

State Bar of Arizona

**Independent Auditor's Report
and
Financial Statements**

December 31, 2011 and 2010

State Bar of Arizona
December 31, 2011 and 2010

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Independent Auditor's Report

The Board of Governors of
State Bar of Arizona

We have audited the accompanying statements of financial position of the State Bar of Arizona as of December 31, 2011 and 2010, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the management of the State Bar of Arizona. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State Bar of Arizona at December 31, 2011 and 2010, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Miller, Allen & Co., P.C.

April 23, 2012

State Bar of Arizona
Statements of Financial Position
December 31, 2011 and 2010

	2011	2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 716,444	\$ 494,588
Receivables (net of allowances of \$34,228 in 2011 and \$16,034 in 2010)	159,060	103,350
Inventories	49,414	42,557
Prepaid expenses	217,033	190,166
Total current assets	1,141,951	830,661
Property and equipment, net	11,623,214	11,487,342
Other assets	16,621	21,764
Total assets	\$ 12,781,786	\$ 12,339,767
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 216,916	\$ 412,983
Property taxes payable	92,349	113,601
Accrued liabilities	757,242	843,001
Dues and fees collected in advance	2,557,649	3,227,763
Total current liabilities	3,624,156	4,597,348
Line of credit payable	1,050,000	-
Other liabilities	1,650	6,751
Total liabilities	4,675,806	4,604,099
Net Assets		
Unrestricted	8,105,980	7,735,668
Total liabilities and net assets	\$ 12,781,786	\$ 12,339,767

See accompanying notes to financial statements.

State Bar of Arizona
Statements of Activities
For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Revenue and gains:		
Dues -		
Active	\$ 7,368,298	\$ 7,174,451
Inactive	900,074	867,230
Sections	308,697	297,643
Board of Legal Specialization	132,870	133,175
Fees -		
Continuing legal education	2,263,836	2,582,931
Convention	466,098	580,059
Lawyer regulations	204,742	174,189
Law office management assistance program	68,178	88,780
Board of Legal Specialization	44,365	45,895
Publication and advertising sales -		
Arizona Attorney Magazine	593,013	570,124
Membership directory	99,380	136,840
Website	36,808	52,693
Mailing lists and labels	3,355	4,983
Economic survey	6,800	15,050
Rental income	203,389	524,092
Pro Hac Vice	423,634	380,924
Late fees mandatory continuing legal education	315,550	318,925
Sections - other	155,905	127,675
Special services	89,308	89,069
Contributions and sponsorships	109,279	83,654
Membership assistance program	54,470	55,810
Membership benefits	9,150	12,555
Interest and dividends	10	298
Other	184,234	359,590
Gain on disposal of equipment	1,050	-
Total revenue and gains	<u>14,042,493</u>	<u>14,676,635</u>
Expenses:		
Program services:		
Discipline	4,920,596	4,697,606
Member services	4,816,662	4,676,006
Support services:		
Management and general	3,084,177	3,423,842
Building related	850,746	914,179
Total expenses	<u>13,672,181</u>	<u>13,711,633</u>
Change in net assets	370,312	965,002
Unrestricted net assets, beginning of year	<u>7,735,668</u>	<u>6,770,666</u>
Unrestricted net assets, end of year	<u>\$ 8,105,980</u>	<u>\$ 7,735,668</u>

See accompanying notes to financial statements.

State Bar of Arizona
Statements of Cash Flows
For the Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Change in net assets	\$ 370,312	\$ 965,002
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Depreciation and amortization	608,775	530,376
Bad debt expense	18,194	-
Gain on disposal of equipment	(1,050)	-
Changes in operating assets and liabilities:		
(Increase)/decrease:		
Accounts receivable	(73,904)	(1,327)
Inventories	(6,857)	(214)
Prepaid expenses	(26,867)	75,327
Other assets	(100)	-
Increase/(decrease):		
Accounts payable	(226,678)	168,300
Property taxes payable	(21,252)	4,232
Accrued liabilities	(85,759)	112,791
Dues and fees collected in advance	(670,114)	260,096
Other liabilities	(5,101)	-
Net cash provided (used) by operating activities:	<u>(120,401)</u>	<u>2,114,583</u>
Cash flows from financing activities:		
Proceeds from line of credit	1,800,000	1,900,000
Principal payments on the line of credit	(750,000)	(3,150,000)
Net cash provided (used) by financing activities	<u>1,050,000</u>	<u>(1,250,000)</u>
Cash flows from investing activities:		
Proceeds from the sale of property and equipment	1,050	-
Purchase of property and equipment	(708,793)	(566,397)
Net cash used in investing activities	<u>(707,743)</u>	<u>(566,397)</u>
Net increase in cash and cash equivalents	221,856	298,186
Cash and cash equivalents, beginning of year	<u>494,588</u>	<u>196,402</u>
Cash and cash equivalents, end of year	<u>\$ 716,444</u>	<u>\$ 494,588</u>
Supplemental Disclosures of Cash Flow Information:		
Interest paid	\$ 8,204	\$ 8,575
Supplemental Schedule of Noncash Investing and Financing Activities:		
Equipment purchases included in accounts payable at year end.	\$ 30,611	\$ 102,509

See accompanying notes to financial statements.

State Bar of Arizona
Notes to Financial Statements
December 31, 2011 and 2010

Note 1 - Nature of the Organization

The State Bar of Arizona (State Bar) is a private, nonprofit Arizona corporation that was founded in 1933 for the advancement of the administration of justice, the regulation of persons seeking to practice law, the regulation and discipline of persons engaged in the practice of law and other purposes. The State Bar has been determined exempt from federal income taxes under §501(c)(6) of the Internal Revenue Code.

Note 2 - Summary of Significant Accounting Policies

The accounting policies of the State Bar conform to U.S. generally accepted accounting principles as applicable to nonprofit organizations.

The more significant accounting policies of the State Bar are described below.

Financial Statement Presentation – The State Bar has adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-205, *Presentation of Financial Statements*.

Basis of Accounting - The financial statements are presented on the accrual basis of accounting. Revenues are recognized when earned and expenses are recorded when incurred.

Contributions – The State Bar has also elected to adopt FASB ASC 958-605, *Revenue Recognition*. In accordance with FASB ASC 958-605, contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence or nature of any donor restrictions.

Contributed Services - Donated materials and professional services are reflected as contributions in the accompanying financial statements at their estimated values at the date of receipt. No amounts have been reflected in the financial statements for certain donated volunteer services because they did not qualify for recording under the guidelines of FASB ASC 958-605; however, a substantial number of volunteers have donated significant amounts of their time in the State Bar's program services.

Estimates - The preparation of financial statements in conformity with U.S generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents - For purposes of the statement of cash flows, the State Bar considers all liquid investments with a maturity of three months or less when purchased to be cash equivalents.

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Receivables –Receivables are stated at the amount the State Bar expects to collect from outstanding balances. The State Bar provides for probable uncollectible amounts through a provision for bad debt expense and an adjustment to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after the State Bar has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to receivables. Changes in the valuation allowance have not been material to the financial statements.

Inventories – Inventories consist of publications related to continuing legal education and are valued at the lower of cost (determined by the first-in, first-out method) or market.

Property and Equipment - Property and equipment are stated at cost, if purchased, or at fair market value, if donated. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets generally as follows.

Buildings	39 years
Building Improvements	10 to 39 years
Furniture and equipment	4 to 10 years
Computer hardware	4 to 5 years
Computer software	3 to 5 years
Vehicles	5 to 7 years

The State Bar has a capitalization threshold policy of \$1,000 for property and equipment.

Impairment of Long-lived Assets – The State Bar accounts for long-lived assets in accordance with the provisions of FASB ASC 360, *Property, Plant and Equipment*. FASB ASC 360 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Management does not believe impairment indicators are present.

Fair Value of Financial Statements – Unless otherwise indicated, the fair values of all reported assets and liabilities which represent financial instruments (none of which are held for trading purposes) approximate the carrying values of such amounts.

Subsequent Events – The State Bar has evaluated subsequent events through April 23, 2012, the date the financial statements were available to be issued.

Comparative Data – Certain amounts presented in the prior year data have been reclassified in order to be consistent with the current year's presentation.

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Note 3 - Cash and Cash Equivalents

The State Bar's financial instruments that are exposed to concentrations of credit risk consist primarily of cash. The State Bar places its cash with institutions of high credit-worthiness. At year-end, cash and cash equivalents consisted of the following:

	<u>2011</u>	<u>2010</u>
Cash on hand	\$ 2,125	\$ 2,025
Cash in bank	714,319	492,563
	<u>\$ 716,444</u>	<u>\$ 494,588</u>

At December 31, 2011 and 2010, the State Bar had no cash deposits in excess of the FDIC insurance coverage.

Note 4 - Property and Equipment

	<u>2011</u>	<u>2010</u>
Property and equipment consists of:		
Land	\$ 1,753,943	\$ 1,753,943
Land improvements	116,195	116,195
Building	7,739,696	7,739,696
Building Improvements	2,349,873	2,224,562
Furniture and equipment	1,696,163	1,341,206
Computer hardware	1,019,798	1,090,207
Computer software	1,174,065	1,026,431
Construction in progress	473,659	409,748
Property and equipment	<u>16,323,392</u>	<u>15,701,988</u>
Accumulated depreciation and amortization	<u>(4,700,178)</u>	<u>(4,214,646)</u>
Property and equipment, net	<u>\$ 11,623,214</u>	<u>\$ 11,487,342</u>

Depreciation and amortization expense charged to operations was \$603,532 for 2011 and \$530,376 for 2010.

Note 5 - Membership Dues and Fees Collected in Advance

Amounts received in advance for annual membership dues and various other fees are deferred and recognized as revenue in the year in which they are earned. Dues and fees collected in advance consisted of the following at December 31, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Membership, section, and other dues	\$ 2,350,456	\$ 3,036,643
Continuing legal education	104,446	105,434
Other	102,747	85,686
Total dues and fees collected in advance	<u>\$ 2,557,649</u>	<u>\$ 3,227,763</u>

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Note 6 - Client Protection Fund

The State Bar collects fees from its members in order to sustain a Client Protection Fund (the Fund) established to protect clients of State Bar members. The State Bar appoints trustees to administer the Fund. The Fund is maintained as a separate trust and is not included in the accounts of the State Bar.

Accrued liabilities includes approximately \$61,107 and \$67,730 at December 31, 2011 and 2010, respectively, of such fees collected by the State Bar, but not yet disbursed to the Fund.

Note 7 - Line of Credit Payable

In 2008, the State Bar updated their existing revolving line of credit agreement with Wells Fargo Bank to a maximum amount of \$9,000,000. The maximum amount under the line of credit balance will be reduced every quarter by \$90,000 until the expiration date of the agreement, July 25, 2014. The line of credit agreement requires that the State Bar make 59 consecutive interest payments and the principal is not due until the expiration of the agreement. The interest rate on the line of credit at December 31, 2011 and 2010 was 2.275% and 2.27%, respectively. The line of credit is secured by a first deed of trust, together with an assignment of rents and leases on real property and improvements.

The total maximum available on the line of credit at December 31, 2011 and 2010 was \$6,690,000 and \$8,100,000, respectively, and is secured by real property. The outstanding loan balance at December 31, 2011 and 2010 was \$1,050,000 and zero, respectively.

Note 8 - Designated Net Assets

The activities of 29 Sections of the State Bar have resulted in a cumulative surplus of \$326,051 and \$288,270 at December 31, 2011 and 2010, respectively. These funds are commingled with the State Bar's cash funds but have been designated for use by the respective Sections.

Note 9- Pension Plan

The State Bar has adopted a qualified deferred compensation retirement plan pursuant to Internal Revenue Code Section 401 (K). The plan allows eligible employees the option to defer a portion of their compensation, subject to annual limits. The State Bar may make discretionary matching contributions on behalf of participants who make elective 401 (K) contributions. In addition, the State Bar, in its sole discretion, may elect to make Employer contributions to the plan. The Bar has chosen to contribute an amount equal to 7% of an eligible employee's annual compensation for 2011 and 2010.

Total employer pension expense for 2011 and 2010 was \$345,949 and \$449,643, respectively.

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Note 10 - Related Party Transactions

The State Bar collects the Client Protection Fund of the State Bar of Arizona (the Fund) assessment revenue and transfers it to the Fund annually. The Fund pays the State Bar of Arizona administrative fees. The total administrative fees charged totaled \$85,777 and \$87,398 for the years ended December 31, 2011 and 2010, respectively.

The Arizona Foundation for Legal Services & Education (Foundation) is a nonprofit charitable and educational organization which has 6 of its 25 Directors appointed by the Board of Governors of the State Bar.

The State Bar currently leases 7,226 square feet of office space to the Foundation under an operating lease agreement that ends on May 31, 2021. This lease was entered into on February 15, 2005 and has subsequently been amended with the Third amendment effective June 1, 2011. This amendment modified the term date of the lease to May 31, 2021. The Foundation has the option to terminate the lease effective at any time after May 31, 2016 by providing the State Bar six months prior written notice and pay compensation for lost rents as defined in Third amendment. In addition for consideration of the extension of the Lease Term, the Foundation shall receive rent abatement for up to ten months ("Free Rent Months") during the term of the Third amendment, but not to exceed two free rent months per lease year.

Also, in 2009 the Bar reduced the required rental payments from the Foundation by \$60,000 for each year remaining per the lease agreement.

Rental payments under the terms of the operating lease were approximately \$63,900 and \$93,800 for the years ended December 31, 2011 and 2010, respectively.

The following schedule details the amount of minimum rentals to be received as of December 31, 2011 from the Foundation, excluding the \$60,000 per year agreed upon future rent payment reduction and the remaining 8 months of rent abatement referenced in the Third amendment to lease.

Year ending December 31,	
2012	\$ 137,294
2013	137,294
2014	137,294
2015	152,047
2016	162,585
Thereafter	718,084
Total minimum lease payments	<u>\$ 1,444,598</u>

Note 11 - Unrelated Business Income

The State Bar generates unrelated business income from advertising sales and endorsement revenue. Federal and State unrelated business income tax expense was estimated to be zero for 2011 and 2010.

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Note 12 - Operating Leases

Lessor

As of December 31, 2011 the State Bar leases office space to three tenants, including the Foundation, in its building located at 4210 North 24th Street, Phoenix Arizona 85016. The State Bar has entered into a property management agreement with a third party to act as the Agent to operate and manage the 24th Street property which includes billing and collecting rent from tenants on behalf of the State Bar. In addition to the management fee the State Bar has historically paid the property management company a 2% leasing fee. The State Bar received \$180,866 and \$483,104 of lease payments during the year ended December 31, 2011 and 2010, respectively.

The following schedule details the amount of minimum rentals to be received as of December 31, 2011.

Year ending December 31,	
2012	\$ 189,547
2013	173,999
2014	171,651
2015	190,472
2016	162,585
Thereafter	718,084
Total minimum lease payments	<u>\$ 1,606,338</u>

Note 13 - Contingencies

The State Bar is involved in a number of legal proceedings which represent litigation related to its business. In the State Bar's opinion, none of these legal proceedings currently pending will have a material adverse effect upon the financial position or results of operations.