

AGENDA ITEM

BUSINESS ITEM III. B
JUL 144 #2

DATE: July 21, 2016

TO: Members, Planning and Budget Committee

FROM: Christine Wong, Chief Financial Officer

SUBJECT: Cost-Benefit Analysis of State Audit Recommendation:
GFOA Budgeting Practice & CAFR Financial Reporting

EXECUTIVE SUMMARY

On May 12, 2016, the California State Auditor completed an audit of the State Bar and issued a report with recommendations. Update regarding progress in implementing those recommendations is due at three intervals from the release of the report: 60 days, six months, and one year. The first status update was due July 11, 2016; that update will be presented to the Board concurrent with this agenda item.

One of the auditor's recommendations is related to the State Bar's budgeting and financial reporting practices in reference to a fund structure study conducted by an independent consultant completed in August 2015. As a follow-up to this recommendation, staff prepared a cost-benefit analysis by comparing the current budgeting and financial reporting practices to the California Society of Municipal Finance Officer (CSMFO), Government Finance Officer Association (GFOA) budgeting and Comprehensive Annual Financial Report (CAFR) financial reporting checklists and estimated additional staffing needed to fully implement these models. Based on that analysis, staff does not recommend full implementation of the CSMFO, GFOA and CAFR models, but instead to utilize the checklists as guidance and partially implement those criteria and elements that are practical, beneficial and manageable given our existing resource levels.

BACKGROUND & DISCUSSION

On May 12, 2016, the State Auditor issued a report with recommendations addressing financial procedures and practices of the State Bar. A summary of those recommendations and the 60-day implementation status is presented to the Board at the July meeting (JUL 144) . One of the auditor's recommendations is related to the State Bar's budgeting and financial reporting

practices in reference to a fund structure study conducted by an independent consultant in August 2015. In that review, the consultant recommended that:

“The State Bar should strongly consider preparing its budget document in accordance with CSMFO and GFOA excellent criteria”. For financial reporting, the State Bar “should strongly consider preparing its audited financial statement as a Comprehensive Annual Financial Report (CAFR) in accordance with CSMFO and GFOA excellent criteria. The State Bar should also consider including budget versus actual comparisons in the CAFR’s supplement schedules. Once the reserve policy has been adopted, the State Bar should also consider including supplemental schedules that show changes in reserves and ending position for the year.”

The relevant excerpt of the consultant’s report is provided as Attachment A.

In its 2016 report, the State Auditor recommended that the State Bar conduct and present to the Board a cost-benefit analysis of implementing the consultant’s recommendations.

Current Budget and Financial Reporting Practices:

Currently, the State Bar’s annual budget document is prepared in accordance with Business and Professions Code section 6140.1. This code section requires the State Bar to “submit its proposed baseline budget for the following fiscal year to the legislature by November 15th, and its proposed final budget by February 15th”. The statute also provides that the budget document should be completed “in a form comparable to the documents prepared by state departments for inclusion in the Governor’s Budget and the salaries and wages supplement. In addition, the Bar shall provide supplementary schedules detailing operating expenses and equipment, all revenue sources, any reimbursements or inter-fund transfers, fund balances, and other related supporting documents”.

For financial reporting, the State Bar utilizes fund accounting in accordance with Generally Accepted Accounting Principles (GAAP) and its financial statement is presented in compliance with the Governmental Accountant Standard Board Statement (GASB) 34 – *Basic Financial Statements*. Fund accounting is the method of classifying resources into categories according to the purpose of use. Each fund is self-balancing and has separate assets, liabilities and a fund balance. GASB 34 provides a framework, criteria and standards of acceptable financial reporting for state and local governments; compliance with GASB 34 (in addition to all other applicable GASB standards) allows auditors to form an unqualified opinion on the Bar’s financial statements.

Further, the State Bar’s audited financial statements include supplemental schedules for each fund, which is greater disclosure than is required by GAAP.

Government Finance Officers Association (GFOA), California Society Municipal Finance Officer (CSMFO) & Comprehensive Annual Financial Report (CAFR) Standards:

The GFOA and CSMFO are professional associations representing public finance officers throughout the United States. These associations work with regulators, hold trainings and conferences, and sponsor awards programs designed to encourage sound budgeting and financial reporting practices. For budget best practices, both the CSMFO and the GFOA publish checklists identifying specific criteria, policies, processes, and frameworks for budget development and preparation. Generally, these checklists reflect requirements to include significant organizational accomplishments, major goals and objectives, and a connection between the proposed budget and those goals in the budget document itself.

CAFR is a set of government financial statements designed and promulgated by the GFOA. Entities who submit a completed CAFR to the GFOA will receive a Certificate of Achievement for Excellence in Financial Reporting award. In addition, the CAFR format is widely lauded by bond rating agencies, which is important for organizations seeking to finance initiatives through the sale of public debt. CAFR goes beyond standard financial statements in that it includes a transmittal memorandum discussing key results and future outlook, supplemental schedules and long-term fiscal trends.

State Bar Implementation of CSMFO, GFOA & CAFR Standards – Cost-Benefit Analysis:

The CSMFO, GFOA and CAFR criteria reflect comprehensive budget and financial reporting practices. A detailed review of the CSMFO, GFOA and CAFR checklists against the State Bar’s current budget preparation and financial reporting practices, in conjunction with the cost-benefit analysis outlined below, reflects the following:

| Standard | # of Elements | Elements Currently Implemented | Elements Recommended for Implementation | Elements Not Recommended |
|-----------------|----------------------|---------------------------------------|--|---------------------------------|
| CSMFO | 43 | 14 | 16 | 13 |
| GFOA | 82 | 28 | 37 | 17 |
| CAFR | 623 | 545 | 13 | 65 |
| Total: | 748 | 587 | 66 | 95 |
| %: | 100% | 78% | 9% | 13% |

In general, those items not recommended for implementation reflect comparisons to other jurisdictions, tie directly to an extended and more involved strategic planning and goal development process than currently exists at the State Bar.

An item-by-item analysis is provided as Attachment B.

For budgeting practices, after reviewing the CSMFO and GFOA budget document checklists, staff recommends implementing a number of elements, focusing on those that are practical and beneficial resulting in greater transparency, while being achievable within existing staffing resources.

With respect to financial reporting, staff does not recommend full adoption of the CAFR model because the costs of fully implementing this model outweighs the benefits. There are a total of 623 required elements in the CAFR model; 545 of them are currently implemented by the State Bar. Staff recommends implementation of an additional 13 CAFR elements relating to report cover, introductory section narrative, and management decision and analysis sections. Adoption of these standards will provide for additional transparency in financial statement preparation. Standards not recommended include those that will require significant research, analytical work and in-depth reviews of existing program functions and activities as part of the reporting process. Organizational capacity to implement these standards would take years and additional staff to develop, an investment not necessarily worthwhile given the questionable value to the Bar of at least a portion of the work product. For example, the Statistic Section required for CAFR requires significant research and analytical work to be done to assess creditworthiness and measure the fiscal condition of the reporting entity. This Section is primarily for bond pricing and rating purposes, activity which is inapplicable to the State Bar.

To estimate the fiscal resources required for consultant proposed implementation of CSMFO, GFOA and CAFR standards, staff compared the staffing levels of the State Bar's Finance Department to that of a comparable organization identified by the consultant – the San Diego County Water District (SDCWD). The consultant identified SDCWD as being highly regarded for its adherence to rigorous CSMFO, GFOA and CAFR criteria, while being comparable in size, after adjustment for water purchases, to the State Bar. Per information available on its website, the SDCWD is currently supported by 19 full-time employees; 9 of them are senior level positions such as senior accountant, accounting supervisor and manager. In contrast, our Finance Department is currently staffed by 14 full-time employees, with 6 of those at a senior level. Based on this comparison, a reasonable estimate of additional staffing needed to implement all recommended standards is three, with at least two of those being senior level positions. With benefit costs included, this amounts to an estimated \$450,000 in additional annual expenditures. These new positions would be in addition to the resource redirection of existing Finance personnel, including the Chief Financial Officer. An attempt to fully adopt these checklists and standards would thus have a direct financial impact on the organization, as well as an indirect impact of redirection of attention and focus from other initiatives, including successful implementation of two rounds of up-coming State Audits provided in the proposed Fee Bill..

In recommending partial implementation (reflecting approximately 87 percent of all checklist elements in total), staff believes that the Bar will realize the intended benefits behind the consultant's recommendation without incurring a need for a significant number of new staff or a redirection of existing staff and other resources.

BOARD BOOK IMPACT:

None

RECOMMENDATION

Staff recommends that the Board of Trustees review the attached checklist comparison and adopt staff's recommendation to partially implement CSMFO, GFOA, and CAFR checklist criteria.

PROPOSED BOARD OF TRUSTEES RESOLUTION:

Should the Board concur with staff's recommendation, the following resolution would be in order:

RESOLVED, that the Board of Trustees hereby adopts staff's recommendation not to fully implement the CSMFO, GFOA and CAFR models, but instead to utilize the checklists as guidance and partially implement those criteria and elements that are practical, beneficial and manageable given existing resource levels.