



## *State Bar of California*

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

*April 2019*

**REPORT 2018-030**





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April 30, 2019

**2018-030**

The Governor of California  
President pro Tempore of the Senate  
Speaker of the Assembly  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As Chapter 659, Statutes of 2018 requires, the California State Auditor presents this audit report regarding the State Bar of California (State Bar).

This report concludes that State Bar should balance its need for fee increases with other actions to raise revenue and decrease costs. We evaluated State Bar's proposed fee increases and determined that the amounts were higher than necessary for 2020. State Bar's proposal would increase active attorneys' mandatory fees from \$383 in 2019 to \$813 in 2020. However, we found costs that could be reduced or delayed and recommend total annual fees in 2020 of \$525 for each active licensee instead. For example, State Bar included in its calculations a plan to hire 58 new staff members to reduce its backlog of cases involving attorney misconduct. 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 recommend an initial increase of only 19 new staff members in 2020. We also recommend reductions to the fee amounts proposed by State Bar to fund specific programs and projects, such as capital improvements and information technology projects, because some projects and improvements are unnecessary at this time or too early in the planning phase to justify immediate funding.

Furthermore, to potentially offset future fee increases, we found that State Bar could increase the revenue it receives from leasing space in the building it owns in San Francisco. State Bar should also continue to implement performance measures that have the potential to increase efficiency and decrease costs. Finally, we recommend that the Legislature adopt a multiyear fee-approval cycle that will allow State Bar to better engage in its own fiscal planning and still maintain the Legislature's necessary oversight. Specifically, we suggest a three-year fee-approval cycle that includes fee reviews and a fee cap. As part of a fee review, State Bar would need to demonstrate that it is performing its key functions effectively and justify any proposed fee increases.

Respectfully submitted,

A handwritten signature in black ink that reads 'Elaine M. Howle'.

ELAINE M. HOWLE, CPA  
California State Auditor

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## Summary

### 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

### 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.*

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.

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.

**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†	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>	0	250‡	41
<b>Client Security Fund</b>	40	120§	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.

† 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.

‡ 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.

§ 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.

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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# Introduction

## Background

The State Bar of California (State Bar) is a public corporation within the Judicial Branch of California, and its mission is to protect the public, as the text box describes.<sup>1</sup>

A 13-member board of trustees (board) governs State Bar. Of these 13 members, seven are attorneys: the Supreme Court of California (Supreme Court) appoints five attorney members, and the Legislature appoints two attorney members.

The remaining six members cannot be attorneys: the Legislature appoints two members, and the Governor appoints the remaining four, subject to the Senate's confirmation. State Bar's 2019 budget accounts for 583 staff members who work in its San Francisco and Los Angeles offices.

### State Bar's Mission

State Bar's mission is to protect the public and includes the primary functions of licensing, regulating, and disciplining attorneys; advancing the ethical and competent practice of law; and promoting greater access to, and inclusion in, the legal system.

Source: State Bar's 2017–2022 Strategic Plan.

State law requires every person practicing law in California to hold an active license from the State Bar. State law classifies all State Bar licensees as either active or inactive. A licensee may become inactive either by voluntary request or by the board's action. For instance, State Bar can change an active licensee's status to inactive if that licensee fails to pay the necessary fees or is deemed mentally incompetent. Inactive licensees cannot practice law in the State. However, inactive licensees are able to restore their active status without retaking the bar examination. As of March 2019, State Bar had 190,000 active and 64,000 inactive licensees.

## State Bar's Public Protection Function

As part of fulfilling its public protection charge, State Bar licenses, regulates, and disciplines attorneys. State Bar's licensing duties include administering the admission exam to become a practicing attorney in California, while its regulatory duties include maintaining the State's official listing of licensed attorneys and overseeing continuing legal education for these attorneys. Finally, as part of its discipline system, State Bar investigates and prosecutes claims of professional misconduct.

<sup>1</sup> Until recently, State Bar included member groups known as *sections* that were organized around areas of legal practice, such as business or criminal law. As a result of a concerted effort by State Bar and the Legislature, in 2017 State Bar separated the sections into a private nonprofit organization—the California Lawyers Association. This change allowed State Bar to focus on its public protection mission.

### ***Discipline System***

State Bar's attorney discipline system comprises multiple divisions, the primary of which are the Office of the Chief Trial Counsel (trial counsel's office) and the State Bar Court. The trial counsel's office investigates and prosecutes attorneys accused of violating state law and State Bar's Rules of Professional Conduct, which establish professional and ethical standards for attorneys to follow. The State Bar Court adjudicates the matters filed by the trial counsel's office and, if warranted, recommends that the Supreme Court—which has the final authority in attorney discipline—suspend or disbar the attorneys in question. The trial counsel's office has long struggled to process all of the complaints that it receives each year, which has contributed to its backlog. Under state law, State Bar must count as part of its backlog any complaints for which it has not dismissed the case, admonished the attorney, or filed disciplinary charges with the State Bar Court within 180 days of their receipt. According to State Bar, the trial counsel's office received about 16,000 complaints in 2018 and filed disciplinary charges in 650 cases. The trial counsel's backlog of complaints and cases at the end of 2018 numbered about 1,750.

### ***Client Security Fund***

If State Bar finds an attorney guilty of misconduct, that attorney's clients may receive reimbursements for financial losses the clients incurred. The Legislature established the Client Security Fund (security fund) to reimburse individuals who suffer monetary losses as the result of dishonest attorneys' conduct. Applicants may file claims with the security fund for these reimbursements. The board appoints a seven-member commission to administer the fund. This commission has authority to approve claims and determine payment amounts, a process that it generally bases on two principles. First, the claimed loss must be the result of attorney conduct—such as theft or embezzlement of money or property—that violates state law or State Bar rules. Second, State Bar may generally investigate claims and determine reimbursements only after the attorney meets particular status requirements, such as being disbarred or disciplined. However, clients may submit their claims before State Bar imposes discipline.

According to State Bar, the security fund received an atypically large number of applications from 2009 through 2013 as a result of the residential mortgage crisis that began in 2007. During the crisis, so-called foreclosure consultants took advantage of distressed homeowners, claiming to offer help in negotiating loan modifications with lenders but instead charged high fees for

worthless services. These foreclosure consultants often secured their fees through deeds of trust on the homeowners' residences, and some attorneys who worked with the foreclosure consultants participated in activities that constituted professional misconduct. The security fund still has many pending claims awaiting reimbursement. In 2018 the security fund paid 879 claims, which totaled \$9.2 million in reimbursements. The average amount that it paid for each claim was \$10,400.

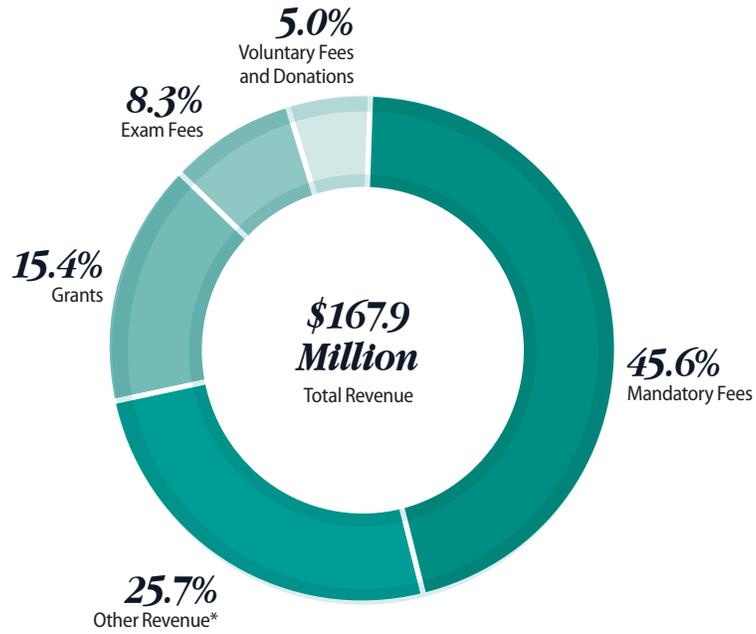
### ***Lawyer Assistance Program***

Another element of State Bar's public protection function is the Lawyer Assistance Program (assistance program), which provides confidential support and resources to California attorneys, law school students, and bar exam applicants who struggle with mental health or substance use issues. The Legislature created the assistance program in 2001 to identify and rehabilitate these attorneys and ensure they do not harm their clients or the public. The program offers services such as assessments by licensed clinicians, facilitated group sessions, and referrals to outside resources. According to assistance program staff, it had 266 participants in 2018. In general, 60 percent of the participants enter the assistance program because State Bar directs them to do so, often as part of a disciplinary proceeding, while 40 percent enter voluntarily.

### **State Bar's Revenue Sources, Budget, and Cost Allocation Plan**

As Figure 1 shows, State Bar projects that 45 percent of its revenue in 2019 will come from the mandatory fees that its active and inactive licensees pay. The Legislature must annually approve and set the amount of State Bar's primary fee—referred to as a *licensing fee*. The Legislature has not increased the licensing fee for 20 years. Licensing fee revenue goes into State Bar's general fund, and the general fund provides funding for most of State Bar's operations, including its discipline and administrative departments. To support specific functions, State Bar has additional mandatory and voluntary fees for active and inactive licensees. For example, the security fund and assistance program both receive funding from mandatory fees. Table 2 details these fees for 2019.

**Figure 1**  
 State Bar Projects That It Will Receive Almost Half of Its 2019 Revenue From Mandatory Fees



Source: State Bar's 2019 budget.

\* The category *Other Revenue* includes revenue from sources such as lease revenue and interest income.

**Table 2**  
 State Bar Collects Both Mandatory and Voluntary Fees From Licensees

2019 FEES	ACTIVE LICENSEES	INACTIVE LICENSEES
<b>Mandatory Fees</b>		
Licensing	\$308	\$68
Discipline	25	25
Security Fund	40	10
Assistance Program	10	5
<b>Subtotals</b>	<b>\$383</b>	<b>\$108</b>
<b>Voluntary Fees</b>		
Legislative Activity	\$5	\$5
Legal Services Trust Fund	40	40
Elimination of Bias	2	2
<b>Subtotals</b>	<b>\$47</b>	<b>\$47</b>
<b>Total Fees</b>	<b>\$430</b>	<b>\$155</b>

Source: California Business and Professions Code and board resolutions.

State Bar prepares an annual budget that allocates revenue from fees and other sources to its operating areas. Its budget process involves submitting a preliminary budget to the Legislature by November 15 each year, followed early in the subsequent calendar year by a final budget that its board has approved. Table 3 shows State Bar’s 2019 budget by major areas of operations. Although State Bar’s Office of Access and Inclusion has the highest budget, the majority of this office’s costs are the result of legal aid grants that it awards to organizations offering free legal services; its operating budget in 2019 is only \$3 million and the remainder is grants. As Table 3 indicates, the discipline system has the highest operating costs within State Bar. For example, the 2019 operating budgets for the trial counsel’s office and the State Bar Court total \$44 million. These budgets include the costs for 295 full-time positions, or 50 percent of State Bar’s workforce.

**Table 3**  
**State Bar’s Discipline System Has Some of the Highest Budgeted Expenditures for 2019**  
 (Dollars in Thousands)

FUNCTION	2019 BUDGETED EXPENDITURES
<b><i>Office of Access and Inclusion*</i></b>	
Operates programs to provide legal aid to low-income Californians	\$66,110
<b><i>Discipline system and related areas</i></b>	
Handles cases of attorney misconduct and includes the assistance program and security fund	54,969
<b><i>Administrative</i></b>	
Includes finance, IT, and human resources	43,119
<b><i>Attorney licensing, regulation, and admissions</i></b>	
Regulates licensed attorneys and administers the California bar examination	24,663
<b>Total</b>	<b>\$188,861</b>

Source: State Bar’s 2019 budget.

\* This office’s functions include administering grants to entities providing free legal services to low-income Californians. These grants represent the majority of the office’s budgeted expenditures. For 2019 the office has budgeted \$63 million toward grants.

State Bar maintains an annual cost allocation plan that uses a formula to distribute its administrative expenses across its divisions and programs. According to state guidance, a cost allocation plan should be timely, consistent, accurate, and auditable. In 2016 a consultant

evaluated State Bar's cost allocation plan and concluded it was sound. The consultant also presented several recommendations for improvements. State Bar has at least partially implemented the majority of these recommendations and is currently working toward full implementation. Administrative costs constituted about 23 percent of State Bar's 2018 budget.

## Audit Results

### State Bar's Proposed 2020 Licensing Fee Includes a Premature Staffing Increase

State Bar has proposed a 2020 licensing fee that is higher than necessary for that year. This fee, which attorneys pay to maintain their licenses to practice law in California, provides revenue to support many of State Bar's operations. State Bar calculated its proposed fee of \$408 per active licensee for 2020 by determining the amount that it believes it will need to fund its current operations, meet its contractual commitments, add new staff to its trial counsel's office, and pay for additional retiree health care benefits for eligible employees. However, our analysis shows that some of State Bar's estimates are higher than necessary for 2020, as we discuss in detail below. We therefore believe that \$379 is a more appropriate licensing fee.

State Bar calculated its proposed licensing fee to include a plan to hire 58 new staff for its trial counsel's office in 2020. State Bar wants to add the additional positions to reduce staff workload and speed its case-processing times: its staff noted that high workloads have contributed to problems with employee retention and to case-processing delays. State Bar based its plan for the 58 staff on a workload study that it presented to its board in 2018. This study determined that the trial counsel's office needed new staff to meet the statutory goal that, for most cases, it must either dismiss the case, admonish the attorney, or file disciplinary charges with the State Bar Court within 180 days of receiving the complaint. Processing a case involves several phases including intake, investigation, and prefiling. The study found that the trial counsel's office had a median time of nearly 180 days for completing the investigative stage alone. To reduce the length of the investigative stage, the study calculated that the trial counsel's office needed 58 additional staff—or about three additional enforcement teams, each including attorneys, investigators, and administrative support staff.

Although we agree that the trial counsel's office needs additional staff, recent and planned procedural changes related to the trial counsel's office may affect its staffing needs. State Bar staff who prepared the workload study discussed above based the study's conclusions, in part, on a staff survey conducted in September and October 2017. At that time, the trial counsel's office had only recently adopted its enforcement team structure, which it hoped would increase efficiency. Also, beginning in 2017 and continuing into 2018, the trial counsel's office implemented a new case prioritization protocol that includes eliminating unnecessary tasks. Finally, in early 2019, State Bar implemented a digital case

management system for the trial counsel’s office that could further increase its efficiency. We believe that it is not prudent to base significant staffing decisions on a study done in the midst of these types of changes.

Adding 58 new positions in 2020 would also be disruptive, and consistent vacancies in the trial counsel’s office makes filling so many positions in 2020 unrealistic. The 58 positions would range from entry to senior levels. Because the trial counsel’s office likely would fill some of the senior positions through internal promotions, it would create vacancies in lower-level positions, causing disruption as promoted staff adjusted to increased responsibilities and as newly hired staff learned their duties. In addition, the trial counsel’s office has had trouble maintaining its current staffing levels. For example, in January 2018, it had 16 vacant positions in classifications comparable to those of the 58 positions, including attorneys and investigators. In January 2019, it had 20 vacant positions in these classifications. The trial counsel’s office will likely continue to have vacant positions to fill in 2020, and adding so many more open positions will only increase the hiring challenges it faces.

We recommend that instead of adding all 58 new staff in 2020, State Bar should set its goal, and the consequent licensing fee

amount, at a level that would allow for a more gradual staffing increase. Specifically, we suggest that it add up to 19 new positions in 2020 and that it subsequently reassess its staffing needs as it moves forward. The 19 new hires would compose one enforcement team, as the text box describes. One additional enforcement team may not provide the staffing needed for State Bar to meet the 180-day goal, but gradually increasing staff over time will allow State Bar to quantify the effects of implementing its new processes and of adding an enforcement team so that it can evaluate and justify any future needs for new staff and the associated fee increases.

While State Bar’s proposed staffing increases for 2020 are premature, its decision to increase its employer contribution to retiree health care benefits for eligible employees is reasonable. However, this change will require an increase to the licensing fee. Before 2018 State Bar did not provide its nonexecutive employees with health care benefits during retirement. After transitioning its benefit plans to CalPERS, State Bar began offering retiree health care benefits to all employees in May 2018. Currently, State Bar

**Trial Counsel Enforcement Team Composition**

Supervising Attorney	1
Senior Attorney	3
Attorney	3
Investigator III	1
Investigator II	2
Investigator I	2
Paralegal	1.33
Legal Secretary II	1.33
Program Assistant II	2.33
Administrative Assistant II	2.33

**Total full-time equivalents 19.32**

Source: State Bar’s five-year general fund projection and interviews with State Bar staff.

Note: State Bar does not have strict requirements about the exact number and type of positions on an enforcement team, but staff indicated a team would include all of these professional and administrative positions. Some positions reflect more than one full-time equivalent, as shown.

pays the minimum that CalPERS requires for the employer contribution to the monthly premiums for these health care benefits. In 2020 State Bar plans to increase its contribution to match what it offers executive retirees. However, according to the chief administrative officer, this change depends on the Legislature approving an increased licensing fee. Table 4 shows State Bar's past, current, and planned maximum retiree medical benefits for its employees.

**Table 4**  
**State Bar Plans to Increase Its Contribution to Employees' Post-Retirement Medical Benefits**

DESIGNATION OF CURRENT EMPLOYEES	MAXIMUM MONTHLY CONTRIBUTION TO MEDICAL PLAN PREMIUM WHEN EMPLOYEES RETIRE*		
	TO DECEMBER 31, 2017	AS OF JANUARY 1, 2018	PLANNED FOR JANUARY 1, 2020
<i>Executive</i>			
Employed as of December 31, 2017	100%	100%	100%
Hired on or after January 1, 2018	NA	80%	80%
<i>Nonexecutive†</i>			
	\$0	\$136‡	80%§

Source: Analysis of board resolutions, State Bar employee contracts, consultant reports, and State Bar's 2019 budget.

NA = Not applicable.

\* These are the maximum contributions State Bar would make, which would apply to employees with at least 15 years of service who are over the age of 50. Employees who do not meet these requirements would receive lesser benefits.

† Nonexecutive employees must have at least one hour of service on or after January 1, 2017.

‡ This amount is CalPERS' minimum required employer contribution for 2019. State Bar began offering this benefit upon its transition to CalPERS' health plans, which took effect on May 1, 2018.

§ This increase is dependent on the Legislature approving a higher licensing fee.

If the planned change takes effect, State Bar will pay 80 percent of the monthly premiums for retiree health care benefits for employees older than age 50 with at least 15 years of service. Providing health care benefits equally to all retired employees is reasonable. Thus, we have included the related necessary fee increase in our proposal. Table 5 compares State Bar's projected costs and licensing fee for 2020 with our recommended costs and licensing fee. In Appendix B we summarize fees for inactive licensees.

**Table 5**  
**State Bar's Proposed Licensing Fee for 2020 Is Larger Than Necessary**  
 (Dollars in Thousands)

EXPENSE TYPE	PROJECTED EXPENSE	
	STATE BAR PROPOSAL	STATE AUDITOR RECOMMENDATION
<i>Wages and salaries*</i>		
Total costs for all State Bar staff, including State Bar's projected addition of 58 staff to the trial counsel's office.	\$60,305	
Total costs for all State Bar staff, including State Auditor's projected addition of 19 staff to the trial counsel's office.		\$56,497
<i>Health care benefits for eligible retired employees</i>	3,215	3,215
<i>Additional operating costs†</i>	34,770	33,364
<b>Totals</b>	<b>\$98,290</b>	<b>\$93,076</b>
	<b>FEE</b>	
<b>2020 Licensing fee‡</b>	<b>\$408</b>	<b>\$379</b>

Source: Analysis of State Bar's five-year general fund projection.

\* Wages and salaries for an additional 58 staff total approximately \$6 million, but for an additional 19 staff, it would be approximately \$2 million, a difference of \$4 million.

† *Operating costs* represent all other operating expenses, including benefits for staff and a cost-of-living adjustment for represented employees. Because we project fewer trial counsel staff, our projected operating costs are lower than State Bar's projection.

‡ We show the fee for active licensees only. See Appendix B for the inactive licensing fee that we recommend.

### State Bar's Proposed 2020 Special Assessment Fee Includes Premature Funding for Some Projects

State Bar has proposed a one-time special assessment fee of \$250 to pay for information technology (IT) and capital improvement projects it hopes to implement over the next five years as well as to rebuild its depleted general fund reserve. State Bar stated that it wants the entire amount in 2020 to ensure the planned IT and capital improvement projects are fully funded. Although we agree that State Bar should be able to plan the projects with the assurance that it will have full funding, we recommend spreading the assessment fee over five years and adjusting it each year as necessary to ensure that it aligns with reasonable upcoming and current project costs. We also recommend a smaller total assessment fee because some of the IT and capital improvement projects the fee would pay for are unnecessary at this time or too early in the planning phase to justify immediate funding. Similarly, we recommend that State Bar gradually rebuild its general fund reserve over a five-year period, which will ensure that the special assessment fee reflects changes in its staffing levels and technology efficiencies that may alter its operating costs and the corresponding reserve amount.

The special assessment fee's first element addresses IT projects, but some of State Bar's proposed IT projects do not align with its current strategic plan or its readiness to pursue them. State Bar has proposed funding 11 IT projects from 2020 through 2024, with costs that total \$16.5 million. However, only six of the 11 projects align with State Bar's strategic priorities or with recognized best practices. As Table 6 indicates, to fund these six IT projects, State Bar would need a total special assessment of \$65 from 2020 through 2024, beginning with an assessment of \$22 in 2020. We discuss the special assessment amount to fund capital improvements later in this section.

**Table 6**  
State Bar's Proposed 2020 Special Assessment for IT and Capital Improvement Projects is Higher Than Necessary

PURPOSE OF SPECIAL ASSESSMENT	STATE BAR PROPOSAL	STATE AUDITOR RECOMMENDATION	
	ONE-TIME	TOTAL 2020 THROUGH 2024*	2020 FEE ONLY†
IT projects	\$82	\$65	\$22
Capital improvements	134	30	16
<b>Totals</b>	<b>\$216</b>	<b>\$95</b>	<b>\$38</b>

Source: Analysis of State Bar's five-year general fund projection and related materials.

Note: We show the fee for active licensees only. See Appendix B for the inactive licensing fee that we recommend.

\* As opposed to collecting the total assessment in 2020, we recommend dividing it over five years to coincide with project timelines.

† We show the 2020 fee here and the fees for the remaining years in Appendix C.

Table 7 identifies each of the 11 IT projects and their associated costs, and it shows the six that we include in the special assessment calculation. We included three projects in the calculation—hardware upgrades, Oracle Fusion, and the Licensee Information Management System—because the board identified them as critical in State Bar's strategic plan for 2017 through 2022. The funding request for these three projects also coincides with the projects' planned timelines. In addition, the two IT security assessments and the disaster recovery plan warrant funding through the special assessment fee at this time. The California Department of Technology—the department responsible for all aspects of technology in California state government—has identified such plans and assessments as best practices to mitigate security and operations risk. Similarly, the Judicial Council of California—the policymaking body of the California courts—has endorsed disaster recovery plans as a good business practice.

**Table 7**  
**Six of State Bar's 11 Proposed IT Projects Currently Warrant Funding**  
**(Dollars in Thousands)**

PROJECT	DESCRIPTION	STATE BAR ESTIMATED 5-YEAR COST	STATE AUDITOR RECOMMENDATION
<i>State Auditor Recommended Projects</i>			
Hardware upgrades	Upgrading equipment, such as computers and printers	\$7,324	✓
Oracle Fusion	Upgrading finance and procurement software	1,379	✓
Licensee Information Management System (LIMS)	Creating a single database to manage licensee records	3,512	✓
Network security assessment	Completing risk assessment for IT networks (every three years)	400	✓
Application security assessment	Completing risk assessment for IT applications (every three years)	200	✓
Disaster recovery services	Creating an IT plan for disasters	350	✓
<b>Total</b>		<b>\$13,165</b>	
<i>State Bar Additional Proposed Projects</i>			
Enterprise Content and Records Management Systems	Creating a single, internal file management system	\$1,400	X
Paperless State Bar projects	Transferring paper documents into a digital format	600	X
Migration of remaining AS400 applications	Updating older systems that manage business processes	633	X
Data warehouse/analytics	Creating a single database for State Bar data	540	X
Mobile applications	Creating mobile applications for licensee use	312	X
<b>Total</b>		<b>\$3,485</b>	

Source: Analysis of State Bar's five-year general fund projection and related materials.

✓ = Yes, State Auditor recommends funding this project.

X = No, State Auditor does not recommend funding this project at this time.

The remaining five projects do not need immediate funding because the projects do not represent critical needs for the agency and State Bar will have more planning to do before their implementation. Creating mobile applications, migrating AS400 applications (updating older systems that manage business processes), and implementing paperless projects will all require additional staff resources, and State Bar's Office of Information Technology (technology office) has not determined its staffing needs for these projects. When we analyzed the technology office's IT planning process, we determined that the enterprise content and record management systems and data warehouse projects could meet planned project timelines. However, a smaller project

portfolio lessens State Bar's risk of missed deadlines. Thus, we also excluded these projects from the fee calculation. The director of the technology office agreed that these five projects are not as critical as the others.

The special assessment fee's second element addresses capital improvements, but some of State Bar's proposed projects are not essential at this time and the costs of others exceed current market rates. Of the 11 capital improvement projects State Bar has included in its proposed special assessment fee, we recommend that eight receive funding from that fee beginning in 2020, as Table 8 indicates. According to the certified real estate appraiser we retained, building owners undertake capital improvement projects either to comply with current building codes or to sustain or improve current lease rates. The eight projects that we recommend are necessary for these reasons.

Of those eight necessary projects, our appraiser found that the proposed costs for four of them exceed acceptable market rates. For instance, State Bar projected that the San Francisco office's heating, ventilation, and air conditioning (HVAC) project would cost \$2.1 million. However, based on the cost manual from Marshall & Swift Valuation Service—an industry-standard appraisal guide—our appraiser determined that State Bar's estimated cost for this project exceeds local market rates by nearly \$1 million. As Table 6 shows, we recommend an assessment totaling \$30 over five years. The amount of the assessment per year would fluctuate depending on the projects underway at that time, and our recommendation for 2020 is \$16. State Bar noted that the final cost of these projects will ultimately depend on the results of a competitive bidding process. We agree that State Bar will need to revisit its estimates as it determines actual costs. Nevertheless, our appraiser's estimates of project value represent a reasonable estimate at this time.

The appraiser found that three of State Bar's proposed projects could not be justified by current building codes or by the projects' potential to elevate or preserve lease rates. The most costly example is State Bar's \$12.5 million proposal for resurfacing and façade repair on its San Francisco office building. State Bar's project sheet notes that this project is meant to eliminate water and air intrusion and improve the building's energy efficiency. However, our appraiser noted that this repair is not necessary to market the property to prospective tenants.

*Some of State Bar's proposed capital improvement projects are not essential at this time and the costs of others exceed current market rates.*

**Table 8**  
Eight of State Bar's 11 Proposed Capital Improvement Projects Warrant Funding  
(Dollars in Thousands)

PROJECT AND LOCATION	DESCRIPTION	5-YEAR COST		STATE AUDITOR RECOMMENDATION
		STATE BAR ESTIMATE	CONSULTANT ESTIMATE*	
<b>State Auditor Recommended Projects</b>				
HVAC (Los Angeles)	Replacing half of the current HVAC system	\$800	\$800	✓
HVAC (San Francisco)	Replacing chiller, existing boilers, and other HVAC system components	2,095	1,146	✓
Fire/life safety (San Francisco)	Upgrading smoke and fire detection system	1,225	319	✓
Energy management system (San Francisco)	Upgrading system that controls the HVAC and life safety systems	350	350	✓
Generator (San Francisco)	Replacing emergency generator and installing pump connection to roof	1,350	572	✓
Elevators (San Francisco)	Upgrading obsolete elevator equipment	2,450	2,653	✓
Floor 4 restroom upgrade (San Francisco)	Bringing the restroom up to disability code	300	164	✓
Ground floor infrastructure (San Francisco)	Upgrading exhaust duct and electrical system	200	200	✓
<b>Totals</b>		<b>\$8,770</b>	<b>\$6,204</b>	
<b>State Bar Additional Proposed Projects</b>				
Seismic/structural upgrades (San Francisco)	Stabilizing the building's core†	\$ 1,955	NA	X
State Bar data center (San Francisco)	Reconfiguring power supply, HVAC, generator, electrical, and room for data center	1,550	NA	X
Façade repair/resurfacing (San Francisco)	Replacing building façade and window seals	12,500	NA	X
<b>Total</b>		<b>\$16,005</b>		

Source: Analysis of State Bar's five-year general fund projection and report by our certified real estate appraiser.

\* Our appraiser based these estimates on the cost manual from Marshall & Swift Valuation Service—an industry-standard appraisal guide—and applied regional and local multipliers designed to formulate values that reflect the current cost estimates for these locations.

† Our appraiser did not recommend this project because building codes and local and state laws do not require it.

NA = Not applicable.

✓ = Yes, State Auditor recommends funding this project.

X = No, State Auditor does not recommend funding this project at this time.

The special assessment fee's third element addresses rebuilding State Bar's general fund reserve, which it recently depleted to less than the board-required level of 17 percent of its operating costs. For the past three years, State Bar has budgeted and spent more from its general fund than it has received in related revenue, and its 2019 budget also reflects deficit spending before accounting

for its using the reserve. State Bar began depleting its reserve in 2017 after the Legislature did not authorize it to collect a licensing fee for that year. Although the Supreme Court approved an interim assessment to fund State Bar's discipline system, the amount was less than the licensing fee had been, and thus State Bar had a \$4.8 million revenue shortfall. In 2018 State Bar continued to draw on its reserve to fund capital improvements and IT projects.

State Bar projects that its reserve will equal 12 percent of its operating budget for 2020. Consequently, it has proposed a one-time \$34 assessment in 2020 to immediately restore its reserve to 17 percent. Although we agree that State Bar should restore its reserve, we recommend that it achieve a target reserve amount of 13 percent in 2020 to mitigate the significant effect a one-time assessment would have on the fee that attorneys must pay. Further, future State Bar operating costs are difficult to predict because of the potential for changes in staffing levels and for technological efficiencies. Thus, we recommend using smaller special assessments to incrementally rebuild State Bar's general fund reserve by 1 percent each year until it reaches 17 percent in 2024. Using our recommended scenario of adding as many as 19 staff to the trial counsel's office, we calculated that a \$3 special assessment in 2020 would bring State Bar's general fund reserve to 13 percent. To meet the board's reserve policy by 2024, State Bar would have to determine the special assessments it will need after 2020 to achieve these 1 percent annual increases. Appendix C, Table C.1, details our recommendations for the special assessment fees to cover IT projects, capital improvements, and rebuilding the general fund reserve over the five-year period.

*We recommend that State Bar achieve a target reserve amount of 13 percent in 2020 to mitigate the significant effect a one-time assessment would have on the fee that attorneys must pay.*

### **State Bar's Proposed 2020 Program Fees Are Higher Than Necessary**

As we discuss in the Introduction, state law authorizes State Bar to impose mandatory fees to support specific functions, such as the security fund and the assistance program. The security fund currently has a significant number of pending claims, and State Bar will need more revenue to pay them than the current mandatory fee generates. State Bar has proposed a 2020 fee that would fund all the current pending claims it expects to pay. However, we recommend a 2020 fee that funds only those claims State Bar will likely pay that year. In contrast to the security fund, the assistance program has an excess reserve that State Bar can use to fund the program's activities in 2020. Consequently, we recommend that the Legislature temporarily suspend the annual fee that State Bar collects from active licensees for the assistance program. In Appendix B we summarize State Bar's program fees for inactive licensees.

***State Bar Has Overestimated the Security Fund's Revenue Needs for 2020***

Although State Bar's \$40 security fund fee has generally remained unchanged for 29 years, the number and value of pending claims against the fund have increased. As we discuss in the Introduction, the security fund received an unusually large number of applications from 2009 through 2013: it averaged 3,062 applications each year in this period, in contrast to the average of 1,118 applications it received from 2005 through 2008. The influx of claims—driven by the residential mortgage crisis, according to State Bar—resulted in the security fund having 2,100 pending claims as of January 2019. State Bar estimates that it will pay 40 cents on the dollar for each claim that it investigates and substantiates. Consequently, State Bar has calculated that it needs \$24.2 million to pay the fund's current pending claims, and to meet this need, it has requested a one-time increase of \$80 to the annual security fund fee for active licensees, raising the fee from \$40 for 2019 to \$120 for 2020.

However, we question State Bar's need to collect fees from its licensees in 2020 to cover all the current pending claims when it may not pay them for several years. We analyzed State Bar's claims payment data to better align the security fund's annual revenue projections to claims activity. Our analysis of paid claims from 2016 through 2018 shows that State Bar took 511 days on average to investigate and pay claims. As we describe in the Introduction, State Bar may generally investigate claims and determine reimbursements only after attorneys meet particular status requirements, such as being disbarred or disciplined. Using this 511-day average, we evaluated the year in which State Bar would likely approve the payment of pending claims. We determined that the security fund would need an additional \$8 million for State Bar to pay eligible claims in 2020, which equates to a program fee of \$80 for active licensees for that year. We summarize our calculation in Table 9. Because pending claims become eligible for review and payment over time, State Bar would have to refine and apply our analysis to determine its revenue needs for 2021 and thereafter.

***We determined that the security fund would need an additional \$8 million for State Bar to pay eligible claims in 2020, which equates to a program fee of \$80 for active licensees for that year.***

The chief of programs noted that State Bar's history of not getting routine fee increases is driving its request to secure the revenue it needs through a one-time fee increase. She expressed concern that if State Bar charged only our recommended smaller fee increase for 2020, and if the assumed future increases were not approved, then State Bar would not be able to effectively resolve all the pending claims. She also said that any revenue stream must be sufficient to allow State Bar to pay as many claims in a year as it approves. To address these potential concerns, we considered in our calculations the timing of when State Bar was likely to pay claims given the security fund's payment history. We also evaluated the security fund's payment activity from 2011 through 2014, when the fund had

a deep reserve and State Bar did not have to balance the number of claims it paid with annual fee revenue limits. The chief of programs agreed that State Bar could include the timing of when it would pay claims in its revenue estimates to offer more refined analysis of the necessary annual fee.

**Table 9**  
**To Pay Pending Claims, State Bar Needs an Increase in the 2020 Security Fund Fee**  
 (Dollars in Thousands)

REVENUE, EXPENSES, AND CLAIMS	AMOUNT
<b>2019</b>	
2019 Budgeted revenue*	\$8,423
2019 Budgeted administrative expenses	(2,054)
<b>Subtotal</b>	<b>6,369</b>
2019 Auditor-estimated claims payments	(9,777)
<b>Total 2019 estimated pending claims in excess of fund revenue</b>	<b>(\$3,408)</b>
<b>2020</b>	
2020 Projected revenue*	\$8,539
2020 Projected administrative expenses	(2,149)
<b>Subtotal</b>	<b>\$6,390</b>
2020 Auditor-estimated claims payments†	(\$11,029)
<b>Total 2020 estimated pending claims in excess of fund revenue</b>	<b>(\$4,639)</b>
<b>2019 Estimated pending claims in excess of fund revenue</b>	<b>(\$3,408)</b>
<b>2020 Estimated pending claims in excess of fund revenue</b>	<b>(4,639)</b>
<b>Total</b>	<b>(\$8,047)</b>
	<b>FEE</b>
<b>2020 Security fund fee needed to pay claims‡</b>	<b>\$80</b>

Source: Analysis of State Bar's 2019 budget and security fund claims data from 2016 through 2018.

\* We combined the security fund's budgeted revenue from security fund fees and other sources.

† We ensured that our projected number of paid claims for 2020 was consistent with the average number of claims that State Bar paid from 2011 through 2014, which were years when the security fund had surplus funds.

‡ We show the fee for active licensees only. See Appendix B for the fee for inactive licensees that we recommend. We calculated the security fund fee for active and inactive licensees using 2020 projected attorney population counts and a methodology consistent with current State Bar practice.

State Bar has identified some additional steps that it can take to improve the security fund's financial condition. In 2018 it presented 14 initiatives to its board that could help pay for the security fund's current and anticipated needs, one of which was the one-time fee increase. The board accepted six and rejected eight of the initiatives.

Table 10 summarizes the initiatives and the board's decisions on them. Three of the six initiatives the board accepted generated \$1.8 million for the security fund in 2018. The remainder have either not yet been implemented or represent a process change. However, these initiatives alone will not generate enough revenue annually for State Bar to pay all approved claims. As we describe earlier, our analysis shows that for 2019 and 2020, State Bar may approve claims that exceed security fund revenue by \$8 million.

**Table 10**  
**The Board Has Approved Some Initiatives to Increase Revenue for the Security Fund**

SECURITY FUND INITIATIVE	BOARD APPROVED
Request a security fund fee increase from the Legislature.	✓
Apply the minimum reserve requirement to program administration costs only.	✓
Transfer surplus funds from the assistance program to the security fund.	✓
Properly allocate fees paid by licensees in the multijurisdictional fee category to the security fund.*	✓
Adopt new rule for the State Bar Court to impose monetary sanctions against attorneys and deposit collections to the security fund.†	✓
Reduce the time it takes to pay claims by changing security fund processes.	✓
Reduce the maximum claim payout from \$100,000 to \$50,000.	◆
Allow licensees to make voluntary contributions to the security fund.	◆
Eliminate or limit claims about loans or investments made through attorneys.	✗
Pay claims from California residents only.	✗
Adjust eligibility for a claim payout based on claimant's income level.	✗
Limit the payout amount on claims for fees for unperformed services.	✗
Impose a time limit within which a claim must be filed.	✗
Require licensees to pay the full security fund fee, regardless of means.‡	✗

Source: Analysis of State Bar's 2018 Client Security Fund Report and the board's meeting minutes for March, May, July, September, and November 2018.

\* To practice law in California, attorneys outside of California and licensed to practice in other states and U.S. territories must register with State Bar and meet certain qualifications through the Multijurisdictional Practice Program.

† State Bar adopted this new rule in November 2018, and the rule is awaiting the Supreme Court's approval.

‡ State law requires State Bar to waive 25 percent of all mandatory fees, including the security fund fee, if an attorney can demonstrate total gross annual individual income of less than \$40,000.

✓ = Yes, board approved.

◆ = No, but State Auditor suggests reconsideration.

✗ = No, board did not approve.

In rejecting eight of State Bar's proposed security fund initiatives, the board noted that it did not want to harm claimants; however, we believe that some of these initiatives could improve the program. The agenda and minutes from the board's July 2018 meeting indicate that it rejected certain security fund initiatives because it viewed those initiatives as contradicting State Bar's priority to protect the public through the regulation of attorneys. For example, as Table 10 shows, the board rejected initiatives to limit or exclude certain categories of claims or to pay the claims of California residents only. The Legislature has also expressed concern about State Bar adopting initiatives to claimants' detriment. However, we believe State Bar and the Legislature share an interest in balancing the fees that licensees pay with compensating individuals who have suffered financial harm because of their attorneys. Consequently, the board and the Legislature may want to explore further two initiatives that the board initially rejected—capping claims payouts and allowing voluntary contributions.

State Bar and the Legislature have the option to change the payout cap as a way to help limit security fund fees. Until January 2009, State Bar maintained a \$50,000 cap. For losses that claimants incurred on or after that time, State Bar increased the payout cap to \$100,000 because the \$50,000 limit had been in place for more than four decades and inflation had eroded the cap's nominal value. State Bar also commissioned an actuarial study in 2008 that concluded that increasing the maximum payout would not threaten the immediate financial viability of the security fund. The study also projected that the security fund would have a revenue reserve through 2017 without State Bar needing to seek an increase in the \$40 annual fee or impose additional limits on the amount claimants could recover. However, shortly after State Bar raised the cap in 2009, the estimated payout value of pending claims grew far more quickly than anticipated. The spike in claim numbers and value, according to State Bar, was driven by the residential mortgage crisis. State Bar depleted its reserve and now does not have sufficient revenue to pay pending claims.

State Bar could decrease the security fund payment cap to allow it to provide more claimants with payments sooner. We analyzed the claims that State Bar paid from 2016 through 2018 to determine the effect on the number of claims paid if the cap were decreased to \$50,000 or \$75,000. We found that 98 percent of the claims that State Bar paid from 2016 through 2018 were less than \$50,000. A \$50,000 cap over that time period would have freed up \$1.7 million and thus allowed State Bar to pay 245 additional claimants. Alternatively, with a cap of \$75,000, the security fund would have had \$604,000 more available, which State Bar could have used to pay 78 additional claimants.

*State Bar could decrease the security fund payment cap to allow it to provide more claimants with payments sooner.*

The board could also reconsider allowing voluntary contributions to the security fund. Licensees can currently make voluntary contributions to certain State Bar programs, like the Legal Services Trust Fund, which provides grants to legal services programs for individuals with low incomes. A 2018 analysis by the Assembly Judiciary Committee suggests that the Legislature would likely approve of allowing similar voluntary contributions to the security fund. However, State Bar's board and the chief of programs expressed concern that licensees would choose to donate to the security fund at the expense of other State Bar programs. We agree that some licensees might commit their contributions to the security fund in lieu of another State Bar program. However, we believe licensees should be able to make that choice if those licensees believe strongly about providing restitution to individuals who have been harmed by members of the legal profession.

### ***The Legislature Should Suspend the Fee for the Assistance Program in 2020***

Because revenue for the assistance program has consistently exceeded its expenditures, State Bar projects that the program's reserve will reach \$3.5 million by the end of 2019—a value that equals as much as 10 times more than State Bar's reserve policy requires. The assistance program receives revenue from an annual fee of \$10 from active licensees. Although that fee is already in place for 2019, our analysis suggests that the Legislature should suspend the fee in 2020 in favor of State Bar spending the assistance program's reserve. The board mandates that State Bar maintain a 17 percent reserve for certain funds to allow it 60 days of operating revenue and that it spend any reserve amount exceeding 30 percent of operating costs. These requirements apply to the assistance program's reserve, which State Bar calculates independently of other funds or programs. Recognizing the assistance program's excessive reserve, the board approved a transfer of \$250,000 to the security fund in 2018. Given the assistance program's high reserve and low expenditures, State Bar does not need to charge a fee for it in 2020.

***Given the assistance program's high reserve and low expenditures, State Bar does not need to charge a fee for it in 2020.***

Low demand for assistance program services—both voluntary and discipline-related—has allowed the program's reserve to grow. According to the assistance program supervisor, in 2018 the program had 266 participants, or 0.1 percent of State Bar's licensees. State Bar surveyed licensed attorneys in 2018 and found that the majority of respondents were unsure if they would use the assistance program if they needed it. Respondents most commonly cited concerns about privacy and the potential threat to licensure as reasons that they might not seek services from the assistance program.

To address licensees' concerns about confidentiality, the board voted in November 2018 to separate the voluntary portion of the assistance program from State Bar. It is too soon to know how State Bar will implement the board's decision, but this could mean an entity entirely separate from State Bar takes on those program functions. Nevertheless, the projected year-end reserve for 2019 is adequate to fully fund the voluntary and disciplinary portions of the assistance program in 2020 regardless of whether State Bar administers the assistance program alone or in coordination with another entity. Furthermore, any future fee should account for the revenue the assistance program needs to cover its costs without its reserve exceeding the board's requirement.

**By Maximizing Revenue and Gaining Efficiencies, State Bar May Be Able To Decrease the Licensing Fee in the Future**

In addition to reviewing State Bar's proposed increases to its annual fees, we evaluated its operations for opportunities to increase revenue. We found that State Bar could improve several aspects of its operations and management. For example, State Bar could better manage its San Francisco headquarters to optimize revenue. It is currently leasing space in that building to tenants at below-market rates and has allowed space to go unleased for long periods of time. Furthermore, according to current standards, State Bar occupies more space in both its San Francisco building and the building it owns in Los Angeles than it needs to accommodate its size. If State Bar were able to capture more revenue from its real estate holdings, it could minimize future fee increases. In addition, State Bar has recently developed performance measures and begun to collect data to implement them. Measuring performance is an important step for State Bar because it could lead to increased efficiency, which in turn could translate to decreased costs and reduced licensing fees.

***State Bar Has Not Maximized Revenue From Its San Francisco Headquarters***

State Bar's headquarters is located in San Francisco's financial district. State Bar leases those floors that it does not use for its own purposes and contracts with a real estate services firm to manage the building. However, it has not maximized revenue from its San Francisco leases. We retained a certified real estate appraiser to assess State Bar's management of this property. The text box summarizes the

**Methodologies Our Real Estate Appraiser Used to Analyze State Bar's Properties**

**Market rates:** Researched current market lease rates on comparable general retail and office locations in and around San Francisco and Los Angeles.

**Space usage:** Estimated ratios of space per employee for State Bar's two office locations and compared them to the industry standard for professional spaces in North America set by CoreNet Global, a nonprofit professional organization that provides research for the real estate industry.

**Capital improvements:** Compared the estimated cost of each proposed capital improvement that State Bar included in its special assessment fee increase proposal to industry standards in the cost manual from Marshall & Swift Valuation Service.

**Property management fee:** Compared the terms of State Bar's existing agreement with its property manager to various industry sources, including the Institute of Real Estate Management and the Society of Industrial and Office Realtors.

**Source:** Report by our certified real estate appraiser.

*In 2018 and 2019, State Bar entered into four leases for its San Francisco building with below-market rates that range from \$12 to \$28 per square foot less than those of comparable properties.*

key methodologies he used in his evaluation. Our appraiser's comprehensive analysis—which evaluated 15 separate properties in San Francisco—determined that retail space comparable to State Bar's should lease for \$54 to \$60 a square foot and office space for \$68 to \$76 a square foot. In 2018 and 2019, State Bar entered into four leases for its San Francisco building with below-market rates that range from \$12 to \$28 per square foot less than those of comparable properties. Even if State Bar had leased its space at the lowest of the appraiser's market rates, it would have earned \$777,000 in additional revenue in just the first year of the four leases. The chief administrative officer had initially believed that the real estate broker had obtained the best lease rates it could, but State Bar commissioned a recent analysis, which confirmed that its San Francisco lease rates are below market, so he now agrees that State Bar could pursue higher lease rates in the future.

State Bar has also lost potential revenue by leaving portions of its San Francisco building unleased for long periods. The San Francisco building is a 13-floor office tower, and State Bar occupies seven floors. However, as Table 11 shows, State Bar has not leased the third floor since at least 2016. At a January 2019 board meeting, the chief administrative officer stated that according to the property manager, in order to lease that floor, State Bar—as the lessor—would have to first install a heating and cooling system—termed a *warm shell*—initially estimated to cost \$2 million. However, our appraiser maintains that a lessor may negotiate such items with a prospective tenant, especially in a market like San Francisco's financial district, which has a low vacancy rate.

At the same January meeting, a board member asked the chief administrative officer to continue looking for a tenant willing to pay for the warm shell. The chief administrative officer shared in March 2019 that State Bar had begun negotiating with an existing tenant that wanted to expand to an additional floor and was willing to pay for the heating and cooling upgrades in exchange for rent concessions. State Bar expects to have a signed lease in April. Using the current market rates estimated by our appraiser, this space could generate \$1.1 million in annual revenue. Although State Bar may not initially receive full market rates because its potential tenant would assume the warm shell cost and therefore likely pay a reduced rent, had State Bar explored this option earlier, it may have been able to find a tenant sooner and would be receiving additional lease revenue.

Further, State Bar has not maximized leasable space in either its Los Angeles or San Francisco building because it uses more square footage than current standards for office space suggest that it needs. Our appraiser determined that State Bar uses 373 square feet per employee in Los Angeles and 400 square feet per employee in San Francisco, whereas the 2017 industry standard for office space

allocations in North America is 151 square feet per worker.<sup>2</sup> This standard includes typical allowances for shared spaces, such as kitchens, conference areas, lobbies, hallways, and breakout rooms.

**Table 11**  
 State Bar Has Not Leased Portions of Its San Francisco Building in Recent Years

FLOOR	YEAR				SQUARE FEET (AS OF 2019)*			
	2016	2017	2018	2019 <sup>†</sup>	STATE BAR	LEASED	NOT LEASED	TOTAL
12					1,550	14,140		15,690
11						16,580		16,580
10					16,570			16,570
9					16,580			16,580
8					16,580			16,580
7					16,570			16,570
6					16,570			16,570
5					16,570			16,570
4					16,570			16,570
3							16,580	16,580
2						16,580		16,580
1						16,570		16,570
G					4,540	5,000		9,540
<b>Total Square Feet</b>					<b>122,100</b>	<b>68,870</b>	<b>16,580</b>	<b>207,550</b>

Source: Analysis of tenant contracts, information from State Bar regarding the use of space, and visual inspection.

\* We rounded figures for this presentation.

<sup>†</sup> Table reflects signed agreements as of January 1, 2019. Per State Bar’s agreement with its property management firm, State Bar provides 3,820 square feet for property management on the 3rd floor and 1,550 square feet for building engineering services on the 12th floor. We include the latter as State Bar space because it would have to set aside office space for this use regardless of whether it contracted out for such services or provided them in-house.

- = Not leased.
- = Leased.
- = State Bar occupied.

<sup>2</sup> In both buildings, State Bar has dedicated courtrooms that total 20,000 square feet. Our appraiser excluded this space—which has a special use—from his calculation of State Bar’s space per worker.

The chief administrative officer asserted that because State Bar last configured the space in both buildings some time ago, it should not be held to the most recent standard. However, even considering earlier standards, the disparity between State Bar's allocations and prevailing standards is significant. The chief administrative officer stated that State Bar designed the office space in the Los Angeles building in 2013, about the time it purchased that building. According to the U.S. General Services Administration, which provides centralized procurement for the federal government, including constructing and acquiring office space, the prevailing office workspace average for the public sector in 2011 was 190 square feet per employee, or a little more than half of the Los Angeles office's allocations. Similarly, although State Bar designed the San Francisco space more than 20 years ago, its space allocations still appear excessive. Our review of office space usage standards from 1995 through 2018 from government and industry experts in commercial real estate shows that the standard ranged from 150 to 225 square feet per employee—still roughly half of the space currently allotted.

Furthermore, State Bar has long been aware of its excessive space use and its effect on revenue. In 2011 a consultant that State Bar hired advised it that improving its space utilization might allow for more revenue-producing space. We do not expect an organization to redesign and allocate space annually to reflect current standards. Nonetheless, it is common for an organization to reconfigure and remodel its space over time to accommodate increased staff or changes in organizational structure. When an organization makes such modifications, an opportunity exists for it to better align its space use with prevailing standards. We believe that State Bar should take advantage of such opportunities in the future, such as when it increases staffing in its trial counsel's office. Considering State Bar's dependence on the fees that licensees pay, it has an obligation to control its expenses and maximize revenue in any way it can. Leasing out the maximum available space in the two buildings that it owns is one way for State Bar to achieve these outcomes.

***Considering State Bar's dependence on the fees that licensees pay, it has an obligation to control its expenses and maximize revenue in any way it can.***

Finally, State Bar's agreement with its San Francisco property management firm may not be in its best interests. State Bar contracts with a commercial real estate services firm to manage its San Francisco building. The firm's services include managing tenants; overseeing tenant improvements; and providing engineering, janitorial, and security services. For 2019 State Bar budgeted about \$300,000 to pay for property management services and about \$600,000 for lease commissions.

Although such terms are common, our appraiser reviewed the agreement and identified an aspect of it that was atypical. Under its agreement, State Bar gives the property management firm almost 4,000 square feet of office space at no cost. Our appraiser questioned this term, especially given that the property management firm has offices nearby. At market rates, the space the property management firm occupies has an annual lease value of \$260,000. We raised this concern with the chief administrative officer. He pointed to the bid analysis showing that State Bar's chosen property management firm was the best option and had comparable rates to the other bids. We suggested that State Bar might benefit from retaining an expert to participate in its future solicitation and negotiation for property management services. State Bar's existing property management agreement expires in August 2019. The chief administrative officer concurs with our suggestion.

***State Bar's Measures to Increase Its Efficiency Are Still New and Addressing Its Discipline Case Backlog Will Require Further Effort***

To increase transparency and accountability, State Bar has recently developed performance measures and goals and has begun collecting relevant data across its organization. Although State Bar's efforts are quite new, we believe that it is heading in the right direction. By measuring performance, State Bar could increase its efficiency, which could enable it to decrease its costs and reduce its licensing fee. In particular, State Bar has established new performance measures for its discipline function, which will supplement its long-standing measure of performance: its discipline case backlog. This backlog generally consists of pending cases that are in its investigations process longer than six months. State Bar believes that the 180-day statutory goal to process cases may be unrealistic and require reevaluation; however, we found that State Bar may get closer to the case-processing goal by developing guidance for each step in its investigations process.

In a January 2019 report to the board, State Bar's executive director noted that performance measures provide a quantifiable way for leaders to recognize successes and identify necessary critical improvements, such as the need to streamline existing processes, better manage limited resources, and plan for future growth. To this end, in recent months State Bar has established a mix of performance measures and program goals across all areas of the agency. For example, State Bar is now measuring the ability of the trial counsel's office to process new cases and monitoring the speed with which it finalizes those cases. State Bar has also developed performance measures for its administrative functions.

***To increase transparency and accountability, State Bar has recently developed performance measures and goals and has begun collecting relevant data across its organization.***

For example, State Bar will measure the time it takes to hire new employees and has set a goal for late 2019 to be able to complete the hiring process in 60 days.

State Bar has coupled its performance measures and goals with data tracking and reporting. In January 2019, the executive director outlined for the board a plan for performance data collection to occur monthly, quarterly, and annually, depending on the data source and collection method that State Bar has established for each measure. For those performance measures it has designated as monthly, State Bar completed its first round of data collection in February 2019 and reported these data to the board in March 2019. For example, the executive director's report listed the monthly measures that State Bar did not meet. The board's Regulation and Discipline committee has also discussed ways to improve some of the discipline measures.

State Bar has made a solid start to its goal of increasing transparency and accountability and has developed plans for staying on track. The executive director noted in her January 2019 report to the board that the metrics will need adjustments and that State Bar is committed to continuous improvement. To that end, the executive director sent a memo in March 2019 to all staff announcing that if a particular office is unable to meet its goals, she will ask management to provide an explanation and a plan to achieve the goals. She also stated that each office should make metrics a standing item on staff meeting agendas and that performance evaluations for executive staff should include metrics. Although State Bar's initial steps to apply metrics are welcome, the success of the effort will only be known over time.

For several years, a primary measure of efficiency for State Bar's discipline system has been its discipline case backlog. According to State Bar, in 2018 the complaint backlog stood at about 1,750 cases, and has remained over 1,100 for the past five years. With its introduction of new performance measures, State Bar will supplement the backlog measure as an indicator of its efficiency with additional measures. We also identified certain reforms that State Bar should consider to help address its backlog. In 2016 State Bar developed time benchmarks for its investigations process but, according to the executive director, did not implement them because of a lack of staff. When we reviewed the investigations process and identified 17 discrete steps, we found that State Bar lacked benchmarks delineating the duration of 10 of them. Defining how long each step in a process should take to accomplish is critical to performing work within time constraints—like the 180-day case processing goal—because such time frames help an organization identify areas for targeted improvement.

*When we reviewed the investigations process and identified 17 discrete steps, we found that State Bar lacked benchmarks delineating the duration of 10 of them.*

State Bar's policy and guidance documents about benchmarks also contain contradictions. For example, the rules that govern its discipline process as a whole state that conducting an evaluation conference with the accused attorney to provide opportunity for settlement of a discipline case should take 25 days. However, State Bar's training documents say that this same step should take 30 days. Another source advises staff that the evaluation conferences should overlap with other procedural steps that can take up to 60 days. This lack of clarity highlights the need for consistent standards and benchmarks to help staff stay on schedule.

State law requires State Bar to report its case-processing activity against a 180-day goal, yet State Bar believes that this goal may not be appropriate. The 180-day goal has existed in statute since 1986, but we found no explanation of its origin. The interim chief trial counsel stressed that the 180-day goal may be unrealistic because many steps in the investigations process are not in State Bar's control. For example, she stated that obtaining the documents needed for an investigation can take a significant amount of time. She specifically identified that procuring immigration documents can take upwards of six months. She also said that State Bar has developed metrics to reduce the backlog by prioritizing cases to maximize public protection. For instance, it plans to prioritize those cases with the potential for significant, ongoing, or serious potential harm to the public.

The interim chief trial counsel also noted that the discipline case backlog represents the difference between the volume of cases State Bar receives and the staff resources available to do the work. As we discuss earlier, State Bar has requested a licensing fee increase to hire 58 staff for its investigations functions, and we recommend a fee increase for 19 staff. With the data it collects from the new metrics and the work it intends to do to use these data to implement process improvements, State Bar can set benchmarks that will help it move closer to meeting the 180-day statutory goal. It can also make more informed estimates for staff resource needs and work with the Legislature to develop a different, more appropriate goal for processing a case, if necessary.

### **A Multiyear Fee Cycle Could Improve State Bar's Management Practices**

A multiyear licensing fee-approval cycle would stabilize State Bar's revenue, allowing it to improve its planning and management practices, while still affording the Legislature necessary oversight. Although in recent years the Legislature has favored an annual fee-approval cycle, it generally authorized the licensing fee for two-year periods in the 1990s. However, in 1997, after it became evident State Bar was not using its resources effectively, the

*State Bar's policy and guidance documents about benchmarks contain contradictions.*

Governor vetoed that year's fee bill. The Legislature subsequently authorized the fee on an annual basis in 1999 and 2000. In 2001 the Legislature again authorized the fee for two years, then returned to approving the fee on an annual basis in 2003, a practice it has generally continued through 2018.

A legislative analysis of the 2001 fee bill noted that approving the fee annually allowed the Legislature to closely monitor State Bar. However, an annual fee-approval cycle does not align with best practices. Both the Government Finance Officers Association and U.S. Government Accountability Office provide best practice guidelines for regulatory entities that are supported by user fees. We determined that State Bar's current annual approval cycle does not meet these guidelines because it does not ensure consistent revenue over time or allow for better planning for long-term revenue needs.

State Bar's current annual licensing fee-approval cycle has been detrimental to both licensed attorneys and the public. An annual approval cycle does not allow licensed attorneys to anticipate future expenses. For State Bar, the lack of consistent revenue makes implementing long-term projects, such as replacing its aging technology systems, riskier because it has no guarantee that funding for these types of projects will continue. Further, in years when the Legislature did not pass a licensing fee bill, such as 2016, State Bar has had to make sudden staffing reductions in the trial counsel's office, compromising its ability to process complaints against dishonest attorneys.

***The Legislature should adopt a multiyear licensing fee-approval cycle that would require State Bar to engage in fiscal planning, that would impose fee caps, and that would enable legislative review to ensure that fees are set at appropriate amounts.***

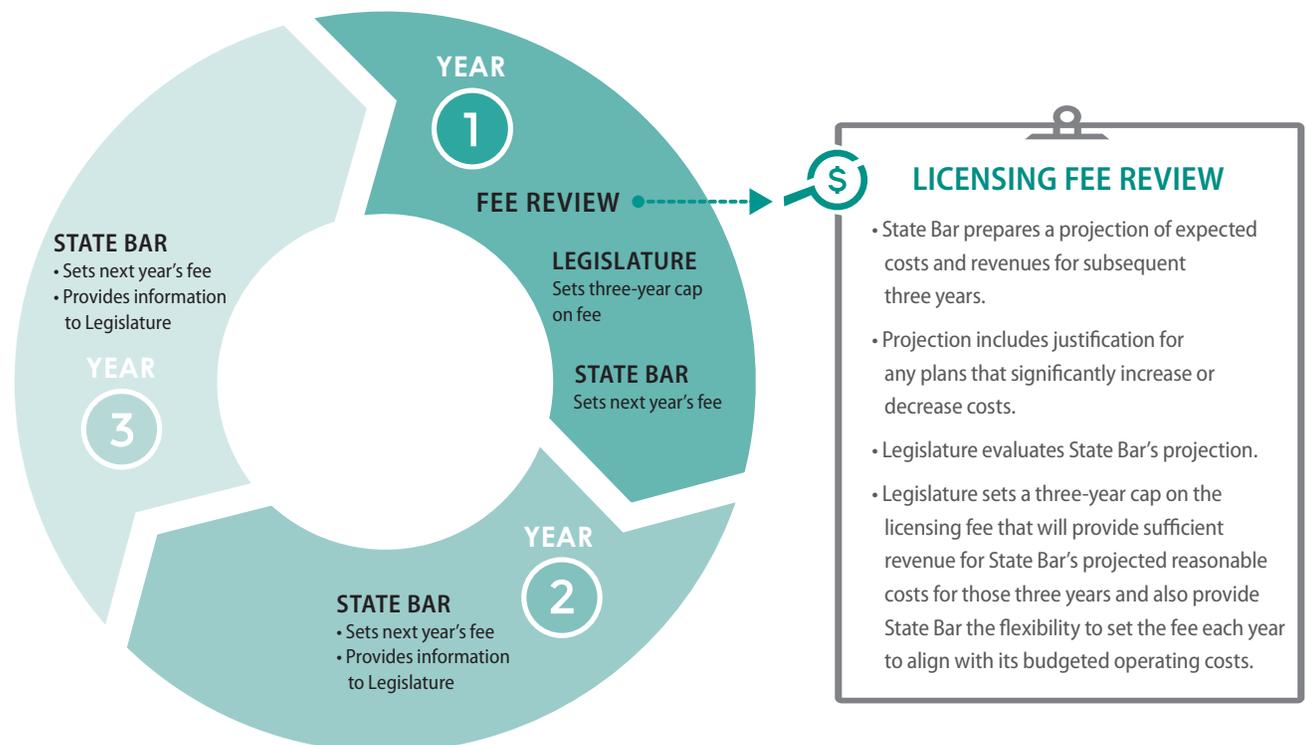
We believe the Legislature should adopt a multiyear licensing fee-approval cycle that would require State Bar to engage in fiscal planning, that would impose fee caps, and that would enable legislative review to ensure that fees are set at appropriate amounts. Figure 2 shows a potential three-year cycle that includes fee reviews and a three-year cap on the fee. This multiyear cycle would require that State Bar develop a longer-term budget in the first year of the cycle to justify its anticipated licensing fees across the three-year period. In the other two years in the cycle, State Bar would set the fee at an amount that reflected its annual budgeted operating costs but did not exceed the established fee cap. Because State Bar's authorization to set the fee would not expire at the end of each year, as it does currently, State Bar could anticipate consistent revenue and plan accordingly.

Such a cycle would also provide the Legislature necessary oversight through State Bar's reporting on its performance measures. As Figure 2 shows, the fee review at the beginning of the cycle could involve State Bar's justifying its costs by demonstrating the efficiency and effectiveness of its current operations, as well as by providing its reasons for any planned cost increases. State Bar has developed a

methodology for projecting costs and revenues, and as we previously discuss, it has also recently developed performance measures for its operations that the Legislature could use to hold it accountable for meeting goals and demonstrating efficiency. Therefore, a rigorous and transparent process for setting a multiyear licensing fee would provide ample opportunity for legislative oversight.

**Figure 2**

**A Multiyear Licensing Fee Cycle Would Allow State Bar to Better Plan for Long-Term Needs**



Source: Analysis of guidelines from the U.S. Government Accountability Office and Government Finance Officers Association for setting user fees and of practices followed by regulatory boards in the Department of Consumer Affairs.

Further, a multiyear fee cycle would supplement rather than eliminate the Legislature's existing oversight opportunities. For example, the Legislature already oversees State Bar through an annual report on the discipline system, a biennial report on efforts to increase access and diversity in the legal profession, and biennial audits. A fee review to set a multiyear fee cap would complement this oversight. Moreover, because the Legislature would maintain the authority to set the fee, it could change the fee cap before it expired or intervene to set a specific fee amount for a year if circumstances warranted.

*Regular reviews and adjustments would allow decision makers to align program revenue with the programs' goals and operating costs and provide opportunities to evaluate the programs' functions.*

The Legislature could also streamline the fee review process by merging the current \$25 discipline fee—which provides additional support for State Bar's disciplinary activities—with the annual licensing fee. The Legislature added the discipline fee in 1986 to address the rising costs of the discipline system, and consequently the fee is authorized under a separate statute. In our calculations of our recommended 2020 fees, we assumed that this fee would continue at its current level, as Table 1 in the Results in Brief shows. However, both it and the licensing fee go into State Bar's general fund, and State Bar uses portions of the licensing fee to support its discipline system. Instead of reviewing and adjusting two fees that provide revenue to the same fund, the Legislature might find it simpler to merge the two.

In addition, we believe the Legislature should incorporate State Bar's program fees into the multiyear fee cycle. The security fund's and assistance program's fees are set in state law. They would benefit from regular fee reviews as part of a multiyear fee-approval process. As we previously discuss, the security fund has been underfunded, while the assistance program has been overfunded because the fees have not been adjusted to align with operating costs. Regular reviews and adjustments would allow decision makers to align revenue with the programs' goals and operating costs, and they would also provide opportunities for the decision makers to evaluate the programs' functions. As with the licensing fee, a three-year cap could be set on each of these program fees.

Finally, special assessment fees should remain part of the multiyear fee cycle. Whereas the licensing fee funds recurring operating costs, special assessment fees fund discrete projects with defined timelines, such as capital improvements. Because a special assessment fee is designated for specific projects, it is an effective way to ensure that State Bar spends collected revenue only on approved projects. The fee review at the beginning of each multiyear fee cycle would provide an opportunity for State Bar to request and justify any future special assessments. Because a special assessment fee might extend longer than the three-year cycle, the subsequent fee review could be used to hold State Bar accountable for meeting the funded projects' goals and projected costs.

## Recommendations

### *Legislature*

To ensure funding of State Bar's operating costs and those costs associated with adding 19 trial counsel staff and increasing retiree health benefits, the Legislature should set the 2020 licensing fee at \$379 for active licensees and \$88 for inactive licensees.

To ensure funding for State Bar's IT projects, capital improvements, and general fund reserve, the Legislature should set a 2020 special assessment fee of \$41 for active licensees and \$11 for inactive licensees. To align the special assessment fee with State Bar's needs in the future, the Legislature should adopt the fee schedule that we present in Appendix C and do the following:

- As necessary, adjust the assessment related to the recommended IT projects and capital improvements each year from 2021 through 2024 to align that amount with State Bar's projected costs.
- Direct State Bar to determine the assessment amount necessary to rebuild its general fund reserve so that the reserve increases by 1 percent each year and reaches 17 percent by the end of 2024.

To enable State Bar to pay the security fund claims that it is likely to approve for payment in 2020, the Legislature should set the 2020 security fund fee at \$80 for active licensees and \$20 for inactive licensees. Should the Legislature decide that it wants to control how much it increases the security fund fee, it can consider State Bar's initiatives to reduce the security fund payout cap and give licensees the option to make voluntary contributions to the security fund.

To ensure that State Bar spends down the assistance program's excessive reserve, the Legislature should suspend the 2020 assistance program fee for both active and inactive licensees.

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 for the licensing, security fund, and assistance program fees. This change should take effect before the Legislature determines the licensing fee for 2021, and the 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.

To simplify the fee-setting process, the Legislature should amend state law to merge the \$25 discipline fee with the licensing fee in a single statute and repeal the statute authorizing the discipline fee. This change should take effect before the Legislature determines the licensing fee for 2021.

**State Bar**

To enable it to effectively determine its budget, State Bar should continue to annually prepare five-year projections.

To ensure that it maximizes the revenue from its San Francisco building, State Bar should do the following:

- Lease all available space and ensure that its leases reflect market rates.
- In the event of any future staff growth, it should avoid adding space by reducing its space allocations when practical to more closely match industry standards.

To further its ability to operate more efficiently and reduce the backlog of discipline cases, State Bar should do the following:

- Develop benchmarks by December 2019 delineating the duration of each step in its investigation process.
- Ensure consistency by December 2019 in the policy and guidance documents its staff follow when performing investigations work.
- Use its performance measures and collected data going forward to evaluate its case processing goals and work with the Legislature to revise the 180-day statutory goal if necessary.

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.

We conducted this audit under the authority vested in the California State Auditor by Government Code 8543 et seq. and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,

Handwritten signature of Elaine M. Howle in black ink.

ELAINE M. HOWLE, CPA  
California State Auditor

Date: April 30, 2019

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## Appendix A

### Scope and Methodology

We conducted this audit pursuant to the audit requirements contained in California's Business and Professions Code. Specifically, we reviewed State Bar's budget, its proposed licensing fee increase, its proposed special assessment fee, and its five-year projection of its revenue needs. We also assessed the security fund's and assistance program's fee needs, as well as other issues of concern related to the two programs. Finally, we evaluated the performance measures that State Bar has established to achieve efficiencies that may reduce its costs and examined its use of its real estate. Table A lists the audit's objectives and the methods we used to address them.

**Table A**  
**Audit Objectives and the Methods Used to Address Them**

AUDIT OBJECTIVE	METHOD
1 Review and evaluate statutes, regulations, rules, and court decisions relevant to State Bar's operations.	Reviewed portions of the California Constitution, state laws, and State Bar policies that are relevant to State Bar's operations.
2 Evaluate each program or division of State Bar receiving support from the annual State Bar licensing fees and other fees required of active and inactive licensees, including the following for each program or division:  a. Assess how much fee revenue, staff, and resources are currently budgeted and subsequently expended to perform existing tasks and responsibilities.	<ul style="list-style-type: none"> <li>• Interviewed State Bar's finance and executive staff.</li> <li>• Identified and reviewed State Bar's budgeting policies.</li> <li>• Reviewed State Bar's financial statements and actual departmental expenditures for 2016 and 2017 as well as State Bar's budgets from 2016 through 2019.</li> </ul>
b. Assess whether State Bar has appropriate program performance measures in place and how these measures are used for budgeting purposes.	<ul style="list-style-type: none"> <li>• Interviewed State Bar executive staff.</li> <li>• Reviewed State Bar's five-year strategic plan, a consultant's report on defining and adopting agencywide performance measures and goals, and relevant board materials outlining the executive director's strategy for instituting performance measures.</li> <li>• For State Bar's discipline function, interviewed staff from the trial counsel's office and State Bar's Office of Research and Institutional Accountability. We reviewed State Bar's performance reports and the board's action approving performance measures for the discipline system. We also evaluated the performance measures that the board adopted for the trial counsel's office.</li> <li>• For the security fund, interviewed executive staff and the program director. We also reviewed performance reports to identify relevant performance measures.</li> <li>• For the assistance program, interviewed the program director. We also reviewed the program's three-year strategic plan and two consultant reports containing recommendations for performance measures, and we determined the program's progress in implementing recommendations from those three documents.</li> </ul>

*continued on next page...*

AUDIT OBJECTIVE	METHOD
c. Assess the usage of real property owned by State Bar.	<ul style="list-style-type: none"> <li>• Interviewed State Bar administrative and executive staff responsible for managing the San Francisco and Los Angeles buildings.</li> <li>• Obtained and reviewed tenant contracts and, for the San Francisco building, determined past, current, and future vacancies.</li> <li>• Procured the services of a real estate appraiser to conduct visual inspections of the Los Angeles and San Francisco buildings, research market rates for leases of similar properties in Los Angeles and San Francisco, and compare these rates to State Bar's lease rates. The appraiser also calculated the amount of space State Bar occupies in both buildings, compared that to industry standards, and reviewed and assessed State Bar's property management agreement.</li> </ul>
d. Review State Bar's cost allocation plan used to allocate administrative costs.	<ul style="list-style-type: none"> <li>• Interviewed State Bar finance and executive staff.</li> <li>• Identified and reviewed State guidance on cost allocation plans.</li> <li>• Reviewed State Bar's 2016 consultant report evaluating its cost allocation plan and determined State Bar's progress in implementing associated recommendations.</li> <li>• Evaluated State Bar's current cost allocation plan.</li> </ul>
e. Review any proposals for additional funding or resources requested by State Bar to determine whether these proposals are necessary to meet State Bar's public protection function, as well as the accuracy of identified associated funding needs, after reviewing how existing resources are used.	<ul style="list-style-type: none"> <li>• Interviewed State Bar executives and staff working in finance, administration, IT, and programs.</li> <li>• Obtained State Bar's five-year general fund projection and evaluated its proposed licensing fee calculations and those calculations' underlying assumptions, including workload studies, labor agreements, and benefits analysis.</li> <li>• Evaluated the proposed special assessment for capital improvement and IT projects, including analyzing State Bar's project development cycles, strategic plan, and capital improvements plans. Reviewed and evaluated the proposed special assessment for rebuilding State Bar's general fund reserve.</li> <li>• Evaluated State Bar's proposal to increase the security fund fee by interviewing executive and program staff and reviewing State Bar's calculations supporting its proposed fee increase. We also analyzed security fund data to develop claims payment scenarios to support State Bar's revenue projections for 2020.</li> <li>• Reviewed State Bar's 2018 security fund report outlining initiatives to improve the program's financial condition, related board agenda materials and minutes, and related legislative analysis.</li> </ul>
f. Calculate how much fee revenue would be needed from each State Bar active and inactive licensee to fully offset State Bar's costs to perform existing tasks and responsibilities and to support additional proposed expenditures determined to be necessary to meet State Bar's public protection function. This calculation shall take into account any proposed business process reengineering, reallocations, or efficiencies identified by the State Auditor.	<ul style="list-style-type: none"> <li>• Based on analysis outlined in item e, we calculated the licensing fee increase for active and inactive licensees necessary to cover State Bar's reasonable operating costs in 2020.</li> <li>• Calculated for active and inactive licensees the special assessment necessary for capital improvements and IT projects from 2020 through 2024 and for the general fund reserve for 2020.</li> <li>• Calculated for active and inactive licensees the necessary fees for the security fund and assistance program.</li> </ul>
3 Review and assess any other issues that are significant to the audit.	To determine the optimal method for setting licensing fees, reviewed policies of regulatory agencies in the Department of Consumer Affairs and best practices from the U.S. Government Accountability Office and Government Finance Officers Association.

Source: Analysis of state law, planning documents, and information and documentation identified in the table column titled Method.

### Assessment of Data Reliability

The U.S. Government Accountability Office, whose standards we are statutorily obligated to follow, requires us to assess the sufficiency and appropriateness of computer-processed information that we use to support our findings, conclusions, or recommendations. In performing this audit, we relied on electronic data files we obtained from State Bar. These files included State Bar's projections for its proposed 2020 through 2024 fee increase. Because State Bar generated these Excel files independently from any database, we could analyze only the assumptions supporting them. We did this by reviewing source materials, such as State Bar budgets, consultant reports, project plans, and estimates, and by calculating the totals. We also used data from State Bar's security fund database to analyze the security fund's historical number of claims paid and average claim amounts, as well as to calculate the average elapsed time for State Bar to process a claim. We verified the nature of the data with State Bar staff, and we also verified record counts and control totals for claims paid. We also conducted logic tests of key data fields, including the case numbers and dates associated with claim activity. We found the data to be sufficiently reliable for our purposes.

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## Appendix B

### Recommended Fees for Inactive Licensees for 2020

Table B shows our recommended mandatory fees for inactive licensees in 2020. Attorneys under the age of 70 can pay the inactive licensing fee to maintain their licenses, although inactive licensees cannot practice law in the State, among other limitations. However, an inactive licensee may become active—and thus be able to practice law in California—by submitting an application and paying all required fees. As we discuss in the Audit Results, the licensing fee increase that we recommend reflects the costs of increasing health benefits for State Bar’s eligible retired employees and of adding up to 19 staff to the trial counsel’s office to perform functions related to the discipline process. The discipline fee is currently set in state law and is in addition to the licensing fee, which is why we show it separately in the Table.

**Table B**

**The State Auditor’s Recommended Mandatory Fees for Inactive Licensees in 2020**

MANDATORY FEE	2019	STATE BAR PROPOSAL	STATE AUDITOR RECOMMENDATION
Licensing	\$68	\$96	\$88
Discipline	25	25	25
Special Assessment*	0	70	11
Security Fund	10	30	20
Assistance Program	5	5	0 <sup>†</sup>
<b>Totals</b>	<b>\$108</b>	<b>\$226</b>	<b>\$144</b>

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

\* The special assessment fee would cover nonrecurring costs related to IT projects, capital improvements, and the general fund reserve. Our recommended fee would be assessed annually from 2020 through 2024. See Table C.1 for the fee level for each of the five years.

† In the past, this fee has raised revenue far in excess of program costs, which led to a high reserve. We recommend using this reserve in 2020 to cover program costs.

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## Appendix C

### Recommended Special Assessment Fees From 2020 Through 2024

Table C.1 shows our recommended special assessment fees for both active and inactive licensees from 2020 through 2024. As we discuss in the Audit Results, these assessment fees would provide funds for State Bar’s IT projects, capital improvements, and general fund reserve. Because State Bar has planned that its IT and capital improvement projects will generate different costs each year depending on project timelines, the related assessment amounts that we recommend would change annually to reflect its actual revenue needs. We recommend implementing a special assessment that would span a five-year period for these projects because the projects have defined timelines and costs that vary during this period. Table C.1 also shows the special assessment amount necessary for State Bar to rebuild its depleted general fund reserve. However, we have proposed an assessment amount for this purpose for 2020 only. On page 21 in the Audit Results, we describe why we are not projecting the reserve special assessment amount for future years.

**Table C.1**  
 The State Auditor’s Recommended Special Assessment Fees for 2020 Through 2024

SPECIAL ASSESSMENT	2020		2021		2022		2023		2024		TOTALS	
	ACTIVE	INACTIVE	ACTIVE	INACTIVE	ACTIVE	INACTIVE	ACTIVE	INACTIVE	ACTIVE	INACTIVE	ACTIVE	INACTIVE
IT projects	\$22	\$5	\$11	\$2	\$14	\$3	\$6	\$1	\$12	\$3	\$65	14
Capital improvement projects	16	5	13	4	1	0	0	0	0	0	30	9
General fund reserve	3	1	*	*	*	*	*	*	*	*	*	*
<b>Totals</b>	<b>\$41</b>	<b>\$11</b>	*	*	*	*	*	*	*	*	*	*

Source: Analysis of State Bar’s five-year general fund projection and related materials.

\* We do not include recommended reserve fees for 2021 through 2024 because we have recommended adjustments to State Bar’s projections and those years are dependent on the Legislature’s decision to adopt our recommendations and actions State Bar takes. Consequently, we do not provide totals for years 2021 through 2024. See page 21 in the Audit Results for a full discussion of the reserve assessment and methodology.

Table C.2 shows the projected five-year costs for the capital improvements and IT projects that we recommend that State Bar implement. As we describe in the Audit Results, we eliminated certain capital improvements and IT projects from State Bar’s projection, and we did not include these projects in the Table.

**Table C.2**  
The State Auditor's Projected Five-Year Costs for Recommended Capital Improvements and IT Projects  
(Dollars in Thousands)

PROJECT	ESTIMATED COST					FIVE-YEAR TOTALS
	2020	2021	2022	2023	2024	
<b>Capital Improvements</b>						
HVAC (Los Angeles)	\$800	\$0	\$0	\$0	\$0	\$800
HVAC (San Francisco)	950	53	143	0	0	1,146
Fire/life safety (San Francisco)	266	0	0	0	53	319
Energy management system (San Francisco)	350	0	0	0	0	350
Generator (San Francisco)	572	0	0	0	0	572
Elevators (San Francisco)	0	2,653	0	0	0	2,653
Floor 4 restroom upgrade (San Francisco)	164	0	0	0	0	164
Ground floor infrastructure (San Francisco)	200	0	0	0	0	200
<b>IT Projects</b>						
Hardware upgrades	\$3,708	\$292	\$1,053	\$601	\$1,670	\$7,324
Oracle Fusion	336	246	255	266	276	1,379
Licensee Information Management System (LIMS)	250	1,250	1,400	300	312	3,512
Network security assessment	0	200	0	0	200	400
Application security assessment	0	0	200	0	0	200
Disaster recovery services	150	200	0	0	0	350
<b>Totals</b>	<b>\$7,746</b>	<b>\$4,894</b>	<b>\$3,051</b>	<b>\$1,167</b>	<b>\$2,511</b>	<b>\$19,369</b>

Source: Analysis of State Bar's five-year general fund projection and report by our certified real estate appraiser.

April 2019



## The State Bar of California

### OFFICE OF THE EXECUTIVE DIRECTOR

180 Howard Street, San Francisco, CA 94105

415-538-2257

leah.wilson@calbar.ca.gov

April 12, 2019

The Honorable Elaine M. Howle\*  
State Auditor  
Bureau of State Audits  
620 Capitol Mall, Suite 1200  
Sacramento, CA 95814

RE: State Bar of California Response to State Audit Report 2018-030

Dear Ms. Howle:

The State Bar (Bar) appreciates the California State Auditor's (Auditor) careful review and ultimate affirmation of the Bar's need for a substantial fee increase, which was supported by the State Bar's multi-year financial forecast delineating one-time and on-going licensing, Client Security Fund, and Lawyer Assistance Program funding needs. The Bar also welcomes the Auditor's recommendation for a multi-year fee bill which would have an unprecedented positive impact on the State Bar's ability to meet its public protection mission.

In advance of the recent audit, the State Bar identified one-time and on-going licensing fee funding needs of \$100 and \$250 respectively (and \$80 for the Client Security Fund). These figures were reflective of history and cognizant of current reality; 21 years has elapsed since the State Bar has realized a licensing fee increase and there is no mechanism for the Bar to secure even modest or regular fee adjustments to meet changing fiscal circumstances. Given this, the Bar developed a comprehensive funding need that, when combined with a proposed annual Consumer Price Index adjustment, could sustain the Bar for what could be another lengthy period without any ability to modify licensing fees.

The State Auditor recognizes these challenges and has recommended a significantly different paradigm, one in which the Legislature authorizes multi-year licensing fees based upon updated financial forecasts prepared by the Bar. Under the Auditor's model, the State Bar would have the ability to justify and request a reasonable fee adjustment every three years, accurately forecast long-term budgets, and gain a level of stability and predictability necessary for sustained public protection efforts. Taken collectively, the State Bar embraces the State Auditor's recommendations, and is hopeful that they form the foundation of the Bar's 2020 fee bill.

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\* California State Auditor's comments begin on page 55.

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Absent Legislative adoption of this new paradigm however, the State Bar has no recourse but to plan for a scenario in which, after 2020, the agency could go a significant period of time without a fee increase. As such, the moderated 2020 funding levels recommended by the Auditor, which reflect phased staffing increases, capital and information technology projects, and CSF payouts, would not be tenable.

Importantly, the State Bar is in agreement with all of the Auditor's recommendations, with the caveat that the Bar believes that one, as described below, should be postponed. Additional context is also provided regarding other aspects of the audit narrative.

## RESPONSE TO SPECIFIC AUDIT RECOMMENDATIONS

*To ensure that the State Bar spends down the assistance program's excessive reserve, the Legislature should suspend the 2020 assistance program fee for both active and inactive licensees.*

The State Bar does not dispute the fact that the Lawyer Assistance Program (LAP) Fund maintains a sizeable surplus. This surplus is ultimately reflective of the low utilization of LAP which has been a trend throughout its history. Concerns about that utilization rate were the impetus for the Board of Trustees' recent action directing staff to work with the Legislature to effectuate a transition of the voluntary portion of LAP to an entity other than the State Bar.

The California Lawyers Association (CLA) has expressed interest in assuming responsibility for the voluntary portion of the program. The State Bar believes that CLA has both the mission alignment and capacity to build a thriving voluntary lawyer assistance program. It will however need resources to do so. At the same time, the State Bar will be substantially restructuring the model it uses to carry out the work of its remaining lawyer assistance program vis-à-vis those in the disciplinary system. This restructuring will involve implementing best practices in discipline-related intervention programs, namely individualized case plans stemming from validated risk/needs assessments, active supervision, and frequent accountability reviews by an adjudicative body. This new approach will give the State Bar the opportunity to more readily identify those whose misconduct may be attributable to substance use or mental health issues and to better protect the public. However, there are a number of unknowns with such a shift, including whether it will result in an increase in the number of lawyers receiving services.

Thus, with respect to both the voluntary program that is expected to grow under CLA's leadership, and the disciplinary program to be maintained by the State Bar, a healthy reserve balance is warranted to support impending operational changes and expansion. The State Bar recommends that an LAP fee holiday be considered at a later date, after full implementation and evaluation of the impact of these transitions.

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## **SUPPLEMENTAL INFORMATION**

### **STAFFING INCREASE, OCTC, PAGES 14-17**

②

The audit cites vacancy rates as one reason for phased implementation of the 58 new positions for the Office of Chief Trial Counsel (OCTC) included in the State Bar's financial forecast. The State Bar notes that high caseloads drive turnover, which in turn leads to staff vacancies. The Bar conducts exit interviews with departing staff; workload is invariably cited as a motivating factor for the majority of employees who leave an OCTC position. A phased staffing approach may therefore not be entirely appropriate given the inter-relationship between caseloads and turnover.

③

Further, while not optimal, OCTC vacancy rates are fairly low. The audit reports cites 16 vacant positions in 2018 and 20 in 2019; compared to the 253 and 255 funded OCTC positions in those years respectively, these figures reflect 6.3 percent and 7.8 percent vacancy rates.

④

### **SPECIAL ASSESSMENT FOR CAPITAL IMPROVEMENTS, PAGES 20-21**

②

The audit generally validates the State Bar's capital improvement plan but reflects a position that certain costs have been overstated. The cost estimates included in the State Bar's financial forecast were generated not by the State Bar alone but in consultation with a team of outside experts: a construction project management firm (CBRE), a general contractor, and an engineering firm. The estimates are based on these experts' knowledge of project scopes, market/industry conditions, and comparable projects completed in other buildings. The State Bar appreciates the Auditor's recognition that ultimately competitive bidding and the market will determine the true costs of approved projects, and the related recommendation that the amount of the capital assessment to be levied for the period 2021-2024 be responsive to these actual costs as they are identified.

### **STATE BAR HAS NOT MAXIMIZED REVENUE FROM ITS SAN FRANCISCO HEADQUARTERS, PAGES 28-34**

②

**Lease Rates Below Market.** As noted in the audit, the State Bar contracts with a professional third-party real estate services company which was selected in 2012 via a competitive bidding process that involved a thorough evaluation of several leading national and regional companies. The firm the Bar selected, CBRE, is a nationally-recognized leader in all of the real estate services it performs for the State Bar – property management, construction project management and leasing brokerage services. It manages approximately 400 buildings in the San Francisco Bay Area, comprising over 40 million square feet, and is regularly ranked as one of the top commercial real estate brokers in the area. The Bar has accordingly relied on CBRE's expertise to obtain the best leasing deals possible, which reflect the building's overall condition and limited amenities. The State Bar appreciates the attention to this issue that the audit has

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generated and looks forward to issuing a new Request for Proposals for property management and brokerage services this summer.

⑤ **Unleased Space.** The State Bar secured a loan in 2016 to invest in warm shell renovation and tenant improvements for the three vacant floors identified in Table 11 of the audit (1, 3, and 11). Although originally the loan could have provided for completion of the work for all three floors, the loan terms were restructured to add a debt service reserve fund, reducing the amount of funding available for capital investments; only two floors could be completed. Those floors (1 and 11) are now fully leased. No funding has been available for warm shell renovation or tenant improvements for the remaining floor (3). As noted by the Auditor, recently, the State Bar's floor 1 tenant expressed an interest in making the requisite investments in floor 3 to support expansion. The Bar is actively pursuing this option and hopes to have a lease finalized in the near term.

⑥ **State Bar Occupied Space Utilization.** The State Bar appreciates the Auditor's identification of square foot per employee as an area of improvement for the Bar. As staffing increases are realized the State Bar will implement the recommendation to reconfigure its space and reduce the per employee footprint. It is important to note however that reconfiguration of the type contemplated by the Auditor is not without a significant cost; related costs are not included in the special assessment amounts recommended by the audit, but will be included in future special assessment calculations.

⑦ Regarding the property management company using tenant space for its management office, the company has been using un-renovated space for this purpose; it has never occupied space in lieu of a paying tenant.

**Property Management Fee.** The majority of the fees paid to CBRE -- \$590,000 for 2019 -- are lease commissions, which are based on industry-standard commission rates. The property management fee for 2019 is \$285,000. The audit report states that the industry-standard property management fee should be approximately 2 percent of gross rent. Taking into account the rental value of the State Bar's own space, a 2 percent property management fee for 2019 would be \$220,000; the actual fee is equivalent to 2.59 percent, a difference of \$65,000.

⑧ With additional rental income from newly signed leases, the fee in 2020 and 2021 would be the equivalent of 2.32 percent and 2.22 percent, respectively. Although the audit report questions the amount of the property management fee, the fee is comparable to that originally proposed by other bidders, who were also leading national or regional real estate services firms.

In closing, I note that, from the State Bar's perspective, the transformative nature of this audit cannot be overstated. The Bar's significant efforts to systematically address the legitimate criticisms that have been leveled against it over the last many years, to institutionalize good governance and operational management, and to make meaningful its public protection

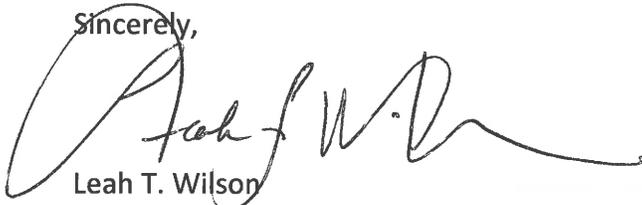
The Honorable Elaine M. Howle

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mission, have been recognized. The methodology for calculating both on-going and one-time fee increases has been validated. And, most significantly, the need for a multi-year fee bill and a rational and predictable process for securing adjustments going forward, has been independently asserted. In addition, the Auditor has raised important issues for the Bar to consider as it seeks a new real estate services company for its San Francisco headquarters this summer.

Sincerely,

A handwritten signature in black ink, appearing to read "Leah T. Wilson". The signature is fluid and cursive, with a large initial "L" and "W".

Leah T. Wilson  
Executive Director

LTW/egl

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## Comments

### CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE STATE BAR OF CALIFORNIA

To provide clarity and perspective, we are commenting on the State Bar of California's (State Bar) response to our audit. The numbers below correspond to numbers we have placed in the margin of State Bar's response.

The intent of our recommendation is to ensure the assistance program fee aligns with the program's costs. Given the history of underutilization of the program, which we describe on page 26, we find it unlikely that program participation will increase so significantly by 2021 that the program's current high reserve would not provide sufficient funding for that year, regardless of whether the California Lawyers Association or another entity assumes management of the voluntary portion of the program. As we discuss on page 36, the Legislature should include the assistance program in a multiyear fee-approval cycle. Thus, in 2020, the Legislature could determine an appropriate fee level for the program moving forward, based on the program's projected expenses.

①

While preparing our draft report for publication, some page numbers shifted. Therefore, numbers State Bar cites in its response may not correspond to the page numbers in our final report.

②

We note that high workloads have contributed to problems with employee retention on page 13 of the Audit Results and took this factor into account in our recommendation to increase the trial counsel office's staff by up to an additional 19 positions in 2020. We do not discount the possibility that the trial counsel's office may determine it still needs more staff beyond these additions, but continue to believe that adding staff gradually is a more prudent decision for the reasons we elaborate on pages 13 and 14.

③

We do not dispute the relative vacancy rate in the trial counsel's office; rather, as we note on page 14, any vacant positions in this office would need to be filled in addition to filling any new positions. Again, this supports our belief that gradually adding new positions would be a more realistic and effective approach.

④

- ⑤ State Bar's response suggests that it could not have taken further action to lease floor 3 at an earlier date. However, as we explain on page 28, State Bar could have explored the option of finding a tenant to pay for the warm shell renovation earlier than it did.
- ⑥ We acknowledge that cost may be a consideration in deciding whether to reconfigure space when we say in our recommendation on page 38 that State Bar should do so "when practical."
- ⑦ State Bar's comment implies that the space it provided at no cost to its property management firm has limited value. However, this is space State Bar could potentially make leasable in order to generate revenue, as we note on page 31.
- ⑧ During the five-day period it was reviewing our draft report, State Bar provided us with information regarding the annual fee it pays its property management firm that it had not provided to us during fieldwork. We reviewed this new information, which included the calculation in State Bar's response, with the certified real estate appraiser we retained. We determined State Bar's calculations were reasonable and have removed the finding in our draft report that this annual fee was higher than industry standard. Nonetheless, we continue to believe that State Bar would benefit from retaining an expert to participate in its future solicitation and negotiation for property management services, as we suggest on page 31.