

AGENDA ITEM

143 MARCH 2015

DATE: March 11, 2015

TO: Members, Planning & Budget Committee
Members, Board of Trustees

FROM: Michael Colantuono, State Bar Treasurer
Lawrence C. Yee, Acting General Counsel
Sam Quan, Acting Chief Financial Officer
Christine Wong, Director of Finance

SUBJECT: Cost Center Budgeting and Other Recommended Revisions to Control Policies

EXECUTIVE SUMMARY

This item would amend existing fiscal control policies and procedures adopted by resolutions of the Board of Trustees to provide that: (1) the annual budget that is presented to the Board for adoption is at the cost-center level in addition to the fund level and will report all variances in budgeted expenditures and receipts from actual expenditures and receipts in the previous budget year; (2) the Semi-Annual Forecast prepared by the Office of Finance shall include a report of all intradepartmental cost-center budget transfers and an explanation of those transfers exceeding \$100,000; (3) all requests for interdepartmental cost-center transfers must be presented to the Board for approval, as an amendment to the adopted budget; (4) commencing in 2015 and every following five years, a review of the State Bar's budget and fiscal control policies and procedures must be conducted by an independent consultant; and (5) the Chief Financial Officer is charged with presenting to the State Bar Audit Committee all material matters not satisfactorily resolved by State Bar Management, including expedient contact with the State Bar Audit Committee Chairperson when necessary.

BACKGROUND

On January 24, 2015, the Board of Trustees adopted the State Bar's three-year budget for the calendar years 2015-2017 annual budget. The Board's action included two provisos: (1) that the spending authority under the budget ends April 30, 2015, subject to further review and action at the Board's March meeting and (2) that staff is directed to submit a revised budget with spending authority identified by program cost center by April 30, 2015. In addition, the Board directed staff to review existing budget control policies and procedures and to recommend revisions to ensure that the proposed

budgets presented to the Board for approval include expenditures by cost centers, as well as any recommendations to control variances that may occur in the budget during the year and when amendments to the adopted budget should be made. Variances are, of course, inevitable given that budget are based on predicted expenses and revenues which can never be completely prescient.

This item summarizes the requirements for the State Bar's budget under (1) Business and Professions Code section 6140.1, (2) resolutions adopted by the Board, and (3) internal management policies of the Office of Finance adopted in response to an independent consulting firm's review of budget controls in 2010. The item then recommends amendments to the control policies of the Board and of management, as well as the need for a new independent review of those controls.

DISCUSSION

At the Board's meeting on January 24, 2015, the State Bar's three-year budget for calendar years 2015-2017 was presented at a high-level, by-budgetary fund, which provided only a consolidated snapshot of the financials for each budgetary fund.

In contrast, the State Bar's proposed final budget for 2016 submitted to the Legislature three weeks later, as required by Business and Professions Code section 6140.1, included a presentation of expenditures at both fund and department (or cost-center)¹ levels. The department budgets included further details of expenditures by program or operation units within each department² and by line item categories, such as salaries, travel, building and equipment, etc.³ Section 6140.1 provides that a proposed final budget shall be submitted by February 15, "so that the budget can be reviewed and approved in conjunction with any bill that would authorize the imposition of membership dues." It requires that the proposed budget "shall include the estimated revenues, expenditures, and staffing levels for all of the programs and funds administered by the State Bar." The proposed budget must be "in a form comparable to the documents prepared by state departments for inclusion in the Governor's Budget and the salaries and wages supplement."

¹ A cost center is "a department or other unit within an organization to which costs may be charged for accounting purposes." (https://www.google.com/search?q=cost+center+definition&rls=com.microsoft:en-us&ie=UTF-8&oe=UTF-8&startIndex=&startPage=1&gws_rd=ssl) For purposes of the State Bar's budget, the Office of Finance defines a cost center as "a distinctly identifiable department, division, or unit whose managers are responsible for all its associated direct and indirect costs and for ensuring adherence to the Bar's budget." For a government entity, a "department" is a distinct part or division within a government or its agency dealing with particular activity or services. See, <http://dictionary.reference.com/browse/department>. For the State Bar, its departments would include, for example, Admissions, the Office of Chief Trial Counsel, the State Bar Court, Client Security Fund, etc.

² For example, the Office of Chief Trial Counsel included its cost centers for its units for Intake, Investigations, Trial, Audit & Review, Abandoned and Unauthorized Practice, as well as Management and Central Administration. (2016 Proposed Final Budget, at pp. 6-9.)

³ The State Bar's 2016 Proposed Final Budget is included in the related Agenda Item 144 and also available at: <http://calbar.ca.gov/LinkClick.aspx?fileticket=O59F-uPEcso%3d&tabid=224&mid=1534>.

As directed by the Board at its meeting on January 24, 2015, a revised 2015-2017 budget is presented as a separate action item⁴ at this meeting, which includes the details of expenditures by cost center as included in the State Bar's proposed final budget submitted to the Legislature for calendar and fiscal years 2015 and 2016. That level of detail is not provided for 2017 as staff does not have sufficient time and resources to accomplish that task to prepare for this meeting. To provide consistency, beginning with the 2016 annual budget, the Office of Finance will provide at minimum the same level of detail in the Bar's annual budget at the cost-center level, in addition to the fund level as required under Business and Professions Code section 6140.1. In addition, beginning in 2016, the annual budget presented for Board approval will include the actual revenues and expenditures of the prior budgeted year and the cost-center budgets for the current, second, and third following fiscal years. For the budgets of the second and third years, it is understood that less detailed data may be included in line item expense categories for some cost centers.

In addition, following the January 24, 2015 Board of Trustees meeting, staff conducted a review of the Board's fiscal control policies and procedures that have been adopted by Board resolutions and are summarized in the Board Book, Tab 17, Article 1.

Significantly, those control policies and procedures provide, among other things, that:

- **Adoption and Amendment of Budget.** When the Board has adopted an annual expenditure budget for each budgetary fund of the State Bar, the Office of Finance shall ensure that no expenditure is incurred which would cause the total expenditures of any fund to exceed its adopted budget. The Board may amend any adopted budget, upon the recommendation of the Planning and Budget Committee. (Board Book, tab 17, art. 1, § 1.)
- **Semi-Annual Forecast.** The Office of Finance shall prepare a semi-annual forecast of receipts and expenditures of the operation of the Bar by funds and by responsible department managers, comparing forecast with budget. The report shall be a joint effort of department managers and the Office of Finance. An explanation of budgeted line item variance greater than one hundred thousand dollars (\$100,000) of the budgeted line item shall be included in the report. The semi-annual forecast report shall be reported to the Board of Trustees at the last Board Meeting before the State Bar Annual Meeting. (Board Book, tab 17, art. 1, § 2.)
- **Quarterly Financial Statements.** Quarterly financial statements shall be received by the Board at the next meeting following their availability. The financial statements shall be prepared following accounting principles generally accepted in the United States in conformance with pronouncements of the Governmental Accounting Standards Board ("GASB") and where not in conflict with GASB pronouncements, the Financial Accounting Standards Board ("FASB") pronouncements issued on or before November 30, 1989. This

⁴ The revised budget by cost center is presented in Agenda Item 144.

includes a reporting of assets, liabilities, revenues, expenses and net assets by funds of the State Bar. (Board Book, tab 17, art. 1, § 3.) Staff also reviewed the Office of Finance's internal *Budget Monitoring Policies and Procedures*.⁵ Those internal budget control procedures included among other things:

- **Monthly Department Expenditure Reports.** A requirement that the Office of Finance shall provide to each senior manager a Department Year-to-Date Expenditure Report. This report provides the following information:
 - Year-to-date actual expenditures by department and service area
 - Current year adopted budget
 - Percentage of adopted budget spent year-to-date
 - Budget benchmark based on prior year actual expenditures
 - Year-to-date expenditures for the prior year
 - Prior year adopted budget

Significant variances at the departmental level should be reviewed for accuracy and for potential impact upon cumulative year-end outcomes. Each departmental budget liaison should also review the monthly operating statements to identify any unusual trends. Variances are important in determining potential budget shortfalls and the need for corrective actions, i.e., additional expenditures, processing a budget transfer, or need for contingency funding. Significant year-to-date variances need to be explained to the Office of Finance as soon as possible after the month-end close. The definition of "significant" varies depending on the departmental budget size and nearness to year-end; generally, all deficits or any variances that may result in the over expenditure of a departmental budget as a whole for a fiscal year should be investigated and explained.

- **Request for Budget Transfer.** In the event of unforeseen expenditures as a result of emergencies or increased service demands, and after efforts to absorb these unforeseen expenditures by prudent spending, savings acquired from more efficient work methods, and quality improvement projects, a budget transfer may be initiated as follows:
 - Request a transfer of funds within a business unit or department. Such intradepartmental transfer must be approved by the Director of Budget and the department's Senior Executive.
 - When an intradepartmental transfer is not adequate to cover the forecasted deficit, a request for an interdepartmental transfer or budget transfer from contingency funds.

⁵ These monitoring policies and procedures were adopted by the Office of Finance in 2010 in response to the report by the consulting firm of Sjoberg Evaschenk, *State Bar of California, Review of Internal Controls: Budget* (June 30, 2010), and was attached to that report.

For additional budgetary control and oversight by the Board, staff proposes and recommends the following revisions to the foregoing policies and procedures, subject to a further review and recommendations by an independent audit consultant:⁶

1. The Office of Finance shall ensure that the annual budget that it presents to the Board for adoption (a) is at the cost-center level in addition to the fund level, in compliance with the requirements of Business and Professions Code section 6140.1; (b) includes a proposed budget for the current and the following two calendar fiscal years; and (c) reports variances by cost center between actual revenues and expenditures for the previous fiscal year and budgeted figures. Based on availability of data, the cost center budgets of the following two fiscal years may contain less detail for some of the line item expense categories.
2. The Office of Finance shall monitor expenditures and report to the Executive Director/CEO expenditures incurred which are likely to cause the total expenditures of any fund to exceed its adopted budget. Departmental operations are expected to be managed within budgets and, when projected variances arise, these are brought to the immediate attention of the Executive Director/CEO and the Office of Finance. Each manager who has budget monitoring duties is responsible for ensuring that receipts and spending are within the approved budgetary authority and for the prudent use and safeguarding of State Bar funds. Corrective action is necessarily taken on a case-by-case basis, depending on the extent to which projected departmental variances impact overall expenditure authority at the department level.
3. The Office of Finance shall adopt, maintain, and adhere to written Budget Monitoring Policies and Procedures, not inconsistent with the policies of the Board and to be included in the independent control review provided in Section 8. The Budget Monitoring Policies and Procedures shall include monthly reports to departments and Senior Executives and Managers that include variance analysis to be allow the identification of significant variances and potential impact upon cumulative year-end outcomes. Variances are important in determining potential budget shortfalls and the need for corrective actions, including but not limited to, an intradepartmental transfer. Significant year-to-date variances need to be explained to the Office of Finance as soon as possible after the month end close. The definition of “significant” varies depending on the departmental budget size and nearness to year-end; generally, all deficits or any variances in that may result in the over expenditure of a departmental budget as a whole should be investigated, explained, and reported to the Board Audit Committee.
4. The Office of Finance shall include in its semi-annual forecast report to the Board, all cost-center budget transfers and an explanation of those transfers exceeding \$100,000. This forecast shall report by cost center variances to date for the fiscal year between actual revenues and expenditures and budgeted figures.

⁶ The related Board Book revisions reflecting these recommendations are set forth in Attachment A.

5. Requests for intradepartmental transfer within the fund of a department may not result in the over expenditure of a departmental budget as a whole.
6. Requests for interdepartmental cost-center transfers must be approved by the Board as an amendment to the adopted budget before the cost-center to benefit from the transfer incurs an expense in excess of its previously budgeted expenditure authority, except in the case of an emergency when approved by the Chief Executive Officer after consultation with the President, Vice President and Treasurer.
7. Commencing in 2015 and every five years thereafter, an independent review of the State Bar's budget and fiscal control policies and procedures shall be conducted under the oversight of the Board Audit Committee.

FISCAL / PERSONNEL IMPACT:

Cost of an independent consultant for review of controls in 2015 and every following five years.

RULE AMENDMENTS:

None

BOARD BOOK IMPACT:

TAB 17, Article 1, Sections 1 and 2.

PROPOSED PLANNING AND BUDGET COMMITTEE RESOLUTION:

Should the Planning and Budget Committee agree with the above recommendation, the following resolution would be appropriate:

RESOLVED, that the Planning and Budget Committee recommends that the Board of Trustees amend the existing budget and other fiscal control policies and procedures as provided herein and in proposed revisions to the Board Book, as provided in Attachment A.

PROPOSED BOARD OF TRUSTEES RESOLUTION:

Should the Board concur with the Planning and Budget Committee's recommendation, the following resolutions would be in order:

RESOLVED, that upon the recommendation of the Planning and Budget Committee, the Board of Trustees hereby amends the existing budget and other

fiscal control policies and procedures as provided herein and in proposed revisions to the Board Book, as provided in Attachment A.

Attachment A
Proposed Revisions to the Board Policy Book

Tab 17, article 1, section 1 is amended to read:

[Insert Text Begins](a)[Insert Text Ends] The Board of Trustees shall adopt, by resolution, an annual expenditure budget for each budgetary fund of the State Bar. [Insert Text Begins]The State Bar's expenditures are formally governed at the cost center level through the annual budget resolution adopted by the Board. The budget allocates spending authority within each fund across the departments of the State Bar. The Office of Finance shall ensure that the annual budget that it presents to the Board for adoption (a) is at the cost-center level, in compliance with the requirements of Business and Professions Code section 6140.1; (b) includes a proposed budget for the current and the following two calendar fiscal years; and (c) reports variances by cost center between actual revenues and expenditures for the previous fiscal year and budgeted figures. Based on availability of data, the cost center budgets of the following two fiscal years may contain less detail for some of the line item expense categories. Cost center refers to the departments of the State Bar and those units or other subdivisions within a department, whose managers are responsible for all its associated direct and indirect costs and for which budget authority is conferred by an adopted budget. For purposes of the budget, cost center units may include a combination of subunit data provided that a meaningful level of detail is provided to the Board. [Insert Text Ends] [Delete Text Begins]The Office of Finance shall ensure that no expenditure is incurred which would cause the total expenditures of any fund to exceed its adopted budget. [Delete Text Ends]

[Insert Text Begins](1) The Office of Finance shall monitor expenditures and report to the Executive Director/CEO on expenditures incurred which are likely to cause the total expenditures of any fund to exceed its adopted budget. Departmental operations are expected to be managed within budgets and, when projected variances arise, these are brought to the immediate attention of the Executive Director/CEO and the Office of Finance. Each manager who has budget monitoring duties is responsible for ensuring that receipts and spending are within the approved budgetary authority and for the prudent use and safeguarding of State Bar funds. Corrective action is necessarily taken on a case-by-case basis, depending on the extent to which projected departmental variances impact overall expenditure authority at the department level.

(2) The Office of Finance shall adopt, maintain, and adhere to written Budget Monitoring Policies and Procedures, not inconsistent with the policies of the Board and to be included in the independent control review provided in Section 8. The Budget Monitoring Policies and Procedures shall include monthly reports to departments and Senior Executives and Managers that include benchmarks to

allow the identification of significant variances and potential impact upon cumulative year-end outcomes.

(3) Variances are important in determining potential budget shortfalls and the need for corrective actions, including but not limited to, any intradepartmental transfer. Significant year-to-date variances need to be explained to the Office of Finance as soon as possible after the month end close. The definition of "significant" varies depending on the departmental budget size and nearness to year-end; generally, all deficits or any variances that may result in the over expenditure of a departmental budget as a whole for a calendar fiscal year shall be investigated, explained, and reported to the Board Audit Committee.

(b) [Insert Text Ends] The Board of Trustees may, by resolution, amend any adopted budget, upon the recommendation of the Planning~~[Delete Text Begins]; Program Development, [Delete Text Ends]~~ and Budget Committee.

[Insert Text Begins] (1) In the event of a new program, an increase in service demands, or unforeseen and unanticipated expenditures in a department, those expenditures should be absorbed within the approved budget of the department. The Office of Finance may approve a request for intradepartmental transfer within the fund of a department, provided that the transfer will not result in the over expenditure of a departmental budget as a whole.

(2) Any request for an interdepartmental cost-center transfer must be presented to the Board for approval, as an amendment to the adopted budget before the cost-center to benefit from the transfer incurs an expense in excess of its previously budgeted expenditure authority, except in the case of an emergency approved by the Chief Executive Officer after consultation with the President, Vice President, and Treasurer.

(c) (1) [Insert Text Ends] Budgets lapse at the end of each fiscal year, except as provided below for project budgets. ~~[Delete Text Begins] If [Delete Text Ends]~~ [Insert Text Begins] When [Insert Text Ends] the Board of Trustees adopts a multi-year budget, it shall adopt distinct budgets for each fiscal year within the budget period for each budgetary ~~[Delete Text Begins] fund [Delete Text Ends]~~ [Insert Text Begins] cost center.

(2) [Insert Text Ends] The Board of Trustees may adopt non-lapsing budgets for multi-year projects. Non-lapsing project budgets shall be identified as such in the adopting resolution.

[Insert Text Begins] (d) [Insert Text Ends] The budgetary funds of the State Bar shall correspond to the accounting funds of the State Bar, as identified in Section 3, below, or to a combination of such funds. The relationship between budgetary funds and accounting funds shall be identified in the annual budget resolution.

Tab 17, article 1, section 2 is amended to read:

Section 2 *Semi-Annual Forecast*

The Office of Finance shall prepare a semi-annual forecast of receipts and expenditures of the operation of the Bar by funds and by responsible department managers, comparing forecast with budget. The report shall be a joint effort of department managers and the Office of Finance. An explanation of budgeted line item variance greater than one hundred thousand dollars (\$100,000) of the budgeted line item shall be included in the report. [\[Insert Text Begins\]The report shall show all intradepartmental cost-center budget transfers and include an explanation of those transfers greater than one hundred thousand dollars. \[Insert Text Ends\]](#) The semi-annual forecast report shall be reported to the Board of Trustees at the last Board Meeting before the State Bar Annual Meeting.

New section 8 is added to tab 17, article 1, to read:

[\[Insert Text Begins\]](#)**Section 8 *Independent Review of Fiscal Controls***

[Beginning in 2015 and every five years thereafter, a review of the State Bar's budget and fiscal control policies and procedures shall be conducted by an independent consultant under the oversight of the Board Audit Committee. \[Insert Text Ends\]](#)