

**MAY AND STANLEY SMITH CHARITABLE TRUST**

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**FINANCIAL STATEMENTS**

December 31, 2018



# MAY AND STANLEY SMITH CHARITABLE TRUST

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## INDEPENDENT AUDITORS' REPORT

To the Trustees  
May and Stanley Smith Charitable Trust

We have audited the accompanying financial statements of May and Stanley Smith Charitable Trust, which comprise the statement of financial position as of December 31, 2018, and the related statements of activities and changes in net assets, and cash flows for the year then ended, and the related notes to the financial statements.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the financial statements referred to above present fairly in all material respects the financial position of May and Stanley Smith Charitable Trust as of December 31, 2018, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

BPM LLP

San Francisco, California  
June 25, 2019

**MAY AND STANLEY SMITH CHARITABLE TRUST**

**STATEMENT OF FINANCIAL POSITION**

As of December 31, 2018

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**ASSETS**

Cash and cash equivalents	\$ 805,567
Investments, at fair value	414,253,425
Dividends and interest receivable	718,137
Prepaid other tax and other current assets	<u>17,141</u>
Total assets	<u>\$ 415,794,270</u>

**LIABILITIES AND NET ASSETS**

Liabilities:	
Grants payable	\$ 8,030,000
Accounts payable	1,012,246
Federal excise and other taxes payable	<u>69,011</u>
Total liabilities	9,111,257
Net assets without donor restrictions	<u>406,683,013</u>
Total liabilities and net assets	<u>\$ 415,794,270</u>

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

**MAY AND STANLEY SMITH CHARITABLE TRUST**  
**STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS**

For the year ended December 31, 2018

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Net investment loss:	
Realized gains from the sale of investments, net	\$ 17,163,326
Unrealized loss on investments held, net	(48,466,849)
Dividends, interest and other income, net of investment expenses	<u>11,405,514</u>
Net investment loss before federal excise and other taxes	(19,898,009)
Federal excise and other taxes	<u>(570,235)</u>
Net investment loss	<u>(20,468,244)</u>
Expenses:	
Grants and grants management	20,909,212
General and administrative	<u>125,146</u>
Total expenses	<u>21,034,358</u>
Change in net assets	(41,502,602)
Net assets without donor restrictions, beginning of year	<u>448,185,615</u>
Net assets without donor restrictions, end of year	<u><u>\$ 406,683,013</u></u>

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

# MAY AND STANLEY SMITH CHARITABLE TRUST

## STATEMENT OF CASH FLOWS

For the year ended December 31, 2018

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Cash flows from operating activities:	
Change in net assets	\$ (41,502,602)
Adjustments to reconcile change in net assets to net cash used in operating activities:	
Net realized and unrealized gains on investments	31,303,523
Changes in operating assets and liabilities:	
Dividends and interest receivable	13,706
Prepaid other tax and other current assets	(9,961)
Grants payable	43,000
Accounts payable	449,363
Federal excise and other taxes payable	<u>21,515</u>
Net cash used in operating activities	<u>(9,681,456)</u>
Cash flows from investing activities:	
Purchase of investments	(221,306,740)
Proceeds from sale of investments	<u>231,672,723</u>
Net cash provided by investing activities	<u>10,365,983</u>
Change in cash and cash equivalents	684,527
Cash and cash equivalents, beginning of year	<u>121,040</u>
Cash and cash equivalents, end of year	<u>\$ 805,567</u>
Supplemental disclosures of cash flow information:	
Federal excise and other taxes paid	<u>\$ 559,030</u>

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

# MAY AND STANLEY SMITH CHARITABLE TRUST

## NOTES TO FINANCIAL STATEMENTS

December 31, 2018

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### 1. Organization

The May and Stanley Smith Charitable Trust (the “Trust”) was established in 1989 to provide grants to organizations that serve the needs of children, the elderly, the disabled and the disadvantaged. The Trust makes grants primarily to organizations serving people in the Western Region of the United States and in British Columbia, Canada. A small number of grants are made to organizations in the Bahamas, the United Kingdom, Hong Kong and Australia. The Trust has been classified by the Internal Revenue Service (“IRS”) as a private foundation, as defined in Section 509(a) of the Internal Revenue Code (“IRC”). The Trust has been recognized by the IRS as a foreign organization for purposes of IRC Section 4948. For the year ended December 31, 2018, the Trust complied with the IRS requirement to spend or distribute for charitable purposes a minimum of five percent of the average fair value of its investment assets for the preceding year. The trustees may distribute principal or income, or both, for the purposes defined in the Trust agreement. The Trust is supported through investment income and contributions.

### 2. Summary of Significant Accounting Policies

#### *Basis of Accounting*

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”).

#### *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results may differ from those estimates.

#### *Cash and Cash Equivalents*

The Trust considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

#### *Concentration of Credit Risk*

The Trust maintains cash balances with multiple banks under a bank deposit program. Those cash balances are insured by the Federal Deposit Insurance Corporation for up to \$250,000 per insured bank. The Trust also may hold cash in a brokerage account, where it is insured by the Securities Investor Protection Corporation up to \$250,000, and by Lloyd’s of London up to an additional \$900,000. Cash balances may at times exceed these limits. To date, the Trust has not experienced any losses in these accounts.

#### *Investments*

Investments are stated at quoted market prices or estimated fair values. Gains or losses that result from market fluctuations are recognized in the period such fluctuations occur. Realized gains or losses that result from sales or maturities of investments are calculated on an adjusted cost basis. Dividend and interest income are accrued when earned. Indirect investment expenses of \$50,875 are included in dividends, interest and other income, net of investment expenses on the statement of activities for the year ended December 31, 2018.

Continued

# MAY AND STANLEY SMITH CHARITABLE TRUST

## NOTES TO FINANCIAL STATEMENTS

December 31, 2018

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### 2. Summary of Significant Accounting Policies, continued

#### *Fair Value Measurement*

Fair value is determined based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants.

Receivables and liabilities are measured at carrying value which approximated fair value due to their short maturity.

#### *Covered Calls*

The use of call options is a part of the Trust's investment strategy. Covered calls are recorded at fair value and generally expire within one to three months from the original dates. Cash flows from covered calls are classified as an investing activity on the statement of cash flows.

#### *Grants*

Grants are expensed when the unconditional promise to give is approved by the Board of Trustees or management in certain cases. There were no conditional promises to give during the year ended December 31, 2018.

#### *Income Taxes*

The Trust is a private foundation and is exempt from federal income taxes under Section 501(c)(3) of the IRC and from the California franchise and/or income taxes under Section 23701(d) of the California Revenue and Taxation Code. The Trust maintains its accounts and files its tax returns using the accrual method of accounting.

The Trust, a private foundation, has been recognized by the IRS as a foreign organization for purposes of IRC Section 4948 and as such is subject only to a federal excise tax of 4% on its gross U.S. sourced interest and dividends. All excise taxes are considered to be current taxes and no deferred taxes are necessary.

#### *Risks and Uncertainties*

The Trust invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risk. The Trust invests in bond funds whose durations are typically less than 5 years. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect investment values reported in the statements of financial position.

#### *Recent Accounting Pronouncements*

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-02, *Leases*. The objective of the update is to increase transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet for leases with a lease term of more than 12 months. In addition, the update will require additional disclosures regarding key information about leasing arrangements. Under existing guidance, operating leases are not recorded as lease assets and lease liabilities on the balance sheet. The ASU will be effective for fiscal years beginning after December 15, 2019, with early adoption permitted. The Trust is currently evaluating the impact of the adoption of this accounting guidance on its financial statements.

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# MAY AND STANLEY SMITH CHARITABLE TRUST

## NOTES TO FINANCIAL STATEMENTS

December 31, 2018

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### 2. Summary of Significant Accounting Policies, continued

#### *Recent Accounting Pronouncements*, continued

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The ASU modifies the accounting for contributions to make it more clearly in distinguishing whether grants or contracts should be accounted for as non-reciprocal contributions, or as exchange transactions that follow revenue recognition accounting. For exchange transactions, the standard clarifies when each party directly receives commensurate value in the transaction, and how to deal with third party payers to a transaction. Additionally, the criteria for determining whether a contribution is conditional has been changed from a probability-based approach to one focused on barriers in an arrangement. The changes in this standard are likely going to result in more transactions being treated as conditional contributions, including those that were previously considered earned revenue as exchange transactions. The ASU is effective for annual financial statements issued for fiscal years beginning after December 15, 2018, with early adoption permitted. The Trust is currently evaluating the effects of adopting the standard.

#### *Change in Accounting Principle*

During the year ended December 31, 2018, the Trust adopted the requirements of the FASB's ASU No. 2016-14, *Not-for-Profit Entities: Presentation of Financial Statements of Not-for-Profit Entities* ("ASU 2016-14"), required for annual reporting periods beginning after December 31, 2017. ASU 2016-14 addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return between not-for-profit entities. A key change required by ASU 2016-14 are the net asset classes used in these financial statements. Amounts previously reported as unrestricted net assets are now reported as net assets without donor restrictions. A footnote on liquidity and availability has also been added.

### 3. Fair Value Measurements and Investments

Generally accepted accounting principles establish a hierarchy to prioritize the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The following is a brief description of these three levels:

*Level 1* – Quoted prices in active markets for identical assets. Investments in this level have been valued at the closing price on the active market on which the securities are traded at year-end.

*Level 2* – Observable inputs other than quoted prices in active markets for identical assets, quoted prices for identical or similar assets in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets. Investments held in this level have been calculated using the most recent trading activity for identical or similar securities and changes in interest rates.

*Level 3* – Inputs that are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset.

Level 1 investments have been valued at the closing price on the active market on which the securities are traded as of December 31, 2018.

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**MAY AND STANLEY SMITH CHARITABLE TRUST**

**NOTES TO FINANCIAL STATEMENTS**

December 31, 2018

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**3. Fair Value Measurements and Investments, continued**

The following table presents the Trust's assets measured at fair value on a recurring basis as of December 31, 2018:

	Quoted Prices in Active Markets (Level 1)	Total
	<u>                    </u>	<u>                    </u>
Investments by fair value level:		
U.S. common stocks:		
Energy	\$ 6,743,440	\$ 6,743,440
Industrials	14,513,006	14,513,006
Consumer discretionary	7,584,000	7,584,000
Health care	4,733,280	4,733,280
Financials	17,489,865	17,489,865
Information Technology	48,617,656	48,617,656
Total U.S. common stocks	<u>99,681,247</u>	<u>99,681,247</u>
U.S. preferred stocks:	<u>9,687,090</u>	<u>9,687,090</u>
U.S. equity funds:		
ETF	47,734,720	47,734,720
Mutual funds	44,485,534	44,485,534
Total U.S. equity funds	<u>92,220,254</u>	<u>92,220,254</u>
International equity funds:		
ETF	22,702,860	22,702,860
Mutual funds	42,149,343	42,149,343
Total international equity funds	<u>64,852,203</u>	<u>64,852,203</u>
Marketable alternatives	<u>22,796,300</u>	<u>22,796,300</u>
Money market funds	<u>17,012,516</u>	<u>17,012,516</u>
U.S. fixed income mutual funds	<u>67,189,431</u>	<u>67,189,431</u>
Total investments by fair value level	<u><u>\$ 373,439,041</u></u>	<u><u>\$ 373,439,041</u></u>
Investments measured at the net asset value ("NAV"):		
Hedge fund		19,595,036
Private equity: real estate funds		<u>21,219,348</u>
Total investments		<u><u>\$ 414,253,425</u></u>

Continued

**MAY AND STANLEY SMITH CHARITABLE TRUST**

**NOTES TO FINANCIAL STATEMENTS**

December 31, 2018

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**3. Fair Value Measurements and Investments**, continued

The Trust uses the NAV to determine the fair value of all the underlying investments, which do not have readily determinable fair values and prepare their financial statements consistent with the measurement principles of an investment company, or have attributes of an investment company. The following table lists the investments in real estate and hedge funds as of December 31, 2018:

<u>Asset</u>	<u>Strategy</u>	<u>NAV in Fund</u>	<u>Number of Funds</u>	<u>Remaining Life</u>	<u>Unfunded Commitments</u>
Private equity:					
Real estate fund II	Domestic real estate related assets	\$ 17,667,537	1	5 years	\$ 4,669,659
Real estate fund III	Domestic real estate related assets	1,567,069	1	7 years	8,041,328
Real estate fund III (2)	Domestic real estate related assets	1,984,741	1	6 years	6,000,000
Hedge fund	U.S. exchange listed equity securities	<u>19,595,036</u>	1	NA	<u>-</u>
		<u>\$ 40,814,383</u>			<u>\$ 18,710,987</u>

As a limited partner in the closed-end real estate funds, the Trust may not withdraw from the real estate funds prior to a fund's dissolution. The hedge fund permits monthly withdrawals with 45 days prior notice.

**4. Covered Calls**

The Trust had written covered calls as part of its investment strategy. Included in equity securities as of December 31, 2017 were short calls on various securities. The 2017 calls expired on January 19, 2018. The Trust recognized \$559,206 of net gains related to derivative activity for the year ended December 31, 2018. The net gains are reported as net realized and unrealized gain on investments in the statements of activities.

**5. Grants Payable**

The Trust sometimes approves grants that have a payment or payments in future years or are paid when certain future requirements are met by the grantee. Grants authorized but unpaid at year end are reported as liabilities. Discounting of grants payable over multiple years would be immaterial and is not reflected in the financial statements. The following is a summary of grants authorized and payable:

Year ending December 31:	
2019	\$ 7,905,000
2020	<u>125,000</u>
Total grants payable	<u>\$ 8,030,000</u>

Continued

# MAY AND STANLEY SMITH CHARITABLE TRUST

## NOTES TO FINANCIAL STATEMENTS

December 31, 2018

### 6. Net Assets

Net assets on the statements of financial position are comprised of original and subsequent capital contributions to the Trust, anticipated contributions, and increases in value through investment activity. Net assets are all without donor restrictions and are comprised of the following for the year ended December 31, 2018:

Contributed capital	\$ 135,970,395
Contributed capital from the May Smith Trust	65,365,606
Cumulative grants paid and payable	(312,959,485)
Net increase in value since inception of the Trust, net of operating expenses	<u>518,306,497</u>
Total net assets without donor restrictions	<u><u>\$ 406,683,013</u></u>

### 7. Functional Expense Allocation

The indirect costs associated with certain expenses have been allocated on a functional basis in the statement of activities. Certain expenses are not directly identifiable with one specific function and require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include the AdminiTrust fee, professional and consultant fees, trustee fees, and other expenses, all of which are allocated on the basis of estimates of time and use. The expenses for the year ended December 31, 2018 are allocated as follows:

	<u>Grants and Grants Management</u>	<u>General and Administrative</u>	<u>Total</u>
Grants	\$ 18,997,130	\$ -	\$ 18,997,130
AdminiTrust fee	1,573,089	62,490	1,635,579
Trustee fees	312,992	13,287	326,279
Professional and consultants	12,428	49,134	61,562
Other	<u>13,573</u>	<u>235</u>	<u>13,808</u>
	<u><u>\$ 20,909,212</u></u>	<u><u>\$ 125,146</u></u>	<u><u>\$ 21,034,358</u></u>

Continued

# MAY AND STANLEY SMITH CHARITABLE TRUST

## NOTES TO FINANCIAL STATEMENTS

December 31, 2018

### 8. Federal Excise and Other Taxes

Federal excise tax expense was calculated at a rate of 4%. The Trust pays foreign taxes on foreign dividends and unrelated business income tax (“UBIT”) as applicable. Federal excise and other taxes are included in the statements of activities for the year ended December 31, 2018 as follows:

Federal excise and other taxes:	
Current federal excise tax	\$ 372,099
Foreign tax	197,809
UBIT	<u>327</u>
Total federal excise tax benefit	<u>\$ 570,235</u>

### 9. Payout Requirement

The IRC requires private foundations to annually disburse approximately 5% of the market value of investment assets, less the federal excise tax, for the current year by the end of next year. This payout requirement may be satisfied by payments for grants, program-related investments, direct conduct of charitable activities, and certain administrative expenses. The Trust has met the required minimum distributions, but has undistributed income amounts that must be distributed before the end of the next fiscal year of approximately \$18,540,000 as of December 31, 2018.

### 10. Liquidity

The Trust has a goal to maintain financial assets, which consist of cash and liquid investments, on hand to meet three years of normal operating expenses, totaling approximately \$75,000,000. The Trust has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, as part of its liquidity management, the Trust invests cash in excess of daily requirements in various short-term investments, including short-term treasury instruments. The Trust had the following financial assets available to meet cash needs for general expenditures within one year as of December 31, 2018:

Cash	\$ 805,567
Investments, at fair value	414,253,425
Interest, dividends, and capital gains receivable	<u>718,137</u>
Total financial assets	415,777,129
Less:	
Hedge fund and private equity investments in real estate	(40,814,384)
Unfunded commitments	<u>(18,710,987)</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 356,251,758</u>

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# MAY AND STANLEY SMITH CHARITABLE TRUST

## NOTES TO FINANCIAL STATEMENTS

December 31, 2018

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### 11. Related Parties

The Trust Instrument authorizes trustees to use the services of a business or professional firm with which a trustee may be associated, and to compensate the firm for those services. A trustee is the managing member of the company that provides administrative services to the Trust. Expenses related the administrative services company were \$1,637,734 for the year ended December 31, 2018. Fees due to the administrative services company at December 31, 2018 were \$456,068.

Another trustee is the managing partner of the accounting firm that provides tax return preparation services to the Trust. Expenses related to the accounting firm were \$12,880 for the year ended December 31, 2018. Fees due to the accounting firm were \$10,750 as of December 31, 2018.

The trustees were paid trustee fees totaling \$375,000 for the year ended December 31, 2018, which are allocated between grants management, general and administrative, and investment related expenses on the statement of activities and changes in net assets.

### 12. Subsequent Events

The Trust evaluated subsequent events for recognition and disclosure through June 25, 2019, the date which these financial statements were available to be issued. Management concluded that no material subsequent events have occurred since December 31, 2018 that required recognition or disclosure in the financial statements.