



The State Bar of California

OPEN SESSION

AGENDA ITEM

4.1 SEPTEMBER 2024

FINANCE COMMITTEE

DATE: September 19, 2024

TO: Members, Finance Committee
Members, Board of Trustees

FROM: Aracely Montoya-Chico, Chief Financial Officer

SUBJECT: Approval of 2024 Midyear Budget Variance Report (Including Quarter Two Financial Statements Report), Projection and Proposed Budget Amendment

EXECUTIVE SUMMARY

This agenda item is presented to the Finance Committee and the Board of Trustees in accordance with the requirements of section 5.2.1 of the Board of Trustees Policy Manual (referred to as the Board Book), which requires midyear forecasting and budget-to-actual variances greater than \$100,000 to be reported to the Board.

This agenda item includes the Q2 financial statements report, the midyear variance analysis of the 2024 budget, projections for each fund for the fiscal year ending December 31, 2024, and proposed transfers and budget amendments.

RECOMMENDED ACTION

This agenda item requests the Finance Committee recommend the approval of the midyear variance report, projection, proposed transfers, and budget amendments to the Board of Trustees.

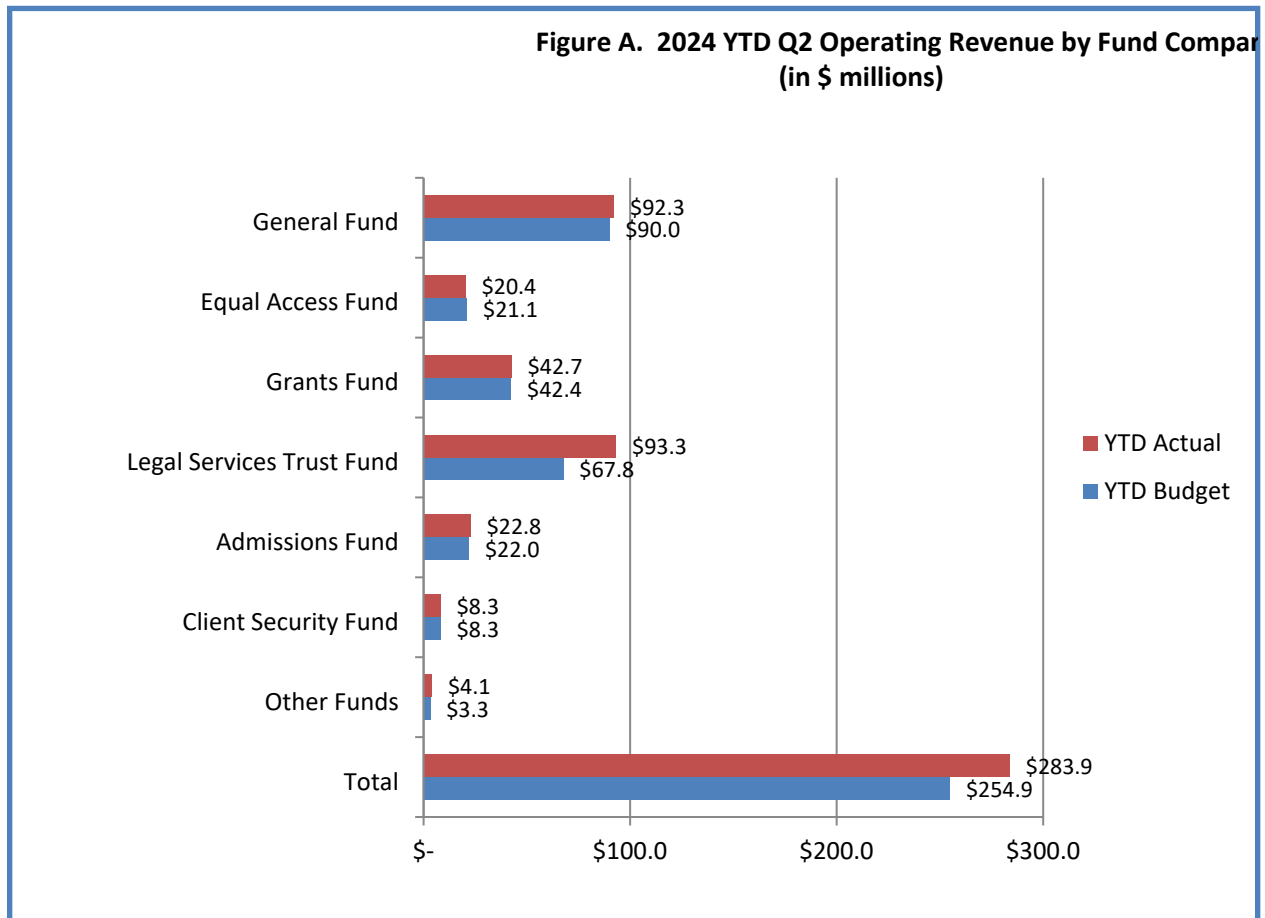
DISCUSSION

FINANCIAL STATEMENTS SUMMARY FOR THE SIX MONTHS ENDED JUNE 30, 2024 (ATTACHMENTS A & B)

The financial statements are composed of the operating results for the six months ended June 30, 2024, with information and comparative analysis regarding revenues and expenses.

REVENUE

Figure A. Comparison of budgeted operating revenues versus actuals at the fund level.



Overall, State Bar-wide operating revenue for the six months ending June 30, 2024, totaled \$283.9 million, above budgeted operating revenue of \$254.9 million by \$29.0 million.

Operating revenue for the General Fund (GF) totaled \$92.3 million, \$2.3 million more than the budgeted revenue of \$90.0 million. The primary driver is \$1.9 million in late compliance fees related to the Client Trust Account Protection Program (CTAPP). The budget assumed a lower rate of noncompliance and subsequent penalties in the program's second year. This assumption did not materialize, resulting in higher revenues. In addition, \$0.2 million of the favorable variance are late fees from Law Corp Renewals and MCLE Provider Fees.

While total GF revenues are above budget primarily from late compliance fees, Mandatory Licensing Fees are still trending below budget as of Q2 by \$0.3 million. An additional \$1.8 million needs to be collected by the end of Q4 in order to meet the annual budget. It is likely that the final amount of licensing fees will fall short of the budgeted level. In the last six months of 2023, the State Bar collected \$1.0 million in mandatory fees. If this trend continues into 2024, mandatory fees would be approximately \$0.8 million short of budget.

Operating revenue for the Equal Access Fund totaled \$20.4 million, which is \$0.7 million less than budgeted revenue of \$21.1 million. This variance is primarily due to \$0.6 million in grant funds returned to the State Bar in 2023 and disbursed in Q1 2024. When the funds were returned, a grant payable was recorded. Upon distributing the returned funds in 2024, instead of recognizing revenue, the payable was reduced. In addition, there was \$0.1 million less in grant administrative reimbursement costs due to staff turnover, resulting in less billable time.

Operating revenue for the Grants Fund totaled \$42.7 million, which is \$0.3 million more than budgeted revenue of \$42.4 million. Homeless Prevention III grant revenues are above budget by \$1.1 million due to the distribution of returned proceeds from 2023. This increased revenue is mostly offset by grant administrative reimbursement costs below budget by \$0.6 million. The shortfall is due to reduced funding for the CARE court grant coupled with staff turnover, resulting in less billable time. The Grants Fund comprises CARE Court, Homeless Prevention (HP) II, HP III, HP IV, CalHFA, Consumer Debt, AccessLex, and grant administrative cost reimbursements.

The Legal Services Trust Fund (LSTF) operating revenue of \$93.3 million exceeded budgeted revenue of \$67.7 million by \$25.6 million. The interest on Lawyers' Trust Accounts (IOLTA) accounts for all but \$0.1 million of the variance. The budget assumed the top 10 banks, which contribute 90 percent of IOLTA revenue, would have a total average daily balance of \$4.4 billion and with an average interest rate of 3.40 percent in the second quarter. However, the actual average daily balance is approximately \$5.527 billion, with an interest rate of 3.16 percent. While the interest rate was 24 basis points lower, the significantly higher daily balances offset the lower rate, resulting in the overall favorable variance.

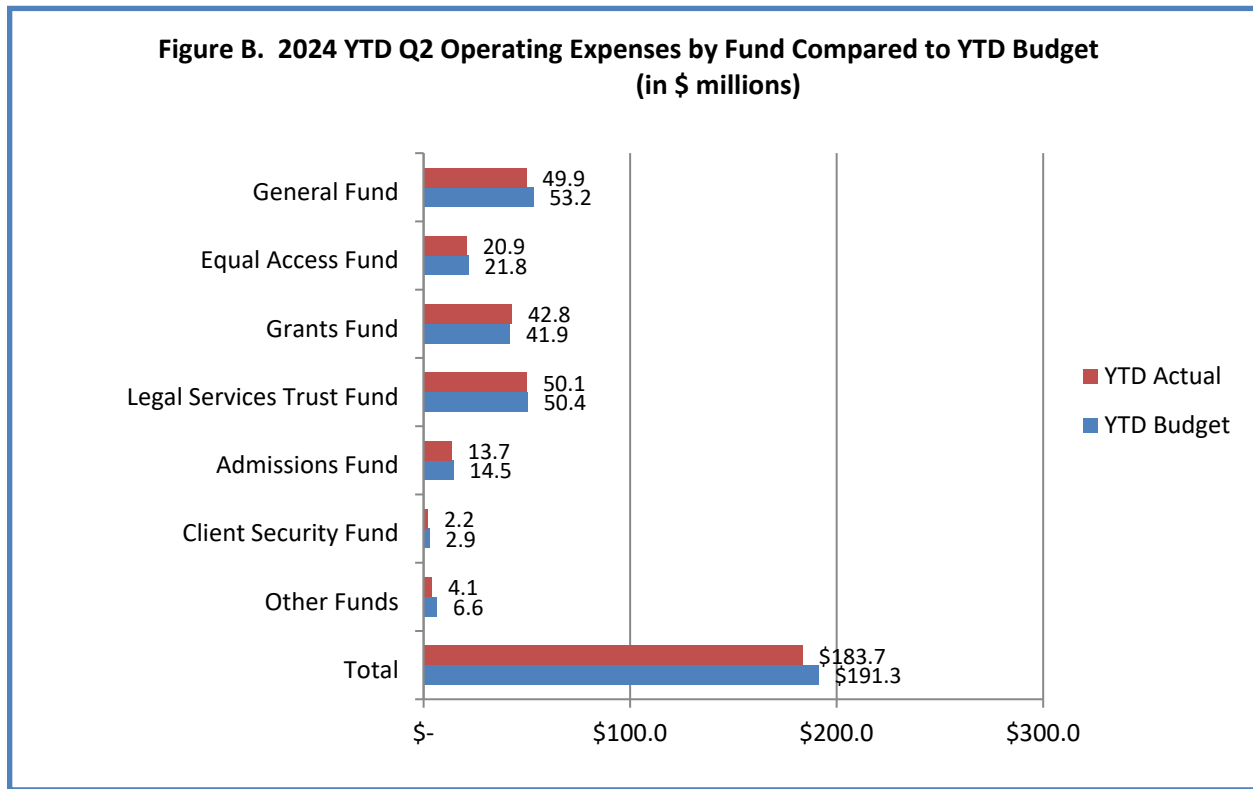
Admissions Fund revenue totaled \$22.8 million, exceeding budgeted revenues of \$22.0 million by \$0.8 million. Due to a larger number of applicants, exam fee revenues exceeded the budget by \$0.4 million. Similarly, \$0.4 million more revenue was collected for Moral Character Determination fees, Law Students and Attorney Applicants registration fees due to a larger number of applicants.

Client Security Fund revenue, funded by mandatory licensing fees, aligned with the budgeted revenue of \$8.3 million.

Other Funds' revenues amounted to \$4.1 million, surpassing budgeted revenues of \$3.3 million by \$0.8 million. Most of the variance is attributed to \$0.7 million higher revenues earned in the Justice Gap Fund from class-action suit settlements donated to this fund.

EXPENSES

Figure B. Comparison of budgeted operating expenses versus actuals at the fund level.



State Bar-wide operating expenses for the six months ending June 30, 2024, totaled \$183.7 million, \$7.6 million less than budgeted expenses of \$191.3 million.

General Fund expenses totaled \$49.9 million, which is \$3.3 million less than budgeted expenses of \$53.2 million. This variance is due to the following:

1. Savings in personnel costs of \$1.1 million, of which \$1.5 million is due to the reversal of the accrual for the last week of payroll in December 2023¹, and \$0.5 million in CalPERS Unfunded Accrued Liability (UAL). The budget was developed assuming the unfunded rate applied to 100% of budgeted 2024 salaries, whereas the actual charges are derived from the actuarial valuation with a 2022 measurement (latest valuation available), prior to the latest MOU. Offsetting these savings are \$0.7 million higher than budget expenditures from severance, overtime, temporary help, and payroll taxes.
2. Professional Services savings of \$1.8 million from delayed projects that are paused or under review: IT (\$0.7 million) and non-IT (\$0.3 million), as well as savings from fewer referrals to the Rule 2201 program and reduced litigation costs (\$0.5 million).

¹ The first payroll of 2024 included five days from December 2023, which were accrued to the prior fiscal year. This accrual temporarily reduces employee expenses until a similar accrual occurs at the end of this year. To address this in the future, the 2025 budget will take into account this accrual, thereby eliminating the variance.

3. \$0.3 million in savings from hardware purchases due to the delayed start of two projects that should resolved by the end of the year.

Equal Access Fund expenses amounted to \$20.9 million, \$0.9 million less than budgeted expenses of \$21.8 million. A majority of this amount (\$0.7 million) is due to the underspend of grant expenses related to the return of prior year revenue mentioned above (\$0.6 million) plus \$0.1 million returned from 2024 disbursements. The remaining savings relate to the timing of invoice submissions and staff vacancies (\$0.2 million).

Grants Fund expenses were \$42.8 million, 0.9 million more than the budgeted \$41.9 million. HP III grant expenses are above budget by \$1.1 million due to the distribution of returned proceeds from 2023 referenced above. Offsetting this overspent is \$0.1 million of savings in personnel due to vacancies.

Legal Services Trust Fund expenses were \$50.1 million, \$0.3 million less than the budgeted expenses of \$50.4 million. Services are below budget by \$0.2 million due to the timing of invoices; however, they will align with the budget by year-end. Grant expenses are \$0.1 million below budget due to a combination of rejected and returned funds.

Admissions Fund expenses totaled \$13.7 million, \$0.8 million less than budgeted expenses of \$14.5 million. This variance is driven by the following:

1. \$0.4 million in savings in services due to pending invoices for testing accommodation consultants and grading and psychometric consultants, in addition to delayed spending on law school inspections.
2. \$0.2 million of savings related to the Multi-State Bar Exam and Laptop License due to fewer applicants than budgeted.
3. \$0.3 million savings from the February exam facility costs due to expansive use of State Bar facilities and use of staff volunteers as proctors, partially offset by \$0.1 million overspent in electrical costs.

Client Security Fund expenses were \$2.2 million, \$0.7 million less than the budgeted expenses of \$2.9 million. The savings are due to fewer applications eligible for payment in the first half of the year. Claim activity in the second half of the year will have more eligible claims, with final payouts for the year expected to exceed \$6.0 million.

Other Funds' expenses totaled \$4.1 million, \$2.5 million less than budgeted expenses of \$6.6 million. Most of the variance is due to a budgeting error of \$2.3 million in the Bank Settlement fund for disbursements that covered two years instead of one. This is being corrected in the budget amendment as part of the midyear projection.

NONOPERATING REVENUE/EXPENSES

Nonoperating revenues/expenses encompass investment income, rental income, transfers, and interest expense on loans. Nonoperating revenue totaled \$8.2 million, exceeding the budgeted revenue of \$4.8 million by \$3.4 million. This variance is due to investment income exceeding the budget by \$3.4 million.

2024 MIDYEAR FINANCIAL PROJECTIONS AS OF JUNE 30 (ATTACHMENT C)

The 2024 midyear financial projection is detailed at the fund level in Attachment C. The projected reserve level for each fund is computed by adding the net effect of 2024 revenues and expenses relative to the 2023 year-end reserve balances. These projections are based on the operating results for the six months ending on June 30, 2024.

The midyear projection estimates that bar-wide, the State Bar will end 2024 with a surplus of \$100.7 million, marking a substantial shift from the initially budgeted operating surplus of \$27.9 million. This significant change is almost entirely attributed to increased IOLTA revenues within the Legal Services Trust Fund.

Table 1. 2024 Midyear Projections (fund level)

in 000s	Reserves Balance 12/31/23	2024 Annual Projected Revenues	2024 Annual Projected Expenses	2024 Projected Surplus/ (Deficit)	Projected Reserves 12/31/24	Reserve Level (%)
General Fund	\$33,711	\$100,712	(\$115,731)	\$ (15,019)	\$18,692	16.2%
Restricted Funds						
Admissions	7,019	28,232	(30,282)	(2,050)	4,970	16.4%
Elimination of Bias	(2)	342	(428)	(86)	(88)	-20.5%
Lawyer Assistance Program	996	2,247	(2,864)	(617)	379	13.2%
Legislative Activities	243	49	(247)	(198)	45	18.3%
Bank Settlement	4,848	123	(2,302)	(2,179)	2,669	N/A
Client Security	8,849	9,094	(7,569)	1,526	10,375	N/A
Equal Access	2,721	37,243	(37,543)	(301)	2,420	N/A
Grants	6,050	64,276	(63,000)	1,276	7,326	N/A
Justice Gap	4,917	1,974	(1,008)	966	5,883	N/A
Legal Services Trust	188,424	217,142	(99,772)	117,370	305,794	N/A
Restricted Funds Total	224,065	360,722	(245,014)	115,708	339,773	
Totals	\$257,776	\$461,433	(\$360,744)	\$100,689	\$358,465	

The projected ending reserve target for the General Fund is anticipated to be 16.2 percent, falling below the established reserve policy target range of 17 to 30 percent. This represents an increase from the originally projected 11.8 percent at the time of budget adoption. Budget amendments and transfers will be detailed later in this item to redirect these savings to necessary projects.

In addition to the General Fund, three funds are projected to have reserves outside the target range of 17 to 30 percent.

Below 17 percent

Elimination of Bias Fund (-20.5 percent) – The Elimination of Bias Fund (EOB) is funded by a \$2 per attorney opt-out fee. The State Bar’s work in diversity, equity, and inclusion has increased over the past few years, and annual donations are insufficient to support these expenses. Ongoing activities will need to be supported by the General Fund.

Lawyer Assistance Program (13.2 percent) – The Lawyer Assistance Program (LAP) Fund is projected to have a year-end reserve balance of \$0.4 million in 2024. The LAP Fund reserves have dropped significantly over the past three years, largely from increased personnel costs. The State Bar will terminate its lease for separate LAP office space in April 2025, resulting in ongoing operational savings for the fund.

Admissions Fund (16.4 percent) – The Admissions Fund is projected to have an overall deficit of \$2.1 million, compared to a budgeted deficit of \$3.8 million. The \$1.7 million change consists of \$1.3 million in increased revenue and \$0.4 million in reduced expenses. The projected revenue surplus is primarily due to higher applicant exam and laptop fees from the February and July bar exams (\$0.4 million), more moral character applicants (\$0.5 million), and increased law student registration fees (\$0.1 million) than anticipated. The projected expense savings of \$0.4 million are due to underspending for the February and July Bar exams on facility and proctor costs.

Midyear projection highlights include the following:

General Fund: Overall, the General Fund has a projected deficit of \$15.0 million, compared to the adopted budget deficit of \$22.1 million. The \$7.1 million change is made up of increased revenue of \$4.3 million and reduced expense spending of \$2.8 million.

Adopted budgeted revenues are \$96.3 million, compared to projected revenues of \$100.7 million. The primary drivers for the increase in revenue are higher CTAAP/late compliance fees (\$3.2 million), increased investment income (\$1.4 million), and mandatory late license fees (\$0.3). Investment income remained high as the Federal Reserve has not reduced interest rates in 2024. This is partially offset by a shortfall in mandatory fees of \$0.9 million due to not meeting aggressive growth targets.

Adopted budgeted expenses were \$118.5 million, whereas expenses are projected to be \$115.7 million. The reduction in costs is due to the delayed elevator project in LA (\$1.5 million), savings from the digitization project (\$1.2 million), and reduced CalPERS unfunded liability contribution (\$1.0 million). These savings are slightly offset by increases in vacation and sick accrual expenses.

Client Security Fund (CSF): CSF is projected to have an overall surplus of \$1.5 million, compared to the budgeted surplus of \$0.5 million. A revenue surplus of \$0.2 million is from discipline sanction fees and investment income exceeding the budget. Expense savings of \$0.8 million result from reduced payouts than anticipated from the budget.

Equal Access Fund (EAF): EAF is projected to have a deficit of \$0.3 million, compared to a budgeted deficit of \$0.8 million. This reduction in the deficit is attributed to higher-than-anticipated interest income earned of \$0.1 million, personnel savings of \$0.1 million, and reducing grant expenses by \$0.2 million to bring grant revenue and expense into equilibrium.

Justice Gap Fund: The Justice Gap Fund is projected to have a surplus of \$1.0 million, compared to a budgeted surplus of \$0.2 million. This increase is attributed to higher-than-anticipated Cy Pres funds from settlements.

Legal Services Trust (LSTF) Fund: The LSTF is projected to have a surplus of \$117.4 million, compared to a budgeted surplus of \$58.5 million. The significant change from the adopted budget to the projected balance results from increased amounts deposited in IOLTA accounts than anticipated (the balance for the top ten banks totals approximately \$5.5 billion) combined with higher than anticipated interest rates earned and larger investments purchased during the year. Revenue projections, which are used to budget, are approved by the LSFT Commission each year.

Legislative Activities: The Legislative Activities Fund changed from opt-out to opt-in last year, significantly reducing revenue. The change reduced the fund's budget from \$700,000 in 2022 to \$55,000 in 2024. Actual revenue collected is only \$48,500 in 2024. The fund is forecasted to end the year with a balance of \$45,200.

2024 BUDGET-TO-ACTUAL VARIANCE ANALYSIS FOR THE SIX MONTHS ENDED JUNE 30 (ATTACHMENT D)

The Budget-to-Actual Variance Report summarizes significant budget variances, both favorable and unfavorable, by comparing actual operating results for revenues and expenses for the six months ended June 30, 2024, to the year-to-date budget amounts. In accordance with the Board Book, significant budget variances are defined as budget-to-actual line-item variances greater than \$100,000. Significant budget variances are detailed in Attachment D.

PROPOSED 2024 BUDGET AMENDMENTS/TRANSFERS BY ITEM (ATTACHMENT E)

The proposed budget adjustments were prepared based on actual financial data through June 30, 2024, which includes known revenues and expenditure activities. The purpose of these amendments/transfers is to correct inaccuracies and unanticipated changes in the adopted budget identified as part of the midyear budget assessment as described below. To make effective and efficient use of the State Bar's fiscal resources and advance Board adopted goals and objectives, staff proposes midyear budget amendments and transfers as follows:

1. Budget amendments to correct inaccuracies in the budget:
 - a. A grant expense adjustment of \$2.4 million in Bank Settlement to correct the inclusion of two years of disbursements and account for \$0.1 million of returned funds.
 - b. A grant revenue and expense adjustment of \$1.2 million to Homeless Prevention III to reflect the distribution of returned 2023 proceeds.

- c. An expense adjustment of \$0.1 million to Access/Lex to match the revenue which was captured in the adopted budget.
- 2. Budget amendments to capture unanticipated changes in income/expense:
 - a. A revenue adjustment of \$55.4 million to IOLTA which reflects larger account balances and robust interest rates.
 - b. A revenue and expense adjustment of \$0.8 million to EAF to reflect grant funds that were returned.
 - c. A revenue and expense adjustment of \$0.2 million to CalHFA of \$0.2 million to reflect grant reallocations.
 - d. A revenue and expense adjustment of \$32.5 million to CARE Court to reflect reduced funding.
 - e. An expense adjustment of \$0.2 million in EAF to match grant revenue.
 - f. An expense of \$0.2 million in LSTF to reflect unspent funds.
- 3. Budget transfers to capture unanticipated changes in income/expense:
 - a. Transfer \$0.2 million from Admissions February exam room rental to professional services for field testing of new multiple choice questions as well as operational testing of the new test administration platform.
 - b. Transfer \$1.0 million from the professional services line item related to the LA elevator project to IT professional services for ARIS enhancements. The current system needs replacing, and this transfer is to correct defects and provide enhancements until such time a replacement system can be obtained.
 - c. Transfer \$0.75 million from professional services for the digitization project in the Administration cost center to IT professional services to support the development of an offer and compromise collections platform.
 - d. Transfer \$1.2 million from the Administrative cost center professional services to the General Services cost center professional services for the digitization project. This non-substantive change moves the budget to where the expenses will be charged.
 - e. As mentioned in Q2 financial statements, there are savings in the CalPERS Unfunded Accrued Liability (UAL). The projected amount of these savings across the General Fund is \$1.0 million. This amendment requests the savings be transferred to the following:
 - i. Transfer \$0.5 million to OCTC Regular Salaries and Casual hourly to account for promotions and temporary help to address the backlog.
 - ii. Transfer \$0.4 million to Regulation to begin implementing the audit management system for CTAPP compliance reviews and the development of a practical trust account reconciliation course.
 - iii. Transfer \$0.1 million to General Services to cover the increased cost of restack in the San Francisco Building and a change order to the emergency generator in the San Francisco building the State Bar is responsible for per the terms of the sale of 180 Howard Street.

- iv. Transfer \$50,000 to Human Resources for employee recognition year-end events.
- v. Transfer \$23,000 to the State Bar Court for judges' salary increases.

These proposed amendments are detailed in Attachment E by item.

PREVIOUS ACTION

None

FISCAL/PERSONNEL IMPACT

Fiscal/personnel impacts are described herein.

AMENDMENTS TO RULES

None

AMENDMENTS TO BOARD OF TRUSTEES POLICY MANUAL

None

STRATEGIC PLAN GOALS & IMPLEMENTATION STEPS

None – core business operations

RESOLUTIONS

Should the Finance Committee concur, it is:

RESOLVED, that the Finance Committee recommends that the Board of Trustees approve the 2024 Midyear Budget Variance Report (including Q2 Financial Statements Report), Projection, and Budget Amendments/Transfers in the form presented this day, for six months ended June 30, 2024.

Should the Board of Trustees concur, it is:

RESOLVED, that the Board of Trustees, upon recommendation of the Finance Committee approves the 2024 Midyear Budget Variance Report (including Q2 Financial Statements Report), Projection, and Budget Amendments/Transfers in the form presented this day, for six months ended June 30, 2024.

ATTACHMENTS LIST

- A. Operating Revenue, Operating Expenses, and Changes in Net Position (State Bar-Wide)

- B. Assets, Liabilities, and Net Position (State Bar-Wide)**
- C. 2024 Midyear Financial Projections**
- D. Budget-to-Actual Variance Analysis for the Six Months Ended June 30, 2024**
- E. Proposed 2024 Budget Amendments/Transfers by Item**