

WASHINGTON STATE BAR ASSOCIATION

FINANCIAL REPORT

SEPTEMBER 30, 2006

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INDEPENDENT AUDITORS' REPORT

To the Board of Governors
Washington State Bar Association
Seattle, Washington

We have audited the accompanying statements of financial position of the Washington State Bar Association ("WSBA") as of September 30, 2006 and 2005, and the related statements of activities, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the WSBA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Washington State Bar Association as of September 30, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

/S/ PETERSON SULLIVAN PLLC

December 1, 2006

WASHINGTON STATE BAR ASSOCIATION

STATEMENTS OF FINANCIAL POSITION

September 30, 2006 and 2005

ASSETS	<u>2006</u>	<u>2005</u>
Cash and cash equivalents	\$ 5,597,006	\$ 854,733
Investments	4,856,539	7,698,672
Restricted cash and cash equivalents	930,647	122,458
Restricted investments		746,257
Receivables, net of allowance for doubtful accounts and returns of \$5,185 in 2006 and \$7,817 in 2005	166,480	121,396
Desk and course books	106,189	91,057
Deferred seminar costs	122,600	87,902
Prepaid expenses	120,536	121,122
Property and equipment, net	<u>913,893</u>	<u>1,264,293</u>
Total assets	<u><u>\$ 12,813,890</u></u>	<u><u>\$ 11,107,890</u></u>
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable	\$ 756,753	\$ 724,530
Lawyers fund for client protection, committed gifts	91,155	31,506
Accrued expenses	347,740	322,700
Unearned seminar revenue	395,990	314,480
Deferred licensing fees	2,514,290	2,388,642
Other deferred revenue	<u>254,935</u>	<u>218,860</u>
Total liabilities	4,360,863	4,000,718
Net Assets		
Unrestricted		
General	4,823,814	3,920,348
Continuing legal education	1,954,241	1,585,026
Sections operations	<u>878,817</u>	<u>780,129</u>
Total unrestricted net assets	7,656,872	6,285,503
Restricted		
Lawyers' fund for client protection	<u>796,155</u>	<u>821,669</u>
Total net assets	<u><u>8,453,027</u></u>	<u><u>7,107,172</u></u>
Total liabilities and net assets	<u><u>\$ 12,813,890</u></u>	<u><u>\$ 11,107,890</u></u>

See Notes to Financial Statements

WASHINGTON STATE BAR ASSOCIATION

STATEMENTS OF ACTIVITIES

For the Years Ended September 30, 2006 and 2005

	2006			2005		
	Revenues	Expenses	Revenues Over (Under) Expenses	Revenues	Expenses	Revenues Over (Under) Expenses
Unrestricted - General						
Access to Justice	\$ 38,120	\$ 500,099	\$ (461,979)	\$ 26,913	\$ 430,636	\$ (403,723)
Administration	446,997	1,096,426	(649,429)	228,849	985,896	(757,047)
Admissions/bar exam	1,316,340	849,730	466,610	1,229,391	754,678	474,713
Alternate Dispute Resolution	7,095	56,962	(49,867)	4,775	38,530	(33,755)
Attorney license fees	10,119,412		10,119,412	9,626,927		9,626,927
Audits	2,292	214,936	(212,644)	1,375	130,638	(129,263)
Bar leaders support	60,555	354,637	(294,082)	32,108	402,832	(370,724)
Board of Governors and office of the executive director		699,328	(699,328)		626,385	(626,385)
Bar News	630,640	838,762	(208,122)	592,858	804,302	(211,444)
Communications	10,336	629,117	(618,781)	15,469	562,292	(546,823)
Discipline	161,832	3,384,813	(3,222,981)	226,996	3,236,933	(3,009,937)
Diversions				31,043	30,028	1,015
Educational outreach		33,486	(33,486)	29,086	98,882	(69,796)
Human resources		236,152	(236,152)		185,303	(185,303)
Law Office Management						
Assistance Program	61,175	236,109	(174,934)	59,917	238,989	(179,072)
Lawyer Assistance Program	56,105	351,713	(295,608)	29,634	295,941	(266,307)
Legislative		243,137	(243,137)		246,380	(246,380)
Licensing and membership records	79,815	573,804	(493,989)	83,954	406,470	(322,516)
Limited practice officers	202,708	159,337	43,371	163,685	81,138	82,547
Mandatory continuing legal education administration	512,518	400,465	112,053	405,962	453,776	(47,814)
Member benefits	19,626	68,952	(49,326)	182	69,184	(69,002)
New Lawyer Training		68,046	(68,046)			
Office of general counsel	672	365,758	(365,086)	521	424,517	(423,996)
Office of general counsel disciplinary board		45,373	(45,373)			
Practice of Law Board		147,397	(147,397)		72,846	(72,846)
Professional responsibility program		217,924	(217,924)		199,648	(199,648)
Resources directory	105,203	44,185	61,018	118,298	45,660	72,638
Sections administration	95,914	142,357	(46,443)	90,398	123,155	(32,757)
Technology	50	861,255	(861,205)	32,126	843,989	(811,863)
Young Lawyers Division	53,443	236,769	(183,326)	10,445	174,676	(164,231)
Other		20,353	(20,353)	177,324	106,253	71,071
Unrestricted - general	<u>\$ 13,980,848</u>	<u>\$ 13,077,382</u>	<u>\$ 903,466</u>	<u>\$ 13,218,236</u>	<u>\$ 12,069,957</u>	<u>\$ 1,148,279</u>
Unrestricted - Continuing						
Legal Education						
Products	\$ 784,231	\$ 624,509	\$ 159,722	\$ 609,041	\$ 525,371	\$ 83,670
Seminars	2,407,612	2,198,119	209,493	2,022,662	1,957,447	65,215
Unrestricted - continuing legal education	<u>\$ 3,191,843</u>	<u>\$ 2,822,628</u>	<u>\$ 369,215</u>	<u>\$ 2,631,703</u>	<u>\$ 2,482,818</u>	<u>\$ 148,885</u>
Unrestricted - Sections						
Operations	<u>\$ 556,938</u>	<u>\$ 458,250</u>	<u>\$ 98,688</u>	<u>\$ 483,387</u>	<u>\$ 488,318</u>	<u>\$ (4,931)</u>
Restricted -						
Lawyers' fund for client protection	<u>\$ 476,090</u>	<u>\$ 501,604</u>	<u>\$ (25,514)</u>	<u>\$ 358,466</u>	<u>\$ 169,274</u>	<u>\$ 189,192</u>

See Notes to Financial Statements

WASHINGTON STATE BAR ASSOCIATION

STATEMENTS OF ACTIVITIES

(Continued)

For the Years Ended September 30, 2006 and 2005

SUMMARY OF ALL ACTIVITIES

	2006		Revenues Over (Under) Expenses	2005		Revenues Over (Under) Expenses
	Revenues	Expenses		Revenues	Expenses	
Unrestricted - General	\$ 13,980,848	\$ 13,077,382	\$ 903,466	\$ 13,218,236	\$ 12,069,957	\$ 1,148,279
Unrestricted - Continuing Legal Education	<u>3,191,843</u>	<u>2,822,628</u>	<u>369,215</u>	<u>2,631,703</u>	<u>2,482,818</u>	<u>148,885</u>
	17,172,691	15,900,010	1,272,681	15,849,939	14,552,775	1,297,164
Unrestricted - Sections Operations	<u>556,938</u>	<u>458,250</u>	<u>98,688</u>	<u>483,387</u>	<u>488,318</u>	<u>(4,931)</u>
Total Change in Unrestricted Net Assets	17,729,629	16,358,260	1,371,369	16,333,326	15,041,093	1,292,233
Restricted - Lawyers' fund for client protection	<u>476,090</u>	<u>501,604</u>	<u>(25,514)</u>	<u>358,466</u>	<u>169,274</u>	<u>189,192</u>
Total Change in Net Assets - All Activities	<u><u>\$ 18,205,719</u></u>	<u><u>\$ 16,859,864</u></u>	<u><u>\$ 1,345,855</u></u>	<u><u>\$ 16,691,792</u></u>	<u><u>\$ 15,210,367</u></u>	<u><u>\$ 1,481,425</u></u>

See Notes to Financial Statements

WASHINGTON STATE BAR ASSOCIATION

STATEMENTS OF CHANGES IN NET ASSETS

For the Years Ended September 30, 2006 and 2005

	<u>General</u>	<u>Unrestricted Continuing Legal Education</u>	<u>Sections Operations</u>	<u>Restricted Lawyers' Fund for Client Protection</u>	<u>Total</u>
Balance, September 30, 2004	\$ 2,724,324	\$ 1,436,141	\$ 832,805	\$ 632,477	\$ 5,625,747
Transfer of net assets from dissolved section	47,745		(47,745)		
Unrestricted revenues over (under) expenses	1,148,279	148,885	(4,931)		1,292,233
Restricted revenues over expenses				189,192	189,192
Balance, September 30, 2005	3,920,348	1,585,026	780,129	821,669	7,107,172
Unrestricted revenues over expenses	903,466	369,215	98,688		1,371,369
Restricted revenues under expenses				(25,514)	(25,514)
Balance, September 30, 2006	<u>\$ 4,823,814</u>	<u>\$ 1,954,241</u>	<u>\$ 878,817</u>	<u>\$ 796,155</u>	<u>\$ 8,453,027</u>

See Notes to Financial Statements

WASHINGTON STATE BAR ASSOCIATION

STATEMENTS OF CASH FLOWS

For the Years Ended September 30, 2006 and 2005

	2006	2005
Cash Flows From Operating Activities		
Cash received from licensing fees	\$ 10,245,060	\$ 9,740,547
Cash received from CLE products and seminars	3,273,353	2,680,519
Cash received from other activities	4,352,222	4,029,187
Cash paid to employees	(7,328,749)	(6,686,396)
Cash paid to vendors	(8,868,057)	(7,705,500)
Interest received	533,233	235,785
Deferred compensation paid		(84,000)
	2,207,062	2,210,142
Cash Flows From Investing Activities		
Change in restricted cash and cash equivalents	(808,189)	(69,422)
Proceeds from sale of investments	22,993,264	14,193,501
Purchase of investments	(19,404,874)	(15,923,430)
Acquisitions of property and equipment	(244,990)	(173,669)
	2,535,211	(1,973,020)
Change in cash and cash equivalents	4,742,273	237,122
Cash and cash equivalents, beginning of year	854,733	617,611
Cash and cash equivalents, end of year	\$ 5,597,006	\$ 854,733
Reconciliation of change in net assets to net cash flows from operating activities		
Change in net assets	\$ 1,345,855	\$ 1,481,425
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Gain on extinguishment of deferred compensation liability		(177,324)
Depreciation and amortization	595,390	650,436
Change in operating assets and liabilities		
Receivables	(45,084)	(3,863)
Desk and course books	(15,132)	29,751
Deferred costs and prepaid expenses	(34,112)	(22,293)
Accounts payable and accrued expenses	116,912	130,327
Deferred compensation		(53,750)
Unearned seminar revenue	81,510	48,816
Deferred licensing fees	125,648	113,620
Other deferred revenue	36,075	12,997
	\$ 2,207,062	\$ 2,210,142

See Notes to Financial Statements

NOTES TO FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

The Organization

The Washington State Bar Association ("the WSBA") is a not-for-profit entity operating under the supervisory authority of the Washington State Supreme Court. Operations consist of regulating the practice of law in the state and providing various law-related services to the members and the public. Lawyers must be active members of the WSBA in order to practice law in Washington State. A primary source of revenues of the WSBA is license fees which members must pay in order to maintain their membership. The WSBA's annual budgets are based on maintaining adequate net assets. The WSBA members are primarily Washington State residents.

The WSBA's financial statements are not consolidated with those of the Washington State Bar Foundation ("the Foundation"), a nonprofit organization related to the WSBA, since the organizations are not financially interrelated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts and disclosures. Actual results could differ from those estimates.

Cash and Cash Equivalents/Investments

Cash and cash equivalents include bank deposits, certificates of deposit, and high rated auction securities with original maturities of three months or less. Bank deposits are maintained for ongoing operating expenses and are sometimes in excess of federally insured limits. Certificates of deposit are all federally insured. Auction securities are not federally insured.

Investments are carried at fair value which generally approximates cost. Unrealized gains and losses, if any, are reported in the statements of activities as increases or decreases in net assets. Investment balances include federally insured certificates of deposit (with original maturities longer than three months), high rated government sponsored notes, and corporate notes.

Restricted cash and cash equivalents and restricted investments relate to funds restricted for the Lawyers' Fund for Client Protection. See Note 2.

The composition of cash balances is broken down in Note 3.

Receivables

Receivables are generally from members and result primarily from unpaid fees related to continuing legal education programs. Receivables are unsecured and do not bear interest. Management reviews receivables on a periodic basis and determines the amount estimated to be uncollectible. A reserve for doubtful accounts is then established. Accounts that are determined to be uncollectible are written off against this reserve.

Desk and Course Books

Inventory of desk and course books is stated at lower of cost (first-in, first-out method) or market.

Property and Equipment

Property and equipment is stated at cost. Depreciation and amortization is computed over the estimated useful lives of the assets, generally three to ten years, using the straight-line method. The capitalization policy threshold is \$2,500.

The WSBA follows the provisions outlined in Statement of Position 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use*, related to the treatment of these types of costs. The WSBA capitalizes certain direct costs incurred developing internal use software.

Deferred Seminar Costs/Unearned Seminar Revenue

Deferred costs are primarily costs associated with seminar planning and the production of seminar materials. Recognition of these expenses is deferred until the related seminars are presented.

Unearned seminar revenue relates to fees collected for seminars to be conducted in subsequent years. Seminar registration fees are recognized as revenue when the related seminars are held.

Deferred Licensing Fees

Licensing fees are recognized ratably over the applicable calendar year membership period. Accordingly, fees collected during the WSBA's fiscal year that relate to the fourth quarter of the calendar membership period are included as deferred revenue in the financial statements.

Income Taxes

The WSBA is an organization exempt from federal income taxes because it is an instrumentality of the State of Washington exercising a governmental function.

Net Assets

The WSBA Board of Governors has directed that portions of the WSBA's unrestricted net assets be designated for Sections and for Continuing Legal Education. The total of revenues over expenses for all sections (which represent specialized legal interests) is included in the Sections designated balance. The difference between revenues and expenses for Continuing Legal Education products and seminars is included in the Continuing Legal Education designated balance.

One section dissolved during the year ended September 30, 2005, and its net assets of \$47,745 were transferred to general unrestricted net assets.

The WSBA has also designated a portion of its general unrestricted net assets in 2006 as follows:

Operating reserve	\$ 1,200,000
Facilities reserve	750,000
Capital reserve	500,000
Board program reserve	<u>250,000</u>
	<u>\$ 2,700,000</u>

The operating reserve provides unrestricted funds for any general, unanticipated, but necessary, expenses that may be incurred throughout the year. The goal is to continue to maintain and build this reserve to ensure that funds are available in the event of an emergency.

The facilities reserve serves two purposes: future rent obligations and office move/refurbishment. The future rent portion of the reserve is for known future rent increases to be incurred from years five through ten of the current lease. The office move/refurbishment reserve is for costs related to a future office move, or if the WSBA chooses to renew the existing lease or refurbish the existing space. The goal of the facilities reserve in its entirety is to build on the base allocation to ensure that at the end of a lease term, there are sufficient funds for WSBA to move or refurbish its existing space.

The capital reserve is for capital expenditures that WSBA will incur in fiscal year 2008. At the end of the term, the Budget and Audit Committee will review the need for a capital reserve based on the effects of a new licensing fee cycle and projected future expenditures.

The board program reserve is to provide funds to cover unanticipated over-expenditures on programs initiated by the Board of Governors and also to fund new programs throughout the year that have not been included in the annual budget.

Reclassifications

Certain reclassifications have been made to the September 30, 2005, financial statements in order for them to conform to the current year presentation.

Note 2. Lawyers' Fund for Client Protection

In 1995, the Washington State Supreme Court and the WSBA created the Lawyers' Fund for Client Protection ("the Fund"). The Fund may be used only for the purpose of relieving or mitigating a loss sustained by any person due to the dishonesty of, or failure to account for money or property entrusted to, any member of WSBA in connection with the member's practice of law, or while acting as a fiduciary in a matter related to the member's practice of law. The Fund receives a mandatory annual assessment from each active WSBA member. As WSBA's use of these funds is restricted as described above, it is referred to as restricted activities in these financial statements.

Note 3. Cash and Cash Equivalents

Cash and cash equivalents consist of the following at year-end:

<u>Unrestricted Cash and Cash Equivalents</u>	<u>2006</u>	<u>2005</u>
Bank deposits	\$ 764,095	\$ 257,036
Short-term corporate notes (5 and 1 issuers, respectively – maturity less than 3 months)	1,765,202	496,844
Money market funds	167,709	100,853
Auction securities (7 issuers – maturity every 28 days)	2,900,000	
	<u>\$ 5,597,006</u>	<u>\$ 854,733</u>
 <u>Restricted Cash and Cash Equivalents</u>		
Bank deposits	\$ 120,205	\$ 37,541
Money market funds	15,442	
Auction securities (2 issuers – maturity every 28 days)	700,000	
Certificates of deposit (various issuers)	95,000	84,917
	<u>\$ 930,647</u>	<u>\$ 122,458</u>

Note 4. Investments

Unrestricted and restricted investments consist of the following at year-end:

<u>Unrestricted Investments</u>	<u>2006</u>	<u>2005</u>
Certificates of deposit (various issuers)	\$ 578,698	\$ 4,887,321
Short-term corporate notes	2,798,946	1,898,982
Notes issued by agencies of the U.S. government	1,478,895	912,369
	<u>\$ 4,856,539</u>	<u>\$ 7,698,672</u>
 <u>Restricted Investments</u>		
Certificates of deposit	\$ -	\$ 375,239
Short-term corporate notes		371,018
	<u>\$ -</u>	<u>\$ 746,257</u>

The following schedule summarizes the returns from investments (and cash balances):

	<u>2006</u>	<u>2005</u>
Interest income - unrestricted	\$ 502,866	\$ 242,204
Interest income - restricted	38,449	17,335
Total investment return	<u>\$ 541,315</u>	<u>\$ 259,539</u>

Investment income is included as revenue in the following categories on the statements of activities:

	<u>2006</u>	<u>2005</u>
Administration	\$ 446,390	\$ 228,465
Sections operations	56,476	13,739
Lawyers' fund for client protection	38,449	17,335
	<u>\$ 541,315</u>	<u>\$ 259,539</u>

Note 5. Property and Equipment

Property and equipment consists of the following at year-end:

	2006	2005
Leasehold improvements	\$ 91,887	\$ 91,887
Furniture	1,058,433	1,058,433
Office equipment	1,079,208	1,037,945
Software	1,805,584	1,797,598
	4,035,112	3,985,863
Less accumulated depreciation and amortization	(3,329,551)	(2,778,011)
	705,561	1,207,852
Software not yet placed in service	90,017	56,441
Construction in progress	118,315	
	\$ 913,893	\$ 1,264,293

Construction in progress consists of leasehold improvements to the new office space that the WSBA will occupy during the year ended September 30, 2007. As of September 30, 2006, the WSBA had construction commitments related to the move of \$1,498,508, of which \$1,263,492 will be paid by the landlord of WSBA's new office space. As of December 1, 2006, the WSBA had entered into additional construction and purchase commitments amounting to \$871,502, related to the office space.

Note 6. Deferred Compensation

The WSBA had a deferred compensation agreement with a former executive director requiring monthly payments of \$4,000 for life and the twelve months thereafter. The executive director retired in December 1981 and passed away on June 18, 2005. The WSBA had recorded a liability for the estimated amount to be paid to the executive director over his life span, discounted at 8%. The total amount paid during 2005 consisted of monthly payments amounting to \$36,000 and a final lump sum payment of \$48,000. The gain on extinguishment of the remaining liability of \$177,324 is recorded as other revenue in the 2005 statement of activities. Imputed interest was approximately \$17,379 for the year ended September 30, 2005.

In addition, the WSBA provides its employees with access to the Washington State Public Employees' Retirement System ("PERS"), a series of defined benefit/defined contribution plans sponsored and managed by the State of Washington Department of Retirement Systems ("DRS"). In accordance with PERS, the WSBA and WSBA employees make contributions to the plan based on rates established by DRS. Contributions by the WSBA were \$197,115 and \$105,947 for the years ended September 30, 2006 and 2005, respectively.

Note 7. Operating Leases

The WSBA signed a lease for new office space it will move into during the year ended September 30, 2007. The lease is an operating lease agreement expiring during the year ending September 30, 2017.

The future minimum rental payments required under this operating lease for the years ending September 30 are as follows:

2007	\$ 501,070
2008	1,004,199
2009	1,074,635
2010	1,103,868
2011	1,174,305
Thereafter	<u>6,908,496</u>
	<u>\$ 11,766,573</u>

Rent expense under all lease agreements was \$753,360 and \$768,057 for the years ended September 30, 2006 and 2005, respectively.

Note 8. Contingencies

The WSBA is subject to various legal proceedings and claims which arise in the ordinary course of its business. Management believes that the final disposition of such matters will not have a material adverse effect on the financial position or results of operations of the WSBA.

Note 9. Indirect Expenses

WSBA programs, services, and functions are assigned to functional categories for purposes of budgeting and reporting revenues and expenses. Each category includes direct revenues and expenses for activities within that category and an allocation of indirect expenses based on the number of staff assigned to each category. The composition of indirect expenses and total direct expenses is as follows:

	<u>2006</u>	<u>2005</u>
Indirect expenses		
Salaries	\$ 7,332,709	\$ 6,685,422
Employee benefits and payroll taxes	1,950,692	1,632,341
Rent	753,360	768,057
Depreciation and amortization	579,897	631,231
Technology and telephone	481,580	483,589
Human Resources	89,983	50,362
Insurance	77,948	74,816
Office relocation	59,452	
Copying and production services	57,270	67,747
Postage	43,663	38,973
Equipment maintenance	34,495	29,885
Professional fees	20,553	39,575
Business taxes	7,790	8,416
Supplies	6,020	6,167
Air quality	234	5,170
Deferred compensation (including imputed interest and changes in life expectancy)		30,250
Staff training		20,873
	<u>11,495,646</u>	<u>10,572,874</u>
Direct expenses	<u>5,364,218</u>	<u>4,637,493</u>
Total expenses	<u><u>\$ 16,859,864</u></u>	<u><u>\$ 15,210,367</u></u>