



# The State Bar *of California*

---

## **OPEN SESSION AGENDA ITEM JANUARY 2023 FINANCE COMMITTEE II.A**

**DATE:** January 6, 2023

**TO:** Members, Finance Committee

**FROM:** Aracely Montoya-Chico, Chief Financial Officer

**SUBJECT:** Discussion of State Bar 2023 Preliminary Budget

---

### **EXECUTIVE SUMMARY**

This item is presented to the Finance Committee for review and discussion; feedback is sought specifically regarding key assumptions reflected in the initial 2023 budget prepared by staff. Because of the specific challenges associated with the Admission Fund and the General Fund, this agenda item will focus almost exclusively on these two areas of the overall budget. No formal action is being requested at today's meeting, however, staff is seeking feedback from the Finance Committee to finalize the proposed budget.

The Board of Trustees (BOT) is expected to approve the 2023 budget at its January 19–20 meeting. The State Bar will submit the final budget to the Legislature to meet the statutory deadline in accordance with Business and Professional Code section 6140.1, which requires the State Bar to submit the final budget by February 28, 2023.

---

### **DISCUSSION**

The State Bar is experiencing decreasing General Fund (GF) reserve balance year-over-year in addition to a significant structural deficit in the Admissions Fund. A high-level overview of key issues impacting these funds is provided below:

## GENERAL FUND

1. One fee increase in the past 25 years. In 2020, the Legislature increased the General Fund portion of the licensing fee by \$71. The breakdown of the increase was \$21 to address the operating deficit, \$17 to expand retiree health to all employees, \$13 to add positions in the Office of Chief Trial Counsel, \$13 to help pay for salary increases due to a COLA adjustment, and \$7 to help with information technology replacements. In addition, there were special assessments for building improvements (\$4 for ten years), technology improvements (\$5 for five years), and to increase the General Fund reserve balance (\$3 for one year).
2. No fee increase was approved for fiscal year 2023.
3. An MOU that guarantees 5 percent salary increases annually for all staff meeting expectations (step increases).
4. A recently negotiated MOU, which included a Cost-of-Living Adjustment (COLA) of 5 percent for non-attorneys and 10 percent for senior and supervising attorneys effective for fiscal year 2023. An additional COLA of 2.5 percent for each of the following two years. For 2023, the increase to personnel expenses as a result of the COLA is \$4.5 million bar-wide.
5. Pending sale of the San Francisco (SF) building. The State Bar's SF building was officially put up for sale in December 2022. However, the real estate market for commercial properties has deteriorated this year as many employers adopted policies that allowed their employees to work remotely. This caused a significant decline in commercial real estate purchases. In particular, the SF office space vacancy remains at an all-time high and is not expected to improve in the foreseeable future. The value of the SF building has decreased 15 to 20 percent from the appraised value since the same time last year. It is very difficult to know what the actual sale price would be or if the State Bar would get an offer that makes the sale viable.
6. Based on the most recent midyear projections, General Fund reserves are projected to be approximately \$10.3 million or 10.9 percent at the end of 2022. The 10.9 percent reserve level is below the minimum threshold (17 percent) adopted by the Board.
7. 2022 budgeted salary savings of 15 percent. Actual savings year-to-date is approximately 9 percent.
8. Growing Information Technology (IT) needs and a transition to the cloud and enterprise platforms increased costs in 2022 and will do so on a go forward basis. Investments in IT infrastructure were a key component of the 2022 budget to provide greater accessibility to the State Bar operations and data. This was meant to support increased internal and external accountability, and provide greater responsiveness to consumers and licensees.
9. Work on GF program fee increases is still underway. The result of proposed fee increases, once approved, are not likely to be realized prior to 2024. Based on the latest fee analysis, the proposed increase to all GF programs would generate approximately \$3 million in total revenues and the overall impact of the fee changes is only a net \$0.7 million increase to the GF. This is all projected at this point.

10. One-time significant expenses related to the special discipline case audit and subsequent investigations and the Odyssey data breach impacted GF spending in 2022.

## **ADMISSIONS FUND**

1. General decreasing trend in Bar Exam applicants the past few years resulting in a decline in revenue. For example, revenue in 2020 was \$22.2 million and has decreased to approximately \$19.7 million for 2022.
2. Declining numbers of people taking the bar exam.
3. Increasing test administration costs.
4. Increased testing accommodations (TA) spending to improve functioning and compliance in this area.
5. With the current spending, the Admissions Fund is still in a severe deficit position and will require use of reserves.
6. Admissions Fund reserves are projected to end 2022 at \$2.9 million or 11.7 percent. The Legal Specialization Fund is a subset of the overall Office of Admissions. The Legal Specialization Fund will be merged with the Admissions Fund, after consideration of guidance received from the Office of General Counsel indicating that the State Bar has the ability to do so. The projected Legal Specialization reserve balance at the end of 2022 (\$6.6 million) will be transferred to the Admissions Fund. The result will increase the Admissions Fund reserve to approximately \$9.5 million beginning of 2023.
7. Work on Admissions fee increases is underway, however, the results of the fees to be proposed will not see the impact before 2024. Based on the latest fee analysis, the proposed increase to all Admissions programs would generate a total of \$26.5 million in revenues. However, the overall net impact of all the fee increases would reduce the Admissions deficit to approximately \$1.4 million. This is all projected at this point.

## **BUILDING 2023 BUDGET**

Recognizing our challenging financial situation, Finance staff attempted to see if it was possible to develop a budget that would not rely on any GF reserves and what that would entail. With these key issues in mind, the 2023 budget was initially generated based on the following assumptions:

1. **General Fund:** Cost neutral with no reserve spending. With most expenditures zeroed out, except for those absolutely necessary to run operations (personnel and certain services/equipment/building operations), the GF would be at a small deficit position of approximately \$55,000. Specific budget provisions under this scenario include:
  - a. 15 percent salary savings applied to personnel expenses based on historical savings rates.
  - b. One position frozen that was approved for recruitment as part of the 2022 budget but remained vacant as of year-end.
  - c. No travel for any employees.

- d. Subentity travel minimized to twice per year and Board travel minimized to four times per year.
  - e. No new professional service expenditures. Only open/committed Purchase Orders (POs) were considered.
2. **Admissions:** Maintain spending from prior year. Admissions has significant expenditures for professional services, exam, temporary help, and travel expenses to perform its core function.
  - a. 15 percent salary savings applied to personnel expenses based on historical savings rates.
  - b. No new positions
  - c. No cuts to professional service, temporary help or travel.

These assumptions generated the following budget for the GF and Admissions:

**Table 1. Minimal Spending Budget**

	Projected Revenues	Projected Expenses	Overall Deficit
<b>General Fund</b>	\$91.3M	\$91.4M	(\$0.1M)
<b>Admissions Fund</b>	\$17.5M	\$24.8M	(\$7.3M)

Given that the GF budget did not account for any new positions, new professional services spending in 2023, beyond those already encumbered in 2024, including, for example, any costs associated with the 2201 program, or other necessary expenditures to run our operations (i.e. IT projects), it was evident that this minimalistic initial budget was unrealistic, not viable and using GF reserves was going to be necessary to produce a more realistic budget.

Additional expenditures, besides those included in the minimal spending budget, needed to be factored into a more realistic budget for State Bar operations. The Office of Finance then circulated the budgets to the respective offices and each office was asked to weigh in. This is a summary of the initial input the offices provided the Office of Finance:

#### **General Fund**

1. \$4.5 million in personnel – new positions and temporary help.
2. \$7.5 million in services, mostly for professional services. Largest requests were \$5.1 million for IT related projects and \$0.8 million for outside counsel.
3. \$2.4 million in equipment – \$2.1 million for software maintenance and \$0.3 million for hardware.
4. \$1.0 million in building operations for repairs and maintenance.
5. \$0.2 million in supplies and travel.

## **Admissions**

Admissions requested \$0.1 million overall increase from the minimal spending budget, mainly from services and exam related expenses. Due to the uniqueness of the Admissions office, Finance staff initially developed the Admissions budget based on prior year spending versus starting with a zero base for most expenses, as was the case for all other offices.

Finance staff and the Executive Director have reviewed each office's requests and generated a revised and more realistic budget that reflects the below budget additions to the GF and Admissions Funds from the minimal spending budget.

## **General Fund**

1. \$1.2 million increase in personnel composed of
  - a. Four new positions in OCTC
  - b. Temporary help in various offices
2. \$4.1 million increase in services mostly comprised of
  - a. \$2.0 million for IT projects
  - b. \$0.8 million for outside counsel
  - c. \$0.8 million for 2201 program
3. \$0.4 million decrease in each building operations due to budgeting six months' worth of expenditures with the assumption the SF building will sell in the latter part of the year.
4. \$0.4 million decrease in equipment due to IT expenditures not approved for spending.

**Admissions** - No significant changes to the Admissions budget were made in the revised budget.

Staff's proposed GF budget assumes that no more than 50 percent of the GF reserve should be used in 2023, leaving the remaining 50 percent for use in 2024. Absent a fee increase, sale of the SF building, or significant cuts in personnel and operating costs, the State Bar GF will not be solvent as of 2025.

The proposed Admissions and GF budgets outlined in Table 2 below reflect the following assumptions:

1. The recently negotiated COLA for 2023 is fully funded.
2. Salary savings of 15 percent.
3. Subentity travel minimized to twice per year, which was the same scenario applied in the minimum spend budget.
4. Board travel minimized to four times per year, which was the same scenario applied in the minimum spend budget.
5. Commission on Judicial Nominees Evaluation (JNE) meetings will continue in person, however, meetings will be reduced from 2 days to 1 day.

6. Bare minimum needed to support the highest priority expenditures for IT infrastructure, security and programmatic projects.
7. Funding for one external auditor to handle OCTC/2201 matters for the Mission Advancement & Accountability Division (MAAD). This is distinct from the one that is currently funded and the two that were recommended by the State Auditor.
8. General services expenditures budgeted for only six months of the year, with the expectation the building will sell the latter part of the year.

**Table 2. 2023 Revised Preliminary Budget**

	Projected Revenues	Projected Expenses	Overall (Deficit)/Surplus
<b>General Fund</b>	\$91.4M	\$96.4M	(\$5.0M)
<b>Admissions Fund</b>	\$17.5M	\$24.6M	(\$7.1M)

See Attachment A for the detailed revised preliminary budget, which includes all revenues and expense categories for the GF and Admissions Fund and the projected 2023 reserve fund balances.

If the Board were to approve these proposed funding levels, the projected GF reserve would be \$5.3 million and the Admissions Fund reserve would be \$2.5 million, at the end of 2023. The 2023 beginning Admission reserve fund balance includes the entire reserve balance from the Legal Specialization fund merged into the Admissions Fund as of the end of 2022.

The Finance Committee's feedback is sought particularly on these issues:

1. Amount of reserve to spend in 2023.
2. Salary savings rate – should we assume a higher or lower rate than 15 percent?
3. Subentity, Board, and JNE travel.
4. Staff travel – currently none or limited travel budgeted.
5. IT – should we have a moratorium on any new projects in 2023?
  - a. Should we also consider a moratorium on any new projects in other GF offices?
6. GS – budgeted only six months' worth of expenses versus the full year in anticipation of building sale.
7. Added four new positions to OCTC – should we add those positions even though we are in a deficit spending position?

Other issues for discussion:

1. Sale of LA building

- a. Given extensive remote work, does it make sense to retain that building? Should we accelerate consideration of sale? Does timing of sale of SF building impact this decision?

### **FISCAL/PERSONNEL IMPACT**

Described above and in detail in Attachment A.

### **AMENDMENTS TO RULES**

None

### **AMENDMENTS TO BOARD OF TRUSTEES POLICY MANUAL**

None

### **STRATEGIC PLAN GOALS & IMPLEMENTATION STEPS**

Goal: None – compliance

### **ATTACHMENT LIST**

- A. 2023 Preliminary Budget.

# GENERAL FUND

	2022 Annual Budget	Minimal	Revised	Change
<b>Revenue</b>				
40-Mandatory Licensee Fees	(84,108,523)	(85,179,200)	(85,179,200)	-
42-Other Fees	(2,900,000)	2,799,800	(2,799,800)	-
45-Other Revenues	3,300	(263,200)	(348,200)	(85,000)
47-Investment Income	(342,400)	(407,620)	(407,620)	-
48-Lease Revenue	(3,652,249)	(2,695,200)	(2,695,200)	-
<b>Revenue Total</b>	<b>(90,999,872)</b>	<b>(91,345,020)</b>	<b>(91,430,020)</b>	<b>(85,000)</b>
<b>Expense</b>				
50-Personnel Costs	81,572,720	85,120,002	86,357,680	1,237,678
51-Building Operations	7,600,257	5,715,159	5,270,827	(444,332)
52-Services	8,854,321	4,465,585	8,585,992	4,120,407
54-Supplies	1,014,055	725,663	685,259	(40,404)
55-Equipment	3,880,336	3,281,836	2,831,844	(449,992)
56-Other Expenses	933,700	472,481	461,141	(11,340)
58-Payouts and Reimbursements	(1,500,000)	(1,500,000)	(1,500,000)	-
59-Indirect Costs	(10,789,500)	(10,789,500)	(10,186,969)	602,531
62-Debt Related	3,508,194	3,508,468	3,508,468	-
69-Transfers Out	-	400,000	400,000	-
<b>Expense Total</b>	<b>95,074,083</b>	<b>91,399,694</b>	<b>96,414,242</b>	<b>5,014,548</b>
<b>Surplus/(Deficit)</b>	<b>(4,074,211)</b>	<b>(54,674)</b>	<b>(4,984,222)</b>	



# ADMISSIONS FUND

2022 Annual Budget

Minimal

Revised

Change

## Revenue

42-Other Fees	(6,674,500)	(6,187,500)	(6,187,500)	-
43-Exam Fees	(9,881,800)	(11,232,373)	(11,232,373)	-
44-Grants	(100)	-	-	-
47-Investment Income	(25,500)	(49,352)	(49,352)	-
<b>Revenue Total</b>	<b>(16,581,900)</b>	<b>(17,469,225)</b>	<b>(17,469,225)</b>	<b>-</b>

## Expense

50-Personnel Costs	7,721,454	8,109,113	8,163,293	54,180
51-Building Operations	39,045	17,506	25,006	7,500
52-Services	5,854,210	1,115,832	1,746,916	631,084
54-Supplies	79,158	39,006	39,588	582
55-Equipment	460,880	299,986	299,919	(67)
56-Other Expenses	187,159	131,157	259,381	128,224
57-Exam Related Expenses	4,164,225	8,014,840	7,366,057	(648,783)
59-Indirect Costs	6,948,492	6,948,492	6,560,460	(388,032)
69-Transfers Out	100,000	100,000	100,000	-
<b>Expense Total</b>	<b>25,554,623</b>	<b>24,775,932</b>	<b>24,560,620</b>	<b>(215,312)</b>
<b>Surplus/(Deficit)</b>	<b>(8,972,723)</b>	<b>(7,306,707)</b>	<b>(7,091,395)</b>	

**State Bar of California**  
**2023 Projected Reserve Balance by Fund**

	Projected Reserve Bal 12/31/22	2023 Budgeted Revenues	2023 Expenses & Indirect Costs	2023 Interfund Transfers	2023 Budgeted Surplus/	Projected Reserve Bal 12/31/23	Reserve Level (%) *
<b>General Fund</b>	<b>\$10,293,890</b>	<b>\$91,430,020</b>	<b>(\$96,014,242)</b>	<b>(400,000)</b>	<b>(\$4,984,222)</b>	<b>\$5,309,668</b>	<b>5.5%</b>
<b>Restricted Funds</b>							
Admissions Fund (320)	9,574,392	17,469,225	(24,460,620)	(100,000)	(7,091,394)	2,482,998	<b>10.2%</b>
Legal Specialization Fund (214)	-	2,195,338	(1,884,937)	100,000	410,402	410,402	<b>21.8%</b>
Elimination of Bias Fund (217)	(38,754)	321,294	(463,278)	-	(141,984)	(180,738)	<b>-39.0%</b>
Lawyer Assistance Program Fund (221)	1,150,166	2,140,553	(2,537,908)	-	(397,356)	752,810	<b>29.7%</b>
Legislative Activities Fund (216)	433,031	502,369	(399,145)	-	103,224	536,255	<b>134.4%</b>
Bank Settlement Fund (237)	4,652,974	72,919	(144,151)	-	(71,232)	4,581,742	<b>NA</b>
Client Security Fund (227)	7,102,119	8,204,672	(10,073,068)	-	(1,868,396)	5,233,723	<b>NA</b>
Equal Access Fund (229)	2,918,755	34,843,922	(35,414,897)	-	(570,975)	2,347,780	<b>NA</b>
Grants Fund (312)	533,694	63,864,329	(63,977,583)	-	(113,254)	420,440	<b>NA</b>
Justice Gap Fund (232)	3,638,941	1,451,368	(10,397)	(1,000,000)	440,971	4,079,912	<b>NA</b>
Legal Services Trust Fund (228)	23,488,805	46,047,328	(52,719,615)	1,400,000	(5,272,287)	18,216,518	<b>NA</b>
Tenant Improvement Fund (338)	2,281,681	-	-	-	-	2,281,681	<b>NA</b>
<b>Restricted Funds Total</b>	<b>55,735,804</b>	<b>177,113,317</b>	<b>(192,085,598)</b>	<b>400,000.00</b>	<b>(14,572,281)</b>	<b>41,163,523</b>	
<b>Grand Total</b>	<b>\$66,029,694</b>	<b>\$268,543,337</b>	<b>(\$288,099,840)</b>	<b>-</b>	<b>(\$19,556,503)</b>	<b>\$46,473,191</b>	

\* Board Reserve Policy specifies that all grant-related funds and the client security fund are excluded from the Minimum Target Reserve requirement of 17%.  
The excluded funds are the Grant, Legal Service Trust, Equal Access, Justice Gap, Bank Settlement, and Client Security Funds.