
State Bar of Arizona

*Combined Financial Statements
and
Independent Auditors' Report
December 31, 2012 and 2011*



CPAs | Business & Financial Advisors

State Bar of Arizona

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Independent Auditors' Report

To the Board of Governors of
State Bar of Arizona

We have audited the accompanying financial statements of the State Bar of Arizona, which comprise the statement of financial position as of December 31, 2012, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements. The financial statements as of December 31, 2011, were audited by Miller, Allen & Co., P.C., who merged with REDW_{LLC} as of November 1, 2012, and whose report dated April 23, 2012, expressed an unqualified opinion on those statements.

Management's Responsibility for the Financial Statements

The State Bar of Arizona's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 as of December 31, 2012, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

REDW LLC

Phoenix, Arizona
April 10, 2013

Financial Statements

State Bar of Arizona
Statements of Financial Position
December 31,

	2012	2011
Assets		
Current assets		
Cash and cash equivalents	\$ 1,087,890	\$ 716,444
Receivables (net of allowances of \$30,199 in 2012 and \$34,228 in 2011)	53,340	159,060
Inventories	42,122	49,414
Prepaid expenses	282,990	217,033
Total current assets	1,466,342	1,141,951
Property and equipment, net	11,628,525	11,623,214
Other assets	11,277	16,621
Total assets	\$ 13,106,144	\$ 12,781,786
Liabilities and Net Assets		
Current liabilities		
Accounts payable	\$ 88,958	\$ 216,916
Property taxes payable	89,917	92,349
Accrued liabilities	1,132,607	757,242
Dues and fees collected in advance	2,475,402	2,557,649
Total current liabilities	3,786,884	3,624,156
Line of credit payable	1,100,000	1,050,000
Other liabilities	5,727	1,650
Total liabilities	4,892,611	4,675,806
Net assets		
Unrestricted	8,213,533	8,105,980
Total liabilities and net assets	\$ 13,106,144	\$ 12,781,786

The accompanying notes are an integral part of these financial statements.

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

	2012	2011
Revenue and Gains		
Dues		
Active	\$ 7,708,941	\$ 7,368,298
Inactive	892,367	900,074
Sections	311,940	308,697
Board of legal specialization	126,775	132,870
Fees		
Continuing legal education	2,206,831	2,263,836
Convention	607,739	466,098
Lawyer regulations	172,151	204,742
Law office management assistance program	83,388	68,178
Board of legal specialization	47,570	44,365
Publication and advertising sales		
Arizona attorney magazine	686,999	593,013
Membership directory	106,553	99,380
Website	2,860	36,808
Mailing lists and labels	5,655	3,355
Economic survey	3,175	6,800
Rental income	139,004	203,389
Pro hac vice	453,095	423,634
Late fees mandatory continuing legal education	351,670	315,550
Sections - other	143,195	155,905
Special services	112,660	89,308
Contributions and sponsorships	152,230	109,279
Membership assistance program	22,830	54,470
Membership benefits	2,114	9,150
Interest and dividends	3	10
Other	104,608	184,234
Gain on disposal of equipment	-	1,050
Total revenue and gains	\$ 14,444,353	\$ 14,042,493

The accompanying notes are an integral part of these financial statements.

State Bar of Arizona
Statements of Activities — continued
For the Years Ended December 31,

	2012	2011
Expenses and Losses		
Program services		
Discipline	\$ 4,879,831	\$ 4,920,596
Member services	4,836,431	4,816,662
Support services		
Management and general	3,702,247	3,084,177
Building related	917,071	850,746
Loss on disposal of equipment	<u>1,220</u>	-
Total expenses and losses	<u>14,336,800</u>	<u>13,672,181</u>
Changes in net assets	107,553	370,312
Unrestricted net assets, beginning of year	<u>8,105,980</u>	<u>7,735,668</u>
Unrestricted net assets, end of year	<u>\$ 8,213,533</u>	<u>\$ 8,105,980</u>

The accompanying notes are an integral part of these financial statements.

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

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities		
Change in net assets	\$ 107,553	\$ 370,312
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities		
Depreciation and amortization	678,918	608,775
Bad debt expense	-	18,194
Loss (gain) on disposal of equipment	1,220	(1,050)
Changes in operating assets and liabilities		
Accounts receivable	105,720	(73,904)
Inventories	7,292	(6,857)
Prepaid expenses	(65,957)	(26,867)
Other assets	5,344	(100)
Accounts payable	(127,958)	(226,678)
Property taxes payable	(2,432)	(21,252)
Accrued liabilities	375,365	(85,759)
Dues and fees collected in advance	(82,247)	(670,114)
Other liabilities	<u>4,077</u>	<u>(5,101)</u>
Net cash provided (used) by operating activities	<u>1,006,895</u>	<u>(120,401)</u>
Cash flows from financing activities		
Proceeds from line of credit	2,000,000	1,800,000
Principal payments on the line of credit	<u>(1,950,000)</u>	<u>(750,000)</u>
Net cash provided by financing activities	<u>50,000</u>	<u>1,050,000</u>
Cash flows from investing activities		
Proceeds from the sale of property and equipment	1,614	1,050
Purchase of property and equipment	<u>(687,063)</u>	<u>(708,793)</u>
Net cash used by investing activities	<u>(685,449)</u>	<u>(707,743)</u>
Net increase in cash and cash equivalents	371,446	221,856
Cash and cash equivalents, beginning of year	<u>716,444</u>	<u>494,588</u>
Cash and cash equivalents, end of year	<u>\$ 1,087,890</u>	<u>\$ 716,444</u>
Supplemental disclosures of cash flow information		
Interest paid	<u>\$ 9,579</u>	<u>\$ 8,204</u>
Supplemental schedule of noncash investing and financing activities		
Equipment purchases included in accounts payable at year-end	<u>\$ -</u>	<u>\$ 30,611</u>

The accompanying notes are an integral part of these financial statements.

State Bar of Arizona
Notes to Financial Statements
December 31, 2012 and 2011

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.

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.

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.

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.

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

State Bar of Arizona
Notes to Financial Statements
December 31, 2012 and 2011

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	10–39 years
Furniture and equipment	4–10 years
Computer hardware	4–5 years
Computer software	3–5 years
Vehicles	5–7 years

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

Impairment of Long-Lived Assets

The State Bar 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 10, 2013, the date the financial statements were available to be issued.

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Notes to Financial Statements
December 31, 2012 and 2011

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>2012</u>	<u>2011</u>
Cash on hand	\$ 1,836	\$ 2,125
Cash in bank	<u>1,086,054</u>	<u>714,319</u>
	<u>\$ 1,087,890</u>	<u>\$ 716,444</u>

At December 31, 2012 and 2011, the State Bar had no cash deposits in excess of the FDIC insurance coverage.

4) Property and Equipment

	<u>2012</u>	<u>2011</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	2,966,270	2,349,873
Furniture and equipment	1,850,855	1,696,163
Computer hardware	641,611	1,019,798
Computer software	638,470	1,174,065
Construction in progress	<u>75,210</u>	<u>473,659</u>
Property and equipment	15,782,250	16,323,392
Accumulated depreciation and amortization	<u>(4,153,725)</u>	<u>(4,700,178)</u>
Property and equipment, net	<u>\$ 11,628,525</u>	<u>\$ 11,623,214</u>

Depreciation and amortization expense charged to operations was \$678,918 and \$608,775 for 2012 and 2011, respectively.

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Notes to Financial Statements
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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, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Membership, section, and other dues	\$ 2,348,234	\$ 2,350,456
Continuing legal education	58,043	104,446
Other	<u>69,125</u>	<u>102,747</u>
Total dues and fees collected in advance	<u>\$ 2,475,402</u>	<u>\$ 2,557,649</u>

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.

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 was 2.15% and 2.275% at December 31, 2012 and 2011, 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 was \$6,280,000 and \$6,690,000 at December 31, 2012 and 2011, respectively, and is secured by real property. The outstanding loan balance was \$1,100,000 and \$1,050,000 at December 31, 2012 and 2011, respectively.

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Notes to Financial Statements
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8) Designated Net Assets

The activities of 29 Sections of the State Bar have resulted in a cumulative surplus of \$308,820 and \$326,051 at December 31, 2012 and 2011, respectively. These funds are commingled with the State Bar's cash funds but have been designated for use by the respective Sections.

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 2012 and 2011.

Total employer pension expense was \$483,383 and \$345,949 for 2012 and 2011, respectively.

10) Related Party Transactions

The State Bar collects assessment revenue and transfers it to Client Protection Fund of the State Bar of Arizona (the "Fund") annually. The Fund pays the State Bar administrative fees for providing these services. The administrative fees charged totaled \$111,010 and \$85,777 for the years ended December 31, 2012 and 2011, 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.

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Notes to Financial Statements
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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 \$55,700 and \$63,900 for the years ended December 31, 2012 and 2011, respectively.

The following schedule details the amount of minimum rentals to be received as of December 31, 2012, 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,	
2013	\$ 137,294
2014	137,294
2015	152,047
2016	162,585
2017	162,585
Thereafter	<u>555,499</u>
Total minimum lease payments	<u>\$ 1,307,304</u>

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 2012 and 2011.

12) Operating Leases

Lessor

As of December 31, 2012, the State Bar leases office space to four 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 \$125,193 and \$180,866 of lease payments during the year ended December 31, 2012 and 2011, respectively.

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Notes to Financial Statements
December 31, 2012 and 2011

The following schedule details the amount of minimum rentals to be received as of December 31, 2012:

Year ending December 31,		
2013	\$	232,573
2014		226,421
2015		204,091
2016		216,068
2017		208,153
Thereafter		<u>555,499</u>
Total minimum lease payments	\$	<u>1,642,805</u>

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.