



Client Protection Fund 2021 Annual Report

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- A. Consolidated Financial Statements, Year Ended December 31, 2021
State Bar of Arizona and the Client Protection Fund of the State Bar of Arizona
(See Appendix pages 36-37 for Fund-specific information.)



I. Introduction

The Supreme Court of Arizona, by its Rule 32(d)(8), requires the State Bar of Arizona to create and maintain the Client Protection Fund ("Fund") as an entity separate from the State Bar. A resolution authorizing the establishment of the Fund was submitted by the State Bar Board of Governors ("Board") to the State Bar membership and approved on April 9, 1960. The Fund was created by a Declaration of Trust dated January 7, 1961, which is amended and restated by the Board as needed.

"The purpose of the Fund is to promote public confidence in the administration of justice and the integrity of the legal profession by reimbursing losses caused by the dishonest conduct of lawyers admitted and licensed or otherwise allowed to practice in Arizona, occurring in the course of the client-lawyer or fiduciary relationship between the lawyer and the claimant." *Declaration of Trust*.

Each year the Fund presents its Annual Report to the Supreme Court of Arizona. The period covered by this report is January 1, 2021 through December 31, 2021. The report summarized the Fund's claim and financial activity for the year and provides other general information about the Fund. Members of the Board are provided with a copy, and the report will be posted on the State Bar's website so that Bar members can monitor the Fund's activities and operations. More specific information that what is in this report may be obtained only with the consent of the Supreme Court.

II. Board of Trustees

A five-person Board of Trustees ("Trustees"), appointed by the Board, administers the Fund. Each lawyer Trustee must be an active member of the State Bar in good standing for at least ten years. The Board, in its discretion, may appoint one non-lawyer Trustee. Trustees serve five-year terms, with no more than two consecutive terms. The Trustees typically hold quarterly meetings to review claims and are not compensated for their service. The Board of Trustees for 2021 included:

Trustee	Appointed	Reappointed	Term End
James B. Penny, Chair (Tucson)	07/01/11	07/01/16	06/30/21
Robert E. Schmitt, Chair (Prescott)	07/01/12	07/01/17	06/30/22
Matthew A. Gerst, Public Trustee (Scottsdale)	07/01/15	07/01/20	06/30/25
Sandra L. Etherton, Sec/Treasurer (Scottsdale)	07/01/18		06/30/23
Gregg Woodnick, Trustee (Phoenix)	07/01/19		06/30/24
Joshua L.J. Estavillo, Trustee (Tucson)	07/01/21		06/30/26

III. Eligible Claims

The Trustees only consider claims alleging a loss of money or property due to the dishonest conduct of a lawyer acting as a lawyer or fiduciary to the claimant. The Trustees cannot approve a claim for payment until one of the “triggering” events listed in Rule 3(C) of the Declaration of Trust has occurred. Rule 3(C) requires that the lawyer must be:

1. Suspended for a term of longer than six months;
2. Placed on interim suspension;
3. Disbarred;
4. Deceased;;
5. Transferred to disability inactive status; or,
6. Convicted of a felony related to the circumstances of the claim

Claims that are eligible by reason of one of the “triggering events” listed above may not be paid prior to the expiration of six months following the event. The Declaration of Trust includes claim caps and a limitations period. The Fund may not award more than \$100,000 to any one claimant and not more than \$250,000 total in claims against any one lawyer. Claims must be filed within five (5) years from the time the claimant knew or should have known of the dishonest conduct. This limitation period can be waived by the Trustees.

IV. Claims Filed in 2021

Seventy-six (76) claims were received in 2021. Not all of the claims received during 2021 were eligible for payment in 2021.

V. Claims Paid in 2021

Thirty-six (36) claims were approved and paid during 2021—one (1) received in 2019, twenty-five (25) received in 2020, and ten (10) received in 2021. Claims filed against the following lawyers were paid in 2020:

CLAIMS FILED IN 2019—PAID IN 2021				
Lawyer	State Bar Status	No. of Claims	Amount Sought	Amount Paid
Scott A. Maasen	Disbarred	1	30,000.00	11,970.00
TOTALS		1	\$30,000.00	\$11,970.00

CLAIMS FILED IN 2020—PAID IN 2021				
Lawyer	State Bar Status	No. of Claims	Amount Sought	Amount Paid
Annette L. Gerhardt	Deceased	4	\$ 18,835.00	\$18,835.00
Garrett J. Wilkes	Disbarred	1	1,900.00	1,700.00
Anthony G. Salvador	Disbarred	4	10,291.85	10,291.85
Guy F. Brown	Deceased	1	9,000.00	8,500.00
Lawrence D. Pew	Disbarred	9	26,641.62	21,675.95
Greg Clark	Disbarred	2	8,000.00	8,000.00
Paul D. Petersen	Disbarred	2	65,800.00	64,000.00
Alexander Z. Monfared	Suspended	1	2,835.00	2,835.00
David K. Rosen	Disbarred	1	3,500.00	3,500.00
TOTALS		25	\$146,803.47	\$139,337.80

CLAIMS FILED IN 2021—PAID IN 2021				
Lawyer	State Bar Status	No. of Claims	Amount Sought	Amount Paid
Alexander Z. Monfared	Suspended	6	\$6,858.62	\$ 6,165.96
Lawrence D. Pew	Disbarred	3	5,700.00	4,094.13
Paul D. Petersen	Disbarred	1	43,100.00	36,000.00
TOTALS		10	\$55,658.62	\$46,260.09

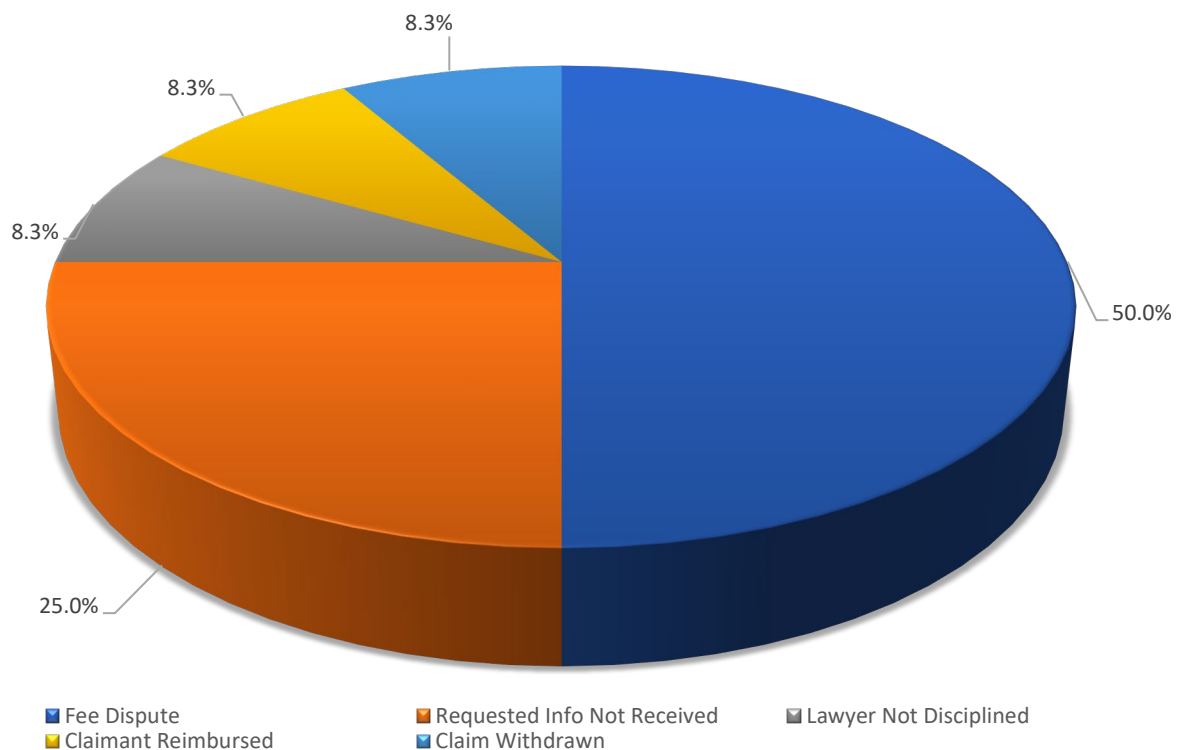
TOTAL CLAIMS FILED 2019-2021—PAID IN 2021			
Year	Claims Paid	Total Sought	Total Paid
2019	1	\$30,000.00	\$11,970.00
2020	25	146,803.47	139,337.80
2021	10	55,658.62	46,260.09
TOTALS	36	\$232,462.09	\$197,567.89

VI. Claims Denied in 2021

The Trustees denied twelve (12) claims in 2021, three (3) fewer denials than in 2020. The Trustees denied claims for the following reasons:

- The lawyer was not disciplined, or the disciplinary sanction received by the lawyer did not meet the criteria outlined in the Declaration of Trust.
- The claim did not demonstrate dishonesty but was a dispute over fees charged.
- Necessary information requested from the claimant was not received.

REASONS FOR DENIAL OF CLAIMS IN 2021



VII. Forecasting

Fifty-seven (57) claims filed in 2021 remained pending at the end of 2021. All of those claims were completed by June 30, 2022, which is within the standard average processing time of six months. There have been seventy (70) claims filed during the first six months of 2022, seeking a total of \$748,464.45 from the Fund. There were forty (40) claims pending consideration as of June 30, 2022—thirty-nine (39) from 2021 and one (1) from 2022.

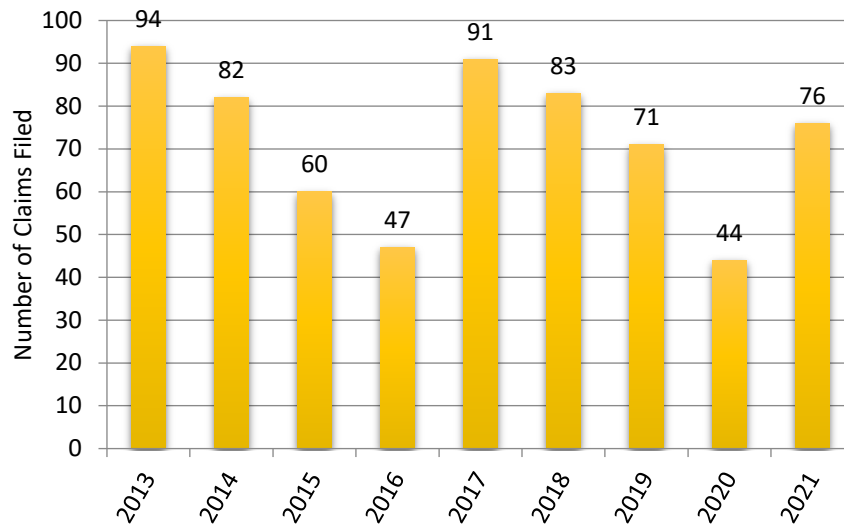
Year	Beginning Fund Balance	Claims Filed	Total Amount Sought	Claims Paid by Year Filed	Total Amount Paid	Claims Denied	Total Claims Resolved	Year End Fund Balance*	Claims Pending Year End	Claims Resolved Following Year
2020	\$2,241,077	44	\$6,391,901	2019: 14	\$106,793	15	33	\$2,463,044	35	35
				2020: 4						
				Total: 18						
2021	\$2,463,044	76	\$1,257,088	2019: 1	\$197,568	12	88	\$2,595,880	57	57**
				2020: 25						
				2021: 10						
				Total: 36						
2022**	\$2,595,880	70	\$748,464	2021: 39	\$238,190	19**	59**	N/A	N/A	N/A
				2022: 2						
				Total: 41						

*Year end Fund balance does not only reflect claims paid. Other factors affecting the final balance include, but are not limited to: dues assessments, interest in investments, staff and operating expenses, and lawyer restitution to the Fund.

**As of June 30, 2022

VIII. 2013-2021 Historical Claims Data

CLAIMS FILED BY YEAR 2013-2021

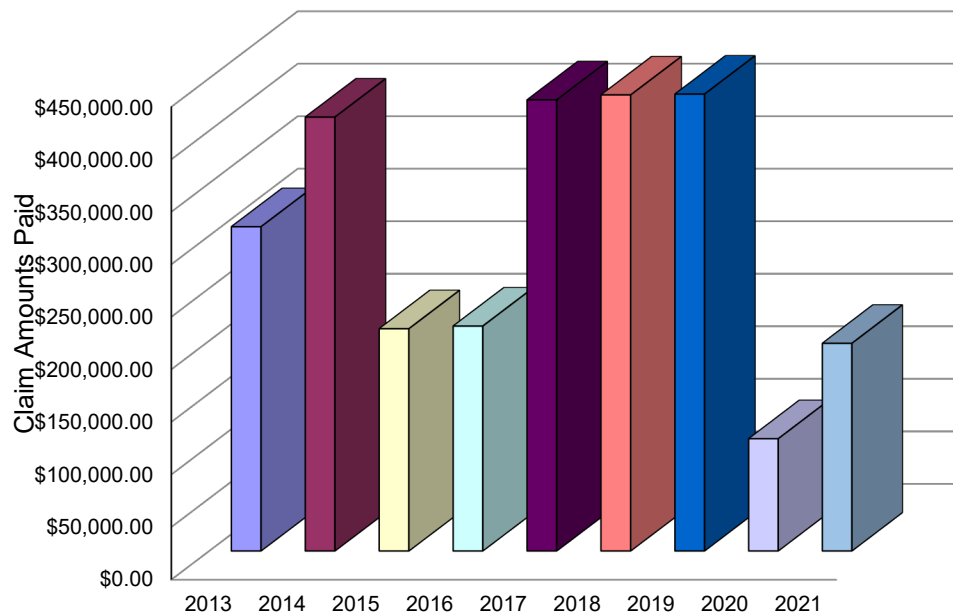


Five-Year Snapshot by Calendar Year

Year	Claims Filed	Claims Paid	Claims Denied	Total Amount Sought for all Claims Filed	Amount Paid by the Fund*
2017	91	52	39	\$1,591,313	\$165,473
2018	83	62	42	\$2,244,393	\$547,907
2019	71	54	44	\$4,281,678	\$346,293
2020	44	18	15	\$6,391,901	\$106,793
2021	76	36	12	1,256,124.74	\$197,568

*Total amount paid out by the Fund for all claims that were filed in a specific calendar year, regardless of when the claim was actually paid. Not all claims are resolved during the calendar year in which the claim was received. The aggregate of approved and denied claims, as well as the number of claims paid, do not always equal the claims filed in a given year.

AMOUNTS PAID 2013-2021



For the last nine years, the annual average for claims paid was \$295,801.

IX. Types of Dishonest Conduct

The Declaration of Trust authorizes the Trustees to consider claims arising out of a lawyer's "dishonest conduct," defined in Rule 3(D) as:

1. Wrongful acts committed by a lawyer in the nature of theft or embezzlement of money or the wrongful taking or conversion of money, property, or other things of value; or,
2. Failure to refund unearned fees received in advance as required by Rule 1.16(d) of the *Arizona Rules of Professional Conduct* (which states, "[u]pon termination of representation, a lawyer shall take steps to the extent reasonable practicable to protect a client's interests, such as ... surrendering documents and property to which the client is entitled and refunding any advance payment of a fee that has not been earned"); or,
3. A lawyer's act of intentional dishonesty or deceit that proximately leads to the loss of money or property.

Examples of the types of dishonest conduct forming the basis for claims paid in 2020 include:

A. Retention of Unearned Fees

A number of claims were paid based upon the respondent lawyers keeping unearned fees. When a lawyer receives fees for work that is never performed, and fails to return the unearned fees,

the Trustees may consider that conduct “dishonest.” The Trustees do not resolve fee disputes, but they can pay claims where virtually no work of value was performed, such that the failure to return the unearned portion of the fee amounted to conversion or theft. These are some of the most difficult claims for the Trustees because they involve an assessment of the value of work performed by a lawyer.

B. Misappropriation of Clients’ Money

Some claims arose from lawyers misappropriating either settlement proceeds or other funds entrusted to them. Arizona currently does not have a third-party payee notification statute that would require entities, such as insurance carriers, to notify clients when the carrier issues a check to a lawyer. Hence, a claimant may not be aware of the misappropriation until after the lawyer cashed the check and the one-year statute of limitations to bring a forged-endorsement action against the paying financial institution has expired.

X. Revenue Received by the Fund

As of December 31, 2021, the Fund had a balance of \$2,595,880 in total net assets. Payments into the Fund include: (1) the annual member assessment; (2) interest income on investments; and (3) restitution to the Fund. Revenues from these sources totaled \$461,342 in 2021.

A. Annual Lawyer Assessment

The Fund receives a \$20 annual assessment from each active bar member. This is not part of a member’s bar dues, but a separate assessment established by the Board with the consent of the Arizona Supreme Court, pursuant to Rule 32(c)(7) and (8). The total assessments received by the Fund in recent years were:

Year	Annual Revenue from Assessment
2017	\$429,420
2018	\$434,115
2019	\$434,866
2020	\$435,390
2021	\$441,800

B. Interest from Investments

In 2021, the Fund earned \$6,289 in interest income from its investments, a decrease from 2020. For the last ten years, interest income has averaged \$13,156 per year. See the history of the Fund's interest income below:

Year	Interest Income
2013	\$4,475
2014	\$3,775
2015	\$8,937
2016	\$9,368
2017	\$11,898
2018	\$21,169
2019	\$32,958
2020	\$19,638
2021	\$6,289

Fund investments are made in compliance with the Board's investment policies.

C. Restitution to the Fund

In 2021, the Fund received a total of \$13,253 in restitution from lawyers against whom claims had been paid. A lawyer whose conduct has resulted in a paid claim may not seek reinstatement to active status until the lawyer has reimbursed the Fund for any claims paid.

XI. Investments

Since 2005, the Fund has invested in the Certificate of Deposit Account Registry ("CDARS"). The CDARS program allows the Fund to purchase certificates of deposit, each within the applicable federal insurance limit, from participating U.S. banks. CDARS are beneficial because they: (1) are FDIC insured up to \$20,000,000; (2) offer varying maturities and fixed rates; (3) allow the Fund to deal with only one bank and receive a single monthly statement and IRS Form 1099; and (4) pay "jumbo" rates with FDIC coverage. The Fund ladders all of its investments in the CDARS program. The benefits of laddering are that market risk is reduced, there is a more stable rate of return, and the interest rates are higher.

In 2021, the Fund invested in the CDARS program through Alliance Bank of Arizona. As of December 31, 2021, the Fund had a balance of \$2,528,933 in CDARS. The table below outlines the Fund's CDARS accounts as of December 31, 2021:

CDARS	Rate	Effective Date	Maturity Date	Principal
WA(1025484351)	0.14989%	12/09/21	01/06/22	\$605,632.55
WA(1025484378)	0.14989%	12/09/21	01/06/22	519,557.88
WA(1025484343)	0.14989%	12/09/21	01/06/22	403,130.23
WA(1025522229)	0.14989%	12/23/21	01/20/22	500,055.45
WA(1025522202)	0.14989%	12/23/21	01/20/22	500,556.85
TOTAL				\$2,528,932.96

XII. Fund Administration

A. Administration

Karen Oschmann, Client Protection Fund Administrator ("Administrator") provided support to the Trustees regarding the administration of the Fund in 2020. Additionally, the Chief Financial Officer of the State Bar, Kathy Gerhart, and the State Bar's Controller, Jessica Iennarella, provided accounting support to the Fund in 2021.

The Fund's Administrator reviews claims, investigates the claimant allegations, corresponds with claimants and lawyers, prepares claim summaries and recommendations, and forwards copies of this information to the Trustees for review at quarterly meetings. The Administrator is also responsible for taking minutes of the meetings, compiling statistical data and other information, and preparing the Fund's annual report for the Trustees' approval.

Each year, the Administrator and/or the Trustees may attend one or both the American Bar Association National Forum on Client Protection and the National Client Protection Organization Workshop. At these conferences, Fund Administrators and Trustees from the United States and Canada meet to discuss issues common to all Funds and learn about emerging trends in the arena of client protection.

Questions regarding the Fund should be addressed to the Fund Administrator, Karen Oschmann, at 602-340-7286 or karen.oschmann@staff.azbar.org.

B. Expenses

The Fund incurred \$130,938 in operating expenses in 2021, including, but not limited to, the apportioned salaries for the General Counsel and Fund Administrator, and Trustee travel to quarterly meetings. Investigators are utilized at the discretion of the Trustees to investigate claim information. The Trustees are volunteers and are not compensated for their service. The chart below demonstrates the Fund's 2021 financial overview:

2021 FINANCIAL OVERVIEW	
Net assets as of 12/31/20	\$2,463,044
Revenue received in 2021	\$461,342
Claims paid in 2021	\$197,568
Operation expenses paid in 2021	\$130,938
Net assets as of 12/31/21	\$2,595,880

XIII. Financial Controls

The Fund maintains a commercial crime insurance policy of \$1,000,000. The Fund also has other financial controls in place, including requiring two Trustee signatures on all checks and an annual audit by an independent auditor.

XIV. Public Awareness

The Trustees have undertaken a variety of activities to create greater public and member awareness of the Fund:

- Information about the Fund is included in State Bar Convention materials.
- The State Bar website provides easy access to information about the Fund.
- Advertisements for the Fund are periodically placed in issues of Arizona Attorney magazine.

XV. Comments from Claimants

- "I wanted to express my gratitude towards yourself and your team for replying to my emails and keeping me informed at all times."
- "Thank you so much!!! The Fund's staff has been amazing!!!"
- "Thank you for your assistance. I'm so glad this matter finally has been resolved, but I couldn't do it without you, thanks again."

- "Thank you so much for your assistance, guidance and communication during this process. I really appreciate it!"
- "Thank you so much for all the work you did! You truly have been professional, kind, and empathetic."
- "The AZ State Bar has been a tremendous help and we appreciate you guys."

**STATE BAR OF ARIZONA
AND THE CLIENT PROTECTION FUND
OF THE STATE BAR OF ARIZONA**

**CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION**

Year Ended December 31, 2021

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

Year Ended December 31, 2021

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INDEPENDENT AUDITORS' REPORT

The Board of Governors and Trustees

STATE BAR OF ARIZONA AND THE CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA

Opinion

We have audited the consolidated financial statements of **State Bar of Arizona and the Client Protection Fund of the State Bar of Arizona** (collectively referred to as "the Organization"), which comprise the consolidated statement of financial position as of December 31, 2021, and the related consolidated statements of activities and change in net assets, functional expenses and cash flows for the year then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Organization as of December 31, 2021, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America ("GAAS"). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of the Organization and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Organization's ability to continue as a going concern for one year after the date that the consolidated financial statements are available to be issued.



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Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

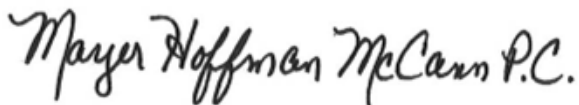
In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Organization's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Report on Consolidating Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information on pages 19 and 20 are presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual organizations, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.



September 21, 2022

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

December 31, 2021

ASSETS

CURRENT ASSETS	
Cash and cash equivalents	\$ 4,974,700
Certificates of deposit	2,528,933
Accounts receivable, net	55,139
Inventories	56,781
Deferred rent - short term	18,704
Prepaid expenses and other assets	476,491
TOTAL CURRENT ASSETS	<u>8,110,748</u>
INVESTMENTS - BOARD DESIGNATED	7,372,651
INVESTMENTS RESTRICTED FOR BENEFIT PLAN	354,896
OTHER ASSETS	51,525
DEFERRED RENT - LONG TERM	48,632
PROPERTY AND EQUIPMENT, net	<u>9,546,426</u>
TOTAL ASSETS	<u>\$ 25,484,878</u>

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES	
Accounts payable	\$ 107,635
Property taxes payable	86,664
Accrued liabilities	1,129,298
Prepaid rent liability	6,970
Membership and other fees collected in advance	3,264,455
TOTAL CURRENT LIABILITIES	<u>4,595,022</u>
OTHER LIABILITIES	<u>434,677</u>
TOTAL LIABILITIES	<u>5,029,699</u>
NET ASSETS	
Net assets without donor restrictions	
Undesignated	9,738,327
Board designated	8,120,972
Statute designated	2,595,880
TOTAL NET ASSETS	<u>20,455,179</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 25,484,878</u>

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA
CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGE IN NET ASSETS**

Year Ended December 31, 2021

SUPPORT AND REVENUE	
Membership fees	
Active	\$ 9,027,979
Inactive	1,193,880
Membership fees penalties	368,450
Sections	322,720
Board of legal specializations	92,250
Admission on motion	105,030
	<u>11,110,309</u>
PROGRAM SERVICE REVENUE	
Regulatory	
Judgement receipts	113,474
Professional services	53,944
Reinstatement fees	14,049
Trust account ethics program	5,500
Miscellaneous charges	17,553
	<u>204,520</u>
COMPLIANCE	
Board of legal specializations	36,000
Pro Hac Vice fees	526,218
Reinstatement fees	11,000
Mandatory continuing legal education - late fees	609,856
Miscellaneous charges	10,483
	<u>1,193,557</u>
PROFESSIONAL DEVELOPMENT	
Continuing legal education	2,420,453
Convention	366,098
Publications, net of costs of good sold of \$40,610	212,854
Advertising sales	1,092,491
Arizona Attorney magazine	1,795
Sections meetings and conferences	39,420
Contributions and sponsorships	45,747
Membership benefits	102,327
Other miscellaneous	110,050
	<u>4,391,235</u>
ACCESS TO JUSTICE	
Lawyer referral services	<u>16,780</u>
CLIENT PROTECTION FUND	
Assessments	441,340
Restitution receipts	13,253
	<u>454,593</u>
OTHER REVENUE	
Rental income	571,164
Interest and dividends	145,251
Realized and unrealized gains, net of investment expenses	208,029
Loss on sale-disposal of assets	(1,473)
Other	126,764
TOTAL SUPPORT AND REVENUE	<u>18,420,729</u>
EXPENSES	
Program Services:	
Regulatory	5,867,492
Compliance	1,605,146
Professional development	5,232,715
Access to justice	546,597
Client Protection Fund	328,506
Total program services	<u>13,580,456</u>
Management and general	<u>2,135,643</u>
TOTAL EXPENSES	<u>15,716,099</u>
CHANGE IN NET ASSETS	2,704,630
NET ASSETS, BEGINNING OF YEAR	<u>17,750,549</u>
NET ASSETS, END OF YEAR	<u>\$ 20,455,179</u>

See Notes to Consolidated Financial Statements

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

Year Ended December 31, 2021

	Program Services					Total Program	Management	
	Regulatory	Compliance	Professional Development	Access to Justice	Client Protection Fund	Services	and General	Total
Salaries and wages	\$ 3,362,915	\$ 914,939	\$ 2,189,588	\$ 216,764	\$ 89,214	\$ 6,773,420	\$ 1,085,422	\$ 7,858,842
Employee benefits	543,274	184,739	364,200	46,299	15,943	1,154,455	200,516	1,354,971
Payroll taxes	252,573	68,545	166,107	16,244	6,710	510,179	79,781	589,960
Bank/credit card fees	150,455	52,278	187,141	14,863	-	404,737	362	405,099
Claims paid	-	-	-	-	197,568	197,568	-	197,568
Conferences, conventions and meetings	269	20	778,805	30	-	779,124	17,826	796,950
Contract labor	-	7,943	8,786	-	-	16,729	1,500	18,229
Contributions	-	-	34,976	107,769	-	142,745	-	142,745
Depreciation	233,792	91,096	187,601	23,828	-	536,317	183,712	720,029
Information technology	232,769	79,032	285,697	73,893	-	671,391	49,133	720,524
Legal fees	11,881	1,466	-	-	162	13,509	50,479	63,988
Member research tool	-	-	80,004	-	-	80,004	-	80,004
Occupancy	187,827	74,102	159,959	20,264	11,227	453,379	285,196	738,575
Office expense	104,413	72,108	468,472	12,973	1,405	659,371	6,603	665,974
Office of Presiding Disciplinary Judge	613,069	-	-	-	-	613,069	-	613,069
Professional services	101,513	32,941	258,492	7,432	-	400,378	45,359	445,737
Training and development	18,423	6,912	20,964	2,722	254	49,275	17,759	67,034
Other expenses	54,319	19,025	82,533	3,516	6,023	165,416	111,995	277,411
Total expenses by function	\$ 5,867,492	\$ 1,605,146	\$ 5,273,325	\$ 546,597	\$ 328,506	\$ 13,621,066	\$ 2,135,643	\$ 15,756,709
Less expenses included with revenues on the statement of activities								
Publications cost of goods sold	-	-	(40,610)	-	-	(40,610)	-	(40,610)
Total expenses included in the expense section of the statement of activities	<u>\$ 5,867,492</u>	<u>\$ 1,605,146</u>	<u>\$ 5,232,715</u>	<u>\$ 546,597</u>	<u>\$ 328,506</u>	<u>\$ 13,580,456</u>	<u>\$ 2,135,643</u>	<u>\$ 15,716,099</u>

See Notes to Consolidated Financial Statements

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

CONSOLIDATED STATEMENT OF CASH FLOWS

Year Ended December 31, 2021

CASH FLOWS PROVIDED BY OPERATING ACTIVITIES

Change in net assets	\$ 2,704,630
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation	720,029
Loss on sale-disposal of assets	1,473
Realized and unrealized gains on investments	(243,830)
Change in assets and liabilities	
Accounts receivable	12,858
Inventories	4,728
Prepaid expenses and other assets	(3,248)
Investments restricted for benefit plan	70,119
Accounts payable	(67,742)
Property taxes payable	1,349
Accrued liabilities	(183,100)
Deferred rent	(14,949)
Membership and other fees collected in advance	(84,957)
Other liabilities	(68,103)
Net cash provided by operating activities	<u>2,849,257</u>

CASH FLOWS USED IN INVESTING ACTIVITIES

Purchases of property and equipment	(376,149)
Purchases of certificates of deposit	(12,934,570)
Redemptions of certificates of deposit	12,606,223
Purchase of investments - board designated	(7,141,474)
Sale of investments - board designated	<u>12,653</u>
Net cash used in investing activities	<u>(7,833,317)</u>

NET CHANGE IN CASH AND CASH EQUIVALENTS (4,984,060)

CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR 9,958,760

CASH AND CASH EQUIVALENTS, END OF YEAR \$ 4,974,700

STATE BAR OF ARIZONA AND THE CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2021

(1) Principal business activity and significant accounting policies

Principal business activity - The State Bar of Arizona ("SBA" or "State Bar") is an Arizona non-profit corporation formed in 1933 and operated under the supervision of the Arizona Supreme Court. SBA regulates approximately 18,500 active attorneys in Arizona and provides education and development programs for the legal profession and the public. The State Bar's mission states that it exists to serve and protect the public with respect to the provision of legal services and access to justice.

Regulatory - Pursuant to Rule 32 of the Supreme Court of Arizona, the State Bar of Arizona assists the Court with the regulation and discipline of persons engaged in the practice of law. The State Bar receives, screens, and investigates complaints against attorneys, which may be dismissed, require remedial action or lead to more formal proceedings resulting in various forms of discipline.

Compliance - Pursuant to Rule 32 of the Supreme Court of Arizona, the State Bar is charged with ensuring the competency of lawyers. Consistent with Rule 44, Legal Specialization, the State Bar administers a program through the Board of Legal Specialization in order to improve the quality of legal services. Additionally, in accordance with Rule 45, Mandatory Continuing Legal Education, the State Bar ensures active members complete required continuing legal education on an annual basis. The State Bar also assists in processing Pro Hac Vice Admissions under Rule 39 and processes In House Counsel registrations under Rule 38.

Professional development - Pursuant to Rule 32 of the Supreme Court of Arizona, the State Bar is to conduct educational programs regarding substantive law, best practices, procedure and ethics and provide forums for discussion regarding the administration of justice and practice of law. The State Bar is also responsible for fostering ideals of integrity, learning, competence, and public service among attorneys and serve the professional needs of its members. The State Bar fosters professional development of attorneys through opportunities to serve on advisory groups, committees, sections, and task forces, and by providing continuing legal education, practice management assistance, legal resources and various other member services.

Access to justice - Pursuant to Rule 32 of the Supreme Court of Arizona, the State Bar mission includes access to justice, which involves efforts to improve access to our legal system for all Arizonians. The Bar carries out this task through its Public Service Center by supporting various legal aid organizations, assisting with access to attorneys, working to educate the public about the legal process, and by supporting the Supreme Court's Access to Justice Commission.

Client Protection Fund - The Client Protection Fund of the State Bar of Arizona ("CPF"): the CPF was established on January 7, 1961, by the Supreme Court of Arizona, pursuant to Arizona Revised Statutes Ct. 32(d)(8). The CPF is a trust that is an entity separate from the State Bar of Arizona but exists as part of the State Bar's business structure. Authority to revoke or amend the Declaration of Trust, which established the CPF, is delegated to the Board of Governors of the State Bar of Arizona. The Declaration of Trust was amended and restated in its entirety on December 13, 2013 and further amended on November 21, 2014, September 29, 2017 and April 16, 2021.

The purpose of the CPF is to promote the public confidence in the administration of justice and the integrity of the legal profession by reimbursing losses caused by the dishonest conduct of lawyers admitted and licensed to practice in Arizona, occurring in the course of the client-lawyer or fiduciary responsibility between the lawyer and the claimant.

STATE BAR OF ARIZONA AND THE CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2021

(1) **Principal business activity and significant accounting policies (continued)**

Principles of consolidation - The consolidated financial statements include the accounts of State Bar of Arizona and the CPF because SBA has both control of and an economic interest in the CPF. All significant intercompany accounts and transactions have been eliminated in consolidation. Unless otherwise noted, these consolidated entities are hereinafter referred to as "the Organization".

Basis of presentation - The Organization maintains its accounts in accordance with the principles and practices of fund accounting. Fund accounting classifies various resources in accordance with activities or objectives as specified, in accordance with regulations, restrictions, or limitations imposed by sources outside of the Organization, or in accordance with directions issued by the governing board.

Management's use of estimates - The preparation of consolidated 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 consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents - For purposes of the consolidated statement of cash flows, highly liquid investments with a maturity of three months or less at date of purchase are considered cash equivalents. No restricted cash balances existed at December 31, 2021.

The Organization maintains cash balances at various financial institutions. Deposits at each institution are insured in limited amounts by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. The Organization has not experienced any loss in such accounts.

Accounts receivable - Accounts receivable consist of program service fees, all of which are due in less than one year and, accordingly, are presented as current assets in the accompanying consolidated financial statements. The Organization is exposed to certain credit risk. The Organization manages its risk by regularly reviewing its accounts and by providing appropriate allowances for uncollectible accounts. The Organization deems accounts over 90 days old to be past due. The Organization does not charge interest on late accounts. Accounts receivable are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to revenue and a credit to the allowance for uncollectible accounts based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for uncollectible accounts and a credit to accounts receivable. As of December 31, 2021, the total allowance for uncollectible accounts was approximately \$2,000.

Inventories - Inventories are measured at the lower of cost, determined on a first in, first out basis, or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. As of December 31, 2021, inventories consisted of handbooks and textbooks for sale.

Investments - The Organization reports investments in equity securities at fair value. The fair values of investments are based on quoted market prices. Investment income and gains and losses are recorded as increases or decreases in the consolidated statement of activities and change in net assets.

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2021

(1) Principal business activity and significant accounting policies (continued)

Property and equipment - Property and equipment additions \$5,000 and above for building and improvements, \$10,000 or above for tenant leasehold improvements, and \$2,500 and above for all other additions, are recorded at cost, or if donated, at fair value on the date of donation. When assets are sold or otherwise disposed of, the cost and related depreciation are removed from the accounts, and any remaining gain or loss is included in the consolidated statement of activities and change in net assets. Costs of maintenance and repairs that do not improve or extend the useful lives of the respective assets are expensed currently.

Depreciation of property and equipment is computed using the straight-line method over the following estimated range of useful lives:

Building, building and land improvements	10 – 39 years
Furniture and equipment	4 – 10 years
Computer software and hardware	3 – 5 years
Capitalized leased assets or leasehold improvements	Lesser of the useful life of the asset or the lease term

The Organization reviews the carrying values of property and equipment for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. When considered impaired, an impairment loss is recognized to the extent carrying value exceeds the fair value of the asset. There were no indicators of asset impairment during the year ended December 31, 2021.

Membership and other fees collected in advance - Membership fees are assessed in November for the following membership period, which correlates with the Organization's fiscal year. All such fees collected prior to the current year end are recorded as deferred revenue and included in membership and other fees collected in advance in the accompanying consolidated statement of financial position. Additionally, registration fees for Continuing Learning Education (CLE) consists of both "live" and online and on demand courses. All registration fees collected in advance of live events, completion of course or expiration of course access is recorded as membership and other fees collected in advance. Deferred revenue is recognized as income in the year in which it is earned.

Net assets - Net assets, revenues, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Net Assets without Donor Restrictions - Net assets that are not subject to donor-imposed restrictions and may be expended for any purpose in performing the primary objectives of the Organization. These net assets may be used at the discretion of the Organization's management and Board of Governors.

Net Assets with Donor Restrictions - Net assets subject to stipulations imposed by donors, and grantors. Some donor restrictions are temporary in nature; those restrictions will be met by actions of the Organization or by the passage of time. Other donor restrictions are perpetual in nature, whereby the donor has stipulated the funds be maintained in perpetuity. The Organization had no donor restricted net assets as of December 31, 2021.

STATE BAR OF ARIZONA AND THE CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2021

(1) Principal business activity and significant accounting policies (continued)

Revenue from contracts with customers - The State Bar Association (“the Association”) has multiple revenue streams that are accounted for as exchange transactions as described below.

Membership fees – Members join the State Bar Association for calendar year annual periods. The Association has allocated the total membership transaction price to the benefits available. As all membership terms terminate at the reporting period end date, all membership revenue is recognized in the calendar year in which it applies. Members generally pay the annual fee in advance. Late fees associated with membership dues are recognized in the period in which they are assessed. Unearned membership dues are reflected as contract liabilities on the consolidated statement of financial position.

Continuing legal education - Continuing legal education (“CLE”) revenue is reported at an amount that reflects the consideration to which the Association expects to be entitled in exchange for providing services to their customers. CLE fees grant the right for the customer to access specified programs. As a CLE registration is for a specific event, the Association considers the contract to be a single performance obligation that is met at the point in time in which the CLE program is completed by the customer. Customers may pay in advance of or on the date of the program, generally resulting in contract liabilities.

Other revenue - Other revenue includes Pro Hac Vice, publications revenue, advertising, and other regulatory and compliance fees and is reported at an amount that reflects the consideration to which the Association expects to be entitled in exchange for the goods or services. Amounts received for other fees are recorded as revenue at the point in time the goods or services are transferred to the customer. Payment is due at the time of the sale and this transaction may result in accounts receivable.

As of December 31, 2021 the CPF received a \$20 annual assessment from each active and inactive member of the Organization. This is not part of the member’s bar fees, but a separate assessment established by the Arizona Supreme Court. Assessments are recognized in the year for which they are assessed.

The beginning and ending balances for contract liabilities and contract assets are as follows:

	<u>Accounts receivable - 1/1/21</u>	<u>Accounts receivable - 12/31/21</u>	<u>Contract liability - 1/1/21</u>	<u>Contract liability - 12/31/21</u>
Membership fees	\$ -	\$ -	\$ 2,637,255	\$ 2,412,160
Continuing legal education	-	-	329,230	365,885
Other fees	<u>67,977</u>	<u>55,139</u>	<u>382,927</u>	<u>486,110</u>
Total	<u>\$ 67,977</u>	<u>\$ 55,139</u>	<u>\$ 3,349,412</u>	<u>\$ 3,264,455</u>

For the year ended December 31, 2021, revenue recognized under a point in time convention totaled approximately \$6,709,868. For the year ended December 31, 2021, revenue recognized under an over-time convention totaled approximately \$10,741,859, which includes membership dues.

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2021

(1) Principal business activity and significant accounting policies (continued)

Contributions - Contributions received are recorded as net assets without donor restrictions or net assets with donor restrictions depending on the existence and/or nature of any donor-imposed restrictions. Contributions that are restricted by the donor are reported as an increase in net assets without donor restrictions if the restriction expires in the reporting period in which the contribution is recognized. All other donor restricted contributions are reported as an increase in net assets with donor restrictions, depending on the nature of restriction. When a restriction expires (that is, when a stipulated time restriction ends, or purpose restriction is accomplished), net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statement of activities and change in net assets as net assets released from restrictions.

Sponsorship revenue – Sponsorship revenue is accounted for in accordance with ASC 958-605 as an unconditional promise to give. Sponsorship revenue is included in the accompanying consolidated statement of activities as follows:

Contributions and sponsorships	\$ 45,747
Convention	<u>23,425</u>
Total sponsorship revenue	<u>\$ 69,172</u>

Donated materials and services - Donated materials and services are reflected as contributions in the accompanying consolidated financial statements at their estimated fair values as of the date of donation. Donated services are recognized as contributions if the services create or enhance nonfinancial assets, or require specialized skills are performed by people with those skills and would otherwise be purchased. The Organization utilizes and depends on the services of volunteers to perform a variety of tasks that assist the Organization with specific programs. The value of this contributed time is not reflected in these consolidated financial statements since the services did not require specialized skills and it was not susceptible to objective measurement.

Rental income - Commercial space is rented under long-term operating lease agreements and rent income related to commercial space is recorded on a straight-line basis. Rent income from tenants is recognized in the month in which it is earned rather than received. Any rent received prior to the month of occupancy is reported as prepaid rent. Tenant securities deposits are included in other long-term liabilities.

Advertising and promotion costs - The Organization expenses advertising and promotion costs as incurred. Advertising and promotion expense for the year ended December 31, 2021 was \$10,700.

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2021

(1) Principal business activity and significant accounting policies (continued)

Functional expense allocation - The costs of providing program and supporting services activities have been summarized on a functional basis in the consolidated statement of activities and change in net assets. The consolidated statement of functional expenses presents the natural classification detail of expense by function. Accordingly, certain departmental costs have been allocated among the programs and supporting services benefited by natural classification. Such allocations are determined by management on an equitable basis.

The departmental expenses that are allocated by natural classification include the following:

<u>Expense</u>	<u>Method of Allocation</u>
Occupancy	Square footage
Information technology	Full time equivalent
Office support services	Full time equivalent
Communications	Full time equivalent
Tucson support office	Full time equivalent

Income and certain excise taxes - SBA is organized as an Arizona non-profit corporation. The Internal Revenue Service has determined that SBA is exempt from federal income taxes under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(6). Management has determined the CPF is a grantor trust and as such it is a disregarded entity treated as a division of SBA solely for income tax purposes. Accordingly, contributions to either organization do not qualify for the charitable contribution deduction under Section 170(b)(1)(A). The combined entity is annually required to file a Return of Organization Exempt from Income Tax (Form 990) with the IRS. In addition, the combined entity is generally subject to income tax on net income that is derived from business activities that are unrelated to their exempt purposes and it files an Exempt Organization Business Income Tax Return (IRS Form 990-T) and the Arizona equivalent (Form 99-T) to report its unrelated business taxable income.

SBA believes that it has appropriate support for any material income tax positions taken, and, as such, does not have any uncertain tax positions that are material to the consolidated financial statements. SBA would recognize future accrued interest and penalties related to unrecognized tax benefits and liabilities in income tax expense if such interest and penalties are incurred. The Organization's federal Form 990, 990-T and Arizona Form 99-T are no longer subject to tax examination for years before 2018 and 2017, respectively.

Fair value measurements - The Organization's significant financial instruments include investments, and deferred compensation plan assets. For these financial instruments, carrying values approximate fair value. FASB ASC 820-10, *Fair Value Measurement*, establishes a common definition for fair value to be applied to accounting principles generally accepted in the United States of America requiring the use of fair value, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal, or most advantageous, market at the measurement date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique. Inputs used to determine fair value refer broadly to the assumptions that market participants would use in pricing the asset including assumptions about risk. Inputs may be observable or unobservable. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available.

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2021

(1) Principal business activity and significant accounting policies (continued)

A three-tier hierarchy categorizes the inputs as follows:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Organization can access at the measurement date.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, and market-corroborated inputs.

Level 3 - Unobservable inputs for the asset or liability. In these situations, the Organization develops inputs using the best information available in the circumstances.

In some cases, the inputs used to measure the fair value of an asset or a liability might be categorized within different levels of the fair value hierarchy. In those cases, the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

Assessing the significance of a particular input to entire measurement requires judgment, taking into account factors specific to the asset or liability. The categorization of an asset within the hierarchy is based upon the pricing transparency of the asset and does not necessarily correspond to the Organization's assessment of the quality, risk or liquidity profile of the asset or liability.

All the Organization's investment assets are classified within Level 1 because they are comprised of open-end mutual funds with readily determinable fair values based on daily redemption values.

Recent accounting pronouncements - In February 2016, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2016-02 to improve financial reporting about leasing transactions (Topic 842). The ASU affects all lease transactions. The Organization as a lessee is required to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, on the consolidated statement of financial position. For leases greater than twelve months, the Organization as a lessee must also recognize interest on the lease liability separately from amortization of the right-of-use asset in the consolidated statement of activities and change in net assets. Repayments of the principal portion of the lease liability must be classified within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the consolidated statement of cash flows. Leases for less than twelve months recognize a single lease cost on a straight-line basis. The effective date for this standard has been delayed to annual reporting periods beginning after December 15, 2021. The Organization is currently evaluating the impact of adopting ASU 2016-02 and has not determined the effect to the consolidated financial statements. The standard requires a modified retrospective approach to implementation.

Subsequent events - The Organization has evaluated subsequent events through September 21, 2022, which is the date the consolidated financial statements were available to be issued.

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2021

(2) Certificates of deposit

The CPF invests in the Certificate of Deposit Account Registry Service ("CDARS"). The CDARS program allows the Organization to purchase certificates of deposit, each within the applicable federal insurance limit, from participating U.S. banks. All certificates of deposit are recorded at amortized cost and are scheduled to mature in 2022. Funds from the maturity of certificates of deposit are generally reinvested in certificates of deposit.

(3) Liquidity and availability of resources

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of the balance sheet date are as follows:

Financial assets at year-end	
Cash and cash equivalents	\$ 4,974,699
Certificates of deposit	2,528,933
Investments – Board designated	7,372,651
Investments restricted for benefit plan	354,896
Accounts receivable, net	<u>55,139</u>
Total financial assets available within one year	15,286,318
Less:	
Investments restricted for benefit plan	354,896
Board-designated funds	8,120,972
Statute designated funds	<u>2,595,880</u>
	<u>11,071,748</u>
Financial assets available to meet general expenditures over the next twelve months	<u>\$ 4,214,570</u>

As part of the Organization's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. Additionally, the Organization had Board-designated net assets without donor restrictions that, while the Organization does not intend to spend for these purposes, the amounts could be made available for current operations, if necessary upon Board approval.

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2021

(4) Investments and fair value measurements

The following table presents investments measured at fair value on a recurring basis at December 31, 2021.

		<u>Fair Value Measurements at Report Date Using</u>		
		Quoted Prices In Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets				
Equity mutual funds – board designated	\$ 4,551,405	\$ 4,551,405	\$ -	\$ -
Fixed income mutual funds – board designated	2,821,246	2,821,246	-	-
Equity securities for benefit plan	354,896	354,896	-	-
Total	<u>\$ 7,727,547</u>	<u>\$ 7,727,547</u>	<u>\$ -</u>	<u>\$ -</u>

The Organization had no other assets or liabilities subject to recurring fair value measurement at December 31, 2021.

(5) Property and equipment

Property and equipment consisted of the following at December 31, 2021:

Land	\$ 1,753,943
Land improvements	116,195
Buildings	7,739,696
Building improvements	5,685,598
Furniture and equipment	2,059,930
Computer hardware	1,124,661
Computer software	615,083
Total cost or donated value	19,095,106
Accumulated depreciation	(9,548,680)
Property and equipment, net	<u>\$ 9,546,426</u>

(6) Line of credit

SBA had a \$4,000,000 revolving line of credit with a financial institution which expired February 2021. The line of credit was not renewed upon expiration. There were no borrowings and no interest charges during 2021.

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2021

(7) Net assets

Each of the Organization's 31 sections charge separate fees and may only spend out of their current year income or their cumulative surplus, if any. The remaining balances are designated by the Organization's Board of Governors for that specific section. The section carryover totaled \$755,772 as of December 31, 2021.

The Board of Directors adopted a cash reserve policy during the year ended December 31, 2017. Under this policy \$7,157,171 as of December 31, 2021, has been designated and allocated between Membership Fees Reserve and Capital Projects Reserves.

Additionally, the net assets of the CPF are designated by Arizona State Statute to only be used for the purposes of the CPF as set forth in the trust agreement and per statute mandate.

(8) Leasing activities

The Organization leases office space to the Arizona Foundation for Legal Services & Education (the "Foundation"), a related party, under an operating lease agreement ending on January 31, 2028. In addition to this lease agreement, the State Bar has a memorandum of understanding in which the State Bar donates 1% of membership fees collected to the Foundation. This donation is required to be utilized to implement pro bono legal service programs and promote pro bono involvement with legal services. For years beginning 2019 and forward, the reduction of rent is expected to be \$60,000 annually, to be adjusted based on the actual membership fees collected. Minimum future rental payments to be received under this lease including the above referenced in-kind reductions at December 31, 2021 are as follows:

<u>Years Ending December 31,</u>	
2022	\$ 94,278
2023	96,552
2024	96,759
2025	96,759
2026	96,759
Thereafter	<u>104,822</u>
Total minimum lease receipts	<u>\$ 585,929</u>

The Organization also leases office space to unrelated third parties. The lease terms call for monthly payments of approximately \$21,000, maturing through November 2023. Minimum future rental payments to be received on these non-cancelable leases at December 31, 2021 are as follows:

<u>Years Ending December 31,</u>	
2022	\$ 375,704
2023	<u>108,571</u>
Total minimum lease receipts	<u>\$ 484,275</u>

(9) Leasing commitments

The Organization leases offsite storage and convention and meeting facilities with varying minimum annual payments under non-cancelable lease agreements. Lease expense under these agreements was \$19,550 during the year ended December 31, 2021. Future minimum lease payments under operating leases are \$19,800 and \$8,250 due in the years ending December 31, 2022 and 2023, respectively.

(10) Retirement plans

Defined contribution plan - SBA sponsors a defined contribution plan (the Plan) qualified under Section 401(k) of the Internal Revenue Code covering substantially all employees who meet specified age and years of service requirements. SBA may make discretionary contributions on behalf of participants. This plan was amended in March 2021 to clarify definitions per the Plan Document. The entry date is the first day of the month following the date the employee satisfies the eligibility requirements. The plan includes an automatic deferral feature and safe harbor plan. Under the safe harbor election SBA is required to make safe harbor matching contributions equal to 100% of the salary deferrals that do not exceed 1% of the employee's compensation plus 50% of the employee's salary deferrals between 1% and 6% of compensation. The safe harbor matching contribution is subject to a different vesting schedule from the employer discretionary non-elective contributions to the plan. The vesting schedule for the employer qualified safe harbor contributions is 0% for one year of service or less and 100% for two years of service or more. During the year ended December 31, 2021, SBA contributed approximately \$405,000 to the 401(k) plan.

Deferred compensation plan - The Organization sponsors a non-qualified deferred compensation plan (the Non-Qualified 457b Plan) for top management employees. This plan allows for deferral of employee salary, as well as discretionary contributions from SBA. Participant contributions are fully vested upon funding. Discretionary employer contributions are made in the first quarter of each fiscal year and fully vest on June 30 of the same year. As of December 31, 2021, all contributions to this plan are fully vested. This plan was restated as of January 1, 2015 and maintains all qualities and characteristics with the exception employees are divided between two tiers with only the top tier eligible to benefit from discretionary employer contributions, and that vesting is achieved over the employee's period of service. The liability related to the plan totaled approximately \$355,000 at December 31, 2021 and is included in other liabilities on the consolidated statement of financial position. During the year ended December 31, 2021, SBA contributed \$30,000 to the 457b plan.

(11) Related party

SBA appoints six of the 25 members of the Board of Directors for the Foundation. Transactions with the Foundation include the following as of and for the year ended December 31, 2021:

In-kind expense - rent (see Note 8)	\$	60,000
In-kind advertising revenue	\$	3,530
Accounts payable	\$	74,200
Rental income - straight line (see Note 8 – includes common area maintenance recovery)	\$	87,930
Expenses (cash paid - 1% Pro Bono & Mock Trial)	\$	56,544

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2021

(12) Risks and uncertainties

On March 11, 2020, the World Health Organization declared the outbreak of a respiratory disease caused by a new coronavirus as a “pandemic”. First identified in late 2019 and now known as COVID-19, the outbreak has impacted millions of individuals worldwide. In response, many countries have implemented measures to combat the outbreak which have impacted global business operations and travel.

The COVID-19 outbreak has triggered volatility in financial markets and a significant negative impact on the global economy. The extent of the impact of COVID-19 on the Organization's operational and financial performance will depend on certain developments, including the duration and spread of the outbreak, and the impact on members, convention exhibitors, employees and vendors, all of which are uncertain and cannot be predicted.

Investments are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in risks in the near term could materially affect account balances and the amounts reported in the accompanying financial statements.

From time to time, the Organization may become involved in various legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material adverse effect on the consolidated financial statements.

(13) Commitments

As of December 31, 2021, SBA had signed various contracts with convention locations for future years. These contracts include minimum revenue guarantees and are subject to a cancellation fee if terminated early. The following is a summary of approximate future minimum guaranteed payments under these contracts:

<u>Years Ending December 31,</u>	
2022	\$ 612,056
2023	420,912
2024	461,588
Total minimum payments	<u>\$ 1,494,556</u>

SUPPLEMENTARY INFORMATION

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

SUPPLEMENTARY INFORMATION

CONSOLIDATING STATEMENT OF FINANCIAL POSITION

December 31, 2021

<u>ASSETS</u>	<u>SBA</u>	<u>CPF</u>	<u>Eliminations</u>	<u>Total</u>
CURRENT ASSETS				
Cash and cash equivalents	\$ 4,872,967	\$ 101,733	\$ -	\$ 4,974,700
Certificates of deposit	-	2,528,933	-	2,528,933
Accounts receivable, net	92,906	100,540	(138,307)	55,139
Inventories	56,781	-	-	56,781
Deferred rent - short term	18,704	-	-	18,704
Prepaid expenses and other assets	476,491	-	-	476,491
TOTAL CURRENT ASSETS	5,517,849	2,731,206	(138,307)	8,110,748
INVESTMENTS	7,372,651			7,372,651
INVESTMENTS RESTRICTED FOR BENEFIT PLAN	354,896	-	-	354,896
OTHER ASSETS	51,525	-	-	51,525
DEFERRED RENT - LONG TERM	48,632	-	-	48,632
PROPERTY AND EQUIPMENT, net	9,546,426	-	-	9,546,426
TOTAL ASSETS	\$ 22,891,979	\$ 2,731,206	\$ (138,307)	\$ 25,484,878
<u>LIABILITIES AND NET ASSETS</u>				
CURRENT LIABILITIES				
Accounts payable	\$ 107,635	\$ -	\$ -	\$ 107,635
Property taxes payable	86,664	-	-	86,664
Accrued liabilities	1,229,839	37,766	(138,307)	1,129,298
Prepaid rent liability	6,970	-	-	6,970
Membership and other fees collected in advance	3,166,895	97,560	-	3,264,455
TOTAL CURRENT LIABILITIES	4,598,003	135,326	(138,307)	4,595,022
OTHER LIABILITIES	434,677	-	-	434,677
TOTAL LIABILITIES	5,032,680	135,326	(138,307)	5,029,699
NET ASSETS				
Net assets without donor restrictions				
Undesignated	9,738,327	-	-	9,738,327
Board designated	8,120,972	-	-	8,120,972
Statute designated	-	2,595,880	-	2,595,880
TOTAL NET ASSETS	17,859,299	2,595,880	-	20,455,179
TOTAL LIABILITIES AND NET ASSETS	\$ 22,891,979	\$ 2,731,206	\$ (138,307)	\$ 25,484,878

See Independent Auditors' Report

**STATE BAR OF ARIZONA AND THE
CLIENT PROTECTION FUND OF THE STATE BAR OF ARIZONA**

SUPPLEMENTARY INFORMATION

CONSOLIDATING STATEMENT OF ACTIVITIES AND CHANGE IN NET ASSETS

Year Ended December 31, 2021

	<u>SBA</u>	<u>CPF</u>	<u>Eliminations</u>	<u>Total</u>
SUPPORT AND REVENUE				
Membership fees				
Active	\$ 9,027,979	\$ -	\$ -	\$ 9,027,979
Inactive	1,193,880	-	-	1,193,880
Membership fees penalties	368,450	-	-	368,450
Sections	322,720	-	-	322,720
Board of legal specializations	92,250	-	-	92,250
Admission on motion	105,030	-	-	105,030
	<u>11,110,309</u>	<u>-</u>	<u>-</u>	<u>11,110,309</u>
PROGRAM SERVICE REVENUE				
Regulatory				
Judgement receipts	113,474	-	-	113,474
Professional services	53,944	-	-	53,944
Reinstatement fees	14,049	-	-	14,049
Trust account ethics program	5,500	-	-	5,500
Miscellaneous charges	17,553	-	-	17,553
	<u>204,520</u>	<u>-</u>	<u>-</u>	<u>204,520</u>
COMPLIANCE				
Board of legal specializations	36,000	-	-	36,000
Legal Services	130,938	-	(130,938)	-
Pro Hac Vice fees	526,218	-	-	526,218
Reinstatement Fees	11,000	-	-	11,000
Mandatory continuing legal education - late fees	609,856	-	-	609,856
Miscellaneous charges	10,483	-	-	10,483
	<u>1,324,495</u>	<u>-</u>	<u>(130,938)</u>	<u>1,193,557</u>
PROFESSIONAL DEVELOPMENT				
Continuing legal education	2,420,453	-	-	2,420,453
Convention	366,098	-	-	366,098
Publications, net of cost of goods sold of \$40,610	212,854	-	-	212,854
Advertising sales	1,092,491	-	-	1,092,491
Arizona Attorney magazine	1,795	-	-	1,795
Sections meetings and conferences	39,420	-	-	39,420
Contributions and sponsorships	45,747	-	-	45,747
Membership benefits	102,327	-	-	102,327
Other miscellaneous	110,050	-	-	110,050
	<u>4,391,235</u>	<u>-</u>	<u>-</u>	<u>4,391,235</u>
ACCESS TO JUSTICE				
Lawyer referral services	<u>16,780</u>	<u>-</u>	<u>-</u>	<u>16,780</u>
CLIENT PROTECTIONS FUND				
Assessments	-	441,800	(460)	441,340
Restitution receipts	-	13,253	-	13,253
	<u>-</u>	<u>455,053</u>	<u>(460)</u>	<u>454,593</u>
OTHER REVENUE				
Rental income	571,164	-	-	571,164
Interest and dividends	138,962	6,289	-	145,251
Realized and unrealized gains on investments, net of investment expenses	208,029	-	-	208,029
Loss on sale-disposal of assets	(1,473)	-	-	(1,473)
Other	126,764	-	-	126,764
	<u>18,090,785</u>	<u>461,342</u>	<u>(131,398)</u>	<u>18,420,729</u>
TOTAL SUPPORT AND REVENUE				
EXPENSES				
Program Services:				
Regulatory	5,867,492	-	-	5,867,492
Compliance	1,605,146	-	-	1,605,146
Professional development	5,232,715	-	-	5,232,715
Access to justice	546,597	-	-	546,597
Client Protection Fund	119,711	328,506	(119,711)	328,506
Total program services	<u>13,371,661</u>	<u>328,506</u>	<u>(119,711)</u>	<u>13,580,456</u>
Management and general	<u>2,147,330</u>	<u>-</u>	<u>(11,687)</u>	<u>2,135,643</u>
TOTAL EXPENSES	<u>15,518,991</u>	<u>328,506</u>	<u>(131,398)</u>	<u>15,716,099</u>
CHANGE IN NET ASSETS	2,571,794	132,836	-	2,704,630
	<u>15,287,505</u>	<u>2,463,044</u>	<u>-</u>	<u>17,750,549</u>
NET ASSETS, BEGINNING OF YEAR				
NET ASSETS, END OF YEAR	<u>\$ 17,859,299</u>	<u>\$ 2,595,880</u>	<u>\$ -</u>	<u>\$ 20,455,179</u>

See Independent Auditors' Report