Office of the Attorney General
Legal Services Revolving Fund
Business Plan for the 2007-2009 Biennium

I. Business Mission

The business mission of the Office of the Attorney General (AGO) is to provide legal services to state agencies and recover the costs of those services through a system of assessing charges for activities undertaken on behalf of each client. This process is similar to that of a major law firm with many clients, with the notable exception of the profit motive. There are numerous other AGO responsibilities in addition to providing billable legal services that are not included or discussed in the business plan.

II. Business Description

RCW 43.10.030 provides that the Attorney General shall (among other duties) provide and recover the costs of the following legal services to approximately 230 state agencies, boards, and commissions:

- Appear for and represent the state before the Supreme Court or the Court of Appeals and trial courts in all cases that involve the state's interest;
- Institute and prosecute all actions and proceedings for, or for the use of the state, which may be necessary in the execution of the duties of any state officer;
- Defend all actions and proceedings against any state officer or employee acting in his official capacity, in any of the courts of this state or the United States;
- Prepare proper drafts of contracts and other instruments relating to subjects in which state agencies are interested; and,
- Provide legal advice and counsel in the organization and administration of client agency activities and operations.

III. Marketing Plan

The AGO provides legal services to state agency clients pursuant to statutory requirement, which eliminates the applicability of a marketing plan. As a public sector law firm representing state government, the legal expertise provided by the AGO is unique and not available from private sector law firms.

IV. Operational Plan

The operational plan of the AGO is focused on the expenditure and cost recovery (billing) side because the AGO has little to no control over the volume of legal services requested/required by state agencies. As discussed previously, responding to requests for legal advice and representing clients in litigation are statutory responsibilities of the office. In addition to the statutory obligation, there is the practical consideration that the interests of the taxpayers are only be served if the AGO provides timely and effective advice and litigation. Good quality legal advice is critical to avoiding and minimizing legal issues in the future, and prompt and high quality response to litigation is necessary to protect the state's interests. In many situations, the client agency (and the AGO) must respond to unexpected litigation that is brought by outside parties. The consequences of not responding effectively to litigation brought against state agency clients can have major financial and operational repercussions.

For these reasons the AGO must exercise business and financial control over operations on the cost recovery (billing) side rather than on the provision of services side. This requires a budgeting and billing system that is not only fair and accurate, but is very adaptable and flexible to deal with the constant flow of unexpected litigation and requests for advice.

Legal Services Revolving Fund (LSRF)

The funding mechanism employed by the AGO to manage expenditures and cost recoveries (billings) is the LSRF. Funding for all billable activities flow through this fund—both expenditures and revenues. Non-billable activities of the AGO such as Consumer Protection, Tobacco litigation and Medicaid Fraud enforcement are funded from legislative appropriations from other funds. <u>All</u> legal services resources deposited in the LSRF come from billings to client agencies, and <u>all</u> expenditures for legal services are paid from the LSRF. The operating budget of most client agencies includes an assumption for legal services payments to the AGO that is reviewed and established each biennium through the legislative process. The amount of resources in each client agency budget can vary from biennium to biennium based on historical trends and the expectation/completion of major litigation.

The AGO then receives an appropriation in the LSRF that is equal to the sum of all client agency allocations for AGO legal services. Monthly bills are then prepared by the AGO to reflect the cost of work performed in the preceding month, and sent to each client. Clients remit payments that are deposited in the LSRF, and the AGO then has sufficient resources to pay staff and all other costs. This mechanism is intended to allocate the cost of legal services to benefiting clients, and to apportion those costs to the various funding sources that are used by each of the clients.

History of the LSRF

The Legal Services Revolving Fund was established by a 1971 act of the Legislature, RCW 43.10.150, which provides for "….. a centralized funding, accounting, and distribution of the actual costs of the legal services provided to agencies of the state government by the attorney general." The act was effective July 1, 1974, for costs, billings and charges affecting Fiscal Year 1975 and subsequent biennia.

In 1981 legislation was passed calling for Office of Financial Management (OFM) approval of Attorney General Office (AGO) and Department of General Administration billing rates. In 1981, the AGO was not using a rate-based billing system but billed actual costs after the fact. This resulted in significant delays in billing and negative LSRF fund balances at different points in time. Rate-based billing began in Fiscal Year 1999. RCW 43.88.350 provides "Any rate increases proposed for or any change in the method of calculating charges from the legal services revolving fund or services provided in accordance with RCW 43.01.090 or 43.19.500 in the general administration services account is subject to approval by the director of financial management prior to implementation."

In 1999 the AGO together with OFM made significant changes to the way client agencies are billed for legal services and tort defense services. The goals of the changes are a more timely and predictable billing for client agencies as well as improved cash flow to the LSRF. To achieve these ends a new rate-based billing mechanism was implemented for the 1999-2001 biennium and further refined in the 2001-2003 biennium. The payment of tort defense costs was changed significantly with the passage of SHB 2111 (Chapter 163 Laws of 1999). Tort defense funding became part of the risk management self-insurance program administered by the Department of General Administration (in 2002 moved to OFM in HB 2352 (Chapter 332, Laws of 2002). Tort defense costs are not billed to client agencies by the AGO. The self-insurance premium paid by state agencies includes the cost of tort defense. The exception is the University of Washington which operates its own risk pool.

Inter-agency Agreements

This process of building an assumed legal services budget for each client agency is based on historical experience and any knowledge of workload changes likely to occur in the upcoming biennium. This approach works well until a major unexpected case arises. When this occurs, sufficient funding is not available in the regular client agency allocation to cover what can be very large expenditures. The common short-term response to such a situation is to prepare an inter-agency agreement specifically related to the unexpected major case or legal matter. The longer term response is to seek supplemental funding from the legislature.

Important aspects of an inter-agency agreement are:

- They are usually major case-specific agreements. Each inter-agency agreement is a form of contract that specifies a certain amount of legal services to be provided by the AGO for a specific purpose/case/matter, and FTEs of effort at a specific price.
- Some inter-agency agreements also make provision for acquiring the services of outside counsel with specific expertise and expenditures for expert witnesses, discovery, and other court-related costs.
- The Director of OFM approves every inter-agency agreement.
- They create a mechanism for the AGO to acquire necessary resources (funding and FTEs) that are in addition to the regularly budgeted level of effort for legal services to that client. Funds and FTEs acquired through the use of an inter-agency agreement are considered non-appropriated resources and the FTEs are not subject to FTE limits or controls.
- Inter-agency agreements are usually related to one-time events or cases. Because they are used to finance work that is one-time in nature, it is usually not necessary to build their costs into the ongoing base budget level for the affected client. Once the major case or matter is completed, the inter-agency agreement ends and the ongoing base budget level for regular legal services is unaffected.

- Additional resources may be requested through the budget process if over time a pattern emerges that the work represents an ongoing need.
- It is up to the client to identify the source of additional funding to cover the amount of the inter-agency agreement. The client may provide funds from their operating budget, their capital budget, or supplemental funds requested from the legislature. Often there is a need for the client (and AGO) to seek supplemental funding to pay the costs of inter-agency agreements.
- Inter-agency agreements may span a number of fiscal years and change in scope depending on what occurs in negotiation, trial or appeal. Inter-agency agreements are very flexible and can be completed in a very short time frame to respond to emergent issues.

Cash Balances in the LSRF

The underlying presumption in the creation of the LSRF is that it will be a self-supporting revolving fund that provides a financial mechanism to apportion the costs of AGO legal services to all clients and their respective funding sources. As such, the fund is not expected to run at a deficit, or to create a profit (positive fund balance). Prudent financial management suggests that a reasonable working capital fund balance be maintained to recognize the fact that expenses occur on a daily basis but revenues are received from monthly billings that lag expenditures by three to six weeks. In addition, there will always be questions and issues to resolve regarding agency billings, and not all clients will provide payments in a timely fashion.

During the 2005-2007 biennium the AGO successfully concentrated efforts on:

- Refining a timekeeping/billing system that consistently produces accurate and timely billings.
- Resolving all outstanding billing issues with client agencies regarding unpaid bills from previous biennia. OFM has provided assistance to accomplish this.
- Establishing and adjusting (when necessary) fair and understandable billing rates that balance each AGO division's costs for legal services and the bills sent to clients to recover those costs.

It is the goal of the AGO to continue streamlining the budgetary and financial processes that have led to recent successes, and maintain positive fund balances in the LSRF in the future.

Current Billing Practices

The current AGO legal services billing system can be summarized as **FTE utilization times billing rate plus direct cost equals the AGO bill**.

- FTE utilization is recorded by the AGO timekeeping system. Time is kept for all attorney, paralegal, and investigator staff. The AGO implemented a new and much improved timekeeping system for the 1999-2001 biennium. All billable staff enter time in fractions of hours and this is converted to FTE percentages and allocated to the benefiting client.

- A billing rate for attorneys, paralegals, and investigators is developed for each AGO division/location.
- In addition to staff work effort, there are other direct costs such as outside counsel, expert witnesses, document reproduction, court reporters, etc. These direct costs are tracked by client agency and (in some instances) by case. Direct costs are also allocated to the benefiting client agency.

Billing rates are set by the AGO at the beginning of each biennium and continually reviewed and modified when necessary.

- Factors used in calculating the billing rate include AGO division budget levels, changes in forecasted client workload, and historical data.
- Billing rates include all costs except direct litigation costs.
- The rate for each attorney is established to cover three types of expenses:
  1. The cost of all attorney salaries and benefits for that division,
  2. A proportionate share of divisional support costs (rent, support staff costs, supplies, etc.), and,
  3. A proportionate share of agency administrative overhead (accounting, payroll, human services, budget, senior management).
- Billing rates for paralegals and investigators are set on an AGO-wide basis to only recover the approximate costs of salaries, benefits and other expenses for paralegal and investigator staff.
- Like other agencies the AGO has a total expenditure limit for the LSRF set by legislative appropriation.

The Billing Process

- On or around the third week of each month, client agencies are sent an invoice for billable time for the prior month. For example, around August 17, 2006, the agencies will receive an invoice for July 2006 billable time.
- In addition, each bill will include the direct costs incurred through the just-passed fiscal month cut-off. Since the bill is completed approximately 3-4 business days after the fiscal month cut-off, each bill will include almost two additional weeks of expenses. For example, the bill that will go out around August 17, 2006, will include direct costs through the fiscal cut-off on August 13, 2006.
- Payments are recorded primarily through the OFM Inter-Agency Payment mechanism, which replaced the use of journal vouchers or warrants.
- The AGO provides all client agencies with fiscal year-end and biennium-end billing statements showing all charges and payments for the preceding fiscal period using excel spreadsheets.
- Each monthly bill shows the total of the client agency allocation. Approved interagency agreements are billed separately from the client agency allocation.
- Included in each client bill is utilization information on the amount of attorney, paralegal, and investigator FTEs charged and direct costs incurred.

- FTE utilization is reported based on client-established reporting categories. Client agencies can modify these categories by contacting the respective AGO division chief.
- Direct costs (litigation-related costs) are billed as a lump sum to each client. The AGO does not have a method to allocate direct costs by reporting category or case.

Tort Defense Services Billing

Tort defense costs are handled differently than legal services costs that are billed to client agencies. All tort defense costs are paid through a single inter-agency agreement with OFM, and therefore not billed to the involved client agency. For this reason, the AGO maintains tort defense cost information by case and not by client agency. OFM maintains defense cost information by case (claim number) and by agency. The same rate-based billing approach used for general legal services is used for tort defense costs. The difference being that only one bill is created and sent to OFM to pay each month. OFM then uses legal defense cost experience and claims experience to allocate tort costs to client agencies in future budgets. Client agencies seeking information on tort defense expenditures will need to reference a case (docket) number when requesting data from the AGO or seek information from the OFM Office of Risk Management.

Billing Rates

For the purpose of clarification, the following billing rate discussion will focus on attorney rates, but the concepts and practices described are similarly applied to AGO investigators and paralegal staff. As described in the last section, the amount billed in each month is calculated by taking FTE utilization times billing rate plus direct cost. All AGO attorneys, investigators, and paralegals track their time through the agency timekeeping system. Client utilization of AGO staff resources is tracked based on FTEs, so the AGO timekeeping system converts hours worked to a percentage of an FTE. This conversion is done to avoid the complications that would ensue if attorneys were charged on an hourly basis since most attorneys work more than 173 hours per month (standard full-time employment at 40 hours per week). Since the billing rates are also calculated on an FTE basis, using FTEs as the basis for timekeeping maintains a balance between operating budget costs incurred by the AGO and total billings to clients. The current AGO billing system allows for 30 separate billing rates for attorneys based on the AGO service division and location.

The AGO functions essentially as a major law office. As such, the attorney billing rate must cover all the costs of a legal firm including attorney salaries and benefits, "division support" and "agency overhead". "Division support" includes legal secretary and other support staff, office rent, utilities, supplies, telephones, travel, and all other support expenses that are incurred in the operation of that AGO division. "Agency overhead" includes agency-wide support functions including executive management, information services, human resources, legal library and research, budget, accounting, payroll, purchasing, etc.
Rates established for AGO investigators and paralegals are different in this aspect than rates set for attorneys. Rates for investigators and paralegals only cover the salaries and benefits and

associated costs of those employees. All division support and agency overhead expenses are included only in the rates set for attorneys.

The billing rate does not include separately-billed direct costs such as outside counsel, expert witness fees, court reporter costs, document reproduction, filing fees, etc.

Rate Setting – Rate Adjustment Process

Billing rates are the calculated result of the legislature action to adopt a budget for the AGO and the clients. Rates are reviewed continually and adjusted as necessary. Billing rates will generally increase over time as the cost of salaries and support costs increase. These increases are controlled by the total amount of funds appropriated to the AGO by the legislature.

Alternatively, rates may also decrease if the amount of AGO division expenditures is below the level estimated in the budget. The goal of the rate adjustments is to keep revenue and expenditures in balance. Downward adjustments can be accomplished through two separate mechanisms:

1. The billing rate can be lowered which will reduce billings in the future, or,
2. A credit can be used to adjust past bills when a one-time adjustment is needed.

Fiscal Year End Process

The Comprehensive Annual Financial Reporting (CAFR) process requirement is a challenge to the AGO billing in terms of timing, just as it is for all agencies that bill their costs to other agencies. To meet the OFM requirement of having a bill sent out to agencies by July 15 after each fiscal year, the AGO completes an “estimated” bill for each client by July 14. Then, on approximately October 1, the final bill for the preceding fiscal year showing all billings and payments is sent to client agencies. While there may be adjustments either up or down to the estimated bill that was sent on July 14, in the vast majority of cases the final bill equals the estimate. The fiscal year end deadlines and resulting requirement for an estimated bill in each July are outside the control of the AGO and are unlikely to change.

Billing Issue – Clients want to be billed at their Budget Level

Most AGO clients are very concerned that billings remain within the budgeted level that the clients receive from the legislature. While the AGO shares this goal, it is not always possible since the AGO is required by statute to charge clients actual costs and the amount of legal services required in any fiscal period may be affected by forces beyond the control of either the AGO or the client. When the estimated (and budgeted) level of legal services proves insufficient to meet client needs for any combination of reasons, the AGO is expected to provide additional legal services—and the result is billings in excess of the budgeted level. Clients find themselves in the difficult situation of needing additional legal services but without sufficient funding to pay for it. And, since the AGO has no source of funds to pay for unexpected or unanticipated legal services for any client, there is a problem. Sometimes a supplemental appropriation from the legislature is requested, but this takes time and is not always successful.

The reverse situation also causes problems. If a client does not need the level of legal services that were estimated in the budget, then attorney time is not billed to that client. When attorney time is billed below the estimated level the amount of revenue received by the AGO is reduced. Insufficient revenue can leave the AGO with an insufficient cash balance in the LSRF to pay for AGO staff because the attorney bills are not only recovering the costs of those attorneys—they are also recovering the cost of division support and agency overhead. This situation is generally addressed by transferring attorneys and other AGO staff among divisions to balance workload and budgets. At times, this balancing can be a challenge depending on the skill sets of the attorneys and staff involved. Balancing workload, staff skill sets, the AGO budget, and client budgets is an ongoing challenge for the AGO to manage.

Attorney Salaries

Attorney salaries have not increased since July 2002, other than the statewide employee COLA provided in September 2005. The AGO has contracted with Owen–Pottier Human Resource Consultants to compare attorney salaries against those paid by other public sector legal offices. The success of the AGO is directly related and dependent on the knowledge, skills and experience of the attorneys in the office. Adequate salary levels is a critical element in building and maintaining the level of professionalism and success the AGO must deliver to its clients and the public. The report of the consultants is currently being analyzed and is expected to be the basis for a salary adjustment proposal in the 2007-2009 biennium budget request.

Funding for Agency Indirect Costs

The AGO received a State Auditor management letter indicating concern that indirect costs are not allocated across all AGO funds and programs. However, Section 927 of the 2005-2007 operating budget bill requires that these costs be allocated to divisions funded from the LSRF. The requirement is the product of a number of fund shifts over time where various activities have been moved from General Fund State and other funds to the LSRF. The most recent of these fund shifts was to eliminate General Fund State support for the Executive Ethics Board and move its funding to the LSRF in the 2003-2005 budget. The Auditor's letter directs the AGO to seek legislation to grant permanent authority to continue the practice prescribed in Section 927 of the budget.

V. Performance and Strategic Assessment

Assessing the performance of the AGO and discussing strategic issues in the context of a business plan requires a different approach be taken. The workload and changes in types of services required by the AGO are not subject to the control of either the AGO or its client agencies. Legal services work comes to the AGO in the form of requests for advice and the need to respond to litigation. While some of this workload is predictable, there are major elements that are not—especially in the area of responding to litigation. As previously discussed, the repercussions of the AGO not responding quickly and effectively to litigation (or to provide advice to avoid/limit legal issues) are not acceptable from either the financial or government management perspectives. So, for the AGO to meet its core responsibility in the area of providing legal services to clients the AGO is required to maintain a professional and effective legal workforce at all times. The business aspect of this challenge is to provide the appropriate level of resources to support this workforce, make changes to the resource levels quickly to respond to emergent issues, and apportion the costs of these activities on a fair and equitable basis to all clients. This places the focus of strategic business planning on maintaining and improving the financial and billing activities of the office.

Workload Issues Affecting the Business Plan

The AGO receives almost 2,000 new cases/filings/matters each month. The vast majority of these are dealt with quickly, but not all. As a result, the number of open cases has grown in recent years:

Fiscal Year	Open at FY End
2002	27,238
2003	28,519
2004	29,434
2005	31,816
2006 (March)	33,220

This growth in the number of open cases is a clear demonstration of the need for the AGO to implement a wide-ranging and innovative series of actions to improve both the efficiency and effectiveness of the legal staff, including:

- Recruitment and retention of the best legal talent available (including appropriate salary levels)
- Training and professional development of existing staff
- Development and implementation of an attorney succession plan
- Upgrading the skills (and salaries) of non-attorney members of the legal team (paralegals, legal assistants)
- Use of "best practices" developed in the public and private legal communities
- Integration of technology in the provision of legal services
- Development of legal teams with specific skills and experience

Most of these actions affect budget levels in some way, and specific proposals will be included in the 2007-2009 AGO operating budget.

Billing Issues

The major issue affecting the recovery of expenses to support the activities of the AGO is the continued viability of the timekeeping and billing systems. These electronic systems are mission-critical in the sense that they are the only tools available to create client agency billings—and these systems are aging. They were developed in 1999 in a proprietary language called Powerbuilder, which is experiencing difficulty interfacing with modern internet applications. Upgrade or replacement of these systems is critical to the ongoing business functions of the agency.

A systemic issue affecting AGO expenditures and recovery is the unpredictability of major litigation faced by clients during a biennium. The state budgeting system stresses control and accountability—at the expense of flexibility. The AGO and its clients start a biennium with a fixed level of resources apportioned among many state funds, and the actual needs for legal services turn out to be different. The result is AGO expenditures and billings that are driven by actual needs being charged against a set of estimated budgets. The outcome is clients that, from their perspective, are over-billed or under-billed based on the level of resources they have in their budgets. From the AGO perspective, they are accurately billed based on the services actually provided. This creates a need for supplemental appropriations during the biennium and continuing adjustments of budgets. Alternate approaches to managing the LSRF and funding the AGO should be carefully considered and discussed in future budget processes.

The Department of Personnel is developing a new automated personnel management system for use by all state agencies. Implementation of this new system is scheduled for July 1, 2006. It is critical that the new statewide system provide the functionality that is required to allow the AGO timekeeping/billing system to continue operating efficiently. It is possible that the level of detail or information contained in the new statewide personnel system might not be sufficient to allow AGO billings to be completed in an accurate and timely manner. This would disrupt the flow of resources necessary to support the legal services budget of the AGO.