



## RESERVE POLICY

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### A. DEFINITION AND CLASSIFICATION OF RESERVES

1. **Working Capital.** In accordance with best practices, State Bar reserves are defined as working capital (current assets less current liabilities). Since the State Bar uses Enterprise Fund accounting for its financial operations in accordance with Generally Accepted Accounting Principles (GAAP), working capital is the financial measure that most closely matches the concept of “fund balance” in the Governmental Funds and what is typically meant by the concept of “reserves” in a budgetary policy context. This is also the financial measure recommended by the Government Finance Officers’ Association of the United States and Canada (GFOA) as a “best practice” in setting reserve policies for Enterprise Funds (web site link): [www.gfoa.org/determining-appropriate-levels-working-capital-enterprise-funds](http://www.gfoa.org/determining-appropriate-levels-working-capital-enterprise-funds)
  
2. **Classification of Reserves.** The Governmental Accounting Standards Board (GASB) is responsible for establishing “GAAP” for state and local governments in the United States. For Governmental Funds, GASB Statement No. 54 adopted in 2009 requires that Fund Balance be classified into five components: non-spendable, restricted, committed, assigned and unassigned. While these classifications are only used for Governmental Funds and are not applicable to Enterprise Funds (in fact, there is no discussion under GAAP of the concept of “fund balance” or reserves for Enterprise Funds), they nonetheless provide a useful framework for assessing the State Bar’s reserves. Accordingly, reserves will be classified within each fund (where applicable) as follows:
  - a. **Non-Spendable.** Amounts that are not in spendable form, such prepaid items or inventories. (The State Bar does not currently have any reserves that would be classified as non-spendable.)
  
  - b. **Restricted.** Revenues where the use is subject to *externally* enforceable restrictions imposed by outside third parties.
  
  - c. **Committed.** These are outstanding obligations for contractual or policy commitment for programs or projects approved in prior fiscal years that are carried forward into the new year. They are typically composed of two types:
    - Encumbrances: unfilled purchase orders and outstanding contractual obligations at year-end. Since these commitments were made during the fiscal year, adequate resources should be available at year-end to cover them and carryover balances into the new fiscal year.
  
    - Policy Commitments: Balances formally set aside by the Board in order to fund future projects based on adopted plans.

- d. **Assigned.** Minimum reserve targets established based on assessing risks in accordance with the structured assessment methodology developed by the GFOA (see Section C), after addressing non-spendable, restricted and committed reserves.
- e. **Unassigned.** Residual classification of spendable amounts available for other purposes. Under GASB Statement No. 54, unassigned fund balance should not be shown as a negative number. However, as noted above, GASB Statement No. 54 is only being used as a policy framework in assessing the State Bar's reserves. Accordingly, in the interest policy clarity, where the State Bar's ending reserves are not sufficient to meet its non-spendable, restricted, committed and assigned amounts, the unassigned balance will be shown as a negative number in clearly disclosing how short reserves are in meeting policy goals.

## **B. ESTABLISHMENT AND CLASSIFICATION OF FUNDS**

While usually created with the goal of improving accountability, the proliferation of funds often makes an agency's financial position and fiscal operations more confusing and less transparent. As such, in accordance with GAAP, the State Bar will limit the proliferation of funds and only establish separate funds where there are compelling policy reasons to do so. This approach will not only simplify accounting and financial reporting, but by focusing on meaningful resource restrictions and earmarking, it will improve accountability, transparency and understandability.

### **Program Funds**

State Bar funds are organized into three Program Fund categories:

1. **Restricted Funds.** Using GAAP as the framework, "restricted" funds are those whose use is externally restricted via legislation, bond covenants or similar external restrictions. In short, to be classified as a "restricted" fund, the restriction must be externally imposed as set forth under GAAP. This this means that all special purpose assessments approved by the State Legislature, including voluntary ones, will be accounted for in a separate restricted fund. In the case of limited-term assessments that will expire at some point, the fund will be closed-out when the last assessment is received or all proceeds are used for designated purposes, whichever occurs last. Closed-out fund balances will typically be transferred to the General Fund; however, the Board will determine the disposition of any residual balances on a case-by-case basis. The following are Restricted Funds:
  - a. Client Security Fund
  - b. Elimination of Bias and Bar Relations Fund
  - c. Equal Access Fund
  - d. Justice Gap Fund
  - e. Lawyer's Assistance Fund
  - f. Legislative Activities Fund
  - g. Legal Services Trust Fund
  - h. Legal Specialization Fund
2. **Special Revenue Funds.** While these could be accounted for within the General Fund, there may be compelling policy reasons to account for the use of resources separately. In

this case, separate “Special Revenue Funds” will be created, recognizing that in accordance with GAAP, these could have been accounted for within the General Fund. Board approval should be required to establish a Special Revenue Fund, with findings as to the fund purpose and why earmarking these resources is appropriate. The following are Special Revenue Funds.

- a. Admissions Fund
  - b. Annual Meeting Fund
  - c. Grants Fund
  - d. Sections Fund
3. **General Fund.** All other revenues, expenditures and other uses will be accounted for in the General Fund.

### **C. MINIMUM RESERVE TARGET**

The State Bar will maintain unrestricted, uncommitted reserves in its General Fund, and each fund within its Restricted and Special Revenue Program Funds, net of reserves that are non-spendable, restricted and committed, that equate to 2 months of operating expenses for the respective funds; this translates to a target minimum reserve level of 17 percent.

### **D. APPROPRIATE RESERVE USES**

Circumstances where taking reserves below target minimum levels would be appropriate include responding to the risks that reserves are intended to mitigate, such as:

1. One-time uses in meeting cash flow needs; closing a projected short term revenue-expenditure gap; responding to unexpected expenditure requirements or revenue shortfalls; and making investments in human resources, technology, liability reductions, revenue base improvements, productivity improvements and other strategies that will strengthen State Bar revenues or reduce future costs.
2. Where a multi-year forecast shows an ongoing structural gap, in providing a strategic bridge to the future.

Any expenditure that would cause the balance of the General Fund, or any fund within the Restricted or Special Revenue Program Funds, to fall to a level totaling 10 percent or less of recurring annual operating expenses, must be approved by the Board of Trustees.

### **E. FUND BALANCE SPEND DOWN WHEN RESERVES ABOVE POLICY LEVELS**

Whenever reserve levels in the General Fund, or any fund within the Restricted or Special Revenue Program Funds, other than the Section Fund, surpass 30 percent, for a consecutive six month period, spend-down funding shall occur in accordance with the following principles:

1. Fund balance spend-down should be utilized to offset member dues and other assessments and use charges, where possible.

2. Fund balance spend-down should be used to advance strategic efficiency investments that will result in short- or long-term reductions in operating costs.
3. Fund balance spend-down should be used to bolster the Client Security Fund, where possible.

All spend-down in excess of \$250,000 must be approved by the Board of Trustees.

**E. RESTORING RESERVES TO POLICY LEVELS**

Whenever reserve levels in the General Fund, or any fund within the Restricted or Special Revenue Program Funds, fall below the target minimum level of 17 percent, the State Bar will strive to restore reserves to this level within five years. As revenues versus expenditures improve, the State Bar will allocate at least half to reserve restoration, with the balance available to fund outstanding liabilities, asset replacements, service levels restoration, new operating programs or capital improvement projects.

2015 Spendable Working Capital and Reserve Level - as of February 29, 2016

Attachment B

Fund Description	2015 Actual Operating Expenses	12/31/2015 Working Capital	Less: Restricted Balance	Unrestricted/Spendable Reserve	Calculated Reserve Level 12/31/2015	Amount to Meet 17% floor (exclude non-recurring expenses)	Meeting 17% Reserve Target	30% Ceiling (exclude non-recurring expenses)	Over 30% Ceiling?	Amount Over Target/(Under Ceiling)	Amount (Under Target)
	(A)	(B)	(D)	(E)	(E)/(A) * 100%	(A) * 17%					
<b>Consolidated General Fund:</b>	(C) 72,890,000	19,944,900	(5,840,000)	14,104,900	19.35%	12,391,300	Yes	21,867,000	No	(7,762,100)	
<b>Special Revenue Fund Group:</b>											
Admissions Fund (20)	20,166,000	3,884,000	-	3,884,000	19.26%	3,428,220	Yes	6,049,800	No	(2,165,800)	
Annual Mtg Fund (14)	887,000	(68,900)	-	(68,900)	-7.77%	150,790	No	266,100	No		(219,690)
Grant Fund (12)	30,700	374,500	-	374,500	1219.87%	5,219	Yes	9,210	Yes	365,290	
Sections (70-89)	8,309,000	8,566,300	-	8,566,300	103.10%	1,412,530	Yes	2,492,700	Yes	6,073,600	
<b>Total Special Revenue Fund Group:</b>	<b>29,392,700</b>	<b>12,755,900</b>	<b>-</b>	<b>12,755,900</b>							
<b>Restricted Fund Group:</b>											
Legislative Activities Fund (16)	535,500	680,800	-	680,800	127.13%	91,035	Yes	160,650	Yes	520,150	
Elimination of Bias & Bar Relations Fund (17)	1,077,844	559,500	-	559,500	51.91%	183,233	Yes	323,353	Yes	236,147	
Lawyer Assistance Program (21)	1,625,400	2,235,100	-	2,235,100	137.51%	276,318	Yes	487,620	Yes	1,747,480	
Legal Specialization Fund (24)	1,580,500	5,470,700	-	5,470,700	346.14%	268,685	Yes	474,150	Yes	4,996,550	
Client Security Fund (27)	2,392,300	2,202,500	-	2,202,500	92.07%	406,691	Yes	717,690	Yes	1,484,810	
Info. Tech Special Assessment Fund (31)	-	1,211,200	(1,211,200)	-	NA	NA	NA	NA	NA	NA	
Legal Service Trust Fund (28)	1,592,000	12,524,600	(10,000,000)	2,524,600	158.58%	270,640	Yes	477,600	Yes	2,047,000	
Equal Access Fund (29)	186,900	18,400	-	18,400	9.84%	31,773	No	56,070	No		(13,373)
Justice Gap Fund (32)	20,000	512,500	-	512,500	2562.50%	3,400	Yes	6,000	Yes	506,500	
<b>Total Restricted Fund Group:</b>	<b>9,010,444</b>	<b>25,415,300</b>	<b>(11,211,200)</b>	<b>14,204,100</b>							
<b>Grand Total:</b>	<b>111,293,144</b>	<b>58,116,100</b>	<b>(17,051,200)</b>	<b>41,064,900</b>	<b>36.90%</b>	<b>18,919,834</b>	<b>Yes</b>	<b>33,387,943</b>	<b>Yes</b>	<b>7,676,957</b>	

Notes:

- (A) Annual expenditures for reserve level calculation purposes does not include non-recurring expenditures, CSF application payout, and grant disbursement.
- (B) According to Generally Accepted Accounting Principles (GAAP), Working Capital is the financial measure most closely matches the concept of "fund balance" in the Governmental Funds and what is typically meant by the concept of "reserves" in a budgetary policy context. (Working Capital = Current Assets - Current Liabilities)
- (C) Consolidated General Fund includes: 180 Howard Building Fund, Legal Education and Development Fund, LA Facility Fund, Public Protection Fund, Support & Admin Fund, Technology Fund, Fixed Asset Fund, Benefit Reserve Fund and the original unconsolidated General Fund.
- (D) As of 12/31/15, total restricted/designated balances are \$17M. This amount includes \$4.6M restricted cash for debt service, \$2.4M restricted for IT related projects, and \$10M designated for LSTF grant disbursement.



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  - e. Lawyer’s Assistance Fund
  - f. Legislative Activities Fund
  - g. Legal Services Trust Fund
  - h. Legal Specialization Fund
  - h.i. Bank Settlement Fund<sup>1</sup>
2. **Special Revenue Funds.** While these could be accounted for within the General Fund, there may be compelling policy reasons to account for the use of resources separately. In

<sup>1</sup> A new Fund to be established pursuant to the State Bar’s receipt of \$44 million in bank settlement monies to be used to support legal services in the areas of economic development and foreclosure prevention.

this case, separate “Special Revenue Funds” will be created, recognizing that in accordance with GAAP, these could have been accounted for within the General Fund. Board approval should be required to establish a Special Revenue Fund, with findings as to the fund purpose and why earmarking these resources is appropriate. The following are Special Revenue Funds.

- a. Admissions Fund
  - b. Annual Meeting Fund
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  - d. Sections Fund
3. **General Fund.** All other revenues, expenditures and other uses will be accounted for in the General Fund.

#### **Fiduciary Fund**

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~~Along with the Program Funds, the State Bar has one Fiduciary Fund: State Bar Access and Education Foundation Fund. This fund is maintained by the State Bar in a third party, trustee capacity on behalf of the Foundation. Under GAAP, these funds are not available for the State Bar’s operations. However, as required under GAAP, they are included in the State Bar’s audited financial statements.—~~

### **C. MINIMUM RESERVE TARGET**

The State Bar will maintain unrestricted, uncommitted reserves in its General Fund, and each fund within its Restricted and Special Revenue Program Funds, other than Excluded Minimum Target Reserve Funds, net of reserves that are non-spendable, restricted and committed, that equate to 2 months of operating expenses for the respective funds; this translates to a target minimum reserve level of 17 percent.

Excluded Minimum Target Reserve Funds include all grant-related Funds, specifically the Grant, Legal Services Trust, Equal Access, Justice Gap, and Bank Settlement Funds.

### **D. APPROPRIATE RESERVE USES**

Circumstances where taking reserves below target minimum levels would be appropriate include responding to the risks that reserves are intended to mitigate, such as:

1. One-time uses in meeting cash flow needs; closing a projected short term revenue-expenditure gap; responding to unexpected expenditure requirements or revenue shortfalls; and making investments in human resources, technology, liability reductions, revenue base improvements, productivity improvements and other strategies that will strengthen State Bar revenues or reduce future costs.
2. Where a multi-year forecast shows an ongoing structural gap, in providing a strategic bridge to the future.

Any expenditure that would cause the balance of the General Fund, or any fund within the Restricted or Special Revenue Program Funds, to fall to a level totaling 10 percent or less of recurring annual operating expenses, must be approved by the Board of Trustees.

#### E. FUND BALANCE SPEND DOWN WHEN RESERVES ABOVE POLICY LEVELS

Whenever reserve levels in the General Fund, or any fund within the Restricted or Special Revenue Program Funds, other than ~~the Sections Fund~~ Excluded Excess Reserve Funds, surpass 30 percent, for a consecutive six month period, spend-down funding shall occur in accordance with the following principles:

1. Fund balance spend-down should be utilized to offset member dues and other assessments and use charges, where possible.
2. Fund balance spend-down should be used to advance strategic efficiency investments that will result in short- or long-term reductions in operating costs.
3. Fund balance spend-down should be used to bolster the Client Security Fund, where possible.
- ~~3.4.~~ Fund balance spend-down should be used to increase legal services funding, where possible.

All spend-down in excess of \$250,000 must be approved by the Board of Trustees.

Excluded Excess Reserve Funds include all grant-related Funds, specifically the Grant, Legal Services Trust, Equal Access, Justice Gap, and Bank Settlement Funds, and the Sections Fund.

#### E. RESTORING RESERVES TO POLICY LEVELS

Whenever reserve levels in the General Fund, or any fund within the Restricted or Special Revenue Program Funds, other than Excluded Minimum Target Reserve Funds, fall below the target minimum reserve level of 17 percent, the State Bar will strive to restore reserves to this level within five years. As revenues versus expenditures improve, the State Bar will allocate at least half to reserve restoration, with the balance available to fund outstanding liabilities, asset replacements, service levels restoration, new operating programs or capital improvement projects.

Excluded Minimum Target Reserve Funds include all grant-related Funds, specifically the Grant, Legal Services Trust, Equal Access, Justice Gap, and Bank Settlement Funds.