letter combinations associated with each action item reflects its numbering in the preceding sections, for cross referencing.)

1. 1a Finance is currently working with State Bar departments to identify and document the specific offices which receive a meaningful volume of mail-in checks (in terms either of quantity or total dollar amount.

Status: Underway
Target: July 31, 2009

2. 1b Finance will provide each office thus identified with a written procedure for the opening of mail, including (i) restrictive endorsement of checks, (ii) logging of checks, (iii) prompt transmittal of checks to Finance for deposit, and (iv) any additional control measures necessary and appropriate to the particular office and types of payments involved. The procedure will ensure that individuals handling inbound checks do not have the ability to modify corresponding accounting records (see Recommendation #12).

Status: Pending completion of 1a
Target: September 30, 2009

3. 1c Senior executives will confirm that the mail handling procedures have been implemented within their respective areas of responsibility.

Status: Pending completion of 1b
Target: October 30, 2009

4. 2a Finance will prepare a written budget control policy specifying the level of budgetary control managers are expected to meet and the scope of their discretion, for adoption by the Senior Executive Team (SET).

Status: To Do
Target: July 31, 2009

5. 2b Finance and IT will review and consider the feasibility of implementing encumbrance accounting or other method of tracking commitments (such as contracts and purchase orders) against budgets. The cost of implementing an automated purchase order encumbrance system may exceed the benefit of this recommendation.

Status: Underway

Target: September 30, 2009

6. 2c Finance will be provided with the name of a "budget liaison" from each department. Finance, in cooperation with IT as needed, will provide the designated liaisons with training on the use of existing PeopleSoft reports and inquiry tools.

Status: To Do

Target: December 31, 2009

7. 2d Finance, in cooperation with IT, is currently investigating the feasibility of alternative reporting tools to prepare more user-friendly budget reports.

Status: Underway

Target: December 31, 2009

8. 2e Finance will investigate the implementation of automated budget "blocks" and report on the matter to the Senior Executive Team. SET will determine whether the added benefits outweigh implementation and ongoing administrative costs and direct subsequent implementation actions as needed.

Status: Pending completion of 2a

Target: October 31, 2009

9. 3a IT, Finance and Human Resources will continue to work together to identify known issues in the payroll system and execute an action plan for their resolution.

Status: Underway

Target: June 30, 2009

Update: Completed

10. 3b IT, Finance and Human Resources are currently developing an ongoing maintenance plan for the existing payroll system, identifying the roles and responsibilities of staff in those departments. The plan encompasses the full cycle of monitoring the availability of ESUs, testing, evaluation, and application of ESUs, and an estimate of the resources necessary in each area to support the cycle.

Status: Underway

Target: July 31, 2009

11. 3c IT, Finance and Human Resources are assessing the feasibility of partial or full outsourcing of the software support for payroll and HR functions, paying due attention to the operational needs of both HR and payroll functions and the issue of data integration with the State Bar's remaining in-house systems.

Status: Underway

Target: December 31, 2009

12. 4a Member Services, with the assistance of the Office of General Counsel, will prepare modified travel and expense reimbursement policies applicable to the Sections, to be reviewed and adopted by the Senior Executive Team, and will define a format and a mechanism for periodic reporting of expenditures to Sections Members.

Status: Underway
Target: July 31, 2009

13. 5a Finance is working with the State Bar's Web Editor to re-structure the State Bar's intranet to include a consolidated "Finance" heading under which financial policies and procedures can be accessed. This project is expected to be completed in May 2009.

Status: Underway
Target: May 29, 2009
Update: Completed

14. 5b The Executive Director's Office will codify existing administrative advisories into an administrative manual that will be available on the Bar's Intranet.

Status: To Do
Target: December 31, 2009

15. 5c Finance (in conjunction with KHA) will continue to conduct Bar-wide workshops on its cash receipts control function. Training sessions will be conducted on all the Department's policies and procedures throughout the remainder of the year.

Status: Underway
Target: December 31, 2009

16. 6a The Executive Director has designated the State Bar's Director of Operations to act as the organization's Risk Management Officer, with responsibility for both traditional risk management (e.g. insurance and loss control) and for raising risk-related issues within the Senior Executive Team on an ongoing basis.

Status: Completed
Target: n/a

17. 6b The Senior Executive Team has global responsibility for performing a risk assessment and will work together to identify key risks to the Bar, match controls to mitigate those risks, and identify areas of potential exposure to the Bar.

Status: To Do
Target: June 30, 2010

18. 7a Human Resources is assembling a stand-alone written code of conduct based upon the State Bar's existing union agreements, administrative advisories, and other sources, supplemented as appropriate, for review and adoption by the Senior Executive Team.
- Status: Underway
Target: August 31, 2009
19. 7b Human Resources will work with the Bar's Web Editor to publish the State Bar's code of conduct on the Bar's intranet, with or linked to its financial policies and procedures.
- Status: Pending completion of 7a
Target: September 30, 2009
20. 7c Human Resources will include the State Bar's code of conduct in the State Bar's annual management and supervisory training materials.
- Status: Pending completion of 7a
Target: December 31, 2009
21. 8a The Audit Committee has adopted an outsourced internal audit function. As a first step, the Committee will authorize the evaluation of the Bar's seven business processes. These are: cash receipts; procurement/disbursements; payroll; budget; financial reporting; treasury; and grants management. The audit of the cash receipts function was performed by KVA in the form of group workshops. Due to the expense and time involved in the group workshops approach, a traditional internal audit approach may be desirable for the procurement/disbursements, payroll and budget functions. Since the remaining control functions of financial reporting, treasury and grant management are not organization wide processes, these may be undertaken as traditional internal audits or may be evaluations performed by Finance staff.
- Status: Underway
Target: Ongoing
22. 9a Within the limits of the budget and existing union agreements, Human Resources will support the development and effectuation of departmental training plans.
- Status: Underway
Target: Ongoing
23. 10a Operations will work with Finance to centralize invoicing of retail and office tenants.
- Status: Completed
Target: n/a

24. 10b Finance will survey the departments and prepare a complete list of all invoices and bills issued by the State Bar outside of Finance, along with the usual quantity of invoices and amounts (to assist in the evaluation of significance and priorities).

Status: To Do
Target: August 30, 2009

25. 10c Finance will recommend centralizing receivables and cash receipting where feasible.

Status: Pending completion of 10b
Target: September 30, 2009

26. 10d Finance will prepare a written invoicing policy governing any remaining decentralized invoicing, to be reviewed and adopted by SET. This policy will be published on the State Bar's intranet alongside other financial policies.

Status: Pending completion of 10b
Target: October 31, 2009

27. 11a The Office of General Counsel will enhance existing policy statements governing the expenditure of business expense funds, establishing appropriate limits and making clear that expenditures must be reasonably related to the State Bar's business or functions sponsored by the State Bar. The policy will be reviewed and adopted by the Senior Executive Team.

Status: Underway
Target: September 30, 2009

28. 11b Finance will establish a regular reporting cycle for "business expense" costs. The Deputy Executive Director and the Chief Financial Officer will regularly review business expenses.

Status: Pending completion of 11a
Target: December 31, 2009

29. 12b Finance will review employee access to the Bar's financial systems and verify that proper segregation of duties exists.

Status: To Do
Target: December 31, 2009

30. 13a The Office of Chief Trial Counsel, the Office of General Counsel, and the CSF program director will review the issues impeding implementation of the this recommendation to ascertain if they still apply, or have become obsolete.
- Status: Underway
 Target: June 30, 2009
 Update: Completed
31. 13b If the restrictions no longer apply, CSF will work with Finance to implement the recommended procedure, under which CSF checks would be mailed directly by Finance to recipients, rather than being returned to the CSF program staff.
- Status: Pending completion of 13a
 Target: September 30, 2009
 Update: Completed
32. 14a Finance will complete the update of the State Bar's indirect cost allocation plan in 2009.
- Status: Underway
 Target: December 31, 2009
33. 14b IT will work with management of the Bar's operating departments to develop an effective organization-wide approach to the "business analyst" issue – i.e. the organization's capability to use technology effectively for business process improvement.
- Status: Underway
 Target: Ongoing
34. 15a Finance will install equipment needed to scan and electronically deposit checks in San Francisco and Los Angeles.
- Status: Underway
 Target: June 30, 2009
 Update: Completed
35. 15b Member Billing will clarify written procedures pertaining to waivers and amendments.
- Status: Underway
 Target: August 28, 2009
 Update: Completed
36. 15c Finance will investigate alternative lockbox procedures which could eliminate "round-tripping" of checks.

Status: Underway
Target: September 30, 2009

37. 16a Finance will cease accommodating "special requests" to return checks to requesters instead of mailing them direct to vendors.

Status: Underway
Target: December 31, 2009
Update: Completed

38. 17a Human Resources will draft procedures to address areas of ambiguity in the State Bar's pay practices.

Status: Underway
Target: September 30, 2009

39. 17b Human Resources, Finance, and IT will work together to implement online time entry.

Status: Underway
Target: October 31, 2009

40. 17c Finance will monitor the CalPERS requirement revision process. When requirements stabilize, Finance will work with Human Resources and IT to obtain necessary reports from the Bar's applications.

Status: Pending CalPERS requirement revisions
Target: December 31, 2009

41. 18a Finance will draft an "Account Codes Manual," providing standardized definitions of revenue and expense account codes, accommodating, to the degree possible, existing departmental practices.

Status: To Do
Target: March 30, 2010