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## State Bar of California

It Should Balance Fee Increases With Other Actions to Raise Revenue and Decrease Costs

Report Number: 2018-030

Public Letter

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# Summary

## Audit Highlights . . .

Our review of State Bar's proposed fee increases revealed the following:

- » Some of State Bar's proposed fees for 2020 could be reduced or delayed.
- » State Bar calculated much of its proposed licensing fee based on hiring 58 new staff to reduce its backlog of attorney misconduct cases, but procedural changes related to its trial counsel's office may decrease its staffing needs.
- » State Bar's proposed one-time special assessment fee for funding information technology and capital improvement projects is higher than necessary and includes premature funding for some projects.
- » For its Client Security Fund, State Bar has proposed a higher fee that would fund all the current pending claims it expects to pay, as opposed to funding only those claims it will likely pay in 2020.
- » Given the Lawyer Assistance Program's high reserve and low expenditures, the Legislature can suspend the fee for it in 2020.
- » To mitigate proposed fee increases, State Bar could increase the revenue it receives from the space it leases to tenants in its San Francisco building.
- » Inadequacy of the current fee-approval process has contributed to the misalignment of State Bar's fees with its costs—the process does not ensure consistent revenue or allow for long-term planning.

## Results in Brief

The State Bar of California (State Bar) protects the public by regulating the practice of law in California. As part of fulfilling its public protection charge, State Bar licenses and disciplines attorneys, and the mandatory fees that licensed attorneys pay are its primary revenue source. The Legislature is currently responsible for setting the amount of State Bar's licensing fee each year through an annual fee bill, and its licensing fee has not increased in 20 years. State Bar recently proposed to its board increasing several of its annual mandatory fees to amounts that would fund current operations, allow for growth in 2020, and generate sufficient revenue to fund the special projects State Bar has planned through 2024. State Bar's proposal would increase each active licensee's total annual mandatory fees from \$383 in 2019 to \$813 in 2020. Although State Bar supports its fee proposal with thorough cost projections, which represents a good step toward strengthening its transparency and accountability, we found some costs that State Bar could reduce or delay. Consequently, we recommend a total annual fee of \$525 in 2020 for each active licensee.

The largest fee that licensees pay to State Bar is the annual licensing fee, which State Bar uses to support many aspects of its operations. State Bar has proposed a 2020 licensing fee of \$408. However, we believe a \$379 fee would be adequate to meet its needs. Specifically, State Bar has calculated much of its requested fee increase based on its proposal to hire 58 new staff to perform discipline activities, such as investigating attorneys accused of misconduct. We agree that additional staff are necessary for State Bar to address its significant backlog of complaints. However, certain changes State Bar implemented from 2017 through early 2019 to improve its discipline process may decrease the number of employees it needs. Thus, we based our recommended 2020 fee amount on a more gradual process of adding 19 new staff in 2020.

State Bar also has proposed a one-time \$250 special assessment fee for 2020 to fund information technology (IT) projects and implement capital improvements it plans for a five-year period, as well as to rebuild its depleted general fund reserve to 17 percent of operating costs. Although we agree with the necessity for a special assessment fee, we believe that State Bar could spread that fee over five years and postpone some projects. For example, some of the IT projects for which it has proposed funding are not priorities according to its strategic plan. Thus, we recommend removing some projects from State Bar's request and spreading the assessment fee over five years, which better matches project timelines and lessens the impact on licensees. We calculated the effects of these and other adjustments on State Bar's proposed special assessment fee for 2020 and found that a fee of \$41 would coincide with projects State Bar has scheduled for that year. State Bar can charge the remainder of the special assessment fee over the following four years.

In addition to its licensing and special assessment fees, State Bar receives program fees that fund its Client Security Fund (security fund) and Lawyer Assistance Program (assistance program). We believe that its proposed fee for the security fund is higher than necessary and that the assistance program fee can be suspended in 2020. The security fund reimburses claimants for financial harm they have suffered because of attorney misconduct. State Bar wants to increase the security fund fee in 2020 from \$40 to \$120 because it has many pending claims awaiting payment and could issue more reimbursements if it received more revenue. However, instead of a 2020 fee that would fund all the current pending claims State Bar expects to pay, regardless of when it will actually pay them, we believe the 2020 fee should only fund those claims State Bar will likely pay that year. Our analysis shows that State Bar needs a fee of \$80 in 2020 for claims that will become eligible for payment that year. Conversely, the assistance program, which offers counseling and support for California bar exam applicants, law school students, and licensees with substance use and mental health issues, has reserves it can use to

fund demand for its services in 2020, and we recommend that the Legislature suspend this program fee in 2020. [Table 1](#) compares our recommended mandatory fees for 2020 with those that State Bar has proposed.

**Table 1**  
**State Bar's Proposed Mandatory Fee Increases for 2020 Are Higher Than Necessary**

MANDATORY FEE*	2019	STATE BAR PROPOSAL	STATE AUDITOR RECOMMENDATION
Licensing	\$308	\$408	\$379
Discipline <sup>†</sup>	25	25	25
<b>Special Assessment</b>			
IT projects	0	82	22
Capital improvements	0	134	16
Rebuild general fund reserve	0	34	3
<b>Subtotals</b>	<b>0</b>	<b>250<sup>‡</sup></b>	<b>41</b>
<b>Client Security Fund</b>	40	120 <sup>§</sup>	80
<b>Lawyer Assistance Program</b>	10	10	0
<b>Totals</b>	<b>\$383</b>	<b>\$813</b>	<b>\$525</b>

Source: Analysis of relevant documents related to State Bar programs funded by mandatory fees licensees pay.

\* We show the fees for active licensees only. See [appendices B](#) and [C](#) for the inactive fees that we recommend and for special assessment fees that we recommend for 2021 through 2024.

<sup>†</sup> This fee supports State Bar's discipline system. We do not recommend changing the amount of this fee, rather we recommend merging it with the licensing fee, as we [discuss later](#) in the report.

<sup>‡</sup> State Bar's proposal is a one-time fee to generate revenue for planned special projects over five years, as well as to immediately bring its general fund reserve back to 17 percent.

<sup>§</sup> State Bar's proposal is a one-time fee increase to generate revenue for all pending claims as of December 31, 2019, that it projects will be paid.

To potentially mitigate proposed fee increases, we reviewed State Bar's operations for opportunities to increase its revenue, which may allow it to decrease the fees that attorneys must pay. We hired a certified real estate appraiser to evaluate State Bar's real estate holdings in San Francisco and Los Angeles. Our appraiser found that State Bar has not maximized lease revenue from its San Francisco building. State Bar has entered into leases that are below market value, and it has not leased all available space in the building. We also considered efficiencies—such as the agencywide performance measures and goals that State Bar has recently developed—that could improve its performance and eventually translate to reduced costs and corresponding reductions in licensing fees.

The inadequacy of the current fee-approval process has contributed to the misalignment of State Bar's fees with its costs and thus to the necessity for a substantial fee increase. The current cycle by which the Legislature sets the licensing fee each year through an annual fee bill does not align with best practices because it neither ensures State Bar has consistent revenue nor enables State Bar to engage in adequate long-term planning. Further, in years when the Legislature has not approved its licensing fee, State Bar has had to make sudden staffing reductions, limiting its ability to process complaints about dishonest attorneys and to fulfill its public protection mission.

We believe that the Legislature should adopt a multiyear fee cycle that will allow State Bar to better engage in fiscal planning while still providing the Legislature with necessary oversight. Specifically, we suggest a three-year fee-approval cycle that includes fee reviews and a fee cap. Establishing a fee cap for the three-year period would enable State Bar to anticipate consistent revenue and would allow licensed attorneys to plan for their future expenses. During each year of this period, State Bar would set the fee at an amount that reflects its budgeted operating costs for that year and does not exceed the cap. To then justify any proposed cost increases, State Bar would have to demonstrate that it is performing its key functions effectively and efficiently by using its recently developed performance measures and its new methodology for projecting costs and revenues. The Legislature could also review and adjust the fees for the security fund and assistance program as part of this cycle in order to better align fees with program costs.

## Selected Recommendations

### *Legislature*

To ensure that State Bar has the funding necessary to fulfill its mission while at the same time limiting the fees that licensees must pay, the Legislature should set State Bar's 2020 fees at the amounts we recommend in [Table 1](#).

To provide State Bar with consistent revenue and to enable it to improve its management practices, the Legislature should adopt a multiyear fee-approval cycle to take effect before it determines the licensing fee for 2021. The new fee-approval cycle should include the following components:

- A multiyear budget, fee justifications, and related performance data submitted by State Bar.
- A fee cap for the multiyear period set by the Legislature.
- The authority for State Bar to adjust the fee each year up to the maximum amount.

## **State Bar**

To better assess the security fund's revenue needs after 2020, State Bar should develop by August 2019 a methodology for estimating the payments that it is likely to make in a particular year. This methodology should consider the average length of time it will spend processing applications that are eligible for reimbursement and estimate the number of applications anticipated to become eligible for reimbursement during the course of that year.

To ensure that it maximizes the revenue it receives from its San Francisco building, State Bar should lease all available space at market rates.

## **Agency Comment**

State Bar generally agreed with the recommendations in our report, except for the recommendation related to suspending the assistance program fee in 2020. Because State Bar plans to restructure the program and may transfer part of the program to another entity, it believes a large reserve balance is warranted to support these changes.

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