

# California State Auditor

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

## **State Bar of California:**

*It Should Continue Strengthening Its Monitoring of Disciplinary Case Processing and Assess the Financial Benefits of Its New Collection Enforcement Authority*



April 2005  
2005-030

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# CALIFORNIA STATE AUDITOR

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April 28, 2005

2005-030

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

Dear Governor and Legislative Leaders:

As required by Chapter 342, Statutes of 1999, the Bureau of State Audits presents its audit report concerning the State Bar of California's (State Bar) disciplinary process, cost recovery efforts, and financial outlook.

This report concludes that the State Bar continued to monitor its backlog of disciplinary cases that resulted from its virtual shutdown in 1998. At the end of 2004, it reported 402 cases in the backlog compared with 401 cases at the end of 2002 and 1,340 cases at the end of 2000. In addition, the State Bar's semiannual reviews of randomly chosen disciplinary cases in 2004 disclosed deficiencies similar to those found in its 2002 random reviews, such as missing or inadequate explanations of case dispositions. To address these deficiencies and in response to our 2003 audit recommendations, the State Bar developed a brief checklist to guide staff in processing disciplinary cases. However, its staff did not always use the checklist and it is not sufficiently comprehensive. The State Bar also adopted a policy to spot check open disciplinary cases to ensure that staff are maintaining files properly and handling complaints correctly. However, we found that staff did not consistently perform the requisite number of spot checks and sometimes failed to document the results. Further, the State Bar's recoveries of disciplinary costs and Client Security Fund payments remained low. Therefore, to subsidize these costs, it used a larger portion of the membership fees it collected than it would have if its recovery rates were higher. Although a law effective in January 2004 improved its ability to recover past and future costs, the State Bar has not yet been able to use this new authority because it is waiting for approval of certain administrative procedures by the California Supreme Court. Finally, the State Bar is pursuing a revenue increase to help reduce projected deficits in its general fund and Client Security Fund.

Respectfully submitted,

ELAINE M. HOWLE  
State Auditor

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# SUMMARY

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## Audit Highlights . . .

*Our review revealed that the State Bar of California:*

- ☑ *Continued to monitor its backlog of disciplinary cases and reported 402 cases in the backlog at the end of 2004.*
  - ☑ *Continued to conduct semiannual reviews of disciplinary case files; however, it noted deficiencies similar to those found in its 2002 reviews.*
  - ☑ *Developed a checklist for case files and adopted a policy to spot check active cases as we recommended, but the checklist is not comprehensive and staff have not consistently performed the spot checks.*
  - ☑ *Obtained additional legal authority to collect money related to disciplinary cases, but needs approval of administrative procedures before it can implement the new authority.*
  - ☑ *Is pursuing an increase in revenues from membership fees to help reduce projected deficits.*
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## RESULTS IN BRIEF

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

Various sources, including our May 1996 audit titled *State Bar of California: Opportunities Exist to Reduce Fees, Better Control Administration and Planning, and Strengthen an Improved Discipline Process*, had indicated that the State Bar was not managing its resources effectively. In 1997 the governor vetoed legislation that would have authorized the State Bar to continue assessing a base annual membership fee, which it used to support its disciplinary function and other operations the State Bar pays for from its general fund. With its membership fees drastically reduced, the State Bar was forced to find ways to cut costs and significantly curtail its activities, which led to a backlog of 2,217 disciplinary cases in 1998. Subsequent statutes passed in 1999 and later years allow the State Bar to charge a base annual membership fee until January 2006.

In our April 2003 audit, *State Bar of California: Although It Reasonably Sets and Manages Mandatory Fees, It Faces Potential Deficits in the Future and Needs to More Strictly Enforce Disciplinary Policies and Procedures*, we reported on the State Bar's efforts to address the backlog of disciplinary cases, such as reorganizing its staff, creating a backlog team, and adopting a policy of 60-day case resolution. As it continued to monitor its backlog, the State Bar reported 402 cases in the backlog at the end of 2004 compared with 401 cases at the end of 2002 and 1,340 cases at the end of 2000. In addition, it processed almost the same number of disciplinary cases in 2004 as in 2002.

The State Bar also continued to conduct semiannual reviews of randomly chosen disciplinary case files to ensure that staff actions are appropriate and consistent with case law and with the State

Bar's policies, standards, and priorities. The two reviews conducted in 2004 disclosed deficiencies similar to those found in the State Bar's 2002 random reviews. In 2004 the State Bar established an audit and review unit that reports directly to the chief trial counsel and is independent of the groups that process disciplinary cases. Among its various tasks, the audit and review unit conducted the second review of randomly chosen cases in 2004.

One of the recommendations in our April 2003 audit report stated that the State Bar should use a checklist to guide staff in processing disciplinary cases, perform spot checks of active case files, and require staff to resolve any issues noted in the spot checks to ensure that they consistently follow policies and procedures for processing disciplinary cases. Although the State Bar developed a brief checklist, which it calls an investigation file reminder (file reminder), it has not established a written policy requiring staff to use it. We also found that State Bar staff have not used the file reminder consistently. Moreover, the file reminder is not an effective tool because it is not sufficiently comprehensive. In 2004 the State Bar also adopted a spot-check policy. However, we found that its staff did not always comply with this policy. In particular, we found that staff did not consistently perform the requisite number of spot checks and sometimes failed to document the results. Therefore, the State Bar has less assurance that its staff are following policies and procedures when completing and maintaining disciplinary case files.

The State Bar still has trouble collecting money related to disciplinary cases. Because its cost recoveries remain low, the State Bar must subsidize its Client Security Fund and pay disciplinary costs using a larger portion of the membership fees it collects than it would if its recovery rates were higher. A law effective January 2004 improved the State Bar's ability to recover not only future costs but also some portion of the \$64 million in billed costs that remain unrecovered as of December 2004. However, the State Bar has not yet been able to use this new authority because it is waiting for approval of certain administrative procedures by the California Supreme Court.

Based on the State Bar's financial forecast, the combined balance of its general fund, which accounts for activities related to the disciplinary system, and its Public Protection Reserve Fund, which was established to ensure the continuity of the disciplinary system, will sink into a deficit of \$13.8 million by the end of 2008 unless revenues from membership fees increase.

The forecast assumes a significant increase in staff salaries and wages beginning in 2006 and no change in membership fees. For its general fund the State Bar predicts that expenses will exceed revenues starting in 2005, which will eventually use up the surplus in the general fund. The State Bar also predicts that its Client Security Fund, which it uses to help alleviate the financial losses suffered by clients of dishonest attorneys, will have a deficit by the end of 2006. To avoid projected deficits, the State Bar has proposed a bill that would increase its membership fees by \$5 for active members and \$95 for inactive members and would change the criteria for active members to qualify for a partial fee waiver. If approved, these changes would become effective on January 1, 2006.

## **RECOMMENDATIONS**

The State Bar should continue its efforts to control its backlog of disciplinary cases.

To ensure that employees follow procedures for processing disciplinary cases, the State Bar should:

- Establish a written policy requiring staff to maintain a checklist of the important steps involved in processing disciplinary cases and include all necessary documents in every case file.
- Develop a more comprehensive checklist and require supervisors to ensure that each case file includes a checklist and that staff use it.
- Enforce its policy of spot checking the files of active disciplinary cases.

To ensure that it maximizes the benefits of its new collection enforcement authority, the State Bar should prioritize its cost recovery efforts to focus on attorneys who owe substantial amounts related to disciplinary costs and payments from the Client Security Fund.

To ensure that its fees are set at reasonable levels, the State Bar should continue to update its forecast for key revenues and expenses as new information becomes available.

## **AGENCY COMMENTS**

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

# INTRODUCTION

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## BACKGROUND

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

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

In 1997 the governor vetoed the bill that would have authorized the State Bar to continue to assess a base annual membership fee, which it used to support its disciplinary function and other operations the State Bar pays for from its general fund. Thus, the State Bar could only charge certain fees that were authorized in statute. Subsequently, Chapter 342, Statutes of 1999 (Chapter 342), authorized the State Bar to assess a base annual fee of up to \$318 per member until January 1, 2001. Currently Chapter 384, Statutes of 2004, authorizes the State Bar to charge a base annual fee of up to \$310 per member until January 1, 2006. In combination with other fees specified in existing statutes, this brought the total fee to \$390 per member for 2004. Additionally, Chapter 342 requires the State Bar to contract with an independent public accounting firm to conduct an audit of its financial statements for each fiscal year after December 31, 1998. The legislation also directs the State Bar to contract with the Bureau of State Audits to conduct a performance audit every two years. We issued the first performance audit report in April 2001 and the second in April 2003.

## SCOPE AND METHODOLOGY

As directed by Chapter 342, our audit is of the State Bar's operations from January 1, 2004, through December 31, 2004. This legislation does not state specific topics the audit should address. In planning the current audit we reviewed the recommendations we made in our 2003 audit. During the 2003 audit we identified three principal areas: the State Bar's processing of disciplinary cases; cost recovery as part of processing disciplinary cases; and the use of mandatory and discretionary funds to support State Bar functions, including legislative activities.

To review its processing of disciplinary cases, we obtained and reviewed the State Bar's policies, training bulletins, case backlog and processing statistics, and documentation of the 2004 semiannual reviews of randomly chosen case files. We also reviewed a sample of case files to assess staff compliance with the policies and procedures of the State Bar and to evaluate whether it had implemented the recommendations in our 2003 report. To determine the status of its cost recovery efforts, we obtained and reviewed key statistics and reports summarizing amounts the State Bar billed and recovered related to its processing of disciplinary cases. We also interviewed State Bar officials to determine whether there were any changes in its cost recovery process. In addition, we reviewed pertinent laws related to its collection enforcement authority. To determine whether the State Bar continued to monitor the necessity of a fee increase, we assessed key fund balances and reviewed its financial forecasts for 2005 through 2008.

In our 2003 audit we determined that the State Bar had a system in place to account for mandatory and discretionary funds. The State Bar has since changed its indirect cost allocation process. In the past it used a step-down process to allocate its indirect costs. Since 2003 it allocates the indirect costs only to program areas that are responsible for those costs. To facilitate the new allocation process, it created a new fund. We limited our efforts to understanding this new process, which we found to be reasonable. Therefore, we did not further test the propriety of the allocation process. Moreover, we inquired about the balance in the Discipline Fund, which we reported in our 2003 audit as having \$2.6 million available for spending. At the end of 2004 the fund balance was \$1.5 million. We determined that the State Bar plans to use most of the remaining balance for a case-tracking system.

Finally, we inquired whether the State Bar has finalized its operational plan, which contains desired outcomes and performance indicators for gauging the results achieved under its strategic plan. We determined that the State Bar's board of governors approved the operational plan in September 2004. The State Bar indicated that it is now identifying ways to collect and track data related to the new performance indicators but does not expect to issue its first review on program measures until after 2006. As a result, we did not assess the strategic plan or the operational plan as part of this audit. ■

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# AUDIT RESULTS

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## THE CALIFORNIA STATE BAR CONTINUED TO MONITOR ITS CASE BACKLOG WHILE SEEING LITTLE CHANGE IN THE NUMBER OF DISCIPLINARY CASES IT PROCESSED

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*The State Bar reported a backlog of 402 cases at the end of 2004, which is almost identical to the backlog at the end of 2002.*

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The State Bar of California (State Bar) processed almost the same number of cases through its intake and enforcement units in 2004 as it did in 2002. In addition, although it reported that its backlog of disciplinary cases increased in 2003, the backlog it reported at the end of 2004 was 402 cases, which is almost identical to the backlog at the end of 2002. Even though the State Bar maintains an “aspirational goal” of reducing the backlog to 250 cases, it believes that having a backlog of about 400 cases may reflect the norm.

Through its intake and enforcement units, under the direction of the chief trial counsel and the State Bar Court, the State Bar operates a disciplinary process to investigate California attorneys who violate their clients’ trust. The State Bar prioritizes inquiries about attorneys to focus its resources and efforts on those that are most critical and to address the less serious inquiries to the extent that resources are available. This approach has not significantly changed since our last review. The intake unit receives allegations of improper conduct by attorneys from the general public and referrals from other sources such as courts, insurers, and law enforcement agencies. Inquiries that the intake unit determines warrant an investigation are forwarded to the enforcement unit. As a result of its investigation of complaints, the enforcement unit may either close a case or forward it to the State Bar Court to initiate formal disciplinary proceedings against the accused attorney. Table 1 on the following page provides a comparison of the number of inquiries and complaints processed by the intake and enforcement units in 2002 and 2004.

**TABLE 1**

**Summary of Inquiries and Complaints Processed by the Office of Chief Trial Counsel  
2002 and 2004**

Disciplinary Process	2002		2004	
	Inquiries and Complaints Processed	Percentage of Total	Inquiries and Complaints Processed	Percentage of Total
<b>Intake Unit</b>				
Total inquiries in intake closed or advanced	14,491		14,247	
Closed without discipline	8,938	62%	8,883	62%
Closed with alternative resolutions or resignations of attorneys pending	1,897	13	1,594	11
Advanced to investigation	3,656	25	3,770	27
<b>Enforcement Unit*</b>				
Total complaints resolved	4,465		4,703	
Closed without discipline	2,700	60	2,656	57
Closed with alternative resolutions or resignations of attorneys pending	794	18	912	19
Cases filed in State Bar Court	971	22	1,135	24

Source: State Bar’s disciplinary computer tracking system.

\* The enforcement unit includes the San Francisco and Los Angeles investigations and trial units.

The total number of inquiries that the intake unit closed or advanced to investigation in 2004 slightly decreased from 2002; however, the percentage of inquiries closed without discipline remained the same at 62 percent. In addition, the drop in cases that the intake unit closed with alternative resolutions or resignations of attorneys pending—from 13 percent in 2002 to 11 percent in 2004—was offset by an increase in inquiries the intake unit advanced to investigation—from 25 percent in 2002 to 27 percent in 2004. The 2004 data also indicate that the enforcement unit resolved more complaints overall and closed fewer complaints without discipline than it did in 2002. Further, the drop in complaints closed without discipline by the enforcement unit—from 60 percent in 2002 to 57 percent in 2004—was offset by an increase in the percentage of complaints the enforcement unit closed with alternative resolutions or attorney resignations pending and cases filed with the State Bar Court. Finally, in 2004 the enforcement unit filed 164 more cases in the State Bar Court than it did in 2002, which represents an increase of almost 17 percent.

As we indicated in our 2003 audit report, the State Bar's loss of revenue in 1998, caused by the suspension of its authorization to collect a base annual membership fee, prompted significant layoffs in the office of the chief trial counsel. As a result, the State Bar faced 2,217 disciplinary cases in its backlog by the end of that year. Backlog cases are investigations that are uncompleted at the year's end and remain pending in the system for more than six months or one year, depending on case complexity. Since 1998, the State Bar has made significant progress in reducing its backlog by implementing a series of initiatives to address

State Bar's Backlog Status at Year-End	
2000	1,340
2001	809
2002	401
2003	540
2004	402

its inventory of pending cases. It developed a system for prioritizing work, reorganized staff into specialized teams, adopted a policy of 60-day case resolution in its intake unit, and created a backlog team composed of experienced investigators in its enforcement unit. Further, the State Bar set an overall goal of no more than 400 backlog cases for 2002 and an "aspirational goal" of reducing the backlog to 250 cases by the end of 2003. As the text box shows, the actual number of cases the State Bar has reported in its backlog has decreased each year since 2000, except in 2003.

When we inquired about the cause for the spike in 2003, the State Bar's chief trial counsel told us that the increase was due to an unusual series of investigations and prosecutions that related to a particular law group and involved 21 investigators, seven paralegals, and two attorneys from his office. As a result, he views 2003 as an anomaly as it relates to the size of the backlog and that the year-end backlog numbers of 401 in 2002 and 402 in 2004 suggest the norm.

### THE STATE BAR NEEDS TO FULLY IMPLEMENT ITS PROCEDURES AND POLICIES FOR MONITORING DISCIPLINARY CASE PROCESSING

The State Bar's random reviews of its disciplinary case files indicate that staff still have not consistently followed policies and procedures when processing complaints filed against its members. In particular, in its 2004 semiannual reviews of randomly chosen case files, the State Bar identified some of the same deficiencies as it identified in its 2002 reviews. To address some of these issues, and in response to the recommendation we made in our 2003 report, the State Bar developed a checklist to ensure that staff complete important steps in processing complaints and include all necessary documents in every case

file. Further, in 2004 the State Bar instituted a policy requiring team leaders to periodically spot check active files. However, we found that staff have not consistently used the checklist and it is not sufficiently detailed. In addition, we found little evidence of compliance with the spot-check policy.

### **Periodic Reviews of Randomly Chosen Case Files Revealed That Staff Did Not Always Follow State Bar Policies and Procedures**

In September 2000 the State Bar established a policy that directed management to conduct periodic reviews of randomly chosen files of disciplinary cases to ensure that the staff's actions are appropriate and consistent with case law and the State Bar's policies, standards, and priorities. According to the September 2000 policy, after completing the reviews each manager would prepare a summary of findings, and the summaries would be consolidated into a final report for the chief trial counsel. The State Bar conducts reviews semiannually. In 2004 the San Francisco and Los Angeles Trial units conducted the first review. The second review was performed by the audit and review unit, which the State Bar created in August 2004. Reporting to the chief trial counsel, the new unit consists of experienced attorneys who are responsible for conducting the semiannual reviews that were previously done by assistant chief trial counsels and supervising trial counsels in the intake, investigations, and trial units.

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*The semiannual reviews the State Bar conducted in 2004 revealed case file deficiencies similar to those it found in 2002.*

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The first random review included a total of 84 files for the period of September 2003 through March 2004. The second review included a total of 283 inquires, investigation files, and trial files closed between February and September 2004 by various units in San Francisco and Los Angeles. Both reviews disclosed some deficiencies similar to those found in the State Bar's 2002 random reviews. Specifically noted were staff's failure to enter information into the computer database and send closing letters to complainants, poor record keeping and file maintenance, and missing or inadequate explanations of case dispositions.

### **The Checklist Created by the State Bar Is Not Used Consistently and Is Not an Effective Tool**

To help address deficiencies in how its staff process complaints filed against its members, the State Bar reported in its one-year response to our 2003 audit that it created a checklist for staff to use to ensure that they complete important steps in processing complaints and include all necessary documents in every case

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*Although the State Bar reported that it had implemented a checklist, staff have not used the checklist consistently and it does not include sufficient detail.*

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file. In our current review we found that the State Bar has instructed its investigators to use an investigation file reminder (file reminder) as a checklist. However, it has not established a written policy to require staff to use the file reminder. In addition, in reviewing 13 case files, we found that eight files did not include file reminders, and one file contained a blank copy of the form. Although the remaining four case files did contain completed file reminders, we saw no evidence that a supervisor had reviewed any of the 13 case files to ensure that staff were using the file reminders. As a result, although the State Bar reported that it had implemented a checklist, staff have not used the checklists consistently.

Moreover, in our view the State Bar's file reminder does not include sufficient detail to ensure that employees follow proper procedures for processing complaints and completing case files and that problems revealed in the semiannual reviews do not recur. Specifically, the file reminder contains only five tasks. However, processing a complaint and completing a file might require many other documents and steps beyond those five tasks. For example, the tool the State Bar's audit and review unit uses to conduct its semiannual reviews contains 49 tasks related to documents and steps that may be necessary to properly complete a case file. Although each of the 49 tasks may not apply to every case file, we believe such thoroughness is required if a tool is to be effective.

#### **Staff Have Not Always Complied With the New Spot-Check Policy**

In October 2004 the State Bar adopted a policy to spot check open disciplinary cases to ensure that staff are maintaining files properly and handling the complaints correctly. The policy requires each team leader to randomly check one currently active file each month for each investigator on his or her team. However, we found little evidence of compliance with the new policy.

For example, the Los Angeles units could not provide any evidence that they had conducted the spot checks as required. According to the chief trial counsel, although the team leaders in Los Angeles conducted the spot checks, it was an informal process and they did not complete any documents to record the results. At the San Francisco unit we found evidence that staff conducted only 12 spot checks. The team leader in the San Francisco unit supervises 12 investigators. Therefore, to comply with the State Bar's new policy, the team leader should have conducted 36 spot checks during the three-month period

from October through December 2004. The team leader told us that he obtained permission from his supervisor to spot check the case files of six investigators one month and those of the other six investigators the following month. Because the spot-check policy has not been fully implemented, the State Bar has less assurance that its staff are following policies and procedures when completing and maintaining disciplinary case files.

### **CHANGES IN STATE LAW MAY IMPROVE THE STATE BAR'S RECOVERY OF DISCIPLINARY COSTS AND CLIENT SECURITY FUND PAYMENTS**

Disciplining attorneys, the State Bar's primary function, protects the public, the court, and the legal profession from lawyers who fail to fulfill their professional responsibilities. According to the State Bar's unaudited financial statements for 2004, roughly \$40 million (82 percent) of its \$49 million in general fund expenses were associated with its disciplinary process. Its billing system showed that the State Bar billed attorneys \$1.1 million for costs related to processing their disciplinary cases. To at least partly alleviate the financial losses suffered by the clients of dishonest attorneys, the State Bar makes payments to those clients from the Client Security Fund and seeks reimbursement from the attorneys whose conduct gave rise to the payments. In 2004 the State Bar billed attorneys \$4.9 million for costs incurred by the Client Security Fund.

The State Bar's cost recovery rates in 2004 were comparable to its recovery rates in 2002; however, they remained low compared with the total amounts billed. Therefore, the State Bar used a larger portion of its membership fees to subsidize its disciplinary activities and the Client Security Fund than it would have with a higher recovery rate. In the past the State Bar had little success in recovering costs from disbarred attorneys or attorneys who resigned, in part because it lacked specific authority to pursue recovery of debts under the Enforcement of Judgments Law. However, based on legislation effective in January 2004, the State Bar now has the requisite legal authority, which may improve its ability to recover not only future costs but also some portion of the \$64 million in billed costs that remain unrecovered since 1990.

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*Because its cost recovery rates remained low, the State Bar used a larger portion of its membership fees to subsidize its disciplinary activities and the Client Security Fund.*

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As described in our 2003 audit report, the State Bar can recover from individual attorneys some of its costs for disciplinary activities. Sections 6140.5 and 6086.10 of the Business and Professions Code require the State Bar to charge attorneys it has

disciplined for certain costs related to its Client Security Fund and disciplinary proceedings. An attorney whose actions caused the State Bar to use the Client Security Fund to pay a claimant must reimburse the fund, and any action to publicly reprove or discipline an attorney requires the member to pay certain costs. Although the State Bar does bill attorneys it has disciplined, the amount collected is substantially lower than the amount it spends on processing disciplinary cases. One reason is that the Business and Professions Code limits the amount of recovery by excluding the costs for services of attorneys or expert witnesses. Further, the State Bar has the authority to collect costs from attorneys only when the State Bar Court publicly imposes discipline. As shown in Table 1 on page 10, only 24 percent of the complaints the enforcement unit resolved in 2004 were ultimately filed in State Bar Court. The State Bar is unable to recover costs when it closes a case without discipline or imposes alternative resolutions, or when the State Bar Court imposes discipline privately.

Table 2 indicates that the State Bar's cost recovery rates in 2004 were comparable to 2002 and continued to show improvement over the rates achieved in 2000. In 2004 the State Bar's cost recovery rate for discipline was 40.5 percent, an increase from the 36.4 percent rate in 2002. The cost recovery rate for the Client Security Fund declined slightly from 10.9 percent in 2002 to 10.7 percent in 2004. According to the chief trial counsel, the State Bar used the same billing practices related to disciplinary costs and payments from the Client Security Fund in 2004 as it used in 2002.

**TABLE 2**

**Billed and Recovered Costs Related to the Client Security Fund and Disciplinary Activities**

Year	Client Security Fund			Disciplinary Activities		
	Costs Billed	Costs Recovered	Percent Recovered	Costs Billed	Costs Recovered	Percent Recovered
2000	\$4,812,990	\$119,400	2.5%	\$1,079,922	\$311,061	28.8%
2002	4,475,737	489,909	10.9	1,010,668	367,881	36.4
2004	4,921,700	527,289	10.7	1,105,829	447,436	40.5

Source: State Bar's membership billing services.

According to the chief trial counsel, the reason the recovery rates for payments from the Client Security Fund are lower than for disciplinary costs is that the Client Security Fund only pays for the financial losses of clients whose attorneys acted dishonestly—by stealing clients' money, for instance. The chief trial counsel indicated that most of these attorneys have serious financial problems and rarely have any funds or assets that can be used to reimburse the Client Security Fund. The recovery rate for disciplinary costs related to attorneys who have been disbarred or who resign with disciplinary charges pending against them is not much different from the recovery rate for Client Security Fund payments. On the other hand, the chief trial counsel indicated that the cost recovery rate for disciplining attorneys who have been publicly reprimanded or suspended is much higher. He stated that most of these attorneys want to return to the practice of law and must pay the disciplinary costs to do so. Moreover, a significantly higher percentage of attorneys who owe disciplinary costs have the financial ability to pay compared with the percentage of attorneys who owe the Client Security Fund. In fact, according to the State Bar's billing data, more than 98 percent of the Client Security Fund billings in 2004 were related to attorneys who resigned or were disbarred. Of the discipline billings in 2004, only 36 percent related to such attorneys.

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***If the supreme court approves proposed amendments to the California Rules of Court, after obtaining a money judgment, the State Bar would be able to garnish wages or obtain judgment liens on real property the attorney owns.***

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Although the State Bar's cost recovery rates in 2004 remained low, statutory changes that became effective in January 2004 may help the State Bar recover a larger portion of costs in the future. Amendments to sections 6086.10 and 6140.5 of the Business and Professions Code passed by the Legislature allow the State Bar to enforce payment of disciplinary costs and Client Security Fund payments as money judgments. In addition, the State Bar has proposed to the California Supreme Court that the California Rules of Court be amended to enable it to carry out the statute. The proposed amendments, which the State Bar submitted to the supreme court in February 2005, would require the superior court clerk of the relevant county to immediately enter a judgment against an attorney for the amount the State Bar certifies the attorney owes for disciplinary costs or Client Security Fund payments. After obtaining the money judgment, the State Bar would be able to garnish wages or obtain judgment liens on real property the attorney owns. Until the supreme court approves the proposed procedures, the State Bar cannot exercise the money judgment authority.

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*As of December 2004 about 2,500 individuals owe \$55 million for Client Security Fund payments and about 4,500 individuals owe \$9 million in disciplinary costs.*

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It is also important to note that the amendments to the Business and Professions Code allow the State Bar to pursue money judgments for costs that were assessed before the effective date of the legislation. According to data from the State Bar's member billing system as of December 2004, about 2,500 individuals owe \$55 million for Client Security Fund payments and about 4,500 individuals owe \$9 million for disciplinary costs. In addition, some of these individuals owe substantial amounts. For example, the 100 individuals with the largest unpaid amounts related to the Client Security Fund owe about 54 percent of the total unrecovered payments. For disciplinary costs, the top 100 individuals account for 20 percent of the total amount the State Bar has not recovered. Currently, the State Bar has no estimate of how much it might be able to recover on amounts previously billed or how much its future recovery rates might improve once it begins pursuing money judgments. The chief trial counsel told us that the State Bar needs to perform some cost-benefit analyses to determine the likelihood of recovery on money judgments.

Finally, the State Bar is working on a legislative amendment that would allow it to settle for partial collection of its Client Security Fund payments. Existing law authorizes the State Bar to reach an agreement with an attorney for partial recovery of disciplinary costs. However, for the Client Security Fund payments, the State Bar is not allowed to accept anything less than the full amount. In certain cases the State Bar believes that attorneys who have provoked disciplinary actions and do not have enough assets to fully reimburse the Client Security Fund might wish to resolve their delinquent accounts by paying less than the full amounts they owe.

### **THE STATE BAR IS PURSUING A REVENUE INCREASE TO HELP REDUCE PROJECTED DEFICITS**

The State Bar predicts that deficits in its general fund and Client Security Fund will occur soon unless revenues from membership fees increase. According to its financial forecast, the general fund and Public Protection Reserve Fund will have a combined balance of only \$874,000 by the end of 2006. The State Bar also predicts a rapid decline in its Client Security Fund reserves, resulting in a negative fund balance of \$264,000 by the end of 2006. Assumptions made in its forecasts exclude the impact its new collection enforcement authority might have on cost recoveries. To avoid projected deficits, the State Bar has proposed a bill that would increase fees by \$5 for active members and \$95 for inactive

members and would change the criteria for active members to qualify for a partial fee waiver. If approved, these changes would become effective on January 1, 2006.

### **To Help Cover Projected Deficits in its General Fund, the State Bar Has Proposed a Fee Increase and Changes in the Fee Waiver Criteria**

The State Bar's 2004 unaudited financial statements indicate that the general fund's revenue of \$50.8 million exceeded expenses and transfers to other funds by \$2.2 million, resulting in a \$2.8 million fund balance at the end of 2004. However, its financial forecast shows that expenses will exceed revenues each year from 2005 through 2008 unless membership fees increase and the fee waiver criteria change. With support from its Public Protection Reserve Fund, the State Bar could forestall a deficit until 2007 if membership fees and the fee waiver criteria remain unchanged. The State Bar established the Public Protection Reserve Fund to ensure the continuity of its disciplinary system and its other essential public protection programs in the event of unexpected emergencies, such as occurred in 1997 when the State Bar was unable to obtain timely statutory authorization to assess and collect annual fees. According to the State Bar's executive director, the fund should not be used to offset anticipated deficits given the ongoing financial instability caused by the requirement that it seek statutory authority to collect member fees, typically on an annual basis. Nevertheless, balances in the fund represent available resources that the State Bar could use to reduce the impact of projected deficits.

As of December 2004 the Public Protection Reserve Fund had \$5.4 million available that, when combined with the balance in the general fund, resulted in a fund balance of \$8.2 million. However, as the Figure shows, the State Bar predicts that the combined balance of \$5.8 million in the general fund and the Public Protection Reserve Fund at the end of 2005 will sink into a deficit of \$13.8 million by the end of 2008 unless membership fees increase and the fee waiver criteria change.

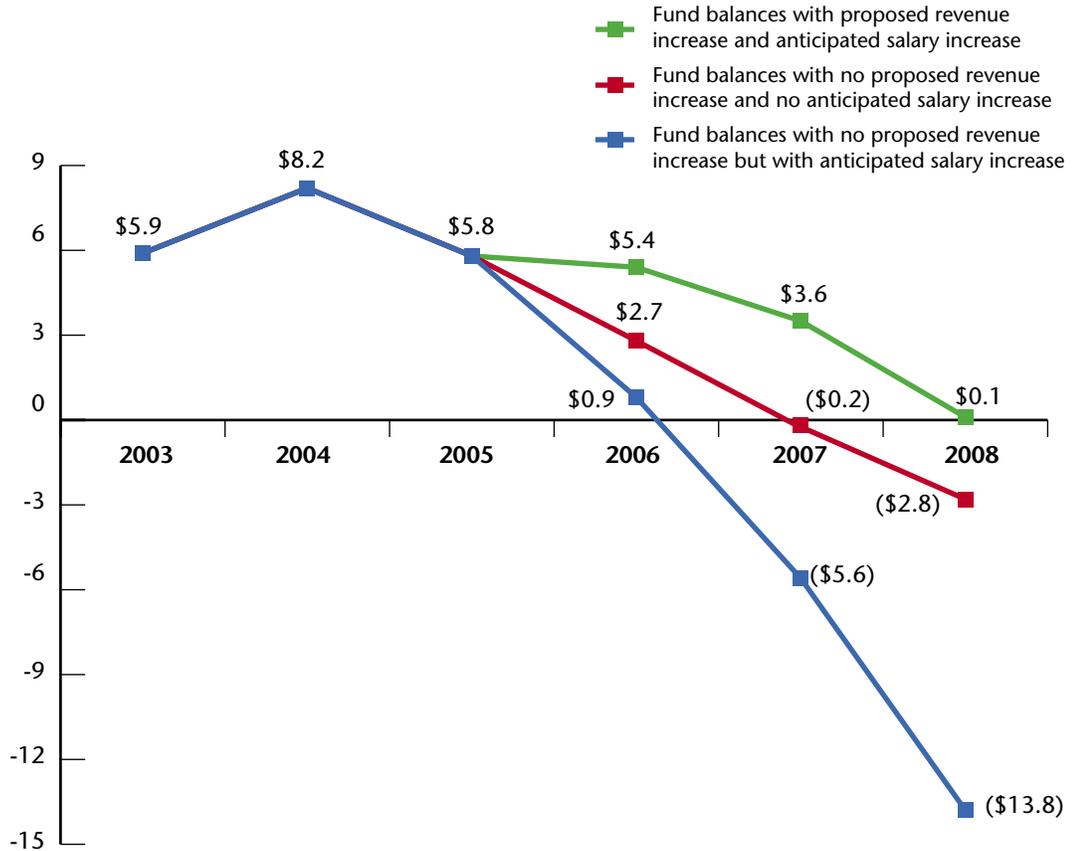
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*The State Bar's financial forecast shows that general fund expenses will exceed revenues each year from 2005 through 2008 unless membership fees increase and the fee waiver criteria change.*

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**FIGURE**

**Effects of Proposed Increase in Revenues From Membership Fees  
and Anticipated Increase in Salaries and Benefits on the Combined Balance  
of the General Fund and Public Protection Reserve Fund  
(in Millions)**



Sources: 2003 fund balances based on the State Bar's 2003 audited financial statements; 2004 fund balances based on the State Bar's 2004 unaudited financial statements; all other fund balances based on the State Bar's financial outlook for 2005 through 2008.

The State Bar developed its forecast using two different scenarios. Both scenarios presume that membership fees and the criteria for active members to qualify for a partial waiver of the base annual membership fee will remain unchanged until January 2006, and the assumptions related to expenses are the same under each scenario throughout the forecast period. As a result, the top and bottom lines in the Figure begin diverging after 2005 because of the difference in revenue projections.

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*The primary driver of the growth in projected general fund expenses is the assumption that salaries and wages will increase 5 percent per year from 2006 through 2008.*

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Although the State Bar's financial forecast is based on various assumptions, revenues from membership fees drive the revenue forecasts, and staff salaries and wages are the primary factor affecting the expense forecasts. In the absence of a fee increase and changes in the fee waiver criteria, the State Bar predicts that its general fund revenue will increase at a steady rate of approximately \$1.2 million a year from 2006 through 2008 based on membership growth of between 2 percent and 2.4 percent per year during the period. On the other hand, the primary driver of the growth in projected general fund expenses is the assumption that salaries and wages will increase 5 percent per year from 2006 through 2008. According to the State Bar's chief financial officer, this assumption is based on recent negotiations with employee bargaining units, which have indicated that among their highest priorities are maintaining 5 percent step increases and negotiating a 5 percent increase in all the salary ranges. In addition, the chief financial officer indicated that the State Bar wants to maintain comparability with public employers in its salary ranges.

Including its effect on payroll taxes, fringe benefits, and salary savings, the 5 percent annual salary increase adds a net \$1.8 million, \$3.6 million, and \$5.6 million to projected general fund expenses for 2006, 2007, and 2008, respectively. As shown by the middle line in the Figure, if the effects of the salary increases were removed from the forecast scenario that assumes no increase in membership fees and no change in the fee waiver criteria, the deficit would drop by \$11 million to \$2.8 million at the end of 2008.

To offset the large impact of expected salary growth, the State Bar has requested a fee increase and a change in the fee waiver criteria that, if approved, would become effective on January 1, 2006. As introduced, Assembly Bill 1529 (AB 1529) of the 2005–06 legislative session would increase the total fees for inactive members from \$50 to \$145 and for active members from \$390 to \$395, as shown in Table 3. However, in its financial forecast, the State Bar has assumed that the total fee for inactive members will be \$135 instead of \$145 because it proposed a base annual fee for inactive members of \$80 rather than the \$90 reflected in the version of AB 1529 introduced to the Legislature. Although AB 1529 would provide an additional \$75 in fees from inactive members to support the general fund, the State Bar estimates that a fee increase of \$65 would generate approximately \$2.2 million in additional general fund revenue in 2006 and \$2.3 million in both 2007 and 2008.

**TABLE 3****Changes in Annual Membership Fees**

	Current Fees	Proposed Fees	Difference
<b>Inactive Member</b>			
Base annual fee	\$40*	\$ 90*	\$50*
Client Security Fund	0	10	10
Disciplinary system	0	25*	25*
Other	10	20	10
<b>Totals</b>	<b>\$50</b>	<b>\$145</b>	<b>\$95</b>
<b>Active Member</b>			
Base annual fee	\$310*	\$310*	\$0
Client Security Fund	35	40	5
Disciplinary system	25*	25*	0
Other	20	20	0
<b>Totals</b>	<b>\$390</b>	<b>\$395</b>	<b>\$5</b>

Sources: Chapter 384, Statutes of 2004, and Assembly Bill 1529 (Introduced) of the 2005–06 Regular Session.

\* Supports the general fund.

In addition to increasing fees for each member, AB 1529 would change the fee waiver criteria. Existing law provides a waiver of 25 percent of the base annual membership fee for active members who earn less than \$40,000 annually from the practice of law and a waiver of 50 percent for active members with less than \$30,000 total annual earned income. AB 1529 would provide only a single waiver of 25 percent of the base annual membership fee for active members with total annual gross income from all sources of less than \$40,000. The State Bar estimates that the change in the fee waiver criteria would provide increased general fund revenues of \$2.3 million in 2006 and \$2.4 million in both 2007 and 2008. As the top line in the Figure on page 19 shows, the State Bar predicts the additional revenue from the fee increase and changes in the fee waiver criteria would help prevent a deficit in the combined general fund and Public Protection Reserve Fund balance through 2008.

As described earlier, changes in state law might improve the State Bar's ability to recover disciplinary costs and Client Security Fund payments from attorneys. However, the State Bar's financial forecast does not incorporate any increased cost recoveries that might help reduce projected deficits. According

to the chief trial counsel, it avoided doing so because the State Bar has no experience with the enforcement of money judgments that would enable it to make an educated forecast. The chief trial counsel also told us that, due to the steps involved in obtaining money judgments and then collecting on them, the State Bar did not expect significant collections in the first year of the program. Finally, according to the chief trial counsel, the State Bar's ability to collect from attorneys it has disciplined depends on the attorneys' ability to pay. However, attorneys who owe the most are those who have resigned or been disbarred and have few if any assets that the State Bar can immediately garnish.

### **The State Bar Predicts That Its Client Security Fund Reserve Will Be Depleted by 2006 Unless Membership Fees Increase**

The State Bar's 2004 unaudited financial statements indicate that Client Security Fund expenses exceeded revenues by \$2.1 million, resulting in a decrease in the fund balance from \$4.3 million to \$2.2 million at the end of 2004. The Client Security Fund balance has declined each year since 2002, when the annual assessment the State Bar charged its active members in support of the fund was reduced from \$40 to \$35. The State Bar reduced fees in 2002 because of the dramatic increase in the fund balance and the two-year decrease in the number of claims filed that resulted when the State Bar lost its authorization to assess a base annual membership fee and had to significantly curtail its activities. State Bar records indicate that in 2004 it processed 1,209 claims asserting financial losses related to the dishonest conduct of attorneys and paid \$5.7 million from its Client Security Fund for 746 of those claims. According to the State Bar's unaudited financial statements, the revenue generated through membership fees totaled \$4.8 million in 2004, an increase of \$215,000 from 2003. The State Bar expects to pay about \$4.4 million for claims still outstanding at the end of 2004. Conceivably, it could receive additional claims for losses incurred in 2002 and 2003 because claimants generally have four years to file claims for reimbursement.

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*The State Bar estimates that it will face deficits in the Client Security Fund by 2006 if the fees supporting the fund do not increase.*

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The State Bar estimates that it will face deficits in the fund by 2006 if the fees supporting the Client Security Fund do not increase. According to the State Bar's financial forecast, the Client Security Fund will be able to absorb an operating loss for only one more year if the fees supporting the fund remain unchanged. The Client Security Fund's major source of revenue

is the \$35 annual fee imposed on active members. Like its general fund revenue forecast, the State Bar's expectation for Client Security Fund revenue is an increase due to a growing active membership and rising investment income. In the absence of a fee increase, the State Bar predicts revenues of \$5.1 million in 2005 and \$5.3 million in 2006. As with the general fund, the forecast assumptions do not incorporate any potential increase in cost recoveries that might result from the State Bar's new money judgment authority.

According to the forecast, Client Security Fund expenses will exceed revenues by \$1.1 million by the end of 2005. As a result, the 2004 fund balance of \$2.2 million is projected to decrease to \$1.1 million in 2005, which will not be sufficient to cover the projected operating loss of \$1.4 million in 2006. The State Bar's forecast for expenses assumes that the claims payout ratio for 2005 and 2006 will stay at 45 percent, which is slightly higher than the average of the last three years ending in 2004, according to the State Bar's 10-year comparison of the fund's activity. The State Bar projects that the fund will have a deficit balance of \$264,000 at the end of 2006.

To prevent future deficits in the Client Security Fund, the State Bar has proposed a fee increase totaling \$15 from active and inactive members in support of the fund. As shown in Table 3 on page 21, fees would increase by \$5 for active members, and inactive members would begin paying \$10 to support the fund. The State Bar estimates the increases in fees will generate approximately \$1.1 million in additional Client Security Fund revenue each year from 2006 through 2008.

## **RECOMMENDATIONS**

The State Bar should continue its efforts to control its backlog of disciplinary cases.

To ensure that employees follow procedures for processing disciplinary cases, the State Bar should:

- Establish a written policy requiring staff to maintain a checklist of the important steps involved in processing disciplinary cases and include all necessary documents in every case file, rather than relying on an informal instruction that the checklist be used.

- Develop a checklist that is more comprehensive than the current investigation file reminder, such as the tool that the audit and review unit uses when it randomly reviews disciplinary case files.
- Make supervisors responsible for ensuring that each case file includes a checklist and that staff use it.
- Enforce its policy of spot checking the files of active disciplinary cases and require team leaders to document the results of their spot checks.

To ensure that it maximizes the benefits of its new collection enforcement authority, the State Bar should prioritize its cost recovery efforts to focus on attorneys who owe substantial amounts related to disciplinary costs and payments from the Client Security Fund.

To ensure that its fees are set at reasonable levels, the State Bar should continue to update its forecasts for key revenues and expenses as new information becomes available. For example, the State Bar should closely monitor the results of its enhanced collection enforcement authority and the benefits it may have on recovery of disciplinary costs and Client Security Fund payments.

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 28, 2005

Staff: John F. Collins II, CPA, Audit Principal  
Nasir A. Ahmadi, CPA  
Barbara Henderson, CPA  
Sheryl Liu-Philo, CPA

*Agency's comments provided as text only.*

The State Bar of California  
Judy Johnson, Executive Director  
180 Howard Street, Floor 10, San Francisco, CA 94105

April 18, 2005

Elaine M. Howle, State Auditor  
555 Capitol Mall, Suite 300  
Sacramento, CA 95814

**Re: State Bar of California Response to State Audit Report of April, 2005**

Dear Ms. Howle:

Please find enclosed the response of the State Bar of California to the State Audit Report, entitled State Bar of California: It Should Continue Strengthening Its Monitoring of Disciplinary Case Processing and Assess the Financial Benefits of Its New Collection Enforcement Authority.

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

I wish to extend my personal thanks to the audit team of: John F. Collins II, Nasir A. Ahmadi, Sheryl Liu-Philo and Barbara Henderson, and fully appreciate their hard work and professionalism in preparing the report.

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

Very truly yours,

*(Signed by: Judy Johnson)*

Judy Johnson  
Executive Director

## Response to State Audit Report

### **Agency Comments:**

The review of the operations and performance of the State Bar of California by the Bureau of State Audits for the period January 1, 2004 through December 31, 2004, is informative and helpful. The recommendations will help the State Bar further optimize the operational efficiency of its discipline system and enhance its cost recovery strategies to ensure that mandatory fees are kept at a reasonable level.

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

### **Recommendation 1**

The State Bar should continue its efforts to control its backlog of disciplinary cases.

### **Response**

We agree. The State Bar will continue to make every effort to keep the statutory backlog at or below 400 cases. The backlog increased significantly in 2003 (i.e., to 540 cases on December 31, 2003), primarily as a result of the investigative resources required for the State Bar's investigation of the multitude of complaints and subsequent involuntary inactive enrollment proceeding pursuant to Business and Professions Code section 6007, subdivision (c)(3) against the attorneys practicing law as The Trevor Law Group. However, by the end of 2004, the statutory backlog was reduced to 402 cases, virtually identical to the backlog of 401 reported by the State Auditor in 2002.

Notwithstanding fluctuations in the size of the backlog in 2003 and 2004, the average age of all State Bar disciplinary investigations has declined significantly. In 2002, 32.5% of investigation cases were more than six months old, while in 2004, only 21.9% of investigation cases were over six months old.

## **Recommendation 2**

To ensure that employees follow procedures for processing disciplinary cases, the State Bar should:

- Establish a written policy requiring staff to maintain a checklist of the important steps involved in processing disciplinary cases and include all necessary documents in every case file rather than relying on an informal instruction that the checklist be used.
- Develop a checklist that is more comprehensive than the current investigation file reminder, such as the tool that the audit and review unit uses when it randomly reviews disciplinary case files.
- Make supervisors responsible for ensuring that each case file includes a checklist and that staff use it.
- Enforce its policy of spot-checking the files of active disciplinary cases and require team leaders to document the results of their spot checks.

## **Response**

We agree. With the commencement of the term of the new Chief Trial Counsel, Scott Drexel (*effective 4/11/05*), a specific policy directive regarding the use of a single comprehensive checklist in all cases will be issued. This will replace the current practice of employing multiple documents for the same purpose, including the intake sheet, the investigation reminder and other documents. It is anticipated that the comprehensive checklist will be similar to the checklist currently used by the audit and review unit for its random audit of closed files. Further, the policy directive will require that the appropriate supervisor (e.g., lead attorney or team leader) ensure that a copy of the checklist is contained in each file and that it is utilized by staff.

Finally, the Office of the Chief Trial Counsel will make its policy of spot-checking active disciplinary cases more specific and will require team leaders or others conducting the spot checks to document the results of their reviews.

## **Recommendation 3**

To ensure that it maximizes the benefits of its new collection enforcement authority, the State Bar should prioritize its cost recovery efforts to focus on attorneys who owe substantial amounts related to disciplinary costs and payments from the Client Security Fund.

## **Response**

The State Bar agrees with this recommendation and has initiated two pilot projects to test its collection efforts. One began in 2003, before the availability of the money judgment amendment. The State Bar authorized its outside collection counsel to initiate civil actions against a list of attorneys owing moneys to CSF, including 54 of the top 100 individuals owing the most in disciplinary costs.

The second project involved disciplinary costs under the money judgment statute, targeting those with the most recent awards of disciplinary costs. Demand letters have been sent and when the proposed procedures in the California Rule of Court are approved, money judgments will be entered. This second pilot project includes 9 of the top 100 individuals with the most unpaid disciplinary costs. The State Bar is in the process of sending demand letters to the remaining individuals owing the most in disciplinary costs, to gather additional comparative data.

The State Bar will use information and data from the pilot projects to conduct a cost-benefit analysis and to target and prioritize its future efforts.

#### **Recommendation 4**

To ensure that fees are set at reasonable levels, the State Bar should continue to update its forecasts for key revenues and expenses as new information becomes available. For example, the State Bar should closely monitor the results of its enhanced collection enforcement authority and the benefits it may have on the recovery of disciplinary costs and Client Security Fund payments.

#### **Response**

We agree. The State Bar will continue its efforts to minimize fee increases through the prudent and efficient management of its resources. While the State Bar is proposing a fee increase for 2006, this is the first proposed increase in almost six years. Additionally, the State Bar will monitor the results of its enhanced collection enforcement authority and the benefits it may have on the collections of disciplinary costs.

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