

**PACIFIC LEGAL FOUNDATION
AND SUBSIDIARY**

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

**YEARS ENDED
DECEMBER 31, 2017 AND 2016**

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 statements of financial position as of December 31, 2017 and 2016, and the related consolidated statements of activities, functional expenses, and cash flows for the years 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 December 31, 2017 and 2016, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Gilbert Associates, Inc.

GILBERT ASSOCIATES, INC.
Sacramento, California

June 19, 2018

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION DECEMBER 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
ASSETS:		
Cash and cash equivalents	\$ 2,029,349	\$ 2,413,940
Investments	43,862,702	39,020,056
Contributions and other receivables	2,452,451	1,208,485
Prepaid expenses and deposits	181,885	158,916
Other assets	30,405	30,171
Property held for sale	217,951	
Charitable remainder trust assets	928,516	1,285,935
Property and equipment, net	<u>3,624,596</u>	<u>3,747,020</u>
TOTAL ASSETS	<u>\$ 53,327,855</u>	<u>\$ 47,864,523</u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable	\$ 175,144	\$ 131,014
Payable to secondary beneficiary from charitable remainder trust		250,152
Accrued expenses and other liabilities	390,118	465,479
Capital lease obligations	19,687	43,615
Liability to beneficiaries	<u>715,637</u>	<u>722,383</u>
Total liabilities	<u>1,300,586</u>	<u>1,612,643</u>
NET ASSETS:		
Unrestricted:		
Undesignated	8,224,003	7,070,315
Board designated	40,702,375	36,015,653
Temporarily restricted	1,775,804	2,017,624
Permanently restricted	<u>1,325,087</u>	<u>1,148,288</u>
Total net assets	<u>52,027,269</u>	<u>46,251,880</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 53,327,855</u>	<u>\$ 47,864,523</u>

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

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF ACTIVITIES YEARS ENDED DECEMBER 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
UNRESTRICTED NET ASSETS:		
OPERATING REVENUES:		
Contributions	\$ 6,595,613	\$ 5,948,707
Grants	2,544,631	2,945,262
Court-awarded attorney fees	2,356,239	167,147
Other income	13,271	40,099
Net assets released from restrictions	1,227,440	2,019,560
Total revenues	<u>12,737,194</u>	<u>11,120,775</u>
OPERATING EXPENSES:		
Program services:		
Legal activities	5,592,140	5,142,544
Public education	3,001,880	1,943,313
Total program services	8,594,020	7,085,857
Supporting services:		
Revenue development	1,395,189	1,984,711
General and administrative	1,679,575	1,512,587
Total expenses	<u>11,668,784</u>	<u>10,583,155</u>
INCOME FROM OPERATIONS	1,068,410	537,620
OTHER UNRESTRICTED ACTIVITY		
Investment income	4,874,963	2,666,988
Change in value of split-interest agreements	<u>(102,963)</u>	<u>(107,371)</u>
INCREASE IN UNRESTRICTED NET ASSETS	<u>5,840,410</u>	<u>3,097,237</u>
TEMPORARILY RESTRICTED NET ASSETS:		
Contributions	933,400	819,787
Change in value of split-interest agreements	52,220	47,516
Net assets released from restrictions	<u>(1,227,440)</u>	<u>(2,019,560)</u>
DECREASE IN TEMPORARILY RESTRICTED NET ASSETS	<u>(241,820)</u>	<u>(1,152,257)</u>
PERMANENTLY RESTRICTED NET ASSETS:		
Investment income	<u>176,799</u>	<u>51,276</u>
INCREASE IN PERMANENTLY RESTRICTED NET ASSETS	<u>176,799</u>	<u>51,276</u>
INCREASE IN NET ASSETS	5,775,389	1,996,256
NET ASSETS, Beginning of year	<u>46,251,880</u>	<u>44,255,624</u>
NET ASSETS, End of year	<u>\$ 52,027,269</u>	<u>\$ 46,251,880</u>

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

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES YEAR ENDED DECEMBER 31, 2017

	<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 & Admin.</u>	
Salaries	\$ 3,828,698	\$ 1,707,387	\$ 5,536,085	\$ 581,672	\$ 807,362	\$ 6,925,119
Employee benefits and insurance	450,358	79,454	529,812	72,453	108,828	711,093
Payroll taxes	<u>302,718</u>	<u>38,886</u>	<u>341,604</u>	<u>53,200</u>	<u>85,158</u>	<u>479,962</u>
Total compensation	4,581,774	1,825,727	6,407,501	707,325	1,001,348	8,116,174
Communications		856,200	856,200	451,606		1,307,806
Rent	164,470	73,345	237,815	24,987	34,683	297,485
Depreciation	159,728	71,230	230,958	24,267	33,682	288,907
Professional services		9,889	9,889	6,981	205,291	222,161
Case costs	205,230		205,230			205,230
Travel	79,381	38,124	117,505	59,416	24,038	200,959
Office expenses	3,216	8,133	11,349	40,034	136,479	187,862
Telephone	64,251	28,724	92,975	9,786	13,582	116,343
Equipment rental	62,292	27,779	90,071	9,464	13,136	112,671
Library and research	97,278		97,278			97,278
Insurance	46,510	20,741	67,251	7,066	9,808	84,125
Miscellaneous expenses	<u>128,010</u>	<u>41,988</u>	<u>169,998</u>	<u>54,257</u>	<u>207,528</u>	<u>431,783</u>
Total expenses	<u>\$ 5,592,140</u>	<u>\$ 3,001,880</u>	<u>\$ 8,594,020</u>	<u>\$ 1,395,189</u>	<u>\$ 1,679,575</u>	<u>\$ 11,668,784</u>

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

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES YEAR ENDED DECEMBER 31, 2016

	<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 & Admin.</u>	
Salaries	\$ 3,547,982	\$ 1,205,478	\$ 4,753,460	\$ 881,843	\$ 707,921	\$ 6,343,224
Employee benefits and insurance	402,560	98,933	501,493	95,058	90,652	687,203
Payroll taxes	<u>231,636</u>	<u>66,944</u>	<u>298,580</u>	<u>61,561</u>	<u>72,153</u>	<u>432,294</u>
Total compensation	4,182,178	1,371,355	5,553,533	1,038,462	870,726	7,462,721
Communications		339,319	339,319	720,696		1,060,015
Rent	128,556	43,679	172,235	31,952	24,446	228,633
Depreciation	161,122	54,743	215,865	40,046	30,638	286,549
Professional services		403	403	7,650	330,126	338,179
Case costs	145,751		145,751			145,751
Travel	67,010	15,662	82,672	46,109	10,917	139,698
Office expenses	37,469	10,685	48,154	17,789	68,899	134,842
Telephone	61,369	20,851	82,220	15,253	11,489	108,962
Equipment rental	98,534	33,478	132,012	24,490	18,736	175,238
Library and research	97,180		97,180			97,180
Insurance	50,167	17,044	67,211	12,468	9,539	89,218
Miscellaneous expenses	<u>113,208</u>	<u>36,094</u>	<u>149,302</u>	<u>29,796</u>	<u>137,071</u>	<u>316,169</u>
Total expenses	<u>\$ 5,142,544</u>	<u>\$ 1,943,313</u>	<u>\$ 7,085,857</u>	<u>\$ 1,984,711</u>	<u>\$ 1,512,587</u>	<u>\$ 10,583,155</u>

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

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in net assets	\$ 5,775,389	\$ 1,996,256
Reconciliation to net cash provided by operating activities:		
Net realized and unrealized gain on investments	(4,342,176)	(1,955,223)
Donated investments	(273,084)	(133,684)
Donated property, held for sale	(217,951)	
Depreciation	288,907	286,549
Changes in:		
Contributions and other receivables	(1,243,966)	726,809
Prepaid expenses and deposits	(22,969)	(38,758)
Other assets	(234)	29,539
Charitable remainder trust assets	357,419	(38,852)
Accounts payable	44,130	(50,673)
Accrued expenses and other liabilities	(75,361)	(665,793)
Liability to beneficiaries	(256,898)	40,206
Net cash provided by operating activities	<u>33,206</u>	<u>196,376</u>
 CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(166,483)	(47,531)
Purchase of investments	(7,248,894)	(21,292,899)
Proceeds from sale of investments	7,021,508	21,135,255
Net cash used by investing activities	<u>(393,869)</u>	<u>(205,175)</u>
 CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on capital lease obligations	<u>(23,928)</u>	<u>(23,211)</u>
 NET DECREASE IN CASH AND CASH EQUIVALENTS	(384,591)	(32,010)
 CASH AND CASH EQUIVALENTS, Beginning of year	<u>2,413,940</u>	<u>2,445,950</u>
 CASH AND CASH EQUIVALENTS, End of year	<u>\$ 2,029,349</u>	<u>\$ 2,413,940</u>
 NON-CASH TRANSACTIONS:		
Charitable remainder trust assets transferred to investments	<u>\$</u>	<u>\$ 67,541</u>
Net realized and unrealized loss in investments held for supplemental pension plan and related change in liability	<u>\$</u>	<u>\$ (7,234)</u>

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

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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 – 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.

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.

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.

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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 \$250. 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 December 31, 2017 and 2016 was \$124,222 and \$122,157, respectively.

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 June 19, 2018, the date the consolidated financial statements were issued. Management concluded that significant subsequent events have occurred since December 31, 2017 that require recognition or disclosure in the financial statements; see notes 10 and 13.

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

3. RECEIVABLES

Receivables consist of the following:

	<u>2017</u>	<u>2016</u>
Pledges receivable	\$ 933,400	\$ 335,825
Contributions receivable	<u>1,519,051</u>	<u>872,660</u>
Total	<u>\$ 2,452,451</u>	<u>\$ 1,208,485</u>

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

	<u>2017</u>	<u>2016</u>
Within one year	\$ 1,652,451	\$ 1,208,485
In one to five years	500,000	
Thereafter	<u>300,000</u>	<u> </u>
Total	<u>\$ 2,452,451</u>	<u>\$ 1,208,485</u>

At December 31, 2017, \$900,000 of pledges receivable is due from a single donor.

4. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	<u>2017</u>	<u>2016</u>
Building and related property	\$ 3,500,000	\$ 3,500,000
Office furniture and equipment	637,610	495,619
Furniture	389,159	386,411
Leasehold improvements	999,895	999,895
Library	<u>24,239</u>	<u>24,239</u>
Total	5,550,903	5,406,164
Less accumulated depreciation and amortization	<u>(1,926,307)</u>	<u>(1,659,144)</u>
Property and equipment, net	<u>\$ 3,624,596</u>	<u>\$ 3,747,020</u>

5. PROPERTY HELD FOR SALE

In December 2017, the Organization received donated property. The asset is classified as Property Held for Sale in the amount of \$217,951. The property was sold in March 2018 for \$193,584.

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

6. CHARITABLE REMAINDER TRUST ASSETS

Charitable remainder trust assets consist of the following:

	<u>2017</u>	<u>2016</u>
Assets held in charitable remainder trusts in which the Organization is both trustee and secondary beneficiary	\$ 328,670	\$ 507,046
Charitable remainder interests receivable from third parties	<u>599,846</u>	<u>778,889</u>
Total	<u>\$ 928,516</u>	<u>\$ 1,285,935</u>

7. INVESTMENTS

Investments consist of the following:

	<u>2017</u>	<u>2016</u>
Money market funds	\$ 2,827,639	\$ 2,958,692
Mutual funds (equity):		
Value	1,921,675	4,120,410
Growth	3,199,382	2,323,681
Foreign	3,191,830	2,888,246
Core	2,450,739	2,770,185
Mutual funds (fixed income):		
High yield	1,527,151	1,532,150
Emerging markets	1,111,093	803,433
Short-term		23,498
Intermediate-term		145,699
World bond	223,569	463,209
Other	91,705	39,258
Equity securities:		
Mid cap	763,363	
Small cap	64,697	
Core	10,219,693	5,170,976
Foreign	2,250,256	2,686,790
Real estate investment trusts	2,500,174	1,794,976
Other real assets	2,262,137	1,504,508
Hedge funds:		
Macro	707,570	688,638
Event driven		1,115,460
Equity	1,792,465	1,521,174
Relative value	1,704,254	1,559,447
Corporate bonds	2,871,260	2,590,556
Government bonds	<u>2,182,050</u>	<u>2,319,070</u>
Total	<u>\$ 43,862,702</u>	<u>\$ 39,020,056</u>

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Investment income consists of the following:

	<u>2017</u>	<u>2016</u>
Interest and dividends	\$ 709,586	\$ 763,041
Net realized and unrealized gain	<u>4,342,176</u>	<u>1,955,223</u>
Total	<u>\$ 5,051,762</u>	<u>\$ 2,718,264</u>

Investment income is reported net of broker fees and commissions of \$117,951 and \$114,457 in 2017 and 2016, respectively.

8. 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.

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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

Year ending December 31, 2017:	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments	\$ 33,465,448	\$ 5,760,880	
Investments held in charitable remainder trusts in which the Foundation is both trustee and secondary beneficiary	328,670		
Charitable remainder interests receivable from third parties	_____	_____	\$ 599,846
Total	<u>\$ 33,794,118</u>	<u>\$ 5,760,880</u>	<u>\$ 599,846</u>
Year ending December 31, 2016:	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments	\$ 29,225,711	\$ 5,598,264	
Investments held in charitable remainder trusts in which the Organization is both trustee and secondary beneficiary	507,046		
Charitable remainder interests receivable from third parties	_____	_____	\$ 778,889
Total	<u>\$ 29,732,757</u>	<u>\$ 5,598,264</u>	<u>\$ 778,889</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 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:

	<u>2017</u>	<u>2016</u>
January 1	\$ 778,889	\$ 742,415
Maturity of charitable remainder interests receivable	(243,626)	(2,703)
Unrealized gain in fair value	<u>64,583</u>	<u>39,177</u>
December 31	<u>\$ 599,846</u>	<u>\$ 778,889</u>

The Foundation has four investments totaling \$4,636,374 and \$4,196,081 at December 31, 2017 and 2016, respectively, in multi-adviser hedge funds and LLCs 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. One of the investments totaling \$1,115,460 at December 31, 2016 was subject to a 5% holdback for 12 months. No investments were subject to holdbacks at December 31, 2017.

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

9. 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 December 31, 2017 or 2016.

10. 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 2019. Rental expense for 2017 and 2016 was \$410,156 and \$403,872, respectively. In March, 2018, the Organization entered into a non-cancellable 91 month lease for its Washington, D.C. area office. Future minimum lease payments on this lease are included in the schedule below. Future minimum lease payments are as follows:

Fiscal year ending December 31:

2018	\$	194,797
2019		206,958
2020		244,603
2021		250,704
2022		256,961
Thereafter		<u>856,790</u>
Total	\$	<u>2,010,813</u>

11. NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	<u>2017</u>	<u>2016</u>
<u>Time Restriction:</u>		
Litigation	\$ 960,712	\$ 747,137
Charitable remainder trusts	791,092	939,206
General operations	24,000	317,281
<u>Purpose Restriction:</u>		
Litigation		10,000
Liberty Clinic		
Other		<u>4,000</u>
Total	<u>\$ 1,775,804</u>	<u>\$ 2,017,624</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.

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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 December 31, 2017 and 2016, 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 \$40,702,375 and \$36,015,653 at December 31, 2017 and 2016, respectively, 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:

	Board Designated <u>Unrestricted</u>	Permanently Restricted
Year ending December 31, 2017:		
Endowment net assets, beginning of year	\$ 36,015,653	\$ 1,148,288
Investment income	4,717,261	176,799
Contributions	3,636,806	
Endowment funds used for operations	(3,558,264)	
Endowment expenditures	<u>(109,081)</u>	<u> </u>
Endowment net assets, end of year	<u>\$ 40,702,375</u>	<u>\$ 1,325,087</u>
	Board Designated <u>Unrestricted</u>	Permanently Restricted
Year ending December 31, 2016:		
Endowment net assets, beginning of year	\$ 33,301,790	\$ 1,097,012
Investment income	2,609,648	51,276
Contributions	2,457,552	
Endowment funds used for operations	(2,250,639)	
Endowment expenditures	<u>(102,698)</u>	<u> </u>
Endowment net assets, end of year	<u>\$ 36,015,653</u>	<u>\$ 1,148,288</u>

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

12. PENSION PLANS

The Organization had established a defined contribution supplemental pension plan for certain executive employees. The Organization annually accrues a fixed percentage of the covered executive employees' annual compensation. Pension expense for this plan was \$0 and \$10,067 for 2017 and 2016, respectively. This plan was discontinued in 2016 as all covered employees have left the Organization.

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 \$225,407 and \$207,594 for 2017 and 2016, respectively.

13. SUBSEQUENT EVENT

In September 2017, the Organization's Board of Directors took action to change the Organization's fiscal year end from December 31 to June 30.