

**PACIFIC LEGAL FOUNDATION
AND SUBSIDIARY**

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

**YEAR ENDED
JUNE 30, 2019**

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, 2019, and the related consolidated statements of activities, functional expenses, and cash flows for the year 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, 2019, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Gilbert CPAs". The signature is written in a cursive, flowing style.

GILBERT CPAs
Sacramento, California

September 23, 2019

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

JUNE 30, 2019

ASSETS:

Cash and cash equivalents	\$ 973,059
Investments	55,634,488
Contributions and other receivables	1,529,127
Prepaid expenses and deposits	165,913
Other assets	20,724
Charitable remainder trust assets	3,480,891
Property and equipment, net	<u>3,361,060</u>

TOTAL ASSETS \$ 65,165,262

LIABILITIES AND NET ASSETS

LIABILITIES:

Accounts payable	\$ 231,579
Accrued expenses and other liabilities	665,710
Liability to beneficiaries	<u>2,733,143</u>
Total liabilities	<u>3,630,432</u>

NET ASSETS:

Without donor restrictions:	
Undesignated	4,646,408
Board designated	52,772,096
With donor restrictions	<u>4,116,326</u>
Total net assets	<u>61,534,830</u>

TOTAL LIABILITIES AND NET ASSETS \$ 65,165,262

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF ACTIVITIES YEAR ENDED JUNE 30, 2019

NET ASSETS WITHOUT DONOR RESTRICTIONS:

OPERATING REVENUES:

Contributions	\$ 9,920,867
Grants	2,910,622
Court-awarded attorney fees	700,180
Other income	32,771
Net assets released from restrictions	<u>806,787</u>
Total revenues	<u>14,371,227</u>

OPERATING EXPENSES:

Program services:	
Legal activities	7,702,197
Public education	<u>3,953,417</u>
Total program services	11,655,614
Supporting services:	
Revenue development	2,096,705
General and administrative	<u>1,688,907</u>
Total expenses	<u>15,441,226</u>

LOSS FROM OPERATIONS (1,069,999)

OTHER ACTIVITY WITHOUT RESTRICTIONS:

Investment income	<u>4,057,129</u>
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INCREASE IN NET ASSETS WITHOUT DONOR RESTRICTIONS 2,987,130

NET ASSETS WITH DONOR RESTRICTIONS:

Contributions	776,655
Change in value of split-interest agreements	11,485
Investment income	29,042
Net assets released from restrictions	<u>(806,787)</u>

INCREASE IN NET ASSETS WITH DONOR RESTRICTIONS 10,395

INCREASE IN NET ASSETS 2,997,525

NET ASSETS, Beginning of period 58,537,305

NET ASSETS, End of period \$ 61,534,830

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES YEAR ENDED JUNE 30, 2019

	<u>Program Services</u>			<u>Supporting Services</u>		
	<u>Legal Activities</u>	<u>Public Education</u>	<u>Total Program Services</u>	<u>Revenue Development</u>	<u>General & Admin.</u>	<u>Total</u>
Salaries	\$ 4,802,111	\$ 2,046,631	\$ 6,848,742	\$ 923,129	\$ 721,664	\$ 8,493,535
Employee benefits and insurance	991,089	186,612	1,177,701	127,706	226,110	1,531,517
Payroll taxes	331,665	74,440	406,105	99,040	65,656	570,801
Total compensation	6,124,865	2,307,683	8,432,548	1,149,875	1,013,430	10,595,853
Communications		979,259	979,259	760,291		1,739,550
Case costs	634,608		634,608			634,608
Travel	2,692	311,018	313,710	5,133	55,512	374,355
Professional services	58,518	25,377	83,895	21,666	240,592	346,153
Depreciation	174,045	74,178	248,223	33,458	26,156	307,837
Rent	173,735	74,045	247,780	33,398	26,109	307,287
Office expenses	122,929	52,392	175,321	23,631	18,474	217,426
Telephone	86,021	36,661	122,682	16,536	12,927	152,145
Library and research	110,846		110,846			110,846
Equipment rental	59,454	25,339	84,793	11,429	8,935	105,157
Fees	39,913	20,531	60,444	11,047	10,349	81,840
Board expenses	39,085	20,105	59,190	10,818	10,135	80,143
Insurance	25,946	11,058	37,004	4,988	3,899	45,891
Miscellaneous expenses	49,540	15,771	65,311	14,435	262,389	342,135
Total expenses	<u>\$ 7,702,197</u>	<u>\$ 3,953,417</u>	<u>\$ 11,655,614</u>	<u>\$ 2,096,705</u>	<u>\$ 1,688,907</u>	<u>\$ 15,441,226</u>

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

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CASH FLOWS YEAR ENDED JUNE 30, 2019

CASH FLOWS FROM OPERATING ACTIVITIES:

Increase in net assets	\$ 2,997,525
Reconciliation to net cash provided by operating activities:	
Net realized and unrealized gain on investments	(2,888,030)
Donated investments	(345,765)
Depreciation	307,837
Changes in:	
Contributions and other receivables	806,553
Prepaid expenses and deposits	86,051
Other assets	29,361
Charitable remainder trust assets	(31,190)
Accounts payable	59,339
Accrued expenses and other liabilities	218,452
Liability to beneficiaries	(550,918)
Net cash provided by operating activities	<u>689,215</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Purchase of property and equipment	(178,269)
Purchase of investments	(33,112,371)
Proceeds from sale of investments	<u>29,275,241</u>
Net cash used by investing activities	<u>(4,015,399)</u>

CASH FLOWS FROM FINANCING ACTIVITIES:

Principal payments on capital lease obligations	<u>(7,729)</u>
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NET DECREASE IN CASH AND CASH EQUIVALENTS (3,333,913)

CASH AND CASH EQUIVALENTS, Beginning of period 4,306,972

CASH AND CASH EQUIVALENTS, End of period \$ 973,059

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2019

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 two classes of net assets:

Net assets without donor restrictions – Net assets that are not subject to donor-imposed restrictions and may be expended for any purpose in performing the primary objectives of the organization. These net assets may be used at the discretion of management.

Net assets with donor restrictions – Net assets subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. When a restriction expires (generally, as payments are made to fulfill the purposes of the contribution), net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the statement of activities as net assets released from restrictions.

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 net assets with donor restrictions. Net assets with donor restrictions become unrestricted, when the time restrictions expire or the contributions are used for the restricted purpose and are reported in the *Consolidated Statement of Activities* as net assets released from restrictions. Net assets with donor restrictions whose restrictions are met in the same reporting period are shown as net assets without donor restrictions.

Court-awarded attorney fees are recorded when received.

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2019

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 held with financial institutions in excess of federal depository insurance limits was \$1,146,040 at June 30, 2019. 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, 2019 is \$366,837.

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. Salaries and related expenses are allocated based on time and effort. Library and research, and case costs are fully allocated to legal activities. All other expenses are allocated based on the payroll allocations, or management's estimate of the usage of resources.

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).

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2019

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.

New accounting pronouncement – In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, Not-for-Profit Entities (Topic 958), *Presentation of Financial Statements of Not-for-Profit Entities*. The update addresses the complexity and understandability of net asset classification, information about liquidity and availability of resources, and consistency in the type of information provided about expenses and investment return. The Organization has adjusted the presentation of these statements accordingly.

Recently issued accounting pronouncement – In May 2014, the FASB issued ASU No. 2014-09, *Revenue with Contract from Customers (Topic 606)*. The new accounting standard develops a common revenue standard that will remove inconsistencies and weaknesses in revenue requirements, provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition practices, provide more useful information to users of financial statements and simplify the preparation of financial statements. Application of this statement is effective for the year ending June 30, 2020. The Organization is currently evaluating the impact this pronouncement will have on its financial statements.

In June 2018, the FASB issued ASU 2018-08, Topic 958, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The new accounting standard clarifies and improves the guidance for (1) evaluating whether transactions should be accounted for as contributions within the scope of Topic 958 or as exchange transactions subject to other guidance and (2) determining whether a contribution is conditional. Application of this statement is effective for transactions in which the entity serves as the resource recipient for the year ending June 30, 2020. For transactions in which the entity serves as the resource provider, the statement is effective for the year ending June 30, 2021. The Organization is currently evaluating the impact this pronouncement will have on the financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The new accounting standard requires lessees to recognize a lease liability measured on a discounted basis and a right-of-use asset for all leases with terms longer than 12 months. Application of this statement is effective for the year ending June, 30, 2020. The Organization is currently evaluating the impact this pronouncement will have on the financial statements.

Subsequent events have been evaluated through September 23, 2019, the date the consolidated financial statements were issued. Management concluded that no significant subsequent events have occurred since June 30, 2019 that require recognition or disclosure in the financial statements.

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2019

3. LIQUIDITY AND AVAILABILITY OF RESOURCES

The Organization's financial assets available within one year of the consolidated statement of financial position date for general expenditure are as follows:

Cash and cash equivalents	\$ 973,059
Investments	55,634,488
Contributions and other receivables	<u>1,529,127</u>
Total financial assets	58,136,674
Less:	
Amounts unavailable for general expenditures within one year, due to:	
Restricted by donors with purpose restrictions	(110,000)
Receivables due to be collected in more than one year	(718,750)
Charitable remainder trusts expected to be collected in more than one year	(838,158)
Restricted by donors in perpetuity	(1,335,955)
Board restricted endowment	<u>(52,772,096)</u>
Total financial assets available to management for general expenditure within one year	<u>\$ 2,361,715</u>

The Organization's endowments consist of donor-restricted contributions and reserve funds that are not restricted by donor intent but are designated by the board as endowments, internally referred to in the Organization's financial materials as the board-designated reserve fund.

Income from donor-restricted endowments is restricted for specific purposes, with the exception of the amounts available for general use. Donor-restricted endowment funds are not available for general expenditures.

The Organization's board-designated reserve fund is, per board-approved policy, subject to an annual spending rate of 5.5 percent of a three-year rolling average. Although the Organization does not intend to spend from the board-designated reserve fund in excess of this annual appropriation, these amounts could be made available if necessary. The Organization invests cash in excess of daily requirements in short-term money market funds.

4. CONTRIBUTIONS AND OTHER RECEIVABLES

Contributions and other receivables consist of the following:

Contributions receivable	\$ 498,377
Pledges receivable	<u>1,030,750</u>
Total	<u>\$ 1,529,127</u>

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2019

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

Within one year	\$ 810,377
In one to five years	618,750
Thereafter	<u>100,000</u>
Total	<u>\$ 1,529,127</u>

At June 30, 2019, \$700,000 of pledges receivable and \$323,557 of contributions receivable are due from two donors.

5. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

Building and related property	\$ 3,500,000
Office furniture and equipment	1,189,120
Leasehold improvements	<u>1,049,116</u>
Total	5,738,236
Less accumulated depreciation and amortization	<u>(2,377,176)</u>
Property and equipment, net	<u>\$ 3,361,060</u>

6. 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	\$ 2,880,619
Charitable remainder interests receivable from third parties	<u>600,272</u>
Total	<u>\$ 3,480,891</u>

The Organization received contributions of charitable remained trusts for the year ended June 30, 2019 of \$547,155. These are trusts in which the Organization is both the trustee and secondary beneficiary.

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2019

7. INVESTMENTS

Investments consist of the following:

Money market funds	\$ 3,834,567
Mutual funds (equity):	
Core	14,909,356
Emerging markets	5,725,302
International markets	229,260
Growth	44,810
Mutual funds (fixed income):	
High yield	1,865,411
Emerging markets	2,313,162
U.S investment grade bonds	258,154
World bond	31,259
Equity securities:	
Core	7,918,812
Foreign	4,803,986
Real estate investment trusts	1,539,125
Other real assets	2,177,371
Hedge funds:	
Equity	1,680,914
Relative value	933,187
Government bonds	<u>7,369,812</u>
Total	<u>\$ 55,634,488</u>

Investment income consists of the following:

Interest and dividends	\$ 1,198,141
Net realized and unrealized gain	<u>2,888,030</u>
Total	<u>\$ 4,086,171</u>

Investment income is reported net of broker fees and commissions of \$137,706 in 2019.

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2019

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.

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

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>NAV</u>
Investments	\$ 44,377,403	\$ 7,369,812		\$ 3,887,273
Investments held in charitable remainder trusts in which the Foundation is both trustee and secondary beneficiary	2,880,619			
Charitable remainder interests receivable from third parties			\$ 600,272	
Total	<u>\$ 47,258,022</u>	<u>\$ 7,369,812</u>	<u>\$ 600,272</u>	<u>\$ 3,887,273</u>

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2019

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:

July 1, 2018	\$ 568,198
Unrealized gain in fair value	<u>32,074</u>
June 30, 2019	<u>\$ 600,272</u>

The Foundation has three investments totaling \$3,887,273 at June 30, 2019 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.

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 June 30, 2019.

10. LEASE OBLIGATIONS

The Organization leases certain equipment and office space under long-term operating lease agreements, which expire at various dates through 2026. Rental expense for June 30, 2019 was \$412,445. Future minimum lease payments are as follows:

<u>Fiscal year ending June 30:</u>	
2020	\$ 356,768
2021	363,827
2022	371,065
2023	378,490
2024	295,820
Thereafter	<u>483,209</u>
Total	<u>\$ 2,249,179</u>

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2019

11. NET ASSETS

Net assets with donor restrictions are available for the following purposes:

Time Restriction:	
General operations	\$ 1,381,619
Charitable remainder trusts	1,288,752
Purpose Restriction:	
Litigation	110,000
Perpetual in nature	<u>1,335,955</u>
Total	<u>\$ 4,116,326</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 net assets with donor restrictions that are perpetual in nature (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. Net assets with donor restrictions that are perpetual in nature as of June 30, 2019 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 \$52,772,096 at June 30, 2019 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. As such, the overall investment objectives are to maximize returns without exposure to undue risk. The assets for the endowment may be invested in a mix of equity, fixed income, real asset, and alternative investment/hedge funds. The desired investment objective of the endowment is an overall annualized time weighted net of investment related fees long-term return on assets in excess of core inflation of at least 4%.

PACIFIC LEGAL FOUNDATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2019

It is the policy of the Board to allocate each year 5.5% of the average endowment over the period of three years from the endowment accounts for expenditure for program operations for the next fiscal year. As a part of the annual budget process the Board will review the status of the endowment and may approve any change to its allocation level for the next fiscal year. Changes in endowment net assets are as follows:

	Board Designated Unrestricted	Permanently Restricted
Endowment net assets, beginning of period	\$ 45,485,884	\$ 1,306,913
Investment income	3,931,066	29,042
Contributions	8,222,507	
Endowment funds used for operations	(4,737,887)	
Endowment expenditures	<u>(129,474)</u>	
Endowment net assets, end of period	<u>\$ 52,772,096</u>	<u>\$ 1,335,955</u>

12. PENSION PLAN

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 \$583,029 for 2019.