

# California State Auditor

B U R E A U O F S T A T E A U D I T S

## **State Bar of California:**

*Although It Reasonably Sets and Manages Mandatory Fees, It Faces Potential Deficits in the Future and Needs to More Strictly Enforce Disciplinary Policies and Procedures*



April 2003  
2002-030

The first five copies of each California State Auditor report are free.  
Additional copies are \$3 each, payable by check or money order.  
You can obtain reports by contacting the Bureau of State Audits  
at the following address:

**California State Auditor  
Bureau of State Audits  
555 Capitol Mall, Suite 300  
Sacramento, California 95814  
(916) 445-0255 or TTY (916) 445-0033**

OR

**This report is also available  
on the World Wide Web  
<http://www.bsa.ca.gov/bsa/>**

The California State Auditor is pleased to announce  
the availability of an online subscription service.  
For information on how to subscribe, please contact  
David Madrigal at (916) 445-0255, ext. 201, or  
visit our Web site at [www.bsa.ca.gov/bsa](http://www.bsa.ca.gov/bsa/)

**Alternate format reports available upon request.**

Permission is granted to reproduce reports.



# CALIFORNIA STATE AUDITOR

---

ELAINE M. HOWLE  
STATE AUDITOR

STEVEN M. HENDRICKSON  
CHIEF DEPUTY STATE AUDITOR

April 24, 2003

2002-030

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 required by Chapter 342, Statutes of 1999, the Bureau of State Audits presents its audit report concerning the State Bar of California's (State Bar) disciplinary process and its management of mandatory and voluntary fees.

This report concludes that the State Bar continues to reduce its backlog of disciplinary cases that resulted from its virtual shutdown in 1998. For example, to address the backlog of cases, it created a team in its enforcement unit to work exclusively on these cases. Overall, the State Bar's efforts have significantly decreased the number of cases in its backlog from 1,340 at the end of 2000 to 401 at the end of 2002. In addition, the State Bar continues to ensure that dues for members are reasonable and are not used to support voluntary functions. However, deficiencies similar to those identified by the State Bar's staff in its 2000 internal random review of disciplinary cases continue to be an issue. For example, two recent reviews specifically noted staff's failure to enter information into the computer database, poor record keeping and file maintenance, and not sending closing letters to complainants or respondents. Moreover, the State Bar's financial forecast indicates that if fees remain at its current level, the State Bar could face a deficit in its General Fund at the end of 2005.

Respectfully submitted,

A handwritten signature in black ink that reads "Elaine M. Howle". The signature is written in a cursive, flowing style.

ELAINE M. HOWLE  
State Auditor

# **State Bar of California:**

*Although It Reasonably Sets and Manages  
Mandatory Fees, It Faces Potential Deficits  
in the Future and Needs to More Strictly  
Enforce Disciplinary Policies and Procedures*

# CONTENTS

---

<i>Summary</i>	1
<hr/>	
<i>Introduction</i>	5
<hr/>	
<i>Chapter 1</i>	
<hr/>	
The State Bar of California Has Reduced Its Backlog of Disciplinary Cases, but More Improvements Are Needed	9
Recommendations	22
<i>Chapter 2</i>	
<hr/>	
Although It Continues to Ensure That Mandatory Fees Are Reasonable and Do Not Support Voluntary Programs, the State Bar of California Faces Potential Deficits in the Future	23
Recommendation	33
<i>Appendix</i>	
<hr/>	
General Fund and Public Protection Reserve Fund Balances Will Not Cover Projected Deficits	35
<i>Response to the Audit</i>	
<hr/>	
The State Bar of California	39

# SUMMARY

---

---

## Audit Highlights . . .

*The State Bar of California (State Bar) continues to make some improvements since our audit in 2001. For example, it:*

- Made further changes to reduce its backlog of disciplinary cases.*
- Continued to ensure that mandatory fees are reasonable and do not support voluntary programs.*

*However, the State Bar needs to do the following:*

- Ensure that policies and procedures for processing disciplinary cases are being followed.*
  - Monitor its need for an increase in membership fees to avoid a potential deficit in its General Fund in the future.*
- 

## RESULTS IN BRIEF

The State Bar of California (State Bar), established by the California State Constitution, is a public corporation with a mission to preserve and improve the justice system. California's Business and Professions Code guides the State Bar in its efforts to fulfill this mission and to protect the public from the unethical or unauthorized practice of law. A 23-member board of governors establishes policy and guides the State Bar's functions, such as licensing attorneys and providing programs to promote the professional growth of its members.

In 1997, the governor vetoed legislation that would have authorized the State Bar to charge its base annual membership fees, which were used to support its disciplinary function, as well as other General Fund operations. Various sources, including our 1996 audit, indicated that the State Bar was not managing its resources effectively.<sup>1</sup> The resulting drastic reduction in membership fees meant the State Bar had to curtail its activities significantly and find ways to cut costs. The significant curtailment of its activities led to a backlog of 2,217 disciplinary cases in 1998.

In our 2001 audit, we reported on the State Bar's efforts to address this backlog, which included implementing a priority system that focuses on the most serious complaints.<sup>2</sup> The State Bar has since made further changes to address the backlog, such as establishing within its enforcement unit a team that focuses exclusively on these cases. At the end of 2002, the backlog of cases was 401. For 2003, it plans to continue its efforts to ensure the backlog does not exceed 400 cases. It also continues to conduct periodic reviews of random cases to ensure that staff actions are appropriate and consistent with case law and with the State Bar's policies, standards, and priorities. However, its 2002 review identified some of the same type of deficiencies it found in 2000. Although it has provided group and individual

---

<sup>1</sup> *State Bar of California: Opportunities Exist To Reduce Fees, Better Control Administration and Planning, and Strengthen an Improved Discipline Process* (report 96021).

<sup>2</sup> *State Bar of California: It Has Improved Its Disciplinary Process, Stewardship of Members' Fees, and Administrative Practices, but Its Cost Recovery and Controls Over Expenses Need Strengthening* (report 99030).

training and issued a training bulletin to address the problems, the State Bar could do more to better ensure that staff are following policies and procedures.

For example, one deficiency is poor record keeping and file maintenance. To address this concern, the State Bar issued a training bulletin listing potential documents to include in the case files. Although the bulletin is a good reminder of what documents they should be requesting or preparing, the State Bar lacks a process, such as a checklist in each file, to ensure that staff consistently follow policies and procedures.

The State Bar continues to have trouble collecting money related to disciplinary cases. Because its cost recoveries remain low, it uses a greater portion of membership fees to subsidize support for its Client Security Fund and for disciplinary costs than it might otherwise need to. Although the State Bar has considered other collection methods, the final decision was to not pursue those methods. However, the executive director believes that the time is right to seek a legislative amendment that would help strengthen its collection enforcement authority.

On the other hand, the State Bar continues to diligently monitor its financial accounting for activities supported by the required membership fees and by the fees that members pay voluntarily. Because legislation precludes it from using mandatory fees to support programs that the law does not require and that are optional for members, the State Bar uses separate funds to account for the receipt and expenditure of voluntary fees. It also continues to allocate administrative costs equitably among mandatory and voluntary programs. To ensure that members' fees are reasonable and that mandatory fees do not support voluntary programs, the State Bar determined the amount of money it needs to perform its required functions. However, based on its financial forecast of its General Fund, it predicts that expenses will exceed its revenues starting in 2003, which will eventually use up the surplus in its General Fund. The financial forecast indicates that if membership fees remain at \$390, the State Bar has enough in its reserve to avoid a deficit until the end of 2005.

## RECOMMENDATIONS

To strengthen its disciplinary process, the State Bar should take the following actions:

- Continue its efforts to reduce its current backlog of disciplinary cases.
- Require that staff maintain a checklist of important steps in the process and potential documents for each file, which should be reviewed by appropriate supervisors. In addition, the State Bar should conduct spot checks of current cases that are being closed. Responsible staff should be required to resolve any issues concerning files determined to be noncompliant.
- Seek a legislative amendment that will strengthen its enforcement ability to collect costs for discipline and client security.

To ensure that mandatory fees are set at a reasonable level to meet its operational needs, the State Bar should continue to monitor for the necessity of a fee increase.

## AGENCY COMMENTS

The State Bar does not dispute any of the report's findings or conclusions. In addition, the State Bar agrees with the recommendations and plans to address them promptly. ■

Blank page inserted for reproduction purposes only.

# INTRODUCTION

---

## BACKGROUND

The California State Constitution established the State Bar of California (State Bar) as a public corporation. It requires every person admitted and licensed to practice law in California to be a member unless the individual serves as a judge in a court of record. Chapter 4 of California's Business and Professions Code, commonly referred to as the State Bar Act, guides and directs the State Bar in fulfilling its mission and carrying out its responsibilities. A 23-member board of governors establishes policy and guides such functions as licensing attorneys and providing programs to promote the professional growth of its members.

The State Bar performs these functions: admissions, discipline and adjudication, administration of justice, administration of the profession, governance, program development, communications, and administration and support. To pay for these functions, the State Bar collects an annual fee from each member. Members can voluntarily pay an additional amount to participate in various activities that relate to specific segments of the legal profession, such as the family law section.

In 1997, the governor vetoed the bill that would have authorized the State Bar to charge its base annual membership fees, which were used to support its disciplinary function, as well as other General Fund operations. Thus, the State Bar could only charge certain fees that were authorized in statute. Subsequently, Chapter 342, Statutes of 1999 (Chapter 342), authorized it to assess a base annual fee up to \$318 per member until January 1, 2001. Currently, Chapter 24, Statutes of 2001, authorizes the State Bar to charge a base annual fee up to \$310 per member until January 1, 2004. In combination with other fees specified in existing statutes, this brought the total to \$390 per member for 2002. Additionally, Chapter 342 requires that the State Bar contract with an independent public accounting firm to conduct an audit of its financial statements for each fiscal year beginning after December 31, 1998. The legislation also directs the State Bar to contract with the Bureau of State Audits to conduct a performance audit every two years. We issued the first performance audit in April 2001.

## SCOPE AND METHODOLOGY

As directed by Chapter 342, our audit is of the State Bar's operations from January 1, 2002, through December 31, 2002. This legislation does not state specific topics the audit should address. In planning the current audit, we reviewed the recommendations we made in our 2001 audit. During the 2001 audit, we identified four principal areas: the State Bar's disciplinary process; cost recovery as part of the disciplinary process; the use of mandatory and discretionary funds to support State Bar functions, including legislative activities; and the procurement process.

To review the disciplinary process, we compiled and reviewed key statistics. In addition, we obtained a report from the State Bar about its goals for reducing its backlog of disciplinary cases. We also analyzed its success in recovering from attorneys costs that it incurred as part of the disciplinary process.

To review its use of mandatory and discretionary funds to support various functions, including legislative activities, we analyzed the two cost allocation plans that were developed for the State Bar by Deloitte and Touche, LLP. We did not review the actual allocations of indirect costs for 2002 because they are subject to testing by the auditors of the State Bar's financial statements (financial auditors). As of March 2003, the financial auditors were in the process of testing the 2002 statements. For the 2001 statements, the financial auditors performed procedures, which they believed sufficient to express an opinion that the financial statements were presented fairly. However, we did review the State Bar's financial statements for 2002 to determine that it appropriately charged costs, including administrative costs, to its Legislative Activities Fund. We also assessed whether the State Bar's monitoring of mandatory fees is reasonable and reviewed its financial forecast for 2003 through 2007.

To determine if the State Bar charged to the Legislative Activities Fund all its activities related to lobbying for specific issues, we examined consultant contracts to see if they listed lobbying duties. We also compared the amount of funds given to the Legislative Activities Fund with the amount of costs charged to it and reviewed the expenditures charged to it for appropriateness.

In evaluating the procurement process, we looked at transactions to determine if the State Bar's employees were following policies and procedures for its purchasing card program. We also reviewed its contracting policies and procedures to address the finding from our 2001 audit concerning some weaknesses

in its controls over contracting. In addition, we reviewed the awarding of selected contracts as well as the payments made against the contracts. We found a few instances where the State Bar did not follow its procedures for requiring supporting documentation for purchases made with the purchasing card. In addition, we found three instances where it did not follow its procedures for reviewing contracts. In another instance, the State Bar did not adequately monitor payments on a purchase order, which resulted in its paying more than the amount approved on that particular purchase order. Because the problems we identified occurred in only a few instances, we have reported them in a separate management letter to the executive director of the State Bar.

Finally, we inquired whether the State Bar has developed a strategic plan. We found that the State Bar issued a strategic plan in August 2002. Its operational plan, which contains desired outcomes to be used to measure the results achieved under the strategic plan, was still in draft form as of March 2003. The State Bar intends to provide a final version of the operational plan to its board of governors in May 2003. As a result, we did not assess the strategic plan or the operational plan as part of this audit. ■

Blank page inserted for reproduction purposes only.

# CHAPTER 1

---

## ***The State Bar of California Has Reduced Its Backlog of Disciplinary Cases, but More Improvements Are Needed***

### CHAPTER SUMMARY

Since we issued our 2001 audit report on its operations, the State Bar of California (State Bar) has continued its efforts to decrease its backlog of disciplinary cases. Its intake unit has addressed the backlog by designating two staff on a rotational basis to work exclusively on cases that are falling behind in the process. In addition, in January 2002 the State Bar created a backlog team in its enforcement unit to work exclusively on backlog cases. Overall, its efforts have significantly decreased the number of cases in its backlog from 1,340 at the end of 2000 to 401 at the end of 2002. In addition, the State Bar has continued its policy of reviewing random cases periodically to ensure that its staff's actions are consistent with case law and with the State Bar policies, standards, and priorities. In its 2002 reviews, State Bar staff identified some of the same type of deficiencies that were noted in its 2000 random review of cases. Specific problems include staff's failure to enter information into the computer database, poor record keeping and file maintenance, and not sending a closure memo to the complainant or respondent. However, the reviewers found that the areas of concern were not generally significant enough to have an adverse effect on the overall outcome of a case's disposition.

Since our 2001 audit, the State Bar's cost recovery rates improved slightly, although the rates remain low. Specifically, the Client Security Fund cost recovery rates increased from 2.5 percent in 2000 to 10.9 percent in 2002. A similar increase occurred in the cost recovery rates from the disciplinary process. In 2002, these amounts increased from 28.8 percent to 36.4 percent. Because cost recoveries are still low, the State Bar uses more of its membership fees to subsidize support for its Client Security Fund and disciplinary process than it might otherwise need to. However, the executive director believes the time is right to seek a legislative amendment that would strengthen its collection enforcement authority.

### Statement of Disciplinary Priorities

**Priority I** may include the following:

- Misappropriation of a client's funds.
- A pattern of failure to perform services or to communicate.
- Insurance fraud.
- Multiple violations that in their entirety are likely to result in at least a one-year suspension from the State Bar.

**Priority II** may include the following:

- Misrepresentation to the client or the court.
- Violation of a court order.
- Improper business transactions with a client.

**Priority III** may include the following:

- Unauthorized practice of law by individuals who are not attorneys.
- Unauthorized practice of law by attorneys who have resigned or are disbarred.
- Isolated failure or delay in returning or releasing client files.

**Priority IV** may include the following:

- An attorney's contempt of court.
- Allegations of sexual harassment.
- Disclosure of confidential client information without evidence that the disclosure caused the client actual harm.

## BACKGROUND

Over the years, one of the State Bar's most important functions has been investigating and disciplining California attorneys who violate their clients' trust. The State Bar operates its disciplinary process through its intake and enforcement units under the chief trial counsel and the State Bar Court.

Since 1998, the intake unit has prioritized inquiries about attorneys according to their seriousness. Although, as of March 2003, the State Bar plans to revise its Statement of Disciplinary Priorities, which sets forth guidelines for the intake and the enforcement units, the existing statement was still used in 2002. This statement allows the State Bar to focus its resources and efforts on the most critical disciplinary inquiries and to address the less serious inquiries to the extent that resources are available.

The intake unit is the initial contact point for the general public to make inquiries about attorneys, seek general information about attorneys, or seek information about the State Bar and its programs. The intake unit operates a toll-free telephone line that allows members of the public to call and initiate a complaint against attorneys who practice in California. In addition to taking calls from these complainants, the intake unit receives referrals from attorneys, courts, banks, insurers, and law enforcement agencies about improper conduct by

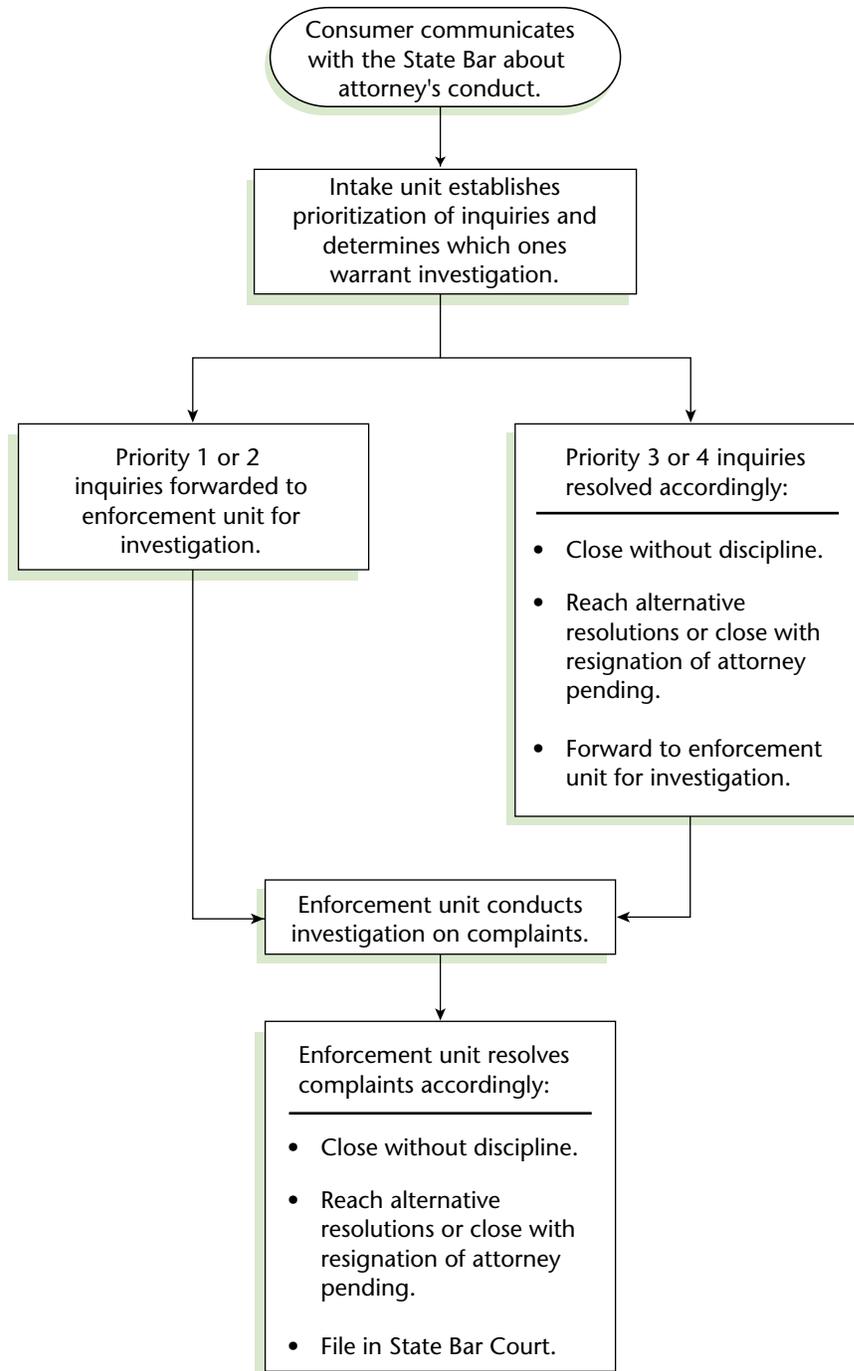
attorneys. It prioritizes all inquiries coming into the State Bar's disciplinary system. This unit also processes the less serious inquiries. Figure 1 illustrates how the State Bar handles inquiries.

Inquiries that the intake unit determines warrant an investigation are forwarded to the enforcement unit where they are considered complaints. The enforcement unit investigates the complaints to determine whether sufficient evidence is available to confirm the allegations and to prosecute the disciplined attorney. If the investigator is unable to substantiate the complaint, the deputy trial counsel closes it. On the other hand, if the complaint is substantiated, the investigator summarizes the evidence and forwards the case to the deputy trial counsel, who drafts a Notice of Disciplinary Charges (notice) that summarizes the allegations

against the attorney. The notice is the document used in the State Bar Court to initiate formal disciplinary proceedings against the accused attorney.

**FIGURE 1**

**The State Bar's System for Prioritizing and Resolving Inquiries and Complaints**



Before the deputy trial counsel files the notice with the State Bar Court, the accused attorney is informed about the allegations and has up to 20 days to negotiate a settlement. This procedure is significant because a complaint does not become public information until the deputy trial counsel files the notice in State Bar Court. If the attorney does not respond to the offer of the 20-day settlement conference or if no settlement occurs, either party may request an early neutral evaluation conference. The conference, conducted by a hearing judge of the State Bar Court, is the attorney's last chance to resolve the issue before the notice is filed in the State Bar Court and becomes public.

The State Bar Court, located in either Los Angeles or San Francisco, hears and decides cases related to attorney misconduct. It consists of two departments, hearing and review. The first hears and decides matters brought by the chief trial counsel. The review department hears and decides matters on appeal from the hearing department. The review department also performs certain adjudicative and administrative tasks related to the attorney discipline process that have been delegated to the State Bar Court by the California Supreme Court. The State Bar Court hears various types of proceedings, including those originating with the chief trial counsel, disciplinary proceedings following an attorney's criminal conviction by the courts or by prosecution offices, and reinstatements initiated by disbarred or resigned attorneys who seek readmission to the State Bar.

### **THE STATE BAR HAS MADE SIGNIFICANT PROGRESS IN DECREASING ITS BACKLOG OF DISCIPLINARY CASES**

Since our 2001 audit, the State Bar has continued its efforts to decrease its backlog of disciplinary cases. For example, it created a backlog team in its enforcement unit. The backlog team, composed generally of the most experienced investigators, focused exclusively on the backlog cases. Overall, the State Bar's efforts have significantly decreased the number of cases in its backlog from 1,340 at the end of 2000 to 401 at the end of 2002.

---

*The State Bar decreased its backlog from 1,340 cases at the end of 2000 to 401 at the end of 2002.*

---

The loss of revenue in 1998, when the State Bar lost its authorization to collect its base annual membership dues, prompted significant layoffs in the office of the chief trial counsel, which investigates, prosecutes, and monitors attorneys accused of misconduct. Because it virtually shut down in 1998, the State Bar faced 2,217 disciplinary cases in its backlog by the end of that year. Backlog cases are uncompleted investigations

pending in the system for more than six months at year's end. As we reported in our 2001 audit, when its disciplinary system reopened on March 1, 1999, with the dues mandated by the California Supreme Court for 1999, the State Bar set into motion a series of initiatives to address its inventory of pending cases. The chief trial counsel developed a system for prioritizing work to ensure that the State Bar concentrated its resources only on those cases with the greatest risk of client and public harm. Next, the chief trial counsel's staff reviewed the entire inventory according to those priorities to ensure that it addressed the most serious consumer cases first. The chief trial counsel then reorganized staff into specialized teams.

### **The Intake Unit Made Changes to Address Its Backlog**

The intake unit, within the office of the chief trial counsel, made changes to address backlog. According to the assistant chief trial counsel, since late 2001, the unit has placed more emphasis on resolving cases within 60 days. It has tested ways of consistently maintaining timely resolution of cases. The assistant chief trial counsel states that the latest approach, which seems the most promising, is the creation of a two-person team assigned on a rotational basis to work cases that may be falling behind in the process. This two-person team is assigned to work cases that others could not work on because of such reasons as their current workload, sickness, or vacations. According to the assistant chief trial counsel, this new process has allowed the intake unit to significantly reduce the aging of cases in the system. As Table 1 on the following page shows, the intake unit increased the percentage of inquiries closed without discipline from 58 percent in 2000 to 62 percent in 2002 while still maintaining the steady advancement of cases to investigations at 25 percent. Although the percentage of complaints closed with alternative resolution decreased from 17 percent in 2000 to 13 percent in 2002, it seems reasonable that this may be due to more resources closing complaints without discipline.

### **The Enforcement Unit Was Restructured to Address Its Backlog**

In January 2002, the Los Angeles investigations office within the enforcement unit was restructured from four investigation teams to three investigation teams and one backlog team that focused exclusively on backlog cases. According to the office of chief trial counsel's backlog reduction report, the investigators assigned to the backlog team were generally the most experienced. Further, the report stated that the backlog team was assigned to

---

*To address its backlog of cases, the State Bar created a team in its enforcement unit to work exclusively on backlog cases.*

---

work 500 cases from Los Angeles, and in July it received an additional 130 cases from the San Francisco office. The goal was to reduce the backlog by 50 to 75 cases per month. The backlog reduction report stated that investigators not on the backlog team focused on the remaining backlog cases and those cases that would soon be pending for more than six months. The overall goal for 2002 was to have a backlog of no more than 400 cases.

**TABLE 1**

**Summary of Inquiries and Complaints Processed by the Office of the Chief Trial Counsel  
Calendar Years 2000 and 2002**

	2000	Percent of Total Inquiries and Complaints Processed	2002	Percent of Total Inquiries and Complaints Processed
<b>Intake Unit</b>				
Total inquiries closed or advanced	11,309		14,491	
Closed without discipline	6,538	58%	8,938	62%
Closed with alternative resolutions or resignation of attorney pending	1,987	17	1,897	13
Advanced to investigation	2,784	25	3,656	25
<b>Enforcement Unit*</b>				
Total complaints resolved	3,818		4,465	
Closed without discipline	2,162	57	2,700	60
Alternative resolutions or resignation of attorney pending	573	15	794	18
Cases filed in State Bar Court	1,083	28	971	22

Source: State Bar’s Disciplinary Computer Tracking System.

\* The enforcement unit includes the following offices: fast track and insurance fraud, San Francisco, general trials, and Los Angeles investigations.

At the end of 2002, the backlog of cases was 401 compared with 1,340 at the end of 2000 and 809 at the end of 2001. According to the backlog reduction report, the State Bar is currently focusing on not allowing the backlog to increase beyond 400 in 2003. Further, it maintains an “aspirational goal” of reducing the backlog to 250 by the end of 2003, but the report stated that the State Bar’s ability to achieve that goal has been negatively impacted by budget constraints and other external factors.

With the creation of the backlog team, we saw a slight increase in the percentage of cases closed without discipline in the enforcement unit. As Table 1 shows, for the year 2002 the State Bar closed 60 percent of such cases compared to 57 percent in 2000. According to the chief trial counsel, this increase was due to the newly created backlog team and the vertical prosecution teams. In the latter, the deputy trial counsel and investigator work together on a case from the moment it becomes an investigation through trial, settlement, or dismissal. The chief trial counsel stated that the backlog team determined that 60 percent of the backlog cases that it reviewed did not have sufficient factual or legal basis upon which to proceed. According to the chief trial counsel, cases in which the presence of misconduct is unclear result in a higher percentage of closures than cases in which the misconduct is clear, and the cases in backlog were disproportionately made up of such cases. Further, he stated that the vertical prosecution teams, while continuing to resolve the highest priority cases with the clearest violations, sought to avoid having cases become part of the backlog after six months.

These teams also focused attention on the cases that would be dismissed in addition to the cases that would be prosecuted. According to the chief trial counsel, the vertical prosecution teams closed 49 percent of the cases they processed due to an insufficient factual or legal basis upon which to proceed with the case. This also contributed to the increase in the number of cases closed without discipline by the enforcement unit, as shown in Table 1.

---

*Even with more resources focused on the backlog, we did not see a significant impact on the State Bar's ability to investigate and file cases in the State Bar Court.*

---

However, even with more resources focused on the backlog, we did not see a significant impact on the State Bar's ability to investigate and file cases in the State Bar Court. For example, the percentage of cases closed with alternative resolution or resignation of attorney pending slightly increased from 15 percent in 2000 to 18 percent in 2002. Although the percentage of cases filed in State Bar Court decreased from 28 percent in 2000 to 22 percent in 2002, overall the enforcement unit still closed with resolution or filed in State Bar Court 40 percent of cases in 2002 compared to 43 percent in 2000. This indicates that the State Bar continues to process disciplinary cases at nearly the same rate as it did in 2000, despite its decision to focus more of its resources on the backlog cases.

## THE STATE BAR NEEDS TO STRICTLY ENFORCE ITS POLICIES AND PROCEDURES WHEN PROCESSING COMPLAINTS

The State Bar's internal random review process indicates that staff do not always follow policies and procedures when processing complaints. Specifically, in 2002 the State Bar identified some of the same type of deficiencies as reported in its random review in 2000. To address some of these issues, the State Bar conducted group and individual training, and it issued a training bulletin to remind staff of the policies and procedures.

In September 2000, the State Bar established a policy that directs management to conduct periodic reviews of random cases to ensure that the staff's actions are appropriate and consistent with case law and with the State Bar policies, standards, and priorities. Once the reviews are complete, each manager prepares a summary of findings, and the summaries are consolidated into a final report for the chief trial counsel. The State Bar conducts reviews semiannually. In 2002, it reviewed files for the periods of October 2001 through March 2002 and April through September 2002. Staff reviewed about 345 to 390 files for each period. State Bar staff reviewed files from the intake unit and the enforcement unit, which includes the following offices: fast track and insurance fraud, general trials, San Francisco, and Los Angeles investigations. The two recent reviews disclosed some deficiencies similar to those found in the State Bar's 2000 random review. Specifically noted were staff's failure to enter information into the computer database, poor record keeping and file maintenance, and not sending closing letters to complainants or respondents.

*Deficiencies similar to those identified in its 2000 random review continue to exist.*

Because State Bar staff did not always provide proper record keeping and file maintenance, the reviewers sometimes found it difficult to determine if a case had been appropriately handled. This causes inefficiencies because to determine if the case were appropriately handled, the reviewers would have to reevaluate information contained in the files. The same problem would occur if another investigator had to take over the case or if the case was forwarded to another unit during processing. As a reviewer stated, one deputy trial counsel should be able to pick up any other deputy trial counsel's file and, in short order, try the case. According to the reviewer this would not be possible given the state of many of the audited files. However, the reviewers found that the areas of concern were not generally significant enough to have an adverse effect on the overall outcome of a case's disposition.

---

***The State Bar lacks an effective procedure to better ensure cases are being closed appropriately and policies and procedures are being followed.***

---

To address the deficiencies identified in its periodic reviews, the State Bar conducted group and individual training to remind staff of policies and procedures. In addition, in November 2002, the deputy chief trial counsel issued a training bulletin about the protocol for maintaining a formal litigation file. Although the bulletin serves as a reminder of the policy for file maintenance, it does not ensure that the policy will be consistently followed. The State Bar lacks a procedure, such as a checklist to accompany each file, that would better ensure important tasks are completed and documents are received. In addition, the State Bar lacks an effective procedure to check recently closed cases to better ensure that cases are being closed appropriately and that staff are following policies and procedures.

In addition to looking at compliance with policies and procedures, we looked at these reviews to ensure that the efforts to reduce backlog did not result in inappropriate closure. The State Bar, at the request of the complainant, may conduct a “second look” at a case if the complainant believes that it was closed inappropriately. Although chief trial counsel staff conduct these reviews, the deputy trial counsel and the investigator involved in the case’s closure do not perform the second look if the complainant’s request originated in the intake unit. If a request is in the enforcement unit, then it is almost always reviewed by a senior trial counsel who did not approve the closure of the case. In a few instances, for example, if the case was extremely complex and the complainant is presenting new evidence, the same senior trial counsel who worked on the case will conduct the second look; the assistant chief trial counsel decides whether to reopen the case. Because State Bar staff, rather than an independent party, conduct the second look, it could appear that they would not overturn the original disposition. However, we found that not to be the case. In 2002, of the 1,710 requests that had a second look, 239 were reopened. The intake unit forwarded 83 of these reopened cases to the enforcement unit, and eight of them may result in some form of disciplinary action against the attorney. Some of the reopened cases are still open and pending investigation—25 in intake and 23 in enforcement.

If still dissatisfied with the outcome, the complainant can file a petition with the California Supreme Court. Following the dismissal of the underlying disciplinary complaint by the State Bar, a complainant may seek review by the California Supreme Court by filing with the court a verified accusation against the attorney. The California Supreme Court will grant the review only if it concludes that the State Bar acted in an arbitrary

manner in dismissing or refusing to take action on the underlying disciplinary complaint. According to the State Bar's office of general counsel, in 2002, the California Supreme Court granted no such petitions and denied 97.

### **A MAJORITY OF THE DISCIPLINARY AND CLIENT SECURITY FUNDS ARE NOT RECOVERED FROM MEMBERS WHO WERE DISBARRED OR RESIGNED**

Discipline of attorneys, the State Bar's largest function, protects the public, the courts, and the legal profession from lawyers who fail to fulfill their professional responsibilities. During 2002, the State Bar used \$28 million (64 percent) of its \$44 million in General Fund expenditures for the direct costs associated with conducting its disciplinary process. It also billed disciplined attorneys \$1 million for costs related to the processing of their cases. Additionally, separate from discipline, the Client Security Fund serves as a remedy to alleviate financial losses caused by an attorney's dishonest conduct. In 2002, the State Bar billed disciplined attorneys \$4.5 million for costs incurred by its Client Security Fund. Although the State Bar's cost recovery rates have slightly improved since 2000, they remain low. To offset this, it uses a greater portion of membership fees to subsidize support for its Client Security Fund and discipline than it might otherwise need to.

---

*Disciplined attorneys were billed \$4.5 million in 2002 for costs incurred by the Client Security Fund because of attorneys' misconduct.*

---

### **State Law Requires Disciplined Attorneys to Pay the Cost of Processing Their Cases**

The State Bar can recover from individual attorneys some of its costs for disciplinary activities. Sections 6140.5 and 6086.10 of the Business and Professions Code require the State Bar to charge disciplined attorneys for certain costs related to its Client Security Fund and disciplinary proceedings. Attorneys whose actions have caused the Client Security Fund to pay a claimant must reimburse the fund, and any action to publicly reprove or discipline a member requires the member to pay certain costs. Although the State Bar does bill these attorneys, the amount collected is substantially lower than the amount it spends on its disciplinary process. One reason is that the Business and Professions Code limits the amount of recovery by excluding the costs for services of attorneys or expert witnesses. Furthermore, the State Bar has authority to collect costs from attorneys only when the State Bar Court imposes discipline publicly. As previously shown in Table 1, only 22 percent of the inquiries opened

in 2002 were ultimately filed in State Bar Court. The State Bar is unable to recover costs for cases that it closes without discipline, cases in which it imposes alternative resolutions, or those in which the State Bar Court imposes discipline privately.

Table 2 indicates that the State Bar’s cost recovery rates for the Client Security Fund have slightly improved since 2000, increasing from 2.5 percent to 10.9 percent in 2002. According to the State Bar, this may be due to the large amounts of costs paid back by those attorneys seeking reinstatement. As a condition of reinstatement, attorneys must replace any amounts the State Bar paid from its Client Security Fund and for disciplinary costs it incurred. Similarly, in 2002 the amounts the State Bar recovered in discipline also increased from 28.8 percent to 36.4 percent.

**TABLE 2**

**Costs Billed and Recovered for Client Security Fund and Disciplinary Activities**

	Client Security			Discipline		
	Costs Billed	Costs Recovered	Percent Recovered	Costs Billed	Costs Recovered	Percent Recovered
2000	\$4,812,990	\$119,400	2.5%	\$1,079,922	\$311,061	28.8%
2002	4,475,737	489,909	10.9	1,010,668	367,881	36.4

Source: State Bar’s Membership Billing Services.

However, not all costs that were incurred by the State Bar are billed annually to the disciplined attorney. At the end of December 2002, the cumulative amount that the State Bar had paid to complainants for attorney misconduct totaled \$9.5 million. It paid \$6.9 million, or 73 percent of that total, to complainants whose attorneys had resigned. If an attorney resigns, the State Bar will bill the attorney once to recover the costs. The State Bar does not bill that attorney again until he or she seeks reinstatement. The same applies to disbarred attorneys. Of the \$9.5 million the State Bar had paid out from its Client Security Fund by the end of 2002, \$2.2 million, or 23 percent, was paid to claimants whose attorneys were disbarred. Based on a State Bar report covering January through December 2002, its recovery rates for collecting from resigned and disbarred attorneys were 5.3 percent and 2.5 percent, respectively.

---

*Because cost recoveries are still low, the State Bar uses a greater portion of membership fees to subsidize support for its Client Security Fund and discipline than it might otherwise need to.*

---

Similarly, the State Bar spent \$28 million of its \$44 million in General Fund expenditures for the direct costs associated with conducting its disciplinary process in 2002 and billed only \$1 million of these costs to its disciplined attorneys.<sup>3</sup> As of December 2002, cumulative costs incurred by the State Bar for which disciplined attorneys are required to pay totaled nearly \$1.4 million. Of this amount, approximately \$375,000, or 28 percent, was incurred by attorneys who have resigned. As previously mentioned, these attorneys are billed once when discipline is imposed and are not billed again until they seek reinstatement. Also, approximately \$206,000 was incurred as a result of the disbarred attorneys. However, most of the costs will not be recovered because the rates of recovery from resigned and disbarred attorneys are 0.6 percent and 11.5 percent, respectively. Because the State Bar's cost recoveries are still low, it uses a greater portion of membership fees to subsidize support for its Client Security Fund and discipline than it might otherwise need to.

It is the State Bar's position that Client Security Fund and disciplinary costs are obligations owed the State Bar by the attorney. Although state law requires that these costs be paid as a condition of reinstatement or return to active membership, the State Bar also has rights that allow it to seek financial recovery of the Client Security Fund payments separate and independent from the reinstatement process. Therefore, in some cases the State Bar has pursued legal action to obtain obligations owed by the attorneys. However, in the case of its disciplinary costs, the State Bar's position is that there is no independent authority to pursue legal action for these costs; therefore, the State Bar must rely on the attorney to seek reinstatement in order to collect these costs.

### **The State Bar Believes Other Recovery Efforts May Not Be Feasible**

We recommended in our 2001 audit that the State Bar pursue additional collection efforts, such as participating in the State's Offset Program. This program allows the State Controller's Office and the Franchise Tax Board to offset from an individual's tax refund any amounts owed to state agencies when the agencies' collection efforts have been unsuccessful. The State Bar's executive director informed us that this proposal was rejected

---

<sup>3</sup> The State Bar reports that it also incurred \$8 million in indirect costs for operating its disciplinary process in 2002.

on public policy grounds. A 2001 bill analysis prepared for the Senate Judiciary Committee stated that the Offset Program includes collections of delinquent child support and unpaid court fines. The analysis stated that it “does not seem that ensuring that State Bar members repay their disciplinary and Client Security Fund costs, so that the annual bar dues could be reduced, rises to the same public purpose, enough to use the Franchise Tax Board as a collection agency.”

---

*The State Bar’s executive director believes that other cost recovery methods, such as the California Enforcement of Judgments Law, may be even more problematic to use for Client Security Fund reimbursements.*

---

Another cost recovery method that may be available is the collection of money debts under the California Enforcement of Judgments Law. This law’s definition of money judgment includes any judgment, order, or decree of a court requiring payment. Disciplinary costs charged to attorneys are court-ordered payments. However, according to the executive director, the State Bar’s position is that state statutes explicitly define the specific circumstances and methods by which it is to impose and collect its disciplinary costs, and thus the Legislature has implicitly excluded other methods more generally provided in the law. The State Bar’s executive director believes it is even more problematic to use this law for Client Security Fund reimbursements, since many of these payments are made without a related court order requiring repayment because a member has already been disbarred or has resigned in another matter. Further, the executive director states that considerations such as expense and ability of the disciplined member to pay must be examined; pursuing collections under this law could result in a net loss in recoveries. Moreover, the State Bar’s executive director believes that disciplined attorneys who have been disbarred or have resigned are unlikely to make any payments, and pursuing the assets of this group is likely to be more problematic because this action may encourage discharge of the costs through bankruptcy.<sup>4</sup>

According to the executive director, the State Bar could report delinquent payments to credit reporting agencies. However, the State Bar’s position is that because state law provides that disbarred or resigned attorneys are not required to make payment until they seek reinstatement, the attorneys could dispute the validity of any reports that their payments were delinquent. In addition, these attorneys may make a demand to the State Bar to correct the information and bring an action for damages and relief through a court order.

---

<sup>4</sup> As the State Bar’s executive director pointed out, in 2001 a federal appeals court did not consider disciplinary costs to be a sanction and thereby held that the costs may be discharged in bankruptcy.

However, the executive director says that the State Bar is seeking a legislative amendment, similar to statutory language applicable to costs imposed in disciplinary proceedings of the Department of Consumer Affairs, to help it strengthen its collection enforcement authority. This amendment would specify that disciplinary costs or Client Security Fund reimbursements, when imposed by court order or by operation of law for the Client Security Fund, are enforceable under the Enforcement of Judgments Law in addition to the methods already in state law. Specifically, this amendment would expressly state that the order for the recovery of costs may be enforced by the courts. Because existing state law does not explicitly state that the State Bar can use the methods provided in the Enforcement of Judgments Law, the State Bar believes it needs statutory language that states it can do so. According to the executive director, a legislative amendment was not sought previously because public policy concerns similar to those raised for the Offset Program, along with the legal uncertainties discussed above, discouraged the State Bar from pursuing this avenue. This language would provide the State Bar independent authority to pursue legal action for these costs. However, according to the executive director, there appears to be some support for the effort in the Legislature and the executive branch, and the time is right to bring forth this idea.

## **RECOMMENDATIONS**

The State Bar should continue its efforts to reduce its current backlog.

To ensure that employees follow policies and procedures for processing cases, the State Bar should require that each file contain a checklist of important steps in the process and potential documents. Each applicable item should be checked off as it is performed or received. An employee's supervisor should be responsible for reviewing the checklists to ensure their use. In addition, the State Bar should conduct spot checks of current cases that are being closed. Responsible staff should be required to resolve any issues concerning files determined to be noncompliant.

The State Bar should pursue a legislative amendment that would help it strengthen its enforcement authority over collections related to client security and disciplinary costs. ■

## CHAPTER 2

---

### ***Although It Continues to Ensure That Mandatory Fees Are Reasonable and Do Not Support Voluntary Programs, the State Bar of California Faces Potential Deficits in the Future***

#### CHAPTER SUMMARY

The State Bar of California (State Bar) continues to ensure that mandatory fees are reasonable and that they do not support voluntary programs. In addition, its methods of allocating general and administrative costs (indirect costs) ensure an equitable distribution of these costs among programs supported by the mandatory and voluntary fees. As a result, both the State Bar and its members have greater assurance that members who choose to pay only the mandatory fees do not bear the costs of voluntary programs. In addition, the State Bar is better able to justify the level of fees it annually charges its members. However, challenges lie ahead. According to its financial forecast for the General Fund, expenses will exceed revenues starting in 2003. Although this will affect its General Fund balance, the State Bar has established a Public Protection Reserve Fund to hedge against the unexpected. As of December 2002, it has a combined available balance for the General Fund and Public Protection Reserve Fund of \$5.8 million. However, if membership fees remain at \$390, the State Bar's General Fund and Public Protection Reserve Fund could face a combined deficit of \$1.3 million by the end of 2005.

#### BACKGROUND

Chapter 342, Statutes of 1999 (Chapter 342), prohibits the State Bar from using any portion of its mandatory membership fees to support directly or indirectly certain activities that laws or regulations do not require. Such voluntary activities include those involving the Conference of Delegates and the State Bar sections. The conference provides an annual forum for members of the State Bar to debate and adopt resolutions proposing changes in California's laws. The sections are special-interest membership groups that form to further knowledge and

education in particular areas of legal practice. The sections serve their members by preparing and publishing newsletters and other publications, delivering specialized training programs, and introducing or commenting on legislation for regulating the legal profession or for improving the quality of legal services in California. Chapter 342 allows the State Bar to collect voluntary fees to fund the conference and the sections.

Chapter 342 also requires the State Bar to give members the option to deduct \$5 from their annual membership fees if they elect not to support direct or indirect costs of lobbying and related activities of the State Bar outside the parameters established by the United States Supreme Court in a 1990 case.<sup>5</sup> That case addressed the question of whether state bars could use compulsory membership fees for activities of a political or ideological nature. The United States Supreme Court considers expenses for political or ideological activities chargeable to membership fees only if the expenses relate reasonably to a state bar's regulatory functions and to improving legal services available to the public. In offering examples of these distinctions, the United States Supreme Court said that state bars may not use compulsory dues to endorse or advance a gun control or nuclear weapons freeze initiative, but they may spend their dues on activities connected with disciplining members or proposing the profession's ethical codes. Chapter 342 also limits the amount the State Bar can spend to support lobbying and related activities that go beyond the federal case parameters. For these activities, the State Bar can only use the \$5 from each member who does not take the \$5 deduction for them.

## **THE STATE BAR HAS A SYSTEM IN PLACE TO ACCOUNT FOR VOLUNTARY AND MANDATORY ACTIVITIES**

In response to the requirements of Chapter 342, the State Bar has improved its accounting for revenues and expenses related to its voluntary and mandatory programs. It uses three separate funds to account for Conference of Delegates activities, all its lobbying activities, and its sections activities, thus helping to assure that it does not use mandatory fees to support voluntary programs. In addition, the State Bar revised its system of accounting for section activities to better ensure that mandatory fees are not used to provide administrative support to the sections.

---

*The State Bar revised its system of accounting for section activities to better ensure that mandatory fees are not used to provide administrative support to the sections.*

---

<sup>5</sup> The 1990 case was *Keller v. State Bar of California*.

In 2002, the State Bar and the Conference of Delegates severed their relationship. The Conference of Delegates wanted to take independent positions on issues of concern to the legal profession without the limitations that accompanied the State Bar's role as a regulatory agency. In our 1996 audit report, we voiced concern that mandatory fees rather than voluntary fees funded legislative activities conducted by the Conference of Delegates. In an agreement signed in October 2002 between the two parties, the Conference of Delegates became the Conference of Delegates of California Bar Associations (CDCBA), a nonprofit mutual benefit organization incorporated under the provisions of the California Nonprofit Mutual Benefit Corporation Law. The CDCBA is independent from the State Bar. However, state law authorizes the State Bar to collect the CDCBA's fees and donations through its annual dues statement. The CDCBA pays the State Bar for its costs associated with processing and remittance of the contributions.

The State Bar uses the Conference of Delegates Fund to account for the revenues and expenses related to the conference's annual meeting. The cost of the meeting is borne by the delegates through their registration fees and by members' voluntary contributions. In its annual membership fee pamphlet for 2002, the State Bar asked members to make a voluntary contribution of at least \$10 to support the conference. Approximately 19,600 members responded, and contributions amounted to about \$211,500.

---

***Since 2001, the State Bar has elected to restrict the expenses of all its legislative activities to voluntary funds, thus better ensuring that only voluntary fees are being used for these activities.***

---

The State Bar uses the Legislative Activities Fund to track revenues and expenses related to its lobbying activities that go beyond the parameters set by the United States Supreme Court case. However, since 2001 the State Bar has elected to restrict the expenses of all its legislative activities to voluntary funds instead of categorizing its programs within or outside of the parameters set by the federal case, thus better ensuring that only voluntary fees are being used for all legislative activities. Revenues recorded in the fund for 2002 amounted to about \$688,000. Of this amount, about \$669,000 came from members who decided to pay the optional \$5 to support legislative activities not chargeable to mandatory membership fees. The remaining \$19,000 came from interest income. Expenses paid from the fund consisted primarily of payroll costs for staff members who spent time working with legislation. In addition, the fund was charged expenses related to indirect costs according to the cost allocation plan discussed in the next section. The remaining costs were for professional services, travel expenses, and miscellaneous items.

The State Bar uses its Sections Fund to account appropriately for the sections' activities. For 2002, members could join as many as 16 different sections by voluntarily paying a fee ranging from \$50 to \$60 per section and contributed a total of about \$3.3 million to this fund. Our review found that the State Bar continues to isolate section activities to ensure that mandatory fees do not support them.

## **COST ALLOCATION PLANS CONTINUE TO DISTRIBUTE ADMINISTRATIVE COSTS AMONG MANDATORY AND VOLUNTARY PROGRAMS**

---

*The State Bar continues to use two cost allocation plans to ensure an equitable distribution of administrative costs to its mandatory and voluntary programs.*

---

Although the State Bar has revised its two cost allocation plans, both still ensure an equitable distribution of administrative costs to its mandatory and voluntary programs. The State Bar updated the first allocation plan, referred to as the indirect cost allocation plan, to reflect changes in its organizational structure and its understanding of legislation. The second allocation plan revised the methodology used to distribute costs to the individual sections. To ensure that costs are predictable, the State Bar establishes allocations at the beginning of each year. Since actual costs vary from year to year, the model adjusts for such changes in the subsequent year.

### **The Indirect Cost Allocation Plan Allows the State Bar to Distribute Costs Fairly**

The indirect cost allocation plan provides a method for allocating to all programs the administrative costs that do not clearly relate to a particular program. The indirect cost allocation plan excludes costs that directly benefit a particular program; the State Bar charges these costs to the program that the costs benefit directly. The indirect cost allocation plan divides all costs into two categories, administrative costs and program areas. The State Bar groups its administrative costs into 12 pools: human resources, property-related services, general counsel, administration and support management, membership billing, board of governors, appointments, executive director, library, information technology, finance, and communications. The 19 program areas represent cost centers, or combinations of various costs. For example, the legal services access program area consists of six different cost centers, including program development, access and fairness, and access to justice.

This model's methodology is called a step-down allocation. In other words, the State Bar allocates all costs included in the first administrative cost pool to all other administrative cost pools and program areas in proportion to an objective, quantifiable category, such as full-time equivalents. The costs of the next administrative cost pool are then allocated to all remaining administrative cost pools and program areas. At the end of the allocation process, the costs in all administrative cost pools will be fully allocated and total zero, and the various program areas will reflect the total cost to the State Bar. The revised cost allocation plan uses the same methodology as the previous plan. The difference between the plans is that in 2002 the State Bar added four new administrative cost pools and redefined certain program areas.

Table 3 illustrates how a step-down allocation works. For purposes of this example, the first administrative cost pool (human resources) has total costs of \$5,000, which are allocated to the other two administrative cost pools and the three program areas based on the number of employees engaged in each activity. The costs in the other two administrative cost pools are allocated in a similar way. The total costs of each of the three program areas include a portion of the indirect costs allocated from each of the administrative cost pools, plus the direct costs of the respective program areas.

**TABLE 3**

**Example of a Step-Down Allocation Model for Indirect Costs  
(Indirect Costs Are Shown in Blue)**

	Administrative Cost Pools			Program Areas		
	Human Resources*	Property-Related Services†	General Counsel‡	State Bar Court	Client Security Fund	Sections Fund
Annual Costs	\$5,000	\$4,000	\$3,000	\$6,000	\$ 8,000	\$10,000
	(5,000)	1,160	783	2,045	814	198
		5,160				
		(5,160)	1,675	410	872	2,203
			5,458			
			(5,458)	1,087	1,385	2,986
<b>Total Costs After Allocation</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$9,542</b>	<b>\$11,071</b>	<b>\$15,387</b>

\* Cost allocated based on number of employees.

† Cost allocated based on square footage.

‡ Cost allocated based on proportion of direct hours billed.

Because the indirect cost allocation plan calls for the allocation of all indirect costs to all programs based on quantifiable measures, the plan allows for an equitable distribution of costs between voluntary and mandatory activities.

### **The Section-Specific Cost Allocation Plan Helps the State Bar Determine the Amount for Voluntary Dues**

In 2002, the board of governors adopted a revised second cost allocation plan, referred to as the section-specific cost allocation plan, to help the State Bar's 16 sections determine appropriate dues to charge members who voluntarily participate in the sections' activities. This cost allocation plan identifies the following five cost categories for each section: costs allocated from the indirect cost allocation plan described above, direct section support costs, membership billing, council of sections chairs, and lobbyist costs. For example, direct section support costs relate to the permanent support staff that handles each section's business. At the end of the year, the State Bar allocates 100 percent of the costs from the five categories to each section based on its membership as a percentage of total section membership. The original plan allocated 20 percent of the costs from the five categories to all the sections evenly, then allocated the remaining 80 percent to each section based on its membership as a percentage of total section membership. According to the State Bar's manager of budget and planning, the board of governors revised the section-specific cost allocation plan to more equitably distribute costs. He further stated that without the change, several of the smaller sections would have been pushed toward insolvency. When asked if the plan is changed on a yearly basis, the manager of budget and planning answered that the sections have the authority to revise the plan at any time. He added that the board of governors took action to adopt the revised plan because the individual sections were unable to reach a consensus on the method of allocation for 2002.

---

*If the membership fees remain at \$390, the State Bar faces a potential deficit in its General Fund at the end of 2005.*

---

### **IT CONTINUES TO ENSURE THE REASONABLENESS OF ITS MANDATORY FEES, BUT THE STATE BAR FACES FUTURE FINANCIAL CHALLENGES**

The State Bar continues to ensure that its mandatory fees are reasonable and necessary. For 2002, its financial records for the General Fund indicate that it charged a reasonable level of fees. However, based on its financial forecast for this fund, the

State Bar predicts that expenses will exceed its revenues starting in 2003, resulting in a decrease in the General Fund surplus. In fact, it predicts that the General Fund and Public Protection Reserve Fund will show a combined deficit of \$1.3 million by December 2005. The forecast indicates that, if membership fees remain at \$390, the State Bar has enough in its available combined fund balances to address a deficit until the end of 2005. Our review indicated a \$3.4 million decrease in the Client Security Fund's reserves as well. However, the State Bar planned this decrease to reduce the \$9 million reserve it accumulated during its shutdown in 1998. The Discipline Fund, which was established in 1999 as a temporary means to capture the California Supreme Court's regulatory assessment during the 1998 virtual shutdown, has a remaining balance of \$2.6 million as of December 2002. We found after further inquiry that the State Bar has reasonable plans to use these resources.

#### Fund Description

**General Fund**—Accounts for membership fees and resources of the State Bar not related to restricted funds. Restricted funds account for resources and activities that are restricted by statute, court rule or order, or resolution of the board of governors for specific uses and purposes.

**Public Protection Reserve Fund**—Established to provide a hedge against the unexpected and to assure continuity of the State Bar's disciplinary system and its other essential public protection programs.

**Client Security Fund**—Maintains funds from which members' clients can be reimbursed for financial losses resulting from dishonest conduct on the part of their attorneys. Such reimbursement is discretionary and currently is not to exceed \$50,000 per application for reimbursement on any one transaction.

**Discipline Fund**—Established principally to account for revenues and expenses of maintaining, operating, and supporting the attorney disciplinary system.

#### The State Bar Has Plans to Help Cover Projected General Fund Deficits

For the year 2002, the State Bar's financial records for the General Fund indicate that it charged a reasonable level of fees. The General Fund's revenues of \$46.4 million exceeded its expenses by \$2.5 million. However, because the board of governors approved transfers to other funds of \$5.9 million, its General Fund balance declined from \$6.6 million in 2001 to \$3.3 million in 2002. The financial forecast predicts that in 2003 through 2007, if membership fees remain at \$390, General Fund expenses will exceed its revenues.

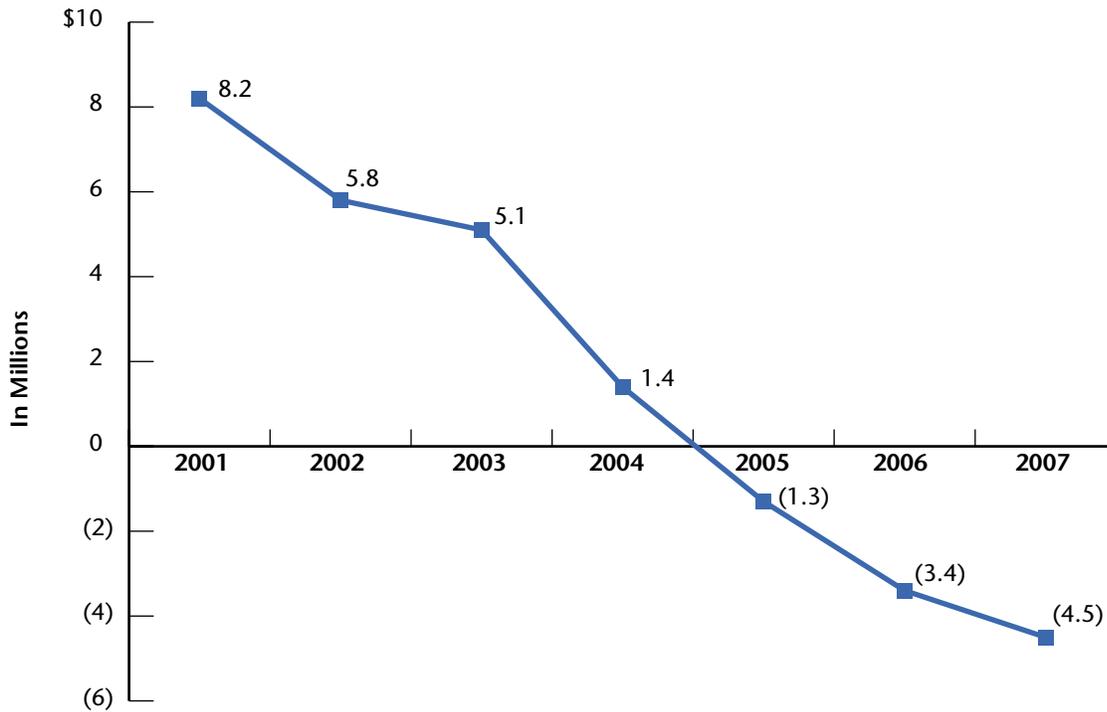
Although the State Bar's General Fund balance is expected to decrease as a result of its expenses increasing faster than its revenues, a deficit is not expected to occur until the end of 2005 because of the newly created Public Protection Reserve Fund. As of January 1, 2001, the State Bar established this fund to provide a hedge against the unexpected and to assure continuity of its disciplinary system and other essential public protection programs. Its goal was to accumulate \$7 million over a five-year

period. To help manage the projected General Fund revenue shortfalls in the future, the board of governors elected to use available monies in the Public Protection Reserve Fund. As of December 2002, the fund has available money of \$2.6 million that, when combined with the General Fund balance, results

in an available surplus of \$5.8 million. However, as shown in Figure 2 and in more detail in the Appendix, if State Bar expenses continue to exceed its revenues, a deficit in the combined available balance for the General Fund and Public Protection Reserve Fund is anticipated by the end of 2005 that will continue to grow through 2007.

**FIGURE 2**

**Combined General Fund and Public Protection Reserve Fund Available Fund Balances**



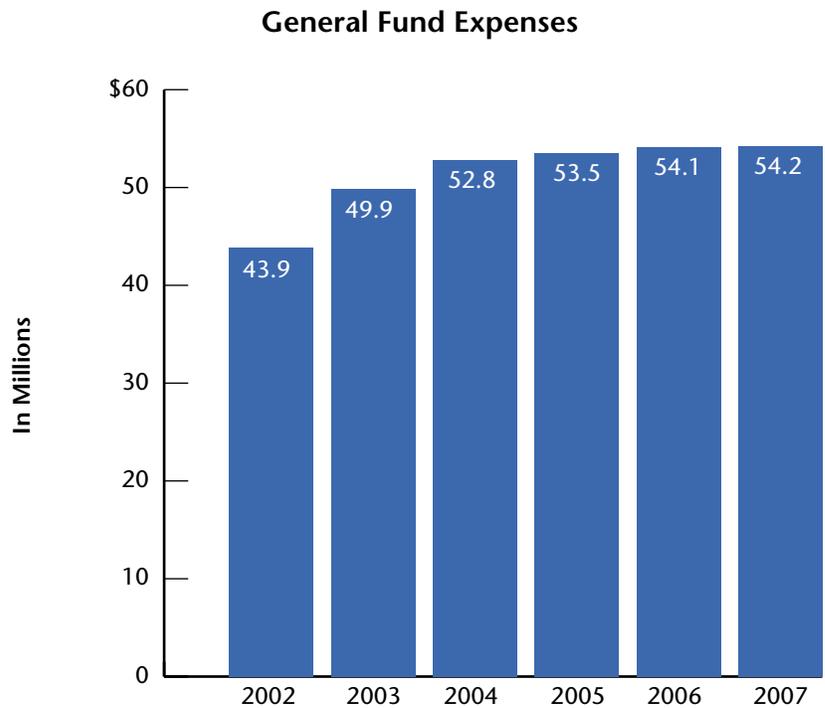
Source: 2001 fund balance based on the State Bar’s 2001 audited financial statements; 2002 fund balance based on the State Bar’s 2002 unaudited financial statements; all other fund balances based on the State Bar’s financial outlook for 2004 to 2007.

Note: The fund balances shown above do not include amounts that the State Bar’s board of governors designated for seismic retrofit building repairs. Those amounts are \$1 million in 2002, \$1 million in 2003, and \$500,000 in 2004. These amounts cannot be used to offset the General Fund revenue shortfalls without the board of governors’ authorization.

The State Bar’s 2003 financial forecast for the General Fund predicts that projected revenues will gradually increase as membership is expected to grow, whereas expenses will increase dramatically. As Figure 3 shows, when we compared the 2002 actual expenses to the projected 2003 expenses, the State Bar’s projections show an increase of \$6 million. Of that increase, \$4.5 million was due to an increase in salaries and related

expenses. One of the related expenses, fringe benefits, increased \$2.6 million, which includes about \$720,000 in required employer contributions to the Public Employees' Retirement System, which the State Bar was not previously required to pay. Required contributions are expected to increase to \$2.1 million in 2004.

**FIGURE 3**



Source: 2002 expenses based on the State Bar's 2002 unaudited financial statements; all other expenses based on the State Bar's financial outlook for 2004 to 2007.

Although the State Bar's financial outlook for 2004 to 2006, issued in December 2002, provided four scenarios, our analysis focused on the scenario that assumed no salary increases and no increase in membership dues. We believe this is the most reasonable scenario because, by existing state law, membership fees are fixed until January 1, 2004. The other three scenarios the State Bar considered included increases in membership fees ranging from \$405 to \$435, with and without salary increases, to no increases in membership fees. In each scenario the State Bar predicted expenses would exceed revenues in 2003 and 2004. However, in the scenarios with an increase

in membership fees, the State Bar predicts that it would generate enough revenue to cover its operating expenses in 2005 and thereafter.

### **The State Bar Plans to Use Money Remaining in the Discipline Fund Appropriately**

As of December 2002, about \$2.6 million remains in the Discipline Fund, which was established in 1999 as a temporary means to capture the California Supreme Court's regulatory assessment paid by members to rebuild and support the discipline function after the veto of the State Bar's 1998 fee bill. As part of its action, the California Supreme Court appointed a special master to oversee the State Bar's use of this money. State Bar officials told us they plan to use the remaining funds according to the special master's final recommendations, which were issued in March 2000. The money will remain segregated from other State Bar funds, and the State Bar will use the assessment money for discipline-related functions and for maintaining or enhancing technology.

### **The State Bar Has Taken Steps to Reduce Its Client Security Fund Balance**

Client Security Fund expenses exceeded revenues by \$3.4 million during calendar year 2002. As a result, the \$9 million fund balance at the end of 2001 decreased to \$5.6 million. In 2002, the State Bar processed 1,286 claims and paid 782 (totaling \$6.6 million) to cover financial losses due to attorney misconduct. In that same year, revenues generated through membership fees totaled \$4.9 million, a decrease of \$400,000 from 2001. The decrease was expected because the annual assessment charged to bar members in support of the fund was reduced from \$40 to \$35. The State Bar decided to reduce fees due to the dramatic increase in the fund balance and the two-year decrease in the number of claims filed resulting from its virtual shutdown. The State Bar expects to pay about \$4.5 million for claims still outstanding at the end of 2002. Conceivably, it could receive additional claims for losses incurred in 2000 and 2001 because claimants generally have four years to file for reimbursement. Because it maintained a surplus in 2001, the State Bar was able to handle the revenue shortfall it incurred in 2002.

---

*The State Bar decided to reduce fees for its Client Security Fund in part because of the dramatic increase in its fund balance.*

---

According to the State Bar's director of finance, the Client Security Fund should have enough reserve accumulated to cover at least another two years of expenses exceeding revenues. The

director of finance further stated that the current year's expenses exceeded revenues because of the historically high payout ratio. One reason for the increase is that the State Bar's fast track team is discovering losses caused by attorneys engaging in serious misconduct much sooner, which causes more claims against attorneys to occur at the same time rather than having them trickle in over time.

## RECOMMENDATION

To ensure that mandatory fees are set at a reasonable level to meet its operational needs, the State Bar should continue to monitor for the necessity of a fee increase.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



ELAINE M. HOWLE  
State Auditor

Date: April 24, 2003

Staff: Karen L. McKenna, CPA, Audit Principal  
Dawn S. Tomita  
Joe Azevedo

Blank page inserted for reproduction purposes only.

# APPENDIX

---

## ***General Fund and Public Protection Reserve Fund Balances Will Not Cover Projected Deficits***

The Table on the following page presents our analysis of the outlook of the State Bar of California (State Bar) for its General Fund and Public Protection Reserve Fund for 2002 through 2007 with the scenario that the State Bar's \$390 membership fee will not increase over this time period. We have combined the available balances for the two funds because the State Bar established the Public Protection Reserve Fund, in part, to provide a hedge against the unexpected. In addition, the available fund balance at the end of December 2002 is based on actual numbers from the State Bar's unaudited financial statements. Estimates for the remaining years, 2003 through 2007, are based on the State Bar's projections.

As the Table shows, under this scenario, the State Bar will need to use the available balance in the Public Protection Reserve Fund to help cover its projected revenue shortfalls beginning in 2003. The available balance of the Public Protection Reserve Fund will not be sufficient to avoid a projected deficit in 2005 and thereafter.

**TABLE**

**Combined Available Balances of the State Bar’s General Fund and  
Public Protection Reserve Fund**

	General Fund	Public Protection Reserve Fund	Totals
<b>Available Fund Balances December 31, 2001</b>	<b>\$ 6,631,826</b>	<b>\$1,524,353</b>	<b>\$ 8,156,179</b>
Revenues	46,361,897	45,461	46,407,358
Expenses	(43,872,496)		(43,872,496)
Excess—revenues over expenses	2,489,401	45,461	2,534,862
Transfers:			
Fixed Assets Fund	(2,551,970)		(2,551,970)
Certification Fund	(300,000)		(300,000)
Public Protection Reserve Fund—available monies	(999,992)	999,992	
Public Protection Reserve Fund—designated for seismic retrofit*	(1,000,000)		(1,000,000)
Technology Improvement Fund	(999,996)		(999,996)
Net transfers	(5,851,958)	999,992	(4,851,966)
<b>Net change in fund balances</b>	<b>(3,362,557)</b>	<b>1,045,453</b>	<b>(2,317,104)</b>
<b>Available Fund Balances December 31, 2002</b>	<b>3,269,269</b>	<b>2,569,806</b>	<b>5,839,075</b>
Estimated revenues <sup>†</sup>	48,598,000		48,598,000
Estimated expenses	(49,891,000)		(49,891,000)
Deficiency—estimated revenues under estimated expenses	(1,293,000)		(1,293,000)
Transfers:			
Lawyers Assistance Program Fund		753,586	753,586
Legal Education and Development Fund	350,000	550,000	900,000
Public Protection Reserve Fund—available monies	(1,201,269)	1,201,269	
Public Protection Reserve Fund—designated for seismic retrofit*	(1,000,000)		(1,000,000)
Annual Meeting Fund	(125,000)		(125,000)
Net transfers	(1,976,269)	2,504,855	528,586
<b>Net change in fund balances</b>	<b>(3,269,269)</b>	<b>2,504,855</b>	<b>(764,414)</b>
<b>Available Fund Balances December 31, 2003</b>		<b>5,074,661</b>	<b>5,074,661</b>
Estimated revenues <sup>†</sup>	49,791,000		49,791,000
Estimated expenses <sup>‡</sup>	(52,803,000)		(52,803,000)
Deficiency—estimated revenues under estimated expenses	(3,012,000)		(3,012,000)
Transfers:			
Public Protection Reserve Fund—available monies	3,637,000	(3,637,000)	
Public Protection Reserve Fund—designated for seismic retrofit*	(500,000)		(500,000)
Annual Meeting Fund	(125,000)		(125,000)
Net transfers	\$ 3,012,000	(3,637,000)	(625,000)
<b>Net change in fund balances</b>		<b>\$(3,637,000)</b>	<b>\$ (3,637,000)</b>

	General Fund	Public Protection Reserve Fund	Totals
<b>Available Fund Balances December 31, 2004</b>		<b>\$1,437,661</b>	<b>\$ 1,437,661</b>
Estimated revenues <sup>†</sup>	\$ 50,905,000		50,905,000
Estimated expenses <sup>‡</sup>	(53,468,000)		(53,468,000)
Deficiency—estimated revenues under estimated expenses	(2,563,000)		(2,563,000)
Transfers:			
Annual Meeting Fund	(125,000)		(125,000)
Public Protection Reserve Fund—available monies	1,437,661	(1,437,661)	
Net transfers	1,312,661	(1,437,661)	(125,000)
<b>Net change in fund balances</b>	<b>(1,250,339)</b>	<b>(1,437,661)</b>	<b>(2,688,000)</b>
<b>Available Fund Balances December 31, 2005</b>	<b>(1,250,339)</b>		<b>(1,250,339)</b>
Estimated revenues <sup>†</sup>	52,057,000		52,057,000
Estimated expenses <sup>‡</sup>	(54,050,000)		(54,050,000)
Deficiency—estimated revenues under estimated expenses	(1,993,000)		(1,993,000)
Transfers:			
Annual Meeting Fund	(125,000)		(125,000)
Net transfers	(125,000)		(125,000)
<b>Net change in fund balances</b>	<b>(2,118,000)</b>		<b>(2,118,000)</b>
<b>Available Fund Balances December 31, 2006</b>	<b>(3,368,339)</b>		<b>(3,368,339)</b>
Estimated revenues <sup>†</sup>	53,233,000		53,233,000
Estimated expenses <sup>‡</sup>	(54,220,000)		(54,220,000)
Deficiency—estimated revenues under estimated expenses	(987,000)		(987,000)
Transfers:			
Annual Meeting Fund	(125,000)		(125,000)
<b>Net change in fund balances</b>	<b>(1,112,000)</b>		<b>(1,112,000)</b>
<b>Available Fund Balances December 31, 2007</b>	<b>\$ (4,480,339)</b>		<b>\$ (4,480,339)</b>

Source: Available fund balance at December 31, 2001, based on 2001 audited financial statements; 2002 revenues, expenses, and transfers based on the State Bar's 2002 unaudited financial statements; 2003 through 2007 revenues, expenses, and transfers based on the State Bar's financial outlook for those years and board of governors' meeting minutes.

\* The State Bar's board of governors designated \$2.5 million to be transferred from the General Fund to the Public Protection Reserve Fund as earmarked for seismic retrofit building repairs. These earmarked funds cannot be used to offset the General Fund revenue shortfalls without the board of governor's authorization. We have shown these earmarked funds as deductions in the General Fund.

† Estimated revenues are based on the assumption that annual membership fees remain at \$390 per member through 2007.

‡ Estimated expenses after 2003 are based on the assumption that salaries are frozen as of December 31, 2003.

Blank page inserted for reproduction purposes only.

*Agency's comments provided as text only.*

The State Bar of California  
180 Howard Street  
San Francisco, CA 94105-1639

April 8, 2003

Elaine M. Howle, State Auditor  
Bureau of State Audits  
555 Capitol Mall, Suite 300  
Sacramento, California 95814

**Re: State Bar of California Response to State Audit Report of April, 2003**

Dear Ms. Howle:

Please find enclosed the response of the State Bar of California to the State Audit Report, entitled *State Bar of California: Although It Reasonably Sets and Manages Mandatory Fees, It Faces Potential Deficits in the Future and Needs to More Strictly Enforce Disciplinary Policies and Procedures.*

Consistent with your request, we have submitted this written response in the envelope provided, and the entire response, including this cover letter, has been reproduced on the enclosed diskette, using a PC-compatible file.

I wish to extend my personal thanks to the audit team of Dawn Tomita, Karen McKenna and Joseph Azevedo, and fully appreciate their hard work and professionalism in preparing the report.

We look forward to working with you and your staff as this process continues.

Sincerely yours,

*(Signed by: Judy Johnson)*

Judy Johnson  
Executive Director

Enclosure

## **Response to State Audit Report**

### **Agency Comments**

The review of the operations and performance of the State Bar of California by the Bureau of State Audits for the period January 1, 2001 through December 31, 2001, is informative and helpful. The recommendations will help the State Bar strengthen its programs and administrative controls, keep its mandatory fees at a reasonable level, and continue to ensure that mandatory fees are not used in support of voluntary programs.

The State Bar of California does not dispute any of the findings or conclusions of the Bureau of State Audits. We agree with the recommendations contained in the report and will develop plans to address them promptly. As required, we will periodically update the Bureau of State Audits on our progress in implementing the recommendations.

### **Chapter 1**

#### **Recommendation**

The State Bar should continue its efforts to reduce its current backlog.

#### **Response**

The State Bar agrees. As noted in the report, the Office of the Chief Trial Counsel is committed to not allowing the backlog to increase beyond 400 in 2003. Indeed, we maintain an aspirational goal of reducing the backlog to 250 by the end of 2003, but recognize that our ability to achieve this has been impaired by budgetary constraints and other external factors.

#### **Recommendation**

To ensure that employees follow policies and procedures for processing cases, the State Bar should require that each file contain a checklist of important steps in the process and potential documents. Each applicable item should be checked off as it is performed or received. An employee's supervisor should be responsible for reviewing the checklists to ensure their use. In addition, the State Bar should conduct spot checks of current cases that are being closed. Responsible staff should be required to resolve any issues concerning files determined to be noncompliant.

### **Response**

The State Bar agrees. The Office of the Chief Trial Counsel is currently developing a plan of action to address issues revealed by our internal random review audit process. We are considering the use of checklists, spot checks, and technological tools to the extent feasible to better ensure staff's adherence to policies and procedures for processing cases. We look forward to reporting on our progress to the Auditor.

### **Recommendation**

The State Bar should pursue a legislative amendment that would help it strengthen its enforcement authority in collections related to client security and discipline costs.

### **Response**

The State Bar agrees. The State Bar has developed, and is currently circulating for comment by lawmakers and key legislative staff, a legislative amendment to specify that disciplinary costs, when imposed by court or operation of law, are enforceable under the Enforcement of Judgments Law. This would allow the State Bar inherent authority to pursue legal action distinct from reinstatement proceedings.

Additionally, the State Bar will continue to explore additional avenues of recovery, including utilization of referral to credit report agencies, asset checks and similar vehicles.

## **Chapter 2**

### **Recommendation**

To ensure that mandatory fees are set at a reasonable level to meet its operational needs, the State Bar should continue to monitor the necessity for a fee increase.

### **Response**

The State Bar agrees. In deference to the State's current dire fiscal condition, the State Bar is currently seeking a one-year fee bill that would maintain mandatory dues at \$390 for the 2004 billing year. This will require the Bar to rely on existing reserves to balance the General Fund budget for 2004. Employing long-range financial forecasts, the Bar anticipates proposing in 2004 a multi-year fee bill incorporating a tiered fee increase that will support ongoing operations without the reliance on reserves.

This approach was suggested by Justice Elwood Lui, the Special Master appointed by the Supreme Court, who recommended in his 2000 Final Report that the State Bar seek three-year fee authority to assist in long-term planning and to ensure stability of the discipline, admissions and regulatory

functions of the State Bar. Similarly, the 2001 ABA report on the State Bar made particular note of the problems inherent in relying upon short-term funding authorization from the Legislature. To address this concern, the ABA report recommended that the authority to establish member fees be assumed by the Supreme Court. To ensure continuity of funding, the State Bar's Board of Governors is focused on planning and long-term accountability with the objective being legislative approval of a multi-year funding bill.

The State Bar will continue prudent fiscal management of its resources while monitoring the level of funding that will be required for 2005 and beyond.

cc: Members of the Legislature  
Office of the Lieutenant Governor  
Milton Marks Commission on California State  
Government Organization and Economy  
Department of Finance  
Attorney General  
State Controller  
State Treasurer  
Legislative Analyst  
Senate Office of Research  
California Research Bureau  
Capitol Press