

AGENDA ITEM

142 JULY 2017

DATE: July 13, 2017

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

FROM: Christine Wong, Chief Financial Officer

SUBJECT: 2017 Mid-Year Forecast, Variance Report & Proposed Budget Amendment

EXECUTIVE SUMMARY

In January the Board of Trustees adopted the State Bar's annual budget covering the 2017 fiscal year. Pursuant to the State Bar's fiscal policy, the Office of Finance is responsible for monitoring budget spending throughout the fiscal year and providing the Board with budget status updates and proposals for amendments when necessary. In this agenda item, staff presents: 1) the budget-to-actual variance report by line item reflecting variances greater than \$100,000; 2) the 2017 mid-year financial forecast/projection; and 3) the 2017 proposed budget amendment.

Both the variance report and the mid-year financial forecast are prepared based on May operating results. When preparing the financial forecast, staff evaluated the current revenues and expenses and estimated the future fiscal condition based on historical information and anticipated expenses for the fiscal year. In this financial forecast, staff projects Bar-wide savings of \$4.9 million: \$3.3 million savings in the General Fund and \$1.6 million savings in Non-General Fund funds. To make effective and efficient use of the State Bar's fiscal resources and in advancement of Board adopted goals and objectives, staff proposes a mid-year budget amendment reallocating a portion of the projected surplus to finance two key projects: an Oracle Enterprise Resource Planning (ERP) system upgrade and space modifications to accommodate OCTC expansion. The budget amendment will also correct technical inaccuracies in the adopted budget and provide funding for other unforeseen expenses that were not anticipated at the time the budget was finalized. In total, the requested amendments will allocate \$1.5 million in projected General Fund savings, which will reduce the projected General Fund year-end surplus from \$3.3 million to \$1.8 million. Staff recommends leaving these remaining savings in the fund balance to address future needs.

DISCUSSION

A. Budget-to-Actual Variance Report as of May 31, 2017 (Attachment A):

The Budget-to-Actual Variance Report summarizes significant budget variances (both favorable and unfavorable) by comparing the budgeted amount to actual operating results for both

revenue and expense line items. The Bar's fiscal policy (Board Book Policy, Section 4, Tab 4.1) defines significant budget variance as per line item budget-to-actual variance greater than \$100,000. Budget variances by line item with explanation are presented in detail in Attachment A, categorized as follows:

- 1) Require Budget Amendment: Variance due to unanticipated fiscal needs or technical inaccuracies in the adopted budget.
- 2) Require Monitoring: Variance due to timing, expected to be self-correcting. No budget amendment is required at this time. Staff will continue monitoring the variance and will report to the Board if adjustment is necessary in the future.

B. 2017 Mid-Year Financial Forecast/Projection (Attachment B):

To prepare the mid-year financial forecast, staff evaluated current revenues and expenses and estimated future fiscal conditions based on May operating results, available historical information, and anticipated expenses for the remainder of the fiscal year. As a result of this analysis, staff projects a total of \$4.9 million in savings for the entire State Bar this year: \$3.3 million in the General Fund and \$1.6 million in non-General Fund. The 2017 mid-year financial forecast summarized by fund level is presented in Attachment B.

The projected savings are due largely to personnel cost savings from delayed hiring and the Reduction-In-Force (RIF) program, as well as increase in projected revenues in non-General Fund programs. For the \$3.3 million projected savings in the GF, approximately \$2.1 million is due to delayed hiring in the Office of Chief Trial Counsel (OCTC) and RIF program. The 2017 adopted budget provides for a fully staffed OCTC. However, between January and May, vacancies have ranged from 29 to 50 positions. Part of this vacancy rate (16 positions specifically) can be attributed to a lengthy negotiation process to finalize the new Supervising Attorney position. In addition, a significant number of OCTC staff took advantage of the RIF program. As a result, salary and benefit cost savings in OCTC are approximately \$2.1 million as of the end of May 2017.

With respect to the impact of the RIF program on the State Bar budget overall, the 2017 adopted budget fully funded all existing State Bar staff, regardless of any potential pending participation in the RIF. As most of the RIF participants left at the end of March, all departments with RIF participants have realized salary savings; some of these savings will continue to accrue for the remainder of the year based on the RIF replacement plan (which prioritizes replacement of OCTC and non-General Fund supported personnel), while other savings will be more limited as new staff are hired. Projected salary and benefit cost savings from the RIF across the entire State Bar total approximately \$1.6 million, about \$1.0 million of which is in the General Fund.

Other savings due to increase in projected revenues for approximately \$1.2 million are related to non-General Fund programs, which include Admissions Fund and Legal Services Trust Fund, Justice Gap Fund and Bank Settlement Fund. Details are summarized in Attachment B.

C. Proposed 2017 Budget Amendment (Attachments C1, C2 and C3):

To make effective and efficient use of the State Bar's fiscal resources and in advancement of Board adopted goals and objectives, staff proposes a mid-year budget adjustment as follows.

Budget adjustments in detail are summarized in Attachments C1 (by transaction), C2 (by fund) and C3 (for General Fund only).

1) Budget adjustment to correct Budget-to-Actual variance:

Staff recommends increasing the revenue budgets for the Justice Gap and Legal Services Trust Funds by \$300,000 and \$175,00, respectively. The adopted budget was conservative based on a concern that the introduction of online billing might adversely affected donations. This negative impact was not realized, and upwards revenue adjustments are required accordingly.

In addition, staff recommends increasing Admissions fee revenues by \$600,000 as more applicants applied for the July exam than last year due to the low February pass rate, and some applicants deferred taking the exam to July with the two-day exam offering.

2) Budget adjustment to correct technical inaccuracies in the adopted budget:

This adjustment includes a \$120,000 positive adjustment to the GF revenue related to the MCLE self-study due to technical inaccuracy in the adopted budget.

3) Budget adjustment to capture expenses or revenues that were unanticipated when the annual budget was finalized; and

4) Budget adjustment to support new initiatives:

- a) Attachment C2, Adjustment # 15: For a total of \$550,000 to support space reconfiguration needed to accommodate new hires in OCTC. The entire \$550,000 will be financed by projected General Fund savings.

In both Los Angeles and San Francisco, OCTC will soon run out of space. Although there are currently a significant number of vacancies, recruiting is underway. The 2017 adopted budget reflects an overall headcount increase for OCTC. After assessing current and projected headcount, the available space in its as-is condition, and options to provide additional space in an efficient and cost effective manner, staff recommends space modifications in both Los Angeles and San Francisco as described below.

In Los Angeles, OCTC occupies the entirety of floor 4 and a portion of floor 5; OCTC currently has an excess of cubicles and shortage of attorney offices. The Lawyer Assistance Program (LAP) currently occupies a small suite adjacent to OCTC on floor 5. LAP will shortly be moving to an offsite space. Staff proposes combining the LAP suite with the existing OCTC suite and constructing additional offices in the merged area where cubicles and small huddle rooms are now located. The estimated cost for this project is \$265,000 (\$190,000 for construction and \$75,000 for furniture).

In San Francisco, OCTC occupies most of floor 7; there will soon be both a shortage of offices and cubicles in OCTC's current space. Human Resources (HR) occupies the balance of floor 7. Staff proposes expanding OCTC into the space currently occupied by HR, constructing offices in the former HR suite where cubicles are located, and reconfiguring other cubicles for a more efficient layout. The estimated cost for this project is \$135,000 (\$55,000 for construction and \$80,000 for furniture).

As a result of OCTC expansion on floor 7, HR staff will need to move to floor 8. Staff proposes that the space currently occupied by General Services on that floor, and the adjacent space that formerly housed the library, be modestly reconfigured to accommodate General Services and HR. The estimated cost for this project is \$150,000 (\$60,000 for construction and \$90,000 for furniture).

- b) Attachment C2, Adjustment # 16: Additional Howard Street building improvement costs for \$430,000. This cost will be allocated to individual programs as indirect costs; 62 percent, or approximately \$266,000, will be allocated to the General Fund.

The Bar maintains 180 Howard Street through continuous preventive maintenance, routine repairs and upgrades, and more significant improvements to the building's structure and major systems that are necessary due to normal aging, wear and tear, technical obsolescence, and the need to comply with updated building codes. In conjunction with its property and construction project management firm, staff has developed a multi-year capital improvement plan, which includes the upgrade, replacement or new installation of components of the building's Heating, Ventilation & Air Conditioning (HVAC) System; Fire / Life Safety Systems; physical structure; and elevators. Many of these components are original to the building, and at 39 years old are past the end of their useful life and are more difficult and costly to maintain. The 2017 portion of that capital improvement plan was originally estimated at \$1.7 million in the adopted budget. More firm cost proposals have increased projected costs by \$430,000 to \$2.13 million. This \$430,000 additional cost will be cost allocated out to individual programs based on office space occupancy.

- c) Attachment C2, Adjustment # 17: Oracle Enterprise Resource Planning (ERP) System Upgrade for a total cost of cost is approximately \$1.8 million (\$0.7 million to be expensed in 2017). Costs will be allocated to individual programs on a full-time equivalent basis with the General Fund bearing approximately \$515,000 of projected 2017 expenses.

A brief summary of the project is provided below. See Attachment D for the complete Business Case for an ERP¹ system upgrade.

The State Bar's Enterprise Resource Planning (ERP) system, JD Edwards (JDE), an Oracle product, was first installed in the 1990's. JDE is a mature and flexible platform with a broad set of applications used across the Offices of Finance, Human Resources, and General Services (Procurement). When initially deployed, the ERP system served the needs of the organization; the annual maintenance fee of \$100,000 was reasonable and covered the technical support and system improvement requirements of the time. In 2008 the Bar upgraded the JDE system to the latest platform provided by Oracle, a process which included enhancements and improvements to functionality.

Since that upgrade the demands for a robust ERP system have skyrocketed. Much of this demand has been driven by increased reporting and compliance requirements placed on the Bar as a result of a series of incidents including the lease-related embezzlement discovered in 2008, the Los Angeles building purchase in 2012, and the former Executive Director's foreign travel in 2011 to 2014. Additional requirements stem from Board and staff action designed to

¹ Submitted pursuant to and satisfying State Bar Policy: "For all contracts, projects and expenditures reasonably expected to exceed \$2,000,000, State Bar staff will develop and present a written cost-benefit analysis to the Board of Trustees before committing to, or making a binding agreement for the contract, project or expenditure."

improve internal controls in a number of areas. Concurrent with these enhanced system needs, annual maintenance fees increased to \$142,000, a cost which did not include server licensing fees, upgraded infrastructure, or increasing customization expenses. The Bar's ERP platform has not been upgraded since 2008 and the organization is heavily reliant on a third-party vendor for sustenance level support. Maintenance of the status quo is not a viable option. The existing system is cumbersome, requires extensive manual workarounds, and allows for only limited integration of Human Resources, Finance, and Procurement modules; together these shortcomings create tremendous inefficiencies for staff and significant risk for the Bar. The State Bar's external auditor, Moss Adams, succinctly assessed the ERP system in a recent letter, excerpted below:

"From our observations and discussions with finance and various other personnel, the system [ERP] challenges aren't isolated to the year-end time frame nor are they solely related to the accounting functions. For example, it was apparent to us, from review of data summaries, reconciliations and reports prepared throughout the year that significant manual manipulation is required for numerous tasks that occur daily, weekly and monthly. Such processes are time consuming, inefficient and inherently prone to error. Other groups, including budget, information technology, and top management, are also negatively impacted by a system that necessitates significant manual, and often, duplicative processes. These impacts include shortcomings to quality and timeliness of information available for decision making."

The full text of the letter is provided as Appendix II of the Business Case.

Modification of the current system is also not a feasible option. The pool of programmers available to support the platform is limited and getting harder (and more expensive) to find - as evidenced in part by the fact that even the Bar's contracted third-party support provider itself has a limited ability to timely make complex system modifications due to a lack of qualified personnel.

Based on research of upgrade and replacement options conducted by staff, which included vendor demonstrations and an assessment of the long-term total cost of ownership, staff recommends remaining with an Oracle system but transitioning from the on-premise JDE to Oracle's cloud-based Software-as-a-Service (SaaS) platform, Fusion. The Fusion option presents the "best of both worlds" as its similarities to the JDE system will make transition to the new system easier with respect to both configuration and staff training, while its amalgamation of multiple high leverage solutions will result in increased efficiencies in many areas of the Bar. Fusion will address a majority of the Bar's ERP requirements, and will automate a significant number of current manual and paper-intensive processes in the Offices of Finance, Human Resources and General Services (Procurement). The system will reduce exposure to risk and provide confidence in Bar reporting. Additionally, the resulting efficiencies will free up impacted departments to create auditable, accurate, and timely reports without the need for time-consuming and error-prone manual processes and input. Expected time savings to the State Bar is over 5,900 hours per year, which is equivalent to approximately three full-time positions (see Time Savings Summary, Appendix I of the Business Case).

As Table 1 below reflects projected system implementation costs for Oracle Fusion are approximately \$1.8 million, with \$700,000 expected in 2017 expenditures.

Table 1: Oracle Fusion (Cloud) Implementation Costs:

Oracle Fusion (Cloud)	Total Costs
<i>Fusion Subscription Fees</i>	\$218,880
<i>Fusion Implementation Services</i>	\$1,600,000
Cost to Implement	\$1,818,880
<i>Annual Fusion Subscription Fees</i>	\$218,880

- d) Adjustment # 18 – Required budget increase for professional service fees for \$150,000 to finance a policies and procedures review and internal control audit in 2017. According to the State Bar’s Board Book (Tab 4.1, Section 10), “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”. The last internal control review was conducted in 2010; the following review initiated in 2015 was postponed due to the special State audit and fund structure review. Staff recommends that the internal control review be conducted in 2017 and requests a budget amendment to support related costs. The \$150,000 service fee will be cost allocated to individual programs based on direct operating expenses, with the General Fund bearing approximately 58 percent or \$87,000.

e) Other Budget Requests for Board Consideration:

In the 2017 adopted budget, it includes a \$1.7 million budget for Howard Street building improvement costs. This costs do not include an elevator upgrade. However the elevators in the Howard Street building, while safe, are becoming increasingly unreliable and difficult to maintain. There is a waiting list of at least a year for elevator upgrade projects due to increased demand throughout San Francisco. Staff has recently been informed that if the Bar enters into an upgrade contract within the next few months, the project, which will take one year to complete, can begin in late 2018. A 10 percent deposit on the \$2.2 million total project cost is required at contract execution. Although payment of this deposit will not technically impact the 2017 budget as it reflects a pre-payment on future costs, Staff includes this request for Board’s approval so that the Board is fully aware of this project and the fact that the prepayment reflects a future commitment to spend approximately \$2.2 million on elevator upgrades in 2018 and 2019.

In addition, for the \$1.8 million projected cost for Oracle Fusion system upgrade, approximately \$700,000 will be expensed in 2017. Approving this project reflects a future commitment to spend the remaining \$1.1 million costs in 2018 and or 2019 in order to complete the system upgrade.

Summaries of the proposed budget amendment by item and by fund are presented in Attachments C1 and C2.

In the aggregate, proposed amendments recognize an increase in State Bar revenues of \$995,000. These increases result primarily from increased legal services and Admissions revenue.

The amendments also seek to reallocate \$1.5 million of projected General Fund savings to support technical corrections, unforeseen expenses, and new initiatives. Approval of these amendments will reduce projected General Fund savings from \$3.3 million to \$1.8 million. Staff recommends leaving the remaining projected GF savings million in the fund balance for future needs.

FISCAL/PERSONNEL IMPACT

Net budget increase from the proposed budget amendment summarized in Attachments C1 to C3.

RULE AMENDMENTS

No rule amendment necessary.

BOARD BOOK IMPACT

None.

BOARD GOALS & OBJECTIVES

State Bar's adopted 2017-2022 Strategic Plan Goals and Objectives – Goal 3: Improve fiscal and operational management, emphasizing integrity, transparency, accountability and excellence.

BOARD COMMITTEE RECOMMENDATIONS

The Planning and Budget Committee recommends that the Board of Trustees approve the following resolution:

RESOLVED, that the Board of Trustees approve the Proposed Budget Amendment summarized in Attachment C.

ATTACHMENT(S) LIST

- A.** Budget-to-Actual Variance Report – As of May 31, 2017
- B.** 2017 Mid-Year Financial Forecast
- C1 to C3.** Proposed Budget Amendment By Item, By Fund and By General Fund
- D.** Oracle Enterprise Resource Planning (ERP) Procurement & System Upgrade Proposal