



THE STATE BAR OF CALIFORNIA

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To: Members, Board Planning, Program Development and Budget Committee

From: Peggy Van Horn

Subject: 2011 Budget Process – Potential Budget Balancing Options

The Planning Subcommittee on Budget met on April 1st to consider a number of potential options for addressing the Bar's budget deficit. As instructed by Committee Chair, Patti White, staff prepared a series of detailed financial reports to assist the subcommittee in developing a recommended strategy for the coming year's budget as well as a schedule of possible short term budget balancing options and options that would likely require a longer term to implement. The financial reports presented to the Subcommittee are included with this agenda in a separate report titled "Supplemental Information".

The Subcommittee was also briefed on background information about the Bar's budget development process and how it has evolved over time to incorporate budget *best practices* as recommended by the National Advisory Council on State and Local Government Budgeting (NACSLB). This information is particularly relevant for the Budget Subcommittee's budget deliberations. I include it in this memo as the basis for developing a structurally balanced budget.

At the conclusion of the meeting, the Subcommittee agreed upon two recommended courses of action. These recommendations will be discussed later in this memo.

Back Ground Information

Budget Definition: the budget process as defined by the NACSLB consists of activities that encompass the development, implementation, and evaluation of a plan for the provision of services and capital assets. A good budget process is characterized by several essential features including the incorporation of a long term perspective, the establishment of a linkage to broad goals, and a focus on decisions based on results and outcomes.

These key characteristics of good budgeting make clear that the budget process is not simply an exercise in balancing revenues and expenditures one year at a time, but is strategic in nature, encompassing a multi-year financial and operating plan that allocates

resources on the basis of identified goals. A good budget process moves beyond the traditional concept of line-item expenditure control, providing flexibility that can lead to improved program efficiency and effectiveness.

The State Bar's budget has evolved over time to incorporate these best practices. This evolution has moved our budget away from the line-item focus used exclusively in previous years to a budget that is linked to the broad goals of the Board and incorporates outcomes and activity measures. Of course, the development of outcomes and activity measures is an ongoing process. The Bar's implementation of these measures is still in the early stages of development - but the first crucial steps have been taken.

Definition of "Balanced Budget": the State Bar has historically defined a "balanced budget" as one that ensures that the Bar's use of resources for operating purposes over a three year period does not exceed available resources over the same time period. Available resources consist of annual revenues and available cash carryover (fund balance) from previous years. Thus, the requirement is to maintain a balance between operating expenditures and available resources over the long term, not just during the current operating period. Under this definition, the Bar has a balanced budget through 2013.

This is how long term budget balancing has worked at the Bar. In *good years*, the Board has not ramped up program costs to absorb the additional revenues; rather, it has accumulated reserves to have available for continuance of required services in the *not so good years*. The planned use of reserves is fundamental good practice. It avoids the need to make drastic changes in programs and service levels while allowing sufficient time for the Board and management to take a balanced and measured approach to address its future needs. The Bar looks ahead three years when developing its budget and plans for the scheduled drawdown of fund reserves. We do this forecasting specifically for the purpose of providing the Board with a longer term view of fund conditions. This is important for the Board to determine when a fee increase will be necessary.

Structural Imbalance: Over the past 2 years, this phrase has entered almost everyone's consciousness due in large part to the severe financial condition of the State. The Bar's structural imbalance is quite different from the State's. Our revenues are not directly influenced by the economy. 92% of the General Fund's revenue is generated by member dues. Absent a fee increase, this revenue source increases only to the extent of each year's new admittees. Historically, this gives the Bar a revenue growth of approximately 2% which does not keep pace with the General Fund's increased costs of providing services. Even without increasing employee salaries, we have other program cost increases that may be beyond our ability to contain. A good example of this is our lease expense for our Los Angeles workforce. The cost of this lease escalates every year; likewise, our utility, maintenance, and insurance costs increase and these are often outside of our direct control.

Forecasts – 2011 through 2013

The Bar finds itself in a rather unique situation: in the absence of employee salary increases, the General Fund has sufficient cash to balance over a three year period. Yet,

each year's expenses are forecasted to exceed that year's revenues, requiring a drawdown of accumulated cash reserves. The level of General Fund unreserved fund balance increased to \$9 million at the end of the year. This is due to the Governor's veto in October 2009 and the resulting decision to defer significant expenditures.

Attachment 1 is a General Fund forecast for 2010 through 2013. As you can see, each year has a deficit (expenditures exceed revenues); however, at the end of 2013, the General Fund will still have approximately \$2.9 million in unrestricted reserves. If the Board wishes to bring each year's expenditures in line with its revenues, a number of options can be considered. The Budget Subcommittee evaluated several options including the elimination of discretionary programs, restructuring existing programs, personnel cost reductions, and revenue enhancements. Attachment 2 is a listing of those options.

These options are not staff recommendations and are not an exhaustive list of all potential avenues for reducing costs. There are literally dozens of variables and combinations of options that can be presented. The intent of this listing is to communicate the types of options that may be considered.

Discretionary Programs: There are very few programs within the State Bar that are completely discretionary – meaning that there is no legislative requirement for them to exist. These are the Elimination of Bias program, Bar Relations and Program Development, the Committee on Professional Responsibility, Professional Competence, and the CalBar Journal/media programs. The Subcommittee did not recommend the elimination of any of these programs because, although discretionary in nature, they nonetheless bring significant value to the Bar.

Possible Program Reductions/Restructurings: The operations of the General Fund could be restructured; however, to attain any significant savings, the discipline functions would have to be evaluated. In the absence of a Chief Trial Counsel, the Subcommittee was not in favor of evaluating the Office of Trial Counsel for restructuring savings. Other areas for possible restructuring would generate relatively little saving; however, the Subcommittee recommends that certain areas be evaluated for eventual phase out. These areas include the mail room, in house print shop, and law library.

Across the Board Percentage Reductions: The practical impact of across the board reductions is staff eliminations. Furthermore, this type of “share the pain” approach often has a more harmful impact on the operations of smaller departments. The savings associated with staffing eliminations is discussed below.

Revenue Options: (subject to Legislative Approval):

At present, active member dues have a \$10 component that is restricted for information technology funding. This special assessment is scheduled to sunset at the end of 2010. If the Legislature were to eliminate the sunset and the restriction, a portion of the revenue could be used for General Fund operations and the remainder set aside for IT needs. This action would result in additional General Fund revenue without the need for a fee increase. This would of course, require legislative approval.

Salary/Benefit Reductions:

Since the majority of the General Fund's expense is personnel costs, the majority of the options relates to salary reductions. These options include savings that may be realized through furloughs, salary cuts, or position eliminations that may be accomplished either through layoffs or the use of voluntary separation incentives. For instance, 13 furlough days save approximately \$1.5 million on an annual basis while 5% pay cuts result in roughly the same amount. A 5% staff reduction will result in \$1.7 million. Each option has its draw backs – furloughs cannot be permanent if current service levels are to be maintained; pay cuts reduce salary expense but many benefit costs are not directly related to salary so there would be limited savings from benefits; and staff layoffs generate costs (severance, unemployment insurance) that will reduce the savings realized in the first two years.

In the place of salary reductions and layoffs, voluntary separation incentive packages could be developed. This option results in immediate savings, both in terms of salary and benefits, and does not result in unemployment benefit costs. Also, the disruption to the workforce resulting from layoffs is avoided. Depending on the type of incentive, the Bar could realize an immediate savings ranging from \$500,000 to \$1 million annually. Over 3 years, this option results in savings of \$3 million, an amount that resolves the 3 year accumulated deficit if salary freezes continue.

Subcommittee Recommendations

After lengthy discussion, the Subcommittee recommended two courses of action. In terms of cost reductions, the Subcommittee preferred the option of a voluntary separation incentive program. The Subcommittee further recommended that the Bar seek legislative approval to remove the sunset provision and current restriction on the \$10 dedicated information technology fee. A portion of this fee could be then used for General Fund operations with the remainder set aside for technology needs.

The combination of these two options results in budgets where annual revenues equal or exceed expenditures. Attachment 3 reflects the impact of implementing these options. When viewing this schedule, it is important to remember that the annual cost forecasts continue to assume no salary increases of any kind. Over the next 3 years, this may not be desirable.

Next Steps

Upon direction from the Planning Committee, staff will develop updated forecasts to reflect the Committee's preferences and will work closely with the Budget Subcommittee over the coming months. The current timeline calls for presentation of the proposed 2011 budget to the Planning Committee in October with an anticipated adoption date of November 20th.

General Fund Three Year Forecast
(millions)

ATTACHMENT 1

	Current Forecast				Deficit to Address
	2010 Amended	Forecast 2011	Forecast 2012	Forecast 2013	
Beginning Fund Balance	9.0	5.5	4.0	3.1	
Revenues	63.9	64.4	65.3	66.4	
Expenditures	67.4	65.9	66.2	66.6	
Deficit	(3.5)	(1.5)	(0.9)	(0.2)	(2.6)
Ending Fund Balance	5.5	4.0	3.1	2.9	

Budget Balancing Options - Short Term Implementation
General Fund Estimated Savings
(millions)

ATTACHMENT 2

	2010 Amended	Forecast 2011	Forecast 2012	Forecast 2013	Deficit to Address
Beginning Fund Balance	9.0	5.5	4.0	3.1	
Revenues	63.9	64.4	65.3	66.4	
Expenditures	67.4	65.9	66.2	66.6	
Deficit	(3.5)	(1.5)	(0.9)	(0.2)	(2.6)
Ending Fund Balance	5.5	4.0	3.1	2.9	

Options to Offset Deficit through 2013:

	Estimated Annual Savings			3 Year Cumulative Savings
	2011	2012	2013	
<u>Discretionary Programs - Eliminations</u>				
Elimination of Bias Program (3 FTE's)	0.6	0.7	0.7	2.0
Program Development (5 FTE's)	0.7	0.8	0.8	2.3
Committee on Professional Responsibility	0.2	0.2	0.2	0.6
Professional Competence - Outreach & Education (7 FTE's)	1.4	1.7	1.7	4.8
Media & Information Services (7 FTE's)	1.7	2.1	2.1	5.9

Budget Balancing Options - Short Term Implementation
General Fund Estimated Savings
(millions)

ATTACHMENT 2

Options to Offset Deficit through 2013:

	Estimated Annual Savings			3 Year
	2011	2012	2013	Cumulative Savings
<u>Possible Program Reductions/Restructure</u>				
Restructure Intake Unit	0.5	0.7	0.7	1.9
Restructure Mail Room	0.2	0.2	0.2	0.5
Restructure Print Shop	0.2	0.2	0.2	0.5
Restructure Library	0.1	0.1	0.1	0.3
<u>Across the Board Reductions</u>				
2% reduction (would likely be workforce reductions)	1.3	1.3	1.3	1.3
<u>Revenue Options: (Subject to Legislative Approval)</u>				
Eliminate restriction on \$10 IT fee - allocate portion to General Fund	0.6	0.6	0.6	0.6
<u>Salary/Benefit: (Subject to Meet & Confer)</u>				
13 furlough days (2011 only)	1.5	0.0	0.0	1.5
5% reduction in work force (approximately 16 FTE's)	1.7	1.8	2.2	5.7
Voluntary work force incentive package (savings)				
2.5% reduction (1 year CalPers credit)	0.7	0.8	0.9	2.4
2.5% reduction (2 years CalPers credit)	0.5	0.8	0.9	2.2
5% reduction (1 year CalPers credit)	1.3	1.7	1.8	4.8
5% reduction (2 years CalPers credit)	1.0	1.7	1.8	4.5

Budget Balancing Options - Short Term Implementation
General Fund Estimated Savings
(millions)

ATTACHMENT 3

	Current Forecast				Deficit to Address
	2010 Amended	Forecast 2011	Forecast 2012	Forecast 2013	
Beginning Fund Balance	9.0	5.5	4.0	3.1	
Revenues	63.9	64.4	65.3	66.4	
Expenditures	67.4	65.9	66.2	66.6	
Deficit	(3.5)	(1.5)	(0.9)	(0.2)	(2.6)
Ending Fund Balance	5.5	4.0	3.1	2.9	

Forecast with Subcommittee Recommendations					
Beginning Fund Balance	9.0	5.5	5.5	5.9	
Revenues	63.9	65.0	65.9	67.0	
Expenditures	67.4	65.0	65.5	65.9	
Estimated Surplus/(Deficit)	(3.5)	-	0.4	1.1	1.5
Ending Fund Balance	5.5	5.5	5.9	7.0	

Budget Balancing Options - Longer Term Implementation General Fund

ATTACHMENT 4

1. Rent 11th and 12th floors in 180 Howard Street facility

This option would require extensive marketing of the facility.

Currently, the Bar receives \$1 million annually from leasing its 2nd and 3rd floors. Taking into account build-out costs, the Bar wouldn't likely see the full benefit from leasing until 4 to 5 years from the date of lease signing.

2. Index member dues to some inflationary measure

This is the most effective way to address the Bar's structural imbalance in that revenue growth could be somewhat matched with expense increases. Each \$1 increase in active member dues results in \$160,000 in additional revenue to the Bar. The Bar has not had a fee increase for regular operational needs since 2007.

3. Develop new business model for the delivery of disciplinary services

This option will need to be addressed by the new Trial Counsel and if feasible, will likely be a multi-year process.

4. Restructure the Bar's benefit programs

This would subject to bargaining with the unions and while it would likely generate significant savings, reducing employee benefits could likely have a negative impact on the Bar's ability to attract and maintain marketable employees.

5. Identify opportunities to generate more non-dues revenue

This is an option that the Bar has been exploring for a number of years and has been able to generate revenue through insurance sponsorship revenue and other affinity programs. However, non-dues revenue generating opportunities are limited.

6. Seek legislative solutions to address unfunded mandates imposed upon the Bar by the Legislature

The Judicial Evaluations responsibility was given to the Bar a number of years ago without any funding. This program currently costs the Bar \$900,000 annually.

7. Seek legislative solution to new requirements on the discipline system that were not accompanied by a fee increase or a sufficient fee increase.

In 2005, the Office of Chief Trial Counsel assumed additional responsibility associated with the unauthorized practice of law without any additional funding.

For 2010, the combined cost for abandoned practice and UPL is estimated at \$2 million.

8. Establish surrogacy program to offset costs of taking control of abandoned law practices.

This proposal is under review.