

**PACIFIC LEGAL FOUNDATION  
AND SUBSIDIARY**

**CONSOLIDATED FINANCIAL STATEMENTS  
WITH INDEPENDENT AUDITOR'S REPORT**

**SIX MONTH PERIOD ENDED  
JUNE 30, 2018**

## **INDEPENDENT AUDITOR'S REPORT**

**Board of Trustees  
Pacific Legal Foundation and Subsidiary  
Sacramento, California**

We have audited the accompanying consolidated financial statements of Pacific Legal Foundation and Subsidiary (Organization), which comprise the consolidated statement of financial position as of June 30, 2018, and the related consolidated statements of activities, functional expenses, and cash flows for the six month period then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free of 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 consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of June 30, 2018, and the changes in their net assets and their cash flows for the six month period then ended in accordance with accounting principles generally accepted in the United States of America.

*Gilbert Associates, Inc.*

**GILBERT ASSOCIATES, INC.**  
**Sacramento, California**

**September 12, 2018**

# PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION JUNE 30, 2018

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### ASSETS:

Cash and cash equivalents	\$ 4,306,972
Investments	48,563,563
Contributions and other receivables	2,335,680
Prepaid expenses and deposits	251,964
Other assets	50,085
Charitable remainder trust assets	856,397
Property and equipment, net	<u>3,490,628</u>

**TOTAL ASSETS** \$ 59,855,289

### LIABILITIES AND NET ASSETS

#### LIABILITIES:

Accounts payable	\$ 172,240
Accrued expenses and other liabilities	447,258
Capital lease obligations	7,729
Liability to beneficiaries	<u>690,757</u>
Total liabilities	<u>1,317,984</u>

#### NET ASSETS:

Unrestricted:	
Undesignated	8,945,490
Board designated	45,485,884
Temporarily restricted	2,799,018
Permanently restricted	<u>1,306,913</u>
Total net assets	<u>58,537,305</u>

**TOTAL LIABILITIES AND NET ASSETS** \$ 59,855,289

# PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF ACTIVITIES SIX MONTH PERIOD ENDED JUNE 30, 2018

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<b>UNRESTRICTED NET ASSETS:</b>	
<b>OPERATING REVENUES:</b>	
Contributions	\$ 10,956,007
Grants	1,017,342
Other income	12,117
Net assets released from restrictions	263,487
Total revenues	<u>12,248,953</u>
<b>OPERATING EXPENSES:</b>	
Program services:	
Legal activities	3,116,205
Public education	1,802,258
Total program services	<u>4,918,463</u>
Supporting services:	
Revenue development	1,068,116
General and administrative	816,157
Total expenses	<u>6,802,736</u>
<b>INCOME FROM OPERATIONS</b>	5,446,217
<b>OTHER UNRESTRICTED ACTIVITY</b>	
Investment income	97,875
Change in value of split-interest agreements	<u>(39,096)</u>
<b>INCREASE IN UNRESTRICTED NET ASSETS</b>	<u>5,504,996</u>
<b>TEMPORARILY RESTRICTED NET ASSETS:</b>	
Contributions	1,222,070
Change in value of split-interest agreements	64,631
Net assets released from restrictions	<u>(263,487)</u>
<b>INCREASE IN TEMPORARILY RESTRICTED NET ASSETS</b>	<u>1,023,214</u>
<b>PERMANENTLY RESTRICTED NET ASSETS:</b>	
Investment loss	<u>(18,174)</u>
<b>DECREASE IN PERMANENTLY RESTRICTED NET ASSETS</b>	<u>(18,174)</u>
<b>INCREASE IN NET ASSETS</b>	6,510,036
<b>NET ASSETS, Beginning of period</b>	<u>52,027,269</u>
<b>NET ASSETS, End of period</b>	<u>\$ 58,537,305</u>

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

## PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

### CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES SIX MONTH PERIOD ENDED JUNE 30, 2018

	<u>Program Services</u>		Total Program Services	<u>Supporting Services</u>		Total
	<u>Legal Activities</u>	<u>Public Education</u>		<u>Revenue Development</u>	<u>General &amp; Admin.</u>	
Salaries	\$ 1,929,391	\$ 1,021,088	\$ 2,950,479	\$ 402,598	\$ 380,418	\$ 3,733,495
Employee benefits and insurance	426,330	61,461	487,791	41,302	74,211	603,304
Payroll taxes	<u>161,018</u>	<u>39,945</u>	<u>200,963</u>	<u>52,314</u>	<u>40,621</u>	<u>293,898</u>
Total compensation	2,516,739	1,122,494	3,639,233	496,214	495,250	4,630,697
Communications		420,590	420,590	371,616		792,206
Case costs	189,646		189,646			189,646
Rent	92,737	49,052	141,789	19,356	18,288	179,433
Depreciation	75,593	39,917	115,510	15,791	14,914	146,215
Office expenses	2,907	4,139	7,046	19,175	86,711	112,932
Travel		62,159	62,159	40,980	7,672	110,811
Professional services	7,427	6,776	14,203	37,943	54,280	106,426
Insurance	41,789	22,116	63,905	8,720	8,239	80,864
Telephone	37,631	19,915	57,546	7,852	7,420	72,818
Equipment rental	32,436	17,166	49,602	6,768	6,396	62,766
Library and research	54,957		54,957			54,957
Miscellaneous expenses	<u>64,343</u>	<u>37,934</u>	<u>102,277</u>	<u>43,701</u>	<u>116,987</u>	<u>262,965</u>
Total expenses	<u>\$ 3,116,205</u>	<u>\$ 1,802,258</u>	<u>\$ 4,918,463</u>	<u>\$ 1,068,116</u>	<u>\$ 816,157</u>	<u>\$ 6,802,736</u>

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

# PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF CASH FLOWS SIX MONTH PERIOD ENDED JUNE 30, 2018

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### CASH FLOWS FROM OPERATING ACTIVITIES:

Increase in net assets	\$ 6,510,036
Reconciliation to net cash used by operating activities:	
Net realized and unrealized loss on investments	389,865
Donated investments	(7,408,766)
Loss on sale of property held for sale	151
Depreciation	146,215
Changes in:	
Contributions and other receivables	116,771
Prepaid expenses and deposits	(70,079)
Other assets	(19,680)
Charitable remainder trust assets	38,838
Accounts payable	(2,904)
Accrued expenses and other liabilities	57,140
Liability to beneficiaries	(24,880)
Net cash used by operating activities	<u>(267,293)</u>

### CASH FLOWS FROM INVESTING ACTIVITIES:

Purchase of property and equipment	(12,247)
Purchase of investments	(11,193,331)
Proceeds from sale of property held for sale	217,800
Proceeds from sale of investments	<u>13,544,652</u>
Net cash provided by investing activities	<u>2,556,874</u>

### CASH FLOWS FROM FINANCING ACTIVITIES:

Principal payments on capital lease obligations	<u>(11,958)</u>
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**NET INCREASE IN CASH AND CASH EQUIVALENTS** 2,277,623

**CASH AND CASH EQUIVALENTS, Beginning of period** 2,029,349

**CASH AND CASH EQUIVALENTS, End of period** \$ 4,306,972

### NON-CASH TRANSACTIONS:

Charitable remainder trust assets transferred to investments	<u>\$ 33,281</u>
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# PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018

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### 1. ORGANIZATION

Pacific Legal Foundation (Foundation) is a nonprofit public benefit corporation operating on voluntary, tax-deductible donations from the private sector, or through court-awarded attorneys fees. Contributors consist of individuals, businesses, associations, and foundations from across the United States. The Foundation litigates nationwide to secure all Americans' inalienable rights to live responsibly and productively in their pursuit of happiness. The Foundation combines strategic and principled litigation, communications and research to achieve landmark court victories enforcing the Constitution's guarantee of individual liberty. The Foundation is headquartered in Sacramento, California, with additional locations in the states of Florida, Washington, and Virginia.

PLF Building, LLC (LLC) is a wholly-owned subsidiary of the Foundation established to act as a title holding company.

### 2. SIGNIFICANT ACCOUNTING POLICIES

**Principles of consolidation and year-end** – The accompanying financial statements reflect the consolidation of the Foundation and the LLC (collectively, the Organization). Material transactions between entities have been eliminated in consolidation.

Subsequent to its fiscal year ended December 31, 2017, management adopted a fiscal year end of June 30 for the Foundation and the LLC.

**Basis of accounting and financial statement presentation** – The consolidated financial statements are prepared on the accrual basis of accounting in conformity with professional standards applicable to not-for-profit entities. The Organization reports information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted.

**Revenue recognition** – Contributions, grants, and promises to give are recognized in full when received or unconditionally promised, in accordance with professional standards. All contributions are considered available for unrestricted use unless specifically restricted by donors for future periods or specific purposes. Donor-restricted amounts are reported as increases in temporarily or permanently restricted net assets. Temporarily restricted net assets become unrestricted, and are reported in the *Consolidated Statement of Activities* as net assets released from restrictions, when the time restrictions expire or the contributions are used for the restricted purpose. Temporarily restricted contributions whose restrictions are met in the same reporting period are shown as unrestricted.

Court-awarded attorney fees are recorded when received.

**Cash and cash equivalents** – For financial statement purposes, the Organization considers all investments with a maturity at purchase of three months or less to be cash equivalents, unless held for long-term purposes.



# PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018

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The Organization minimizes credit risk associated with cash by periodically evaluating the credit quality of its primary financial institution. The balance at times may exceed federally insured limits. The Organization has not experienced any losses in such accounts and management believes the Organization is not exposed to any significant credit risk related to cash.

**Investments** are stated at fair value.

**Property and equipment** – Furniture, office equipment, library, leasehold improvements, building and land are recorded at cost. The Organization capitalizes all expenditures of property and equipment in excess of \$1,000. Depreciable assets are depreciated using the straight-line method over estimated useful lives of three to thirty years.

**Charitable remainder trust assets** include the estimated fair value of irrevocable charitable trusts in which the Organization is both the trustee and secondary beneficiary, as well as the estimated fair value of the Organization's remainder interest in irrevocable trusts for which the Organization is the secondary beneficiary. The fair value of the Organization's remainder interest in irrevocable trusts is determined using investment returns consistent with the composition of the asset portfolios, life expectancies, and relevant discount rate. Irrevocable charitable trusts whose use is limited by the Organization due to time or donor-imposed restrictions increase temporarily restricted net assets.

**Liability to beneficiaries** represents the present value of the liability due to primary beneficiaries and other secondary beneficiaries of the irrevocable charitable remainder trusts and charitable gift annuities for which the Organization is both trustee and secondary beneficiary. On an annual basis, the Organization reviews the need to revalue the liability to make distributions to the designated beneficiaries based upon actuarial assumptions. The present value of the estimated future payments is calculated using discount rates ranging from 2.0% to 8.92% and applicable mortality tables. The current portion of the liability to beneficiaries at June 30, 2018 is \$126,800.

**Functional expenses** – The costs of providing the program and supporting services have been summarized on a functional basis in the *Consolidated Statement of Activities* and *Consolidated Statement of Functional Expenses*. Accordingly, certain costs have been allocated to program and supporting services in proportion to the estimated benefit received by each activity.

**Income taxes** – The Foundation is exempt from income taxes under Internal Revenue Code Section 501(c)(3), and is classified as a public charity within the meaning of Internal Revenue Code Section 509(a).

**Use of estimates** – The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**Subsequent events** have been evaluated through September 12, 2018, the date the consolidated financial statements were issued. Management concluded that significant subsequent events have occurred since June 30, 2018 that require recognition or disclosure in the financial statements; see note 9.

# PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018

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### 3. RECEIVABLES

Receivables consist of the following:

Contributions receivable	\$ 1,235,930
Pledges receivable	<u>1,099,750</u>
Total	<u>\$ 2,335,680</u>

Pledges, contributions, and other receivables are due to be collected as follows:

Within one year	\$ 1,429,430
In one to five years	706,250
Thereafter	<u>200,000</u>
Total	<u>\$ 2,335,680</u>

At June 30, 2018, \$800,000 of pledges receivable and \$926,820 of contributions receivable are due from two donors.

### 4. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

Building and related property	\$ 3,500,000
Office furniture and equipment	1,060,541
Leasehold improvements	<u>999,895</u>
Total	5,560,436
Less accumulated depreciation and amortization	<u>(2,069,808)</u>
Property and equipment, net	<u>\$ 3,490,628</u>

### 5. CHARITABLE REMAINDER TRUST ASSETS

Charitable remainder trust assets consist of the following:

Assets held in charitable remainder trusts in which the Organization is both trustee and secondary beneficiary	\$ 288,199
Charitable remainder interests receivable from third parties	<u>568,198</u>
Total	<u>\$ 856,397</u>

# PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018

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### 6. INVESTMENTS

Investments consist of the following:

Money market funds	\$ 1,042,737
Mutual funds (equity):	
Value	1,592,820
Growth	3,388,903
Foreign	3,756,760
Core	6,975,445
Mutual funds (fixed income):	
High yield	1,501,048
Emerging markets	1,992,062
U.S investment grade bonds	263,488
World bond	43,208
Equity securities:	
Core	7,411,982
Foreign	4,795,574
Real estate investment trusts	2,379,073
Other real assets	4,175,076
Hedge funds:	
Macro	667,707
Equity	1,821,571
Relative value	1,719,638
Government bonds	<u>5,036,471</u>
Total	<u>\$ 48,563,563</u>

Investment income consists of the following:

Interest and dividends	\$ 469,566
Net realized and unrealized loss	<u>(389,865)</u>
Total	<u>\$ 79,701</u>

Investment income is reported net of broker fees and commissions of \$66,049 in 2018.

# PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018

### 7. FAIR VALUE MEASUREMENTS

Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same—to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (that is, an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). In order to increase consistency and comparability in fair value measurements, a fair value hierarchy that prioritizes observable and unobservable inputs is used to measure fair value into three broad levels, as follows:

Level 1 Inputs	Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.
Level 2 Inputs	Inputs other than quoted prices in active markets that are observable either directly or indirectly.
Level 3 Inputs	Unobservable inputs for the assets or liabilities.

When a price for an identical asset or liability is not observable, a reporting entity measures fair value using another valuation technique that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, a reporting entity's intention to hold an asset or to settle or otherwise fulfill a liability is not relevant when measuring fair value.

The Organization's assets subject to fair value are classified as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments	\$ 38,175,600	\$ 5,704,178	
Investments held in charitable remainder trusts in which the Foundation is both trustee and secondary beneficiary	288,199		
Charitable remainder interests receivable from third parties			\$ 568,198
Total	<u>\$ 38,463,799</u>	<u>\$ 5,704,178</u>	<u>\$ 568,198</u>

The Organization's investments and investments held in charitable remainder trusts in which the Organization is both trustee and secondary beneficiary are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative sources with reasonable levels of price transparency. The Organization's charitable remainder interests receivable from third parties are classified within Level 3 of the hierarchy because determination of the present value of future cash flows is based on little or no market data and requires management to develop their own assumptions. The Organization's investments are

# PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018

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classified within Level 2 of the hierarchy because the value is calculated on the basis of pricing information obtained from various pricing sources and from inputs other than quoted prices in active markets.

Changes in the Level 3 assets consist of:

January 1, 2018	\$ 599,846
Maturity of charitable remainder interests receivable	(95,613)
Unrealized gain in fair value	<u>63,965</u>
June 30, 2018	<u>\$ 568,198</u>

The Foundation has four investments totaling \$4,683,785 at June 30, 2018 in multi-adviser hedge funds that are valued using the net asset value reported by the fund managers, which is used as a practical expedient to estimate the fair value. There are no outstanding capital calls on these investments and they are fully redeemable on a quarterly tender basis.

### 8. LINE OF CREDIT

The Organization has a \$3,000,000 revolving line of credit agreement with Wells Fargo Bank that expires on July 10, 2020. The interest on the line of credit is variable and is equal to the Daily One Month LIBOR plus 1.5%. There was no outstanding balance as of June 30, 2018.

### 9. LEASE OBLIGATIONS AND SUBSEQUENT EVENT

The Organization leases certain equipment and office space under long-term operating lease agreements, which expire at various dates through 2026. Rental expense for 2018 was \$242,200. In July, 2018, the Organization entered into a non-cancellable 63 month lease for its Florida office. Future minimum lease payments on this lease are included in the schedule below. Future minimum lease payments are as follows:

Fiscal year ending June 30:

2019	\$ 261,061
2020	351,044
2021	358,103
2022	365,341
2023	372,766
Thereafter	<u>775,213</u>
Total	<u>\$ 2,483,528</u>

# PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018

### 10. NET ASSETS

Temporarily restricted net assets are available for the following purposes:

<u>Time Restriction:</u>	
General operations	\$ 2,053,882
Charitable remainder trusts	730,136
<u>Purpose Restriction:</u>	
Litigation	<u>15,000</u>
Total	<u>\$ 2,799,018</u>

The Organization's endowments include both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Organization classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) accumulated unrealized appreciation and depreciation of endowment investments if directed by the donor gift instrument, (c) the original value of subsequent gifts to the permanent endowments, and (d) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. Permanently restricted net assets as of June 30, 2018 consist of one endowment fund, and are to be invested in perpetuity with gains and losses. Interest and dividends are to be used for operating or other purposes as designated by the Board of Trustees.

Board endowments of \$45,485,884 at June 30, 2018 have been designated to provide annual income that is predictable and reliable to assure the ability of the Organization to meet long-term professional obligations inherent in the nature of its litigation services.

The endowment investment policy, approved by the Board of Trustees, emphasizes preservation of capital as its primary objective and growth and income as secondary objectives. Changes in endowment net assets are as follows:

	<b>Board Designated Unrestricted</b>	<b>Permanently Restricted</b>
Endowment net assets, beginning of period	\$ 40,702,375	\$ 1,325,087
Investment income	75,478	(18,174)
Contributions	8,519,491	
Endowment funds used for operations	(3,750,000)	
Endowment expenditures	<u>(61,460)</u>	<u>                    </u>
Endowment net assets, end of period	<u>\$ 45,485,884</u>	<u>\$ 1,306,913</u>

# **PACIFIC LEGAL FOUNDATION AND SUBSIDIARY**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2018**

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### **11. PENSION PLANS**

The Organization has a defined contribution pension plan under Internal Revenue Code Section 403(b). Employees are eligible to participate upon date of hire and are eligible to receive employer contributions after completing six months of service. On a discretionary basis, the Organization may make nonelective contributions. Plan expense was \$254,848 for 2018.