

California State Auditor

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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



April 2001
99030

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CALIFORNIA STATE AUDITOR

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April 25, 2001

99030

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, its stewardship of members' fees, and its administrative practices.

This report concludes that, in recovering from its virtual shutdown, the State Bar has reduced costs and improved the effectiveness of its disciplinary process by developing a priority system that allows staff to address the most serious disciplinary cases first. In addition, the State Bar has taken steps to ensure that its dues for members are reasonable and that it uses required dues to support only the State Bar's mandated functions and not the programs in which members participate voluntarily. However, to avoid using an unnecessarily large portion of membership fees to reimburse the complainants in discipline cases and to pay the costs of these cases, the State Bar needs to recover from disciplined attorneys a higher percentage of its disciplinary costs. Moreover, the State Bar needs to maintain credibility with its members and the public by making certain that employees use properly the State Bar's purchasing cards and business expense account, and adhere to its contracting policies and procedures.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

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SUMMARY

Audit Highlights . . .

In rebounding from its virtual shut down, the State Bar has made the following improvements:

- ☑ *Developed a complaint prioritization system that allows staff to address the most serious disciplinary cases first.*
- ☑ *Increased the amounts it charges disciplined attorneys to recover discipline costs.*
- ☑ *Taken steps to ensure that its mandatory membership fees are reasonable and not used to support voluntary programs.*
- ☑ *Improved controls over contracting.*

However, the State Bar needs to make the following additional improvements:

- ☑ *Adopt additional collection methods to increase the amounts it actually collects from disciplined attorneys.*
 - ☑ *Clarify and enforce policies regarding its purchasing cards, business expense account, and contracting.*
-

RESULTS IN BRIEF

The State Bar of California (State Bar) is rebounding well since a veto of legislation limited its revenue and forced it to suspend operations almost completely for six months during 1998. Under the California State Constitution, all attorneys who practice law in California must be members of the State Bar unless they are serving as judges, and the State Bar is responsible for disciplining attorneys who have engaged in misconduct. In recovering from its virtual shutdown, the State Bar has reduced costs and improved the effectiveness of its disciplinary process by developing a priority system that allows staff to address the most serious disciplinary cases first. In addition, it significantly increased the amounts it can charge disciplined attorneys to recover disciplinary costs. The State Bar also has taken steps to ensure that its dues are reasonable and that it uses required dues to support only its mandated functions and not the programs in which members participate voluntarily. Nevertheless, the State Bar needs to recover a higher percentage of disciplinary costs from disciplined attorneys to avoid using an unnecessarily large portion of membership fees to reimburse the complainants in disciplinary cases and to pay the costs of these cases. Moreover, the State Bar needs to maintain credibility with its members and the public by making certain that employees use its purchasing cards and business expense account properly and adhere to its contracting policies and procedures.

The State Bar, established by the California State Constitution, is a public corporation with a mission to preserve and improve the justice system in order to assure a free and just society under law. 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. In addition, 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 collect fixed, mandatory fees from its members. Various sources, including our 1996 audit report on the State Bar, already had shown that the State Bar was not

managing its resources effectively. The drastic reduction in membership fees meant the State Bar had to curtail its activities significantly and find ways to cut costs. After nearly shutting down during 1998, the State Bar began to improve its disciplinary and administrative processes. In the meantime, however, the State Bar developed a large backlog of disciplinary cases.

To make its disciplinary process more efficient and to address this backlog, the State Bar implemented a priority system that focuses staff efforts on the most serious complaints against attorneys. Further, the State Bar has developed a reasonable plan to reduce the backlog and has implemented a policy 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's policies, standards, and priorities.

The State Bar also has revised its cost model to include all the activities for which it can recover costs from disciplined attorneys. However, it has not updated the cost model to reflect current salaries for State Bar employees. Further, although it is charging disciplined attorneys more, the State Bar continues to have trouble collecting the money. Because its cost-recovery efforts are poor, the State Bar must use an unnecessarily large share of the membership fees to support programs that reimburse the disciplined attorneys' clients and for the disciplinary process. Consequently, the State Bar is missing an opportunity to reduce members' fees.

On the other hand, the State Bar has improved 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 has developed a method to allocate administrative costs equitably among mandatory and voluntary programs. Moreover, to ensure that members' fees are reasonable and that mandatory fees do not support voluntary programs, the State Bar has worked to determine the amount of mandatory fees it needs to perform its required functions.

Finally, since it began re-creating itself in 1998, the State Bar has improved its procurement policies. It established a purchasing card program that has strengthened controls over travel and minor business expenses, and it has enhanced controls over its

contracting practices by establishing competitive bidding requirements. Nevertheless, it must clarify one of its policies and ensure that employees adhere to others. In a sample of 36 monthly statements for purchasing cards, we identified about \$4,400 in questionable transactions that did not represent a prudent use of State Bar funds. The State Bar also exceeded by about \$5,500 its general fund budget for discretionary spending in the business expense account. Furthermore, our audit sample disclosed that the State Bar paid about \$2,600 for purchasing card transactions even though the employees responsible for the charges failed to provide required receipts for their purchases. The State Bar also did not always enforce its policies and procedures for contracting. Thus, it cannot be certain that expenses are appropriate and that its members are funding only purchases that are necessary.

RECOMMENDATIONS

To improve recovery of costs from offending attorneys so it can reimburse their clients and pay for the disciplinary process, the State Bar should maximize the costs it can recover from disciplined attorneys by including in an updated cost model the current salary costs for State Bar employees. Additionally, the State Bar should pursue other collection strategies, such as participation in the State's Offset Program, which 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.

To prevent abuse of its purchasing card program and to make certain that employees use the cards appropriately, the State Bar should clarify its definitions of purchases that constitute appropriate business expenses and enforce its policy requiring receipts for purchases exceeding \$25. It should require employees to charge all discretionary spending to the business expense account, and it should monitor total charges to this account. Finally, to ensure that it obtains the best price and that its purchases are necessary, the State Bar must enforce its policies and procedures for contracting.

AGENCY COMMENTS

The State Bar agrees with our recommendations and outlines its corrective action plans. The State Bar states that it will update its cost model and renew its efforts to participate in the State's Offset Program. In addition, the State Bar will review existing policies related to business expense and purchasing card usage, make revisions as necessary, and redistribute them to all employees. Also, the State Bar will clarify and strengthen its contracting policies and procedures as necessary and plans to provide training for its staff. ■

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 of the State Bar except when 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.

The State Bar performs these functions: admissions, discipline and adjudication, administration of justice, legal education and competence, program development, communications, and administration and support.

To support the cost of performing its many 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 a specific segment of the legal profession, such as the Family Law Section. However, in 1997 the governor vetoed the bill that would have authorized the State Bar to fix the amount of membership dues. Consequently, the State Bar eliminated about 460 positions during the first six months of 1998.

Finally, Chapter 342, Statutes of 1999, authorized the State Bar to fix the amount of membership dues. This legislation specified that the annual fees not exceed \$318 per member until after January 1, 2001. In combination with other fees specified in existing statutes, this brought the total to \$395 per member for 2000. Additionally, the legislation required that the State Bar contract with an independent public accounting firm to conduct an audit of the State Bar's financial statements for each fiscal year beginning after December 31, 1998. The legislation also mandated the performance of this audit.

SCOPE AND METHODOLOGY

In addition to requiring a financial audit, Chapter 342, Statutes of 1999, directs the State Bar to contract with the Bureau of State Audits to conduct a performance audit of the State Bar's operations from July 1, 2000, through December 31, 2000. This legislation states that the Bureau of State Audits submit a copy of the performance audit to the Legislature by May 1, 2001. This legislation does not state specific topics the audit should address.

To fulfill the requirements of the statute, we reviewed the recommendations we made in a 1996 audit of the State Bar.¹ During this review, we identified four principal areas: the State Bar's disciplinary process; cost recovery as part of the disciplinary process; the use of mandatory and voluntary fees to support State Bar functions, including legislative activities; and the procurement process used by State Bar employees.

To review the disciplinary process, we compiled and reviewed key statistics from the process. In addition, we analyzed the State Bar's success in collecting fines imposed on attorneys through the disciplinary process.

Our audit also evaluated the State Bar's use of mandatory and voluntary fees to support its various functions, including its legislative activities. We analyzed two new cost allocation plans developed for the State Bar by Deloitte and Touche, LLP. We did not review the actual allocations of indirect costs because the auditors of the State Bar's financial statements for 2000 told us they planned to test them. However, we did review the State Bar's financial statements for 2000 to determine the costs, including administrative costs, that the State Bar charged to its legislative activity fund. We also assessed whether the State Bar's monitoring of mandatory fees is reasonable.

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 activity fund with the amount of costs charged to it. Further, we reviewed the program descriptions of cost centers

¹ Our 1996 audit report is titled *State Bar of California: Opportunities Exist to Reduce Fees, Better Control Administration and Planning, and Strengthen an Improved Discipline Process*.

(specific accounts within the State Bar to which charges are posted) supported by mandatory fees to determine whether the descriptions list activities the State Bar should charge to the legislative activities fund.

In evaluating the procurement process, we analyzed the State Bar's new purchasing card program. We looked at its effect on the controls for travel expense claims and small business expense purchases. To address a finding from our 1996 audit of the State Bar concerning inadequate controls over the travel expense claims process, we reviewed any travel expense claims that corresponded to a purchasing card statement in our sample. We also reviewed the State Bar's contracting policies and procedures to address another finding from our 1996 audit concerning inadequate controls over contracting.

Finally, we inquired whether the State Bar has developed a strategic plan and learned that it has not yet done so. The State Bar's virtual shutdown in 1998 and its subsequent reopening in the spring of 2000 have diverted energy from this project. However, State Bar management claims that formulation of a strategic plan is still one of its goals. ■

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CHAPTER 1

The State Bar Has Made Some Improvements to Its Disciplinary Process

CHAPTER SUMMARY

Since we issued our May 1996 report on its operations, the State Bar of California (State Bar) has changed significantly its disciplinary process and its cost model for recovering the expenses associated with this process. Overall, these changes have increased the efficiency and reliability of the disciplinary process, which protects the public by addressing attorney misconduct. The State Bar has implemented a priority system to ensure that its staff works first on the most serious consumer complaints about attorneys practicing in California. Additionally, by forwarding only the most severe cases to its enforcement unit, the State Bar uses its investigators' time to process just those cases that probably will result in disciplinary action. The priority system helps State Bar staff identify, investigate, and prosecute promptly those cases that pose the most significant threat to the public. In addition, the State Bar has implemented a policy to review random cases periodically to ensure that its staff's actions are consistent with case law and standards and with State Bar policy and procedures. Although the State Bar's most recent review noted some minor noncompliance issues and some potential problems, none was significant enough to change the outcome of the decision. Further, our review of supporting documentation of the Office of Chief Trial Counsel (chief trial counsel) staff did not reveal any cases that were closed inappropriately.

Moreover, since it reorganized its operations after the 1998 shutdown, the State Bar has revised the cost model for the disciplinary process to include all types of costs that it can recover from disciplined attorneys. Using the new model, the State Bar has more than doubled the highest amount it can charge an attorney for the costs of investigating and pursuing disciplinary action. Additionally, the State Bar has paid \$4.8 million from its Client Security Fund during 2000 to complainants for losses due to attorney misconduct. However, the State Bar's success rate for collecting costs from offending attorneys declined in 2000 compared with its 1995 rate. Because of the poor recovery efforts, the

State Bar uses more of its membership fees than necessary to support its Client Security and disciplinary programs. As a result, members pay a fee that is larger than necessary to support these programs.

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.

Statement of Prosecutorial Priorities

Priority 1 complaints may include these allegations:

- 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 2 complaints may include these matters:

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

Priority 3 complaints may include these charges:

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

Priority 4 complaints may include these issues:

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

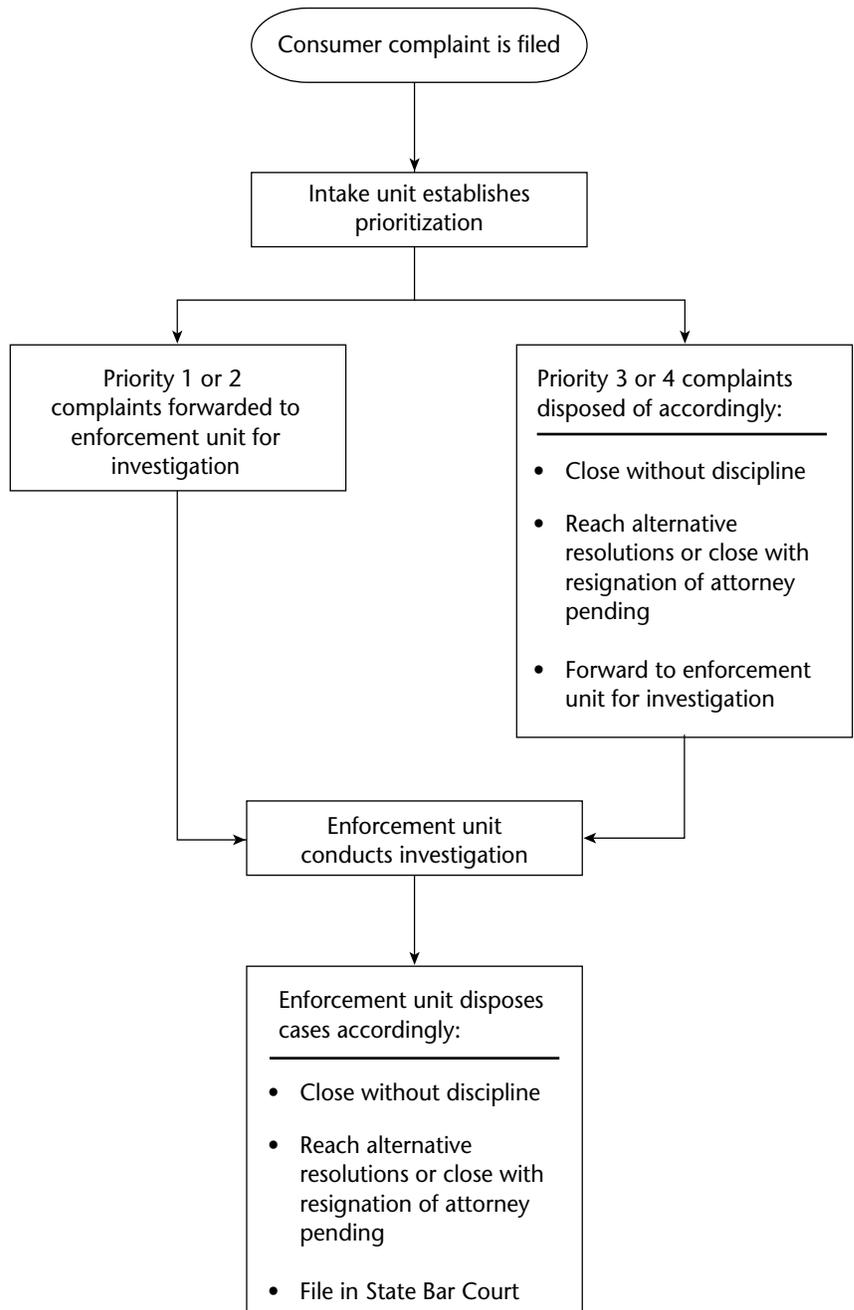
Before its restructuring in 1998, the State Bar forwarded even minor issues to its enforcement unit. Since 1998, the intake unit has prioritized new complaints according to their seriousness. In January 1999, the State Bar's Board of Governors (board) adopted the chief trial counsel's revision of the Statement of Prosecutorial Priorities, which sets forth guidelines for the intake unit and the enforcement unit. This revision allows the State Bar to focus its resources and efforts on the most critical disciplinary cases and to address the less serious complaints to the extent that resources are available.

The intake unit is the initial contact point for individuals submitting complaints against attorneys, seeking general information about attorneys, or seeking 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 make complaints against attorneys who practice in California. In addition to taking calls from these complaining witnesses (complainants), the intake unit receives referrals from attorneys, courts, banks, insurers, and law enforcement agencies about improper conduct by attorneys. The intake unit prioritizes cases coming into

the State Bar’s disciplinary system. This unit also processes the less serious cases. The following figure illustrates how the State Bar handles complaints.

FIGURE

The State Bar’s System for Prioritizing and Disposing of Complaints



The intake unit forwards to the enforcement unit the complaints that, if substantiated, are likely to result in prosecution. The enforcement unit investigates the complaints to determine whether sufficient evidence is available to confirm the allegations and to prosecute the offending attorney. If the investigator is unable to substantiate the complaint, the deputy trial counsel closes the case. 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.

Before the deputy trial counsel files the notice with the State Bar Court, the accused attorney is formally notified about the allegations and has up to 20 days to negotiate a settlement with the complainant. 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 Los Angeles and San Francisco, hears and decides cases related to attorney misconduct. The State Bar Court consists of two departments, Hearing and Review. The Hearing Department 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 adjudicatory and administrative tasks related to the attorney disciplinary 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'S PLAN TO HANDLE ITS SIGNIFICANT BACKLOG OF DISCIPLINE CASES APPEARS REASONABLE

The State Bar has implemented reasonable methods for dealing with the numerous complaints that have accumulated in its backlog of disciplinary cases. The loss of revenue in 1998, when the State Bar lost its authorization to collect annual membership dues, prompted significant layoffs in the office of the chief trial counsel, which investigates, prosecutes, and monitors attorneys accused of misconduct. Facing an enormous backlog of open complaints, the State Bar instituted a plan to prioritize cases so the most serious complaints receive attention first. Also, by parceling out backlogged complaints to all investigators, the State Bar expects to reduce the number of backlogged cases from 1,340 to 600 by the end of 2001.

Layoffs of employees of the chief trial counsel reduced the number of staff from 285 to 22. With a limited number of staff available, the primary focus at the time was to process and support complaints already filed in the State Bar Court and to receive, record, and store complaints still coming into the system. During July through December 1998, while it was inactive, the State Bar received 3,000 new complaints against attorneys. In addition to these complaints, the State Bar had about 4,400 complaints on hold in inventory.

Because it had been shut down, the State Bar faced a growing number of open complaints in its inventory and the backlog steadily grew. However, the State Bar's disciplinary system reopened on March 1, 1999, with the dues mandated by the Supreme Court for 1999. The State Bar set into motion a series of initiatives to address its inventory of pending complaints. The chief trial counsel began by developing a system for prioritizing work to ensure that the State Bar concentrated its resources only on those complaints 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 complaints first. The chief trial counsel then realigned the enforcement unit into specialized units.

At the end of 2000, the backlog of complaints was 1,340 compared to 145 at the end of 1995, however, the State Bar plans to reduce the backlog to 600 by the end of 2001.

Still the backlog remained relatively high. At the end of 2000, the backlog of complaints was 1,340 compared with 145 at the end of 1995. The State Bar plans to reduce the backlog to 600 by December 31, 2001, and it considers this amount an acceptable level for the present. It plans to achieve this goal by targeting for resolution, on average, one backlogged complaint per investigator

per month. This increase to the investigators' current workload does not seem unreasonable because the number of cases advanced to investigation has decreased under the new priority system. Also, the goal seems attainable because the State Bar's staffing is close to pre-1998 levels, and the units have more experienced investigators than when the State Bar reopened in March 1999.

As of December 31, 2000, the backlog of 1,340 cases consisted of 1,185 noncomplex and 155 complex complaints. The State Bar was actively working on 1,131, or 84 percent, of the backlogged cases. The remaining 209, or 16 percent, were in abeyance, held, or in legal review. A complaint is in abeyance when the State Bar temporarily suspends work on the case for a specific reason, such as pending acceptance by the Supreme Court of an attorney's resignation. A complaint that is held is not being worked, but pending the outcome of investigation of other complaints against that same attorney.

THE NEW PRIORITY SYSTEM HELPS STAFF FOCUS ON SERIOUS OFFENSES

Before the implementation of the new priority system, the State Bar did not use its resources in the most effective ways because it frequently forwarded relatively minor issues to the enforcement unit. Whenever it used valuable investigative resources on cases that had no merit, the State Bar had fewer resources to spend on cases that would result in discipline. Moreover, the enforcement unit filed fewer cases in the State Bar Court. Under the new policy, the chief trial counsel allocates time to a complaint according to a particular complaint's priority. Because the intake unit immediately forwards to the enforcement unit only the cases that pose the most significant threat to the public, more resources are available to process these types of cases. The State Bar will spend fewer resources on those cases remaining in the intake unit because such cases will warrant closure or minimal resolution, such as a resource letter. A resource letter directs attorneys to programs aimed at helping them avoid ethical problems in the future.

The State Bar is doing a better job of using its resources than it did in 1995.

TABLE 1

**Summary of Complaints Processed by the Office of Chief Trial Counsel
Calendar Years 1995 and 2000**

	1995 Totals	1995 Percent of total complaints processed	2000 Totals	2000 Percent of total complaints processed
Intake Unit				
Total Inquiries in Intake Closed or Advanced	16,305		11,309	
Inquiries closed without discipline	7,725	47%	6,590	58%
Inquiries closed with alternative resolutions or resignation of attorney pending	2,860	18	1,935	17
Inquires advanced to investigation	5,720	35	2,784	25
Enforcement Unit				
Total Cases Investigated	7,384		3,327	
Closed without discipline	4,225	57%	1,554	47%
Alternative resolutions or resignation of attorney pending	1,703	23	690	21
Cases filed in State Bar Court	1,456	20	1,083	32

Because the intake unit forwards only the most serious cases to the enforcement unit, a greater percentage of relatively minor cases remains in the intake unit for resolution than was the practice before the State Bar's shutdown. Consequently, we can reasonably expect that a high percentage of inquiries opened in the intake unit will be closed without discipline. As Table 1 shows, for the year 2000 the State Bar closed 58 percent of such cases in its intake unit and 47 percent in the enforcement unit. These percentages indicate a notable change from 1995 data, which show that a higher percentage of cases were closed without discipline in the enforcement unit than in the intake unit.

The data indicate that the priority system is enabling the State Bar to use its resources better than in 1995. Another indication that the priority system results in a better application of resources is that the cases filed in State Bar Court increased from 20 percent in 1995 to 32 percent in 2000.

The number of complaints received in the intake unit dropped from 137,780 in 1995 to 109,259 in 2000. Similarly, the number of inquires opened dropped from 15,957 in 1995 to 10,842 in 2000. These decreases are due partly to the State Bar's shutdown

and to changes implemented when the State Bar reopened. When the hotline went back into service, the State Bar reduced consumer access to “live” staff by 50 percent. Instead of staffing the hotline eight hours a day, five days a week, the State Bar gives consumers access to “live” staff four hours a day. However, access to information is always available because the phone system has a “self-help” voicemail and phone-tree system that callers can use to resolve their own issues. This phone system includes recorded messages that offer information on the most frequently asked questions. In addition, the hotline provides consumer information on how to file a complaint and what other programs may help the callers. Finally, using its priority system, the State Bar opens fewer cases for inquiry. Cases that are unlikely to result in disciplinary action may be dismissed outright because they have no merit.

REVIEWS INDICATE THAT THE DISCIPLINARY PROCESS YIELDS APPROPRIATE RESULTS

The percentage of cases closed without discipline in the intake and enforcement units was 56 percent in 2000 compared with 50 percent in 1995. The fact that the number of cases closed without discipline did not increase dramatically suggests the State Bar continues to evaluate complaints appropriately and that the new priority system has not yielded questionable outcomes for cases of attorney misconduct. Nonetheless, to ensure that it closes cases properly, the State Bar has implemented a review process.

In September 2000, the State Bar issued a policy that directs management to conduct periodic reviews of random cases to ensure that the staff’s actions are appropriate and consistent with the State Bar’s policy, case law, standards, and priorities. Initially, the State Bar’s goal was to conduct the reviews quarterly. However, the initial review required more time than anticipated, so the State Bar will perform the reviews semiannually.

The first review covered the quarter ending September 30, 2000. The staff of the chief trial counsel evaluated approximately 330 case files within the intake and enforcement units. The team leaders reviewed each case file for compliance with the State Bar’s policies and procedures and for appropriate closure. Managers conducted a second review of 10 percent of those cases to ensure the appropriateness of the team leaders’ reviews.

Once the reviews were complete, each manager prepared summaries of their findings and consolidated these reports into a final report for the chief trial counsel.

In general, the areas of noncompliance identified in the State Bar's initial review were staff's failure to enter information into the computer database and poorly organized case files. Other issues that the State Bar reported as potential problems were insufficient information provided to complainants and respondents in the closing letters and confusion in the instructions from the Deputy Trial Counsel. In one instance, a question was raised regarding the disposition of the case, but after a second review the disposition was deemed appropriate. However, all areas of concern were not significant enough to have an adverse effect on the overall outcome of the case dispositions. In addition, our review of the supporting documentation used by chief trial counsel staff did not indicate any instances of inappropriately closed cases.

Complainants who feel that their case was closed inappropriately can request a "second look." In 2000, of 653 requests only 54 were reopened following the second review.

In addition to the internal review, the State Bar, at the request of the complainant, may conduct a "second look" at a case if the complainant feels that it was closed inappropriately. Although the chief trial counsel conducts these reviews, staff involved in the case's closure does not perform the second look. Although it might seem that reviewers may be biased and might not overturn the original disposition, we found that this is not the case. In 2000, of the 653 requests that had a second look, 54 were reopened after the State Bar's review process. Following receipt of additional information from the complainants, the intake unit reopened and forwarded five cases to the enforcement unit. One of those cases is pending with the California Supreme Court for final approval of the disciplinary action. The other four cases may result in discipline. One is at the Hearing Department and the other three are potential filings of disciplinary charges with the State Bar Court. None of the five cases was selected as part of the internal random review conducted for the quarter ending September 2000. Finally, 22 of those 54 reopened cases are still open and pending investigation.

If a complainant remains dissatisfied with the outcome, the complainant can file a petition with the California Supreme Court under *In Re: Walker*. 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. In 2000, complainants filed 72 petitions with the California Supreme Court, but the court granted none of the petitions.

THE COSTS THE STATE BAR CHARGES TO DISCIPLINED ATTORNEYS HAVE INCREASED, BUT EFFORTS TO RECOVER THEM REMAIN POOR

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 2000, the State Bar used \$23 million of its \$82 million total expenditures, including those for voluntary programs, to conduct its disciplinary process. By implementing a new cost model, the State Bar has more than doubled the highest amount it can charge an attorney for its costs to discipline that attorney. Also, the State Bar has paid \$4.8 million from its Client Security Fund during 2000 to complainants for losses they suffered from attorney misconduct. However, compared with its 1995 figures for recovering Client Security funds and disciplinary costs, the State Bar's success in collecting these costs declined in 2000.

During 2000, the State Bar paid \$4.8 million from its Client Security Fund to complainants for losses that clients suffered from attorney misconduct.

The State Bar can recover from offending attorneys some of its costs for disciplinary activities. The Business and Professions Code, Sections 6140.5 and 6086.10, requires the State Bar to charge offending attorneys for certain costs related to its Client Security Fund and disciplinary proceedings. Specifically, attorneys whose actions have caused the Client Security Fund to pay a claimant must reimburse the fund. Further, any action by the State Bar 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, Section 6086.10, limits the recovery of costs 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. A small proportion of the inquiries opened in 2000 were ultimately filed in State Bar Court. Of the cases filed in State Bar Court, only 111 resulted in a form of discipline in which the State Bar could bill attorneys for discipline costs. 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.

Since our 1996 audit, the State Bar has revised the cost model it uses to determine the amounts to charge disciplined attorneys. The change, implemented in February 1998, has increased the amounts it bills attorneys for discipline costs. With the adoption of this new model, the most the State Bar can charge is more than twice as much as it could under the old model. The major difference is that the new cost formula includes all types of recoverable costs. The previous cost model had not been updated since 1988 and did not capture all types of costs that the State Bar was entitled to recover from disciplined attorneys.

We estimated that the State Bar could bill disciplined attorneys for about \$1.3 million of the disciplinary costs it incurred during 2000.

To determine if the new cost model reflects actual recoverable costs, we estimated how much of the \$23 million in disciplinary costs for 2000 that the State Bar could collect. To do so, we used the State Bar's cost model and determined that the State Bar technically could recover \$16.5 million if all cases had discipline imposed publicly by the State Bar Court. However, since not all cases result in a form of public discipline, the State Bar cannot charge disciplined attorneys for this full amount. Using State Bar data on the dispositions of cases during 2000, we estimated that the State Bar could bill \$1.3 million to disciplined attorneys. To develop our estimate, we determined that 870 cases processed during 2000 resulted in a form of public discipline according to State Bar records. This represents about 8 percent of the 10,842 inquiries opened during the year. Although not all inquiries opened will be closed in the same year, we made this assumption to get a rough estimate of how much of the discipline costs incurred during 2000 could be recovered from disciplined attorneys.

As Table 2 shows, the State Bar billed attorneys \$1 million, which is slightly less than our estimate. We attribute part of the difference to the salaries used in the new cost model. The cost model uses 1997 salaries instead of the most current salaries for State Bar employees. Because it has not updated the salaries in the cost model, the State Bar is not billing for all costs that it is entitled to collect.

TABLE 2**Costs Billed and Recovered for Client Security and Disciplinary Programs**

Year	Client Security			Discipline		
	Costs Billed	Costs Recovered	Percent Recovered	Costs Billed	Costs Recovered	Percent Recovered
1995	\$3,126,107	\$123,042	3.9%	\$1,047,831	\$408,387	39.0%
2000	4,812,990	119,400	2.5	1,079,922	311,061	28.8

Table 2 clearly indicates that the State Bar’s collection efforts have not improved since 1995. Despite the laws requiring repayment of some disciplinary costs, the State Bar recovers only a small portion of such costs. As in 1995, the only way the State Bar can seek recovery from an attorney without a formal court judgment is by adding the costs to the attorney’s annual bill for dues. However, using the annual bill for cost recovery has had limited success because many of the attorneys billed are insolvent or unlikely to practice law in the future. Additionally, although the State Bar pursues judgments against some attorneys to recover Client Security Fund payments when the dollars involved are significant, it is too costly to do so in most cases. Thus, the expenses associated with recovering disciplinary costs also contribute to low recovery rates.

We recommended in our 1996 report that the State Bar pursue additional collection efforts, and we suggested that it participate 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. State Bar officials informed us that it did not obtain legislative support in 1997 for participation in this program. Shortly after this effort, the governor vetoed the bill concerning the State Bar’s fee for members, and the State Bar’s operations virtually shut down. Now that the State Bar is operating again, officials told us they agree with our recommendation and are committed to pursuing participation in the State’s Offset Program.

Because the State Bar’s recovery efforts are poor, it uses a greater portion of membership fees than necessary to support its Client Security Fund and disciplinary programs. Consequently, members must pay a fee that is higher than necessary.

RECOMMENDATIONS

To improve recovery of costs related to its disciplinary and Client Security programs, the State Bar should maximize the costs it can recover by using figures for current salary costs to update the cost model. In addition, the State Bar should pursue additional collection efforts, such as participation in the State's Offset Program. ■

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CHAPTER 2

The State Bar Has Taken Steps to Ensure That Mandatory Fees Are Reasonable and Do Not Support Voluntary Programs

CHAPTER SUMMARY

Reacting to changes in the statutes that direct its operations, the State Bar of California (State Bar) has improved its accounting for the voluntary and mandatory fees it charges members and for the programs that the fees support. As a result, the State Bar can better ensure that mandatory fees are reasonable and that they do not fund voluntary programs. Chapter 342, Statutes of 1999 (Chapter 342), precludes the State Bar from using mandatory fees after January 1, 2000, to support certain voluntary programs and legislative activities, such as lobbying efforts. The legislation does allow the State Bar to obtain voluntary payments from members to support these activities. To meet these requirements, the State Bar uses separate funds to account for the receipt and use of these optional fees. In addition, it has changed its methods of allocating general and administrative costs (indirect costs) to ensure an equitable distribution of these costs among programs supported by the mandatory and voluntary fees. Finally, the State Bar has determined the amount of mandatory fees it needs to perform its required functions. 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.

BACKGROUND

Chapter 342 prohibits the State Bar from using after January 1, 2000, 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 (conference) and the State Bar Sections (sections). The conference is a representative group of local bar associations that gather voluntarily to conduct an annual three-day meeting during which representatives

consider resolutions on issues affecting lawyers and the administration of justice. 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, producing training programs and workshops, and reviewing or proposing legislation for regulating the legal profession or 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.

Case law prohibits the State Bar from using mandatory membership fees to advance political or ideological positions such as gun control or nuclear weapons freeze initiatives.

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 during 1990 in *Keller v. State Bar of California* (Keller standard). The issue in the Keller case concerned whether state bars could use compulsory membership fees for various activities of a political or ideological nature. The United States Supreme Court considers expenses for political or ideological activities chargeable to membership fees if the expenses relate reasonably to a state bar's regulatory functions and to improving legal services available to the public; otherwise, a state bar may not charge such expenses to its members. 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 state bars 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 Keller parameters. For these activities, the State Bar can use no more than the amount it collects from members who do not take the \$5 deduction.

THE STATE BAR HAS IMPROVED ITS ACCOUNTING FOR VOLUNTARY AND MANDATORY ACTIVITIES

In response to the requirements of Chapter 342, which became effective in 2000, the State Bar has improved how it accounts for revenues and expenses related to its voluntary and mandatory programs. It established two new funds to account for the conference's activities and for lobbying activities outside the Keller parameters. (A separate fund for section activities already existed.) In addition, the State Bar has changed its system of accounting for section activities so it has better assurance that

mandatory fees are not used to provide administrative support to the sections, a practice we observed during our 1996 audit. By using separate funds to account for these activities, the State Bar is better able to ensure that it does not use mandatory fees to support voluntary programs.

For 2000, the State Bar established 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. On its annual membership fee statement for 2000, the State Bar asked members to make a voluntary contribution of \$3 to support the conference. Approximately 28,000 members responded, and contributions amounted to about \$84,000. The State Bar did not use any mandatory fees to fund the \$70,000 in expenses for conference activities during 2000.

Also in response to Chapter 342, the State Bar created the Legislative Activities Fund to account separately for revenues and expenses related to its lobbying activities that go beyond the parameters set by the Keller case. Revenues recorded in the fund for 2000 amounted to about \$679,000. Of this amount, about \$644,000 came from members who did not choose the optional deduction but instead decided to pay the \$5 to support legislative activities that, under the Keller standard, the State Bar may not charge to mandatory membership fees. The remaining \$35,000 came from interest income. Expenses paid from the fund consisted primarily of payroll costs for staff members in the offices of General Counsel, Research, and Program Development who spent time working with legislation that was not chargeable to mandatory membership dues. These employees tracked the time they spent on such activities so the State Bar could charge related costs to the fund. Our review disclosed that the State Bar inadvertently failed to charge to the Legislative Activities Fund one month's worth of costs totaling \$819 from the Office of Program Development. However, its new practice of recording staff time represents an improvement since our 1996 audit, when we noted that the State Bar did not use a time-reporting system to track the time staff spent on legislative activities. The remaining expenses charged to the fund related to indirect costs according to the new cost allocation plan discussed in the next section.

The State Bar created the Legislative Activities Fund to account for revenues and expenses related to lobbying activities.

Finally, the State Bar uses its Sections Fund to account appropriately for the sections' activities. For 2000, members could join as many as 18 different sections by voluntarily paying a fee ranging from \$30 to \$60. During 2000, members contributed a total of

about \$3 million for all sections combined. Consisting of interest on investments, fees for seminars and workshops, and miscellaneous income, the other revenues for the Sections Fund amounted to about \$700,000. During our 1996 audit, we found that the State Bar had used mandatory fees collected from members and deposited in its general fund to pay the salaries and related administrative costs of section administrators and other support staff. During our current review, we found that the State Bar has made adjustments to its cost centers and program structures that allow it to better isolate section activities and help ensure that mandatory fees do not support section activities.

NEW COST ALLOCATION PLANS DISTRIBUTE ADMINISTRATIVE COSTS AMONG MANDATORY AND VOLUNTARY PROGRAMS

The State Bar is changing the way it allocates administrative costs to allow for an equitable distribution of these costs to its mandatory and voluntary programs. In 1999, the State Bar contracted with a consultant to develop a new method for allocating administrative costs, and the consultant devised two cost allocation plans (allocation plans). 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 Allocation Plan Allows the State Bar to Distribute Costs Fairly

The first allocation plan, referred to as the indirect allocation plan, provides a method for allocating to all programs the administrative costs that do not clearly relate to a particular program. Costs that benefit a particular program are excluded from the indirect allocation plan; instead, the State Bar charges such costs to the program that the costs benefit directly. The indirect allocation plan requires that all costs fall under two categories: administrative cost pools and program areas. The State Bar's administrative costs are grouped into the following eight administrative cost pools: administration and support management, property-related services, general counsel, governance, library, human resources and payroll, information technology, and finance. The 19 program areas represent *cost centers*, or combinations of various costs. For example, the program area for the State Bar Court consists of 11 different cost centers, such as presiding and review judges, hearing judges, and State Bar Court reporter.

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 square footage. 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.

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 so that no costs remain in the pools after the allocations. The total costs of \$9,542, \$11,071, and \$15,387 reflected under State Bar Court, Client Security Fund, and Sections Fund, respectively, 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 Italics)**

	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
	↳	<i>1,160</i>	<i>783</i>	<i>2,045</i>	<i>814</i>	<i>198</i>
		\$5,160				
		↳	<i>1,675</i>	<i>410</i>	<i>872</i>	<i>2,203</i>
			<i>5,458</i>			
			↳	<i>1,087</i>	<i>1,385</i>	<i>2,986</i>
Total Costs After Allocation				\$9,542	\$11,071	\$15,387

* 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 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 Allocation Plan Helps the State Bar Determine the Amount for Voluntary Dues

The consultant developed a second allocation plan, referred to as the section-specific allocation plan, to help the State Bar's 18 sections determine appropriate dues to charge members who voluntarily participate in the sections' activities. This allocation plan identifies the following five cost categories for each section: costs allocated from the indirect allocation plan described above, direct section support costs, membership billing, Council of Sections chairs, and lobbyist costs. For example, direct section support costs represent the costs related to the permanent support staff that handles each section's business. The State Bar allocates to each section both the direct section support costs and the costs allocated to the program area specified in the indirect allocation plan according to the number of staff assigned to that section. This method provides an equitable way to determine the total costs for each section's functions.

The Two New Allocation Plans Address Concerns Raised in Our 1996 Audit

In helping to ensure a fair distribution of funds among the State Bar's mandatory and voluntary activities, the new allocation plans address three recommendations from our 1996 audit. Specifically, the State Bar has taken the following actions:

- To ensure that the basis the State Bar uses to allocate administrative costs to the Sections Fund reflects the benefit derived from the administrative costs, the State Bar now intends to allocate indirect administrative costs to the Sections Fund as part of the indirect allocation plan. The State Bar then can allocate costs in the Sections Fund among the individual sections as part of the section-specific allocation plan.
- To make certain that it allocates the costs for its risk management activities to the funds that benefit from these expenses, the State Bar includes as part of the administrative cost pool for property-related services the cost center for risk management, which covers costs for earthquake and other

types of insurance. The State Bar intends to allocate this cost pool according to the square footage occupied by each program area.

- To make sure that the State Bar allocates its administrative costs to each program area supported by the State Bar's general fund, the indirect allocation plan now calls for allocating among all such program areas any administrative costs that remain in the State Bar's general fund.

These all seem to be reasonable actions that respond to our recommendations.

THE STATE BAR MONITORS RESPONSIBLY THE LEVEL OF MANDATORY FEES IT CHARGES

The State Bar has taken steps to ensure that its mandatory fees are reasonable and necessary. In reviewing the State Bar's year-end financial statements for 2000, we had initial concerns about the size of the fund balances remaining in the State Bar's general, Client Security, and Discipline funds. After further inquiry, we learned that the State Bar reduced the balance in its general fund and has reasonable plans to use remaining resources in all three funds.

For the year 2000, the State Bar's actions reflected good stewardship of the mandatory fees that it collects from attorneys practicing in California.

For the year 2000, the State Bar's actions reflected good stewardship of the mandatory fees that the State Bar collects from attorneys practicing in California. Its general fund revenues exceeded expenses by about \$15.1 million during 2000, and the fund balance at year-end amounted to almost \$13.4 million. In addition, the total amount of cash and investments in the fund at December 31, 2000, exceeded \$30.4 million and surpassed total fund liabilities by about \$12.4 million. This surplus occurred primarily because the State Bar is rehiring and recruiting new staff after its virtual shutdown and has been unable to fill all its vacancies. As a result, its actual payroll costs were much less than budgeted. Before the end of 2000, the State Bar realized it was accumulating a surplus and decided to reduce the mandatory membership fee by \$50 for 2001. The State Bar expects that this fee reduction will absorb about \$7 million of the \$15 million operating surplus. Instead of taking out a loan, the State Bar plans to use the remaining \$8 million to complete some delayed construction primarily at its San Francisco headquarters. In addition, the State Bar expects that payroll costs will be less than budgeted for 2001 because of a tight labor market that will give

rise to staff vacancies that are higher than normal through the first half of 2001. Therefore, the State Bar believes the mandatory fee of \$345 for 2001 will be sufficient to maintain services and activities in a financially responsible manner.

Although not as significant as the operating surplus in the State Bar's general fund, a large increase occurred in the Client Security Fund's balance during 2000. Growing by about \$2.4 million to about \$9 million, this balance reflects, according to State Bar officials, a slowdown in the number of claims received because of the State Bar's virtual closure. Specifically, in 1998 and 1999 the State Bar received an average of 632 new claims of financial loss due to attorney misconduct. This figure represents a little more than half the average number of claims (1,129) it had received in each of the previous six years. Although the number of new claims received in 2000 increased to 1,049, the number of claims is still below the average before the shutdown. In addition, the State Bar expects that it will need to pay about \$2.7 million for outstanding claims at the end of 2000. Further, it is conceivable that the State Bar could receive additional claims for losses incurred in 1998 and 1999 because claimants generally have four years to file for reimbursement. Therefore, the State Bar believes it would be premature to consider adjusting that portion of the membership fee that supports the Client Security Fund until claims activity settles into a more predictable pattern.

Although a large increase occurred in the Client Security Fund's balance during 2000, the State Bar believes it is premature to adjust the portion of the membership fee that supports the fund.

Finally, about \$4 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 use of funds collected from the assessment. State Bar officials told us they plan to use the remaining funds according to the special master's final recommendations. In other words, the funds 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. ■

CHAPTER 3

The State Bar Does Not Consistently Follow Its Improved Procedures for Using Purchasing Cards, Charging Its Business Expense Account, and Awarding Contracts

CHAPTER SUMMARY

The State Bar of California (State Bar) has established controls over the purchasing card program used by its employees. However, it must clarify which purchases constitute appropriate business expenses. Additionally, the State Bar should clarify which costs employees should charge to the State Bar's business expense account. In addition, the State Bar must enforce more strictly its policy requiring receipts from employees who use the purchasing cards. Although the problems we identified in the use of purchasing cards involved less than \$8,000, weaknesses in controls increase the risk that employees could abuse the purchasing card program.

Also, the State Bar has developed a competitive bid methodology for attracting and awarding contracts, but the procedures are not always followed. Furthermore, payments are not always made in accordance with contract terms. Finally, we found two instances in which vendors provided services to the State Bar without prior authorization. Because of these weaknesses, the State Bar cannot be sure that the price it pays for goods and services is competitive or reasonable and that purchases are necessary.

Unless it can ensure that expenditures of members' funds are proper, the State Bar risks losing credibility with its members. Moreover, because it accepts as part of its duties the improvement of judicial administration for all Californians, the State Bar must demonstrate that it can administer members' funds fairly.

BACKGROUND

According to the State Bar, it implemented the purchasing card program to save money and increase its employees' efficiency. The purchasing card is similar to a personal credit card, but the

State Bar has liability for the charges and each cardholder has transaction and monthly limits. Managers determine which employees should hold purchasing cards. A State Bar senior executive approves spending limits for each transaction and for each month, while the State Bar's Office of Finance reviews and assigns these limits as appropriate.

Although the State Bar has established policies and procedures for the use of its purchasing card, we identified some questionable expenditures.

State Bar policy states that cardholders may use the purchasing card to pay for any approved merchandise or services required for their duties at the State Bar. In addition, the policy specifies that, except in highly unusual situations, employees may not use the purchasing card to buy items for personal use even if the cardholder intends to reimburse the State Bar. Furthermore, State Bar policy requires cardholders to keep all receipts and packing slips and to submit them with their monthly statements for approval and payment. Specifically, the travel policy states that original receipts for lodging, taxi, air travel, car rentals, and any expenditure of \$25 or more must be attached to the expense report. According to State Bar accounting staff, the travel expense policy requiring receipts for expenses exceeding \$25 is the rule that applies to purchasing card charges generally.

In our 1996 audit, we noted that the State Bar's policy did not require those who procured goods and services to obtain competitive bids before selecting a contractor. Since that time, the State Bar has improved its procedures for contracting. The State Bar has developed policies regarding when competitive bids are required and how many bids are required. In general, competitive bidding is required only for purchases exceeding \$1,000. At least two oral bids are required for purchases between \$1,000 and \$14,999. At least three written quotations are required for purchases between \$15,000 and \$49,999. Finally, State Bar policy requires staff to solicit more formal and specific bids or proposals from interested vendors for purchases of \$50,000 or more.

Controls over employee expenditures are essential. Indeed, elements of a satisfactory system of internal accounting and administrative control should include a system of authorization and record-keeping procedures adequate to provide effective management of assets, liabilities, revenues, and expenditures. Such systems separate duties related to financial transactions between two or more people so that one person's work serves as a check on another person's work. When detected, weaknesses should be corrected promptly. Internal controls are necessary to provide public accountability and to minimize fraud, abuse, and waste of funds. In addition, by maintaining internal accounting and

administrative controls, entities such as the State Bar can be reasonably certain that their administrative measures are protecting members' assets, providing reliable accounting data, promoting efficiency, and encouraging adherence to managerial policies.

PURCHASING CARD POLICIES HAVE STRENGTHENED CONTROLS OVER TRAVEL AND MINOR BUSINESS EXPENSES, BUT THEY NEED ADDITIONAL IMPROVEMENTS AND EMPLOYEES MUST FOLLOW THEM CONSISTENTLY

Although the State Bar's purchasing card policy has strengthened controls over employees' travel and minor business expenses, the policy outlining which business expenses are appropriate needs further clarification. Additionally, the State Bar should define the business expenses that employees may charge to purchasing cards or to the business expense account, and it needs to follow its policy requiring receipts from employees. In examining a sample of 36 monthly purchasing card statements totaling \$154,717, we identified \$4,426 in questionable expenses. If the State Bar lacks adequate controls over employee expenditures, its members may be paying for charges that do not relate to the organization's essential functions.

One questionable payment involved a \$934 charge to the General Fund for limousine service to transport members of the Board of Governors from their hotel in Oakland to a party at a private residence in Danville.

One questionable payment involved an employee charging \$934 to the State Bar's general fund for limousine service to transport members of the Board of Governors of the State Bar from their hotel in Oakland to a party at a private residence in Danville. The invoice shows that part of the charge was for two drivers spending five and one-half hours waiting to transport the passengers back to their hotel. Furthermore, the \$934 included a \$114 gratuity charge. The employee used the purchasing card to pay for an additional \$85 in gratuities. Thus, the drivers received a total of \$199, or a 24 percent tip. We believe the State Bar could have found more economical, prudent ways to transport the participants to this event.

According to another statement in our sample, a different employee charged \$2,885 for a reception and dinner for five retiring judges and a limited number of guests. The State Bar's accounting staff told us that hosting an event for retiring judges is common practice, but the State Bar could not provide a list of individuals who attended the event. The employee who organized the event explained that 40 people were invited to the reception

for which the State Bar paid \$2,385. The employee charged \$500 to the purchasing card as a deposit for the dinner to which 21 people were invited. Each person who attended the dinner paid \$50 to an individual who used the funds to pay the difference between the \$500 deposit and the actual cost of the event. According to the State Bar's accounting unit, none of the money collected from attendees was used to reimburse the State Bar, nor was the State Bar involved in accounting for any of the \$50 collected from attendees of the dinner. Although the State Bar reallocated \$2,835 of its costs for the dinner and reception to its business expense account (designed for discretionary spending), these charges do not appear reasonable or prudent in that they benefited only a few individuals and not the membership as a whole.

Designed for discretionary business purchases, the State Bar's business expense account is usually available to senior executives who use it at their discretion in the course of their duties. However, because the State Bar leaves to the executives' discretion any decisions about the account's use, and because it has not defined purchases that constitute reasonable business expenses, it may be spending its funds in ways that do not serve its members' best interests.

Further, the State Bar has allowed its senior executives to exceed the amounts budgeted for their discretionary spending. Specifically, the State Bar budgeted \$11,970 from its general fund for the business expense account in 2000, but it allowed senior executives to spend \$17,505. According to the State Bar's accounting staff, the size of the business expense account's budget is intended to limit the amount of discretionary spending. Because this account was over its budget by at least \$5,535, or 46 percent, the account's budget clearly does not function as an adequate control. Furthermore, during our review of 36 monthly statements for purchasing cards, we found \$641 in general fund charges that should have been charged to the business expense account but were not.

***Senior executives
overspent the \$11,970
budget for their
discretionary business
expense account by
\$5,535, or 46 percent.***

In addition to overcharging and incorrectly charging its business expense account, the State Bar has not consistently required employees to submit receipts for job-related purchases. Although State Bar policy states that all expenses exceeding \$25 require a receipt, the State Bar paid \$2,613 in purchasing card charges for which the cardholders provided no receipts. For example, the State Bar paid a \$1,428 hotel bill that was not supported with a copy of the hotel's detailed bill. The cardholder reported that

she lost the hotel bill and five other receipts from that particular monthly statement. Total charges submitted without receipts by this individual for that month totaled \$2,011. Although duplicate receipts are not as reliable as originals, and it is possible that the cardholder would not be able to obtain duplicate receipts for all charges, the cardholder should have been able to obtain a copy of her bill from the hotel. Without such support, it is difficult to assess the appropriateness of the charges or their compliance with State Bar policies. After we inquired about the missing receipts, the cardholder located the hotel receipt and submitted it to State Bar accounting. However, the receipt should have been provided in the first place to verify the reasonableness of the charges before payment was made.

THE STATE BAR GENERALLY FOLLOWS ITS IMPROVED PROCEDURES FOR CONTRACTING, BUT SOME WEAKNESSES STILL EXIST

Contracts are agreements to do or provide certain things in exchange for payment. Contracts set forth terms, conditions, and the statement of work to be performed. A purchase order, a type of contract, also requests goods or services from outside vendors. The State Bar's competitive bidding policy applies to both purchase orders and contracts.

When the State Bar does not follow its procedures, it cannot be sure it receives a competitive price for the goods and services it purchases and that purchases are appropriate or necessary.

For most of the contracts and purchase orders tested, we found that the State Bar adhered to its improved controls over contracting. However, in our sample of 48 contracts and purchase orders totaling \$1,692,176, we identified five instances in which control procedures were not followed. As a result of these weaknesses, the State Bar cannot be sure it receives a competitive price for the goods and services it purchases and that purchases are appropriate or necessary.

We found two examples in which State Bar employees appeared to split a single purchase into two separate purchase orders to avoid competitive bidding requirements. In the first example, \$2,993 for typesetting and \$14,827 for printing one publication were placed onto two sequentially numbered purchase orders. While State Bar staff obtained two oral bids for each purchase order, it obtained the bids from the same two vendors in each case. Ultimately, the State Bar issued both purchase orders to one of the two vendors. The total of the two purchase orders exceeded \$15,000, an amount that requires three written bids. The manager of the unit maintains that the printing and the typesetting of

this publication were considered to be separate services that warranted different purchase orders. We believe this should have been considered one transaction.

In the second case, the State Bar issued two separate purchase orders on the same day for printing multiple copies of a particular informational pamphlet, one for \$994 and the other for \$985. Consolidating the printing onto one purchase order would have caused the dollar value to exceed \$1,000, thereby requiring two oral bids. State Bar purchasing staff discovered this issue and required consolidation of the printing of the informational pamphlets on subsequent purchase orders. In fact, we found that two oral bids were solicited appropriately when a subsequent purchase order for printing of these pamphlets exceeded \$1,000.

We also found one contract for services that did not contain a sufficient description of the terms affecting the contract price. Specifically, the contract stated that the billing rate per hour would be \$154. In contrast, the invoices submitted to and paid by the State Bar were based on a billing rate of \$170.96. State Bar accounting staff stated that the additional charges were to cover surcharge fees including standard payroll taxes. However, the contract did not specify a price for these additional services. In addition, the contract did not specify any range or set any upper limit for these charges. Therefore, the State Bar had no protection against exorbitant or excessive costs. Furthermore, State Bar policy requires that each contract include a detailed breakdown of costs, including the rate of payment and a payment schedule. It also requires that vendors itemize charges on the invoices they submit. However, the invoices for this contract included only a single hourly rate and provided no breakdown between the labor charge and the surcharge fee.

Finally, we identified two instances in which outside vendors provided services to the State Bar without prior authorization. State Bar policy states that all purchases must have prior approval. Specifically, the policy states that if a supplier provides goods or services to a State Bar employee without first receiving a purchasing card authorization, purchase order, or contract, that supplier accepts the possibility that the State Bar may refuse to pay. Without prior authorization, the State Bar cannot ensure that purchases are necessary or prudent.

RECOMMENDATIONS

To maintain better control over its purchasing card program and business expense account, the State Bar should:

- Clarify its policies about purchases that constitute appropriate business expenses.
- Ensure that business expenses are appropriate and do not exceed the budgeted amount by requiring employees to charge all discretionary spending to the business expense account. The State Bar also should monitor the total charges to this account to prevent its exceeding the account's budget.
- Make certain that employees use purchasing cards appropriately by enforcing its policy requiring receipts for purchases exceeding \$25.

To ensure it receives a fair price for goods and services and that purchases are necessary, the State Bar should enforce more strictly its contracting policies and procedures.

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 25, 2001

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Agency's comments provided as text only.

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April 11, 2001

Ann Campbell, Audit Principal
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Sacramento, California 95814

Dear Ms. Campbell,

Here is a printed copy of our response to your audit report about the State Bar of California. We have also enclosed on diskette a copy in ".txt" format so you can edit into your report.

If you have any questions please do not hesitate to call me at (415-538-2295) . Thank you for the opportunity to respond.

Sincerely,

(Signed by: Mark Shannon)

Mark Shannon
Chief Financial Officer

Enclosures

Response to State Audit Report

Agency Comments

The review of the State Bar of California operations and performance by the Bureau of State Audits for the period July 1, 2000 through December 31, 2000 is both helpful and rewarding. The report is helpful in that the recommendations will strengthen our programs and administrative controls and rewarding in that our strategies to rebuild the discipline system and appropriately manage member fees are validated.

The State Bar of California does not dispute any of the findings or conclusions of the Bureau of State Audits. We agree with all of the recommendations contained in the report and will develop plans to address them promptly. Our response to the recommendations will be discussed in detail at the end of the audit report and we will periodically update the Bureau of State Audits on our progress in the future.

As the State Bar of California improves its operations by implementing the proposed recommendations we look forward to the next operational audit by the Bureau of State Audits in the year 2003.

Chapter 1

Recommendation

To improve recovery costs related to its Discipline and Client Security programs, the State Bar should maximize the costs it can recover by using figures for current salary costs to update the cost model.

Response

The State Bar agrees. As soon as possible the State Bar will contract with the consulting firm which developed the existing cost models approved in February of 1998 to update them based upon current salaries. The State Bar will continue to contract with a provider of professional expertise in the continuing development and updating of the discipline cost recovery models on a periodic basis.

Recommendation

In addition, the State Bar should pursue additional collection efforts, such as participation in the State's Offset Program, which allows the State Controller's Office and the Franchise Tax Board to offset from an individual's tax refund the amounts owed to state agencies that have been unsuccessful in collecting fees from the individual.

Response

The State Bar agrees with this recommendation as it did when the same recommendation was made by the bureau of State Audits in 1996. Based upon meetings in 1996 with the Franchise Tax Board's Inter agency Intercept Collection Program and our Office of General Counsel it was determined that legislation would be required for the State Bar to participate in this program. The audit report correctly states that the State Bar did attempt to find an author for this legislation in 1997 but was unsuccessful. In subsequent years the focus of the bar's legislative efforts was restoring funding and this project was not pursued. The State Bar will renew its efforts to structure legislation and find a author for it which will allow us to participate in this program.

Chapter 2

(No recommendations)

Chapter 3

Recommendation

To maintain better control over its purchasing card program and business expense account, the State Bar should take the following actions:
Clarify its policies about purchases that constitute appropriate business expenses

Response

The State Bar agrees. A new definition for "business expense account" will be developed. In addition, certain types of transactions determined to be an "inappropriate" use of the business expense account, or State Bar funds, will be identified as well and included in a resulting

Administrative Advisory. Existing policies related to business expense and Purchasing-Card usage will be reviewed, revised as necessary and redistributed to all employees.

Recommendation

Ensure that business expenses are appropriate and do not exceed the budgeted amount by requiring employees to charge all discretionary spending to the business expense account. The State Bar should also monitor the total charges to this account to prevent its exceeding the accounts budget.

Response

The State Bar will make sure certain business expenses are appropriate by advising employees what are appropriate and inappropriate business expenses. Employees will be directed to charge all business expenses to the business expense account. The Bar will monitor on a quarterly basis the business expense accounts with the respective Senior Executives to make certain of the appropriateness of the charges.

The State Bar also agrees that total charges to the business account not exceed the total budget for this line item. As the auditors noted the budget for these expenses was exceeded by over \$5,000. However, the budgeted amount for business expense activity was just under \$12,000 annually. This amount needs to be reviewed for its adequacy. Since there are eleven Senior Executives and at least one business expense account in each of their areas we should ensure that the budgeted amounts are adequate to cover today's business expense needs. Once the appropriate budget level is established, the budget can once again be an effective tool in controlling business expenses.

Recommendation

Make certain that employees use purchasing cards appropriately by enforcing its policy requiring receipts for purchases over \$25.00.

Response

The State Bar agrees. Although the need for receipts for purchases of \$25.00 or more tracks the bar's policy with regard to travel reimbursement claims a separate administrative advisory with regard to Purchasing-cards needs to be issued. Purchasing-card statements with purchases not supported by an invoice, receipt or packing slip will require a written justification and additional

approval of the Senior Executive. Users will be advised that Purchasing-card purchases without appropriate documentation or explanation will be rejected and be the responsibility of the card holder.

Recommendation

To ensure it receives a fair price for goods and services and that purchases are necessary, the State bar should more strictly enforce its contracting policies and procedures.

Response

The State Bar agrees. The internal Task Force which developed the State Bar of California General Procurement Manual and contracting guidelines will reconvene to review the existing policies and the first nine months experience with this program. They will clarify and strengthen policies and procedures as necessary and plan refresher training for responsible staff. Additionally, managers will be advised that added emphasis will be placed on the "fiscal responsibility" category of their annual performance reviews. Exceptions and anomalies which occur in the contracting and purchasing activities will be identified as they occur and the appropriate Senior Executive notified.

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