



# The State Bar *of California*

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## **OPEN SESSION AGENDA ITEM 701 AUGUST 2023**

**DATE:** August 10, 2023

**TO:** Members, Board of Trustees

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

**SUBJECT:** Approval of Proposed 2023 General Fund Budget Amendment

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### **EXECUTIVE SUMMARY**

This agenda item is presented to the Board of Trustees in accordance with the requirements of section 5.2.1 of the Board of Trustees Policy Manual (referred to as the Board Book), which states that the Board may, by resolution, amend any adopted budget, upon the recommendation of the Finance Committee. This agenda item outlines the Finance Committee's proposed 2023 General Fund budget amendments, to take effect as of August 31, 2023. The item also includes a discussion of the impact of these amendments on the 2024 budget projection.

Subsequent to Board action on August 10, staff will submit an update on the State Bar's financial position to the Legislature as recommended by the California State Auditor in its April 2023 report. That update will form the basis for negotiations regarding a 2024 licensing fee increase.

### **BACKGROUND**

The 2023 State Bar budget was approved by the Board of Trustees on February 27, 2023, and submitted to the Legislature in accordance with Business and Professions Code section 6140.1 on February 28, 2023. State Bar-wide revenues were budgeted to be \$269.9 million and budgeted expenses to be \$286.5 million. General Fund revenues were budgeted at \$91.3 million and expenses at \$95.7 million.

At its July 2023 meeting, the Board approved non-General Fund 2023 budget amendments. General Fund budget amendments were not included as the Finance Committee chair

determined that a full Board discussion regarding the impact of the potential building sale on the State Bar's financial position was a prerequisite to committee action on General Fund amendments.

As of the time of drafting this item, the State Bar's headquarters at 180 Howard Street has not been sold.

## **DISCUSSION**

### **GENERAL FUND AMENDMENTS**

The Finance Committee recommended budget adjustments outlined below have been prepared based on actual financial data through June 2023. The adjustments are categorized broadly under two separate headers: Unanticipated and Anticipated But Not Budgeted. The latter category captures those amendments that are being sought now but which typically have not been formally budgeted as well as omissions in the originally adopted 2023 budget.

#### **Unanticipated**

##### **1. BUILDING OPERATIONS ADJUSTMENTS**

The 2023 State Bar adopted budget anticipated that the 180 Howard Street building would be sold in the first six months of the year. The building has not in fact been sold in that anticipated timeline. A budget amendment is sought to add six months' worth of building-related operating costs to the budget, which will cover the operation of the building from July to December 2023. The total increase in General Fund expenses is \$1.3 million for operating costs.

##### **2. ADDITIONAL STAFFING FOR FINANCE FUNCTIONS**

Due to a combination of various audits and stakeholder demands, the Office of Finance is currently facing an escalating workload. The State Auditor report recently issued five recommendations to the State Bar, two of which significantly impact Finance. The recommendations were:

- a. By October 2023, the State Bar should identify any service fees that do not fully cover the costs of providing the services. The State Bar should increase the fees it has identified to the amount necessary to recoup its costs unless it determines that doing so would limit the public's access to the services. It should also identify any service fees that have not been updated in five years or more and assess whether they should be updated. The State Bar should then determine the effect that the increased service fees will have on the amount of mandatory licensing fee revenue that it needs.
- b. To ensure that it appropriately plans for its upcoming funding needs and takes all steps possible to maintain an adequate reserve level, the State Bar should reinstitute its practice of producing and posting on its public website forecasts for its general fund starting with its 2024 budget. These forecasts should encompass at least the following three years.

Those recommendations have and will further burden an already understaffed office grappling with a hiring freeze and unexpected absences. Current staffing levels and other pressures have resulted in Finance being unable to produce timely fiscal reports for internal management and the Board, let alone address the expanded scope of work contemplated by the State Auditor and reasonably expected by the Board and others. To address this situation, the proposed amendment includes the addition of one position to the office. This new position will play a vital role in both addressing the audit recommendations as well as, and related, implementing the Finance Committee's recently adopted policy of triennial fee reviews. The work of developing, documenting, and implementing these new processes is significant and is not something that can be effectively absorbed with current staffing levels.

The amendment will increase expenses by \$79,000 in the General Fund.

### **3. PUBLIC TRUST LIAISON**

The Office of Public Trust Liaison plays a crucial role in educating the public regarding the services the State Bar provides. Within this office, there is a public-facing contact center that functions on an outdated and poorly organized phone tree; the phone tree needs simplifying and new recorded messages are needed throughout. This amendment proposes allocating an additional \$60,000 to contract with an external entity specialized in redesigning phone tree systems.

### **4. MAY INVESTIGATION EXPENSES**

Halpern May Ybarra Gelber LLP was engaged to investigate the State Bar's handling of past discipline complaints against Thomas Girardi. However, the actual expenses incurred due to the services provided by the law firm are expected to exceed the allocated budget by \$200,000. This amendment recommends adjusting the Office of General Counsel's budget accordingly to cover these additional costs.

### **5. ODYSSEY DATA BREACH**

In February 2022, the State Bar became aware of a data breach where a website aggregating court records had limited information on nonpublic attorney discipline cases exposed. This breach resulted in substantial expenses for the State Bar, a considerable portion of which is covered by insurance. However, subsequent assessments have identified certain residual costs that will not be reimbursed. To address these unrecoverable expenses, this amendment proposes adding \$50,000 to the Office of General Counsel's budget to cover these financial obligations.

### **6. HARPER TRIAL**

The State Bar is defending against respondent Gregory Harper's claim that he was discriminated against based on race in his disciplinary proceedings. The State Bar lacks the internal expertise in these matters involving disparate impact claims to defend itself without the assistance of outside legal counsel. This amendment adds \$250,000 for outside counsel costs related to this litigation.

## **7. REMOTE MEETINGS EXPENSES**

The ability to conduct meetings for subentities solely through remote means expired on July 1, 2023. The rules have reverted back to in-person meetings and locations of all persons attending remotely will need to be noticed on the agenda 10 days in advance of the meeting. To accommodate committee members who prefer not to disclose their home addresses for public notice, the State Bar intends to cover the cost of utilizing WeWork facility space. This item proposes an additional \$25,000 to cover the anticipated expenses associated with securing suitable space. This amendment will affect several funds, including the General Fund (\$10,000).

## **8. CALPERS UNFUNDED ACTUARIAL LIABILITY (UAL) ADJUSTMENT**

An increase of \$600,000 is needed to fund the updated 2023 UAL.

### **Anticipated But Not Budgeted**

#### **1. LEGAL SPECIALIZATION CHANGES**

The Legal Specialization program administers the licensing and regulations functions for certified legal specialists. The Office of General Counsel (OGC) reviewed Admissions and General Fund fees last year as part of the broader cyclical fee review effort. At that time, OGC opined that the functions performed in the Legal Specialization program were not admissions-related per se, as designation as a legal specialist does not allow an attorney to do anything practice of law-wise that they cannot do otherwise. In light of this opinion, staff planned to transfer the majority of the program from the Office of Admissions to the Division of Regulation<sup>1</sup>. The transfer was not effectuated with the adoption of the 2023 budget due to a lack of readiness in the Division of Regulation. The division is now able to absorb the Legal Specialization program and the present requested amendment will enable the transition. This amendment will transfer the expenses and revenue for the regulatory functions of the Legal Specialization program to the Division of Regulation.

The amendment will reduce revenue and expenses in the Legal Specialization Fund by \$82,800 and increase the General Fund's revenue/expenses by the same amount.

#### **2. REVENUE ADJUSTMENTS**

The Office of Strategic Communications & Stakeholder Engagement was erroneously budgeted for MCLE self-study revenue of \$75,000. The MCLE self-study site was disabled in 2022 due to outdated content, technical issues, and lack of staffing resources to address either. This amendment revises General Fund revenue down by \$75,000 as there is no revenue to be collected.

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<sup>1</sup> Legal specialization testing is conducted every other year; examination development and delivery will remain housed in the Office of Admissions under the rationale that efficiencies are gained by housing all test development functions in one area of the State Bar. Similarly, because the primary responsibility of the California Board of Legal Specialization is to identify new areas for specialization, test development, and grading, that body will also remain housed in the Office of Admissions.

### 3. VACATION AND SICK LEAVE ACCRUALS

The 2023 adopted budget did not include funding for vacation and sick leave accruals. Historically, these expenses have not been budgeted. Instead, at year end an estimate is made for vacation/sick amounts expected to be paid to employees the following year and is recorded at year-end. Rather than waiting for year-end to record this estimate, staff is proposing to account for this estimate now to better reflect the expenses to be incurred for the remaining of the year. This will result in an additional \$2.3 million.

### 4. FINAL PAYROLL ACCRUAL ADJUSTMENT

Every year end an accrual adjustment is made to record the last week of December payroll that gets paid out the following January. The accrual is to account for the portion of the payroll expenses that belong to December. This amount has historically not been budgeted and is added to expenses at year end. This adjustment will result in an additional \$1.6 million in expenses.

### 5. INABILITY TO MEET 15 PERCENT VACANCY RATE

The adopted 2023 personnel expenses budget was based on aggressive salary savings that were to be generated through a combination of natural turnover and delayed hiring for vacant positions. While the levels were aggressive, they aligned with 2022 actuals. However, year-to-date vacancy rates have hovered at 8 percent, versus the 15 percent budgeted. Given the inability to meet budgeted salary savings, a budget augmentation is needed to account for actual personnel costs. This salary adjustment will result in an additional \$3 million in expenses.

Refer to Attachment A for details of proposed General Fund budget amendments.

### UPDATED RESERVE FUND BALANCE

The impact of the outlined General Fund Budget amendments on the State Bar's reserve balance is outlined in table 1 below.

**Table 1. Amended 2023 General Fund Reserve Balance**

	12/31/23 Projected Reserve Balance	Amendment Increase/ (Decrease)	12/31/23 Amended Reserve Balance	Reserve Level %
<b>General Fund</b>	<b>\$ 8,071,000</b>	<b>\$ (7,651,000)<sup>2</sup></b>	<b>\$ 420,000</b>	<b>0.4</b>

### UPDATED 2024 PROJECTED DEFICIT

The adopted 2023 budget forecasted 2024 General Fund deficit spending of \$6.5 million. However, that amount did not include any expenditures for building operations or lease costs. Given the uncertainty that exists with the pending sale of the building, 2024 projected spending

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<sup>2</sup> The proposed amendments total \$9.5M, however, the General Fund realized \$1.9M more revenue than budgeted. The revenue surplus is netted against the total amendment amount for a net balance of \$7.6M.

needs to be updated to include the cost of owning the building for 2024. This will add \$3.2 million to the forecasted deficit spending.

2024 personnel expenses were forecasted based on the continuation of a 15 percent vacancy rate. As noted above, it is unrealistic to continue with assumed salary savings at these levels. To better reflect total personnel expenses using a more reasonable vacancy rate and salary savings, an additional \$6.6 million needs to be added for personnel expense. This reflects a change in the budgeted vacancy rate from 15 percent to 8.3 percent.

Also as discussed above, every year end an accrual adjustment is made to record the last week of December payroll that gets paid out the following January. The accrual is to account for the portion of the payroll expenses that belong to December. This amount has historically not been budgeted, however, it would be appropriate to account for this anticipated 2024 expense at this time, given the serious challenges that the organization is facing heading in to 2024. An additional \$2.9 million should be added to projected 2024 expenditures accordingly.

A state audit was included in the 2024 budget. Based on the most current draft of the 2024 fee bill, an audit does not appear to be directed for 2024. As such, \$500,000 can be reduced from projected 2024 expenses.

Table 2 summarizes the updated 2024 budget projection.

**Table 2. Revised 2024 General Fund Deficit Spending**

	2024 Amount	Notes
<b>Adopted deficit spending</b>	<b>\$ 6,546,700</b>	
2024 building expenses	\$ 3,225,000	Net cost to own/operate the building in 2024
True-up of salary expenses	\$ 6,640,000	True-up personnel expense using a more reasonable rate of 8.3% vs 15%
Budgeting vacation and sick accrual spending	\$ 2,972,000	Vacation/sick costs to add to 2024 cost not normally budgeted
CSA audit savings	\$ (500,000)	Expense for state audit budgeted but not needed in 2024
<b>Revised deficit spending</b>	<b>\$ 18,883,700</b>	

With a projected ending 2023 reserve in the General Fund of \$0.4 million, there are insufficient reserves going into 2024 to support anticipated deficit spending of \$18.9 million. The shortfall of \$18.5 million equates to \$90 (active) and \$23 (inactive) per licensee. While this deficit is significant, staff believes it important that the Board act to accurately reflect the State Bar's 2024 financial position as the organization enters a challenging period of advocacy on multiple fronts to secure sufficient budget year funding to avoid layoffs and other draconian measures.

#### **OPTIONS FOR ADDRESSING 2024 FUNDING GAP**

Should the State Bar be unable to sell its San Francisco building options for addressing the projected 2024 shortfall would include: a statutory fee increase, a Supreme Court special

assessment, deferral of 2024 obligations, and/or borrowing or transfer from other funds. Some of these options are described in greater detail below.

### **Fund Transfer**

An option that could alleviate a portion the deficit for 2024 is to make transfer to the General Fund from funds that have excess fund balance reserve levels. At this time, the Lawyer Assistance Program Fund (LAP) and the Client Security Fund (CSF) have health fund balances that might be considered for such transfers (\$1 million and \$8.1 million, respectively).

A preliminary analysis from OGC suggests that CSF funds generated through attorney reimbursements or donations could be transferred to the General Fund; statutory authorization would be needed for all other transfers. Approximately \$1.2 million in CSF revenue is generated annually through attorney reimbursements. Although it appears statutory authorization would not be required to redirect this revenue, staff does not recommend that the Board take action to do so absent discussion with legislative staff.

The Finance Committee, as part of its amendments to the 2023 budget, recommends that the Board amend adopted legislative priorities to explicitly include pursuit of the ability to utilize excess LAP and CSF reserves to support General Fund operations in light of the General Fund balance that will result from the proposed 2023 budget amendments.

### **Deferral of 2024 OPEB Obligations**

The State Bar makes annual contributions for its Other Post-Employment Benefits obligations. If such payments were suspended for 2024 approximately \$2.1 million in cost savings would be generated.

### **Other Options**

In addition to recommending that the Board amend the State Bar's legislative priorities to seek authority to use excess LAP and CSF reserves, the Finance Committee more generally recommends that staff be authorized to pursue all other options for addressing the projected budget deficit arising from the proposed 2023 budget amendments.

## **FISCAL/PERSONNEL IMPACT**

The impact on the General Fund is a decrease to the 2023 ending fund balance by \$7.65 million. The impact of the 2024 Projected deficit is an increase of \$12.3 million.

## **AMENDMENTS TO RULES**

None

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

None

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

### **Goal 1. Protect the Public by Strengthening the Attorney Discipline System**

b.1. Assist members of the public needing assistance in submitting complaints and resolving problems by providing clear information about how the system works, outlining what constitutes a viable complaint.

### **Goal 4. Protect the Public by Engaging Partners**

c. 3. Engage diverse voices in the development and evaluation of State Bar policy.

d. 1. Collaborate with the legislature and other stakeholders to increase public protection and support the State Bar's mission.

## **RECOMMENDATION**

**Should the Board of Trustees concur in the proposed action, passage of the following resolution is recommended:**

**RESOLVED**, that the Board of Trustees, upon recommendation of the Finance Committee, approve the 2023 Proposed Budget Amendment, including the adjustment in the budgeted vacancy rate from 15 percent to 8 percent, in the form presented this day, for the period ended August 31, 2023; and it is

**FURTHER RESOLVED**, that the Board of Trustees, upon recommendation of the Finance Committee, as part of the 2023 recommended budget amendments, amend its legislative priorities to include provisions allowing the State Bar to use excess Client Security Fund and Lawyer Assistance Program reserves to support General Fund operations and authorizes staff to pursue all other options for addressing the projected budget deficit arising from the 2023 budget amendments.

## **ATTACHMENT LIST**

**A. Proposed 2023 General Fund Budget Amendments**



**THE STATE BAR OF CALIFORNIA**  
**PROPOSED 2023 GENERAL FUND BUDGET AMENDMENT**

UNANTICIPATED						
Item	Fund	Account Category	2023 Adopted Budget	Proposed Adjustment	2023 Amended Budget	Explanation
<b>1) Building Operations</b>						
123	Building Operations		1,666,855	1,303,500	2,970,355	Increase SF building related budget an additional 6 months.
				<b>1,303,500</b>		<b>Total Building Operations Amendment</b>
<b>2) Staff for Finance Functions</b>						
123	Personnel		2,217,100	79,000	2,296,100	Adjust budget to fund one new position in Finance.
				<b>79,000</b>		<b>Total Finance Personnel Amendment</b>
<b>3) Public Trust Liaison</b>						
110	Personnel		1,205,700	60,000	1,265,700	Adjust budget for expenses related to updating the phone tree system for Public Trust Liaison.
				<b>60,000</b>		<b>Total Public Trust Liaison Amendment</b>
<b>4) May Investigation Expenses</b>						
123	Services		800,000	200,000	1,000,000	Adjustment to include May investigation expenses.
				<b>200,000</b>		<b>Total May Investigation Amendment</b>
<b>5) Odyssey Data Breach</b>						
123	Services		-	50,000	50,000	Adjustment to include data breach attorney expenses.
				<b>50,000</b>		<b>Total Odyssey Data Breach Amendment</b>
<b>6) Harper Trial</b>						
123	Services		-	250,000	250,000	Adjustment to include Harper investigation expenses.
				<b>250,000</b>		<b>Total Harper Trial Amendment</b>
<b>7) Remote Meeting Expense</b>						
110	Other Expenses		51,642	10,000	61,642	To account for WeWork expense for subentity committee in Board of Trustees (General Fund).
227	Other Expenses		4,000	2,500	6,500	To account for WeWork expense for subentity committee in Client Security Fund.
228	Other Expenses		75,553	5,000	80,553	To account for WeWork expense for subentity committee in Access and Inclusion (Legal Service Trust Fund).
221	Other Expenses		18,733	2,500	21,233	To account for WeWork expense for subentity committee in Lawyer Assistance Program (LAP Fund).
320	Other Expenses		22,000	5,000	27,000	To account for WeWork expense for subentity committee in Admissions.
				<b>25,000</b>		<b>Total Remote Meetings Amendment</b>
<b>8) CalPERS Unfunded Actuarial Liability (UAL) Adjustment</b>						
110	Personnel		10,109,200	600,000	10,709,200	To account for certain personnel overages (CalPERS UAL)
				<b>600,000</b>		<b>Total CalPERS UAL Amendment</b>
ANTICIPATED BUT NOT BUDGETED						
Item	Fund	Account Category	2023 Adopted Budget	Proposed Adjustment	2023 Amended Budget	Explanation
<b>1) Legal Specialization</b>						
110	Other Fees (revenue)		-	(82,800)	(82,800)	Transfer of two positions into Regulation from Legal Specialization.
110	Personnel		3,039,700	82,800	3,122,500	Transfer of two positions into Regulation from Legal Specialization.
214	Other Fees (revenue)		(2,177,930)	82,800	(2,095,130)	Transfer of two headcount out of Legal Specialization into Regulation.
214	Personnel		814,100	(82,800)	731,300	Transfer of two headcount out of Legal Specialization into Regulation.
				-		<b>Total Legal Specialization Fund Amendments</b>
<b>2) Revenue Adjustment</b>						
110	Other Fees (revenue)		(75,000)	75,000	-	Decrease MCLE self-study application fee revenue in 2023. The program was shut down in 2023 and inadvertently included in the budget.
				<b>75,000</b>		<b>Total Revenue Amendment</b>
<b>3) Vacation and Sick Leave Accruals</b>						
110	Personnel		-	2,335,436	2,335,436	To account for vacation/sick accruals
				<b>2,335,436</b>		<b>Total Vacation/Sick Accrual Amendment</b>
<b>4) Final Payroll Accrual Adjustment</b>						
110	Personnel		-	1,596,926	1,596,926	To account for last week of December payroll accrual
				<b>1,596,926</b>		<b>Total Personnel Payroll Accrual Amendment</b>
<b>5) Inability to Meet 15% Vacancy Rate</b>						
110	Personnel		-	2,991,593	2,991,593	To account for actual personnel costs at 8.3% vs 15% salary savings
				<b>2,991,593</b>		<b>Total Personnel Expenses with Adjusted Vacancy Rate</b>