

S. H. COWELL FOUNDATION

DECEMBER 31, 2006 AND 2005

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

S. H. Cowell Foundation

Independent Auditors' Report and Financial Statements

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Independent Auditors' Report

THE BOARD OF DIRECTORS
S. H. COWELL FOUNDATION
San Francisco, California

We have audited the accompanying statement of financial position of the **S. H. COWELL FOUNDATION (the Foundation)** as of December 31, 2006 and 2005, and the related statements of activities and changes in net assets and cash flows, for the years then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly in all material respects the financial position of the S. H. Cowell Foundation as of December 31, 2006 and 2005, and changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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June 1, 2007

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S. H. Cowell Foundation

Statement of Financial Position

<i>December 31,</i>	2006	2005
Assets		
Cash and money market funds	\$ 4,097,235	\$ 4,472,589
Investments in securities - at fair value	146,623,759	140,230,666
Investments in real property - at fair value	1,274,000	1,366,250
Other investments	13,190,719	11,269,571
Notes receivable	8,654,571	6,516,560
Future real estate proceeds		288,000
Other assets (including furniture, equipment and leasehold improvements of \$314,132 in 2006 and \$287,443 in 2005, net of accumulated depreciation and amortization of \$206,772 in 2006 and \$180,708 in 2005)	705,758	871,375
	\$ 174,546,042	\$ 165,015,011
Liabilities and Unrestricted Net Assets		
Liabilities:		
Current liabilities	\$ 350,191	\$ 241,756
Deposits	2,500	2,500
Deferred tax liability	566,084	381,021
Total liabilities	918,775	625,277
Unrestricted Net Assets	173,627,267	164,389,734
	\$ 174,546,042	\$ 165,015,011

S. H. Cowell Foundation

Statement of Activities and Changes in Net Assets

<i>Years Ended December 31,</i>	2006	2005
Income:		
Interest	\$ 2,349,510	\$ 2,483,082
Dividends	1,989,193	1,841,021
Net realized and unrealized gains on investments in securities	16,088,211	4,653,965
Unrealized loss on real property		(230,000)
Royalties and other gains and losses related to real properties, net	602,155	295,407
Total income	21,029,069	9,043,475
Expenses:		
Office expense	1,461,239	1,410,137
Investment advisory and management and custodial fees	619,864	623,644
Legal, accounting and other professional fees	143,174	147,027
Property taxes	3,601	5,333
Other expenses related to real properties	156,337	128,593
Other foundation related expenses	145,102	232,746
Total expenses	2,529,317	2,547,480
Income Over Expenses	18,499,752	6,495,995
Deferred Tax Expense	185,063	(271,099)
Current Tax Expense	218,000	450,000
Income available for grants	18,096,689	6,317,094
Grants Authorized	8,938,158	10,270,607
Grants Cancelled	(79,002)	(25,000)
Change in Net Assets	9,237,533	(3,928,513)
Unrestricted Net Assets - Beginning of year	164,389,734	168,318,247
Unrestricted Net Assets - End of year	\$ 173,627,267	\$ 164,389,734

S. H. Cowell Foundation

Statement of Cash Flows

<i>Years Ended December 31,</i>	2006	2005
Cash Flows from Operating Activities:		
Change in net assets	\$ 9,237,533	\$ (3,928,513)
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Depreciation	30,354	24,541
Unrealized gains on investments	(9,775,508)	5,270,025
Realized gains on investments	(6,312,702)	(9,923,990)
Realized (gain) loss on real estate, net	(531,069)	(229,702)
Unrealized loss (appreciation) on real property		230,000
Increase (decrease) in:		
Other assets	166,242	(108,744)
Notes receivable	(2,138,011)	(870,560)
Grants payable		(55,000)
Current Liabilities	108,433	70,958
Deferred tax liability	185,063	(271,099)
Net cash used by operating activities	(9,029,665)	(9,792,084)
Cash Flows from Investing Activities:		
Real estate deposits applied		(602,644)
Proceeds from sale of real estate	531,069	13,529,703
Future real estate proceeds collections	288,000	522,000
Proceeds from sale of securities	72,774,298	64,363,214
Purchases of securities	(64,418,787)	(58,448,068)
Purchase of partnership interest	(585,000)	(10,525,000)
Purchases of furniture, equipment, and leaseholds	(30,979)	(108,064)
Partnership distributions	95,710	35,050
Net cash provided by investing activities	8,654,311	8,766,191
Change in Cash and Equivalents	(375,354)	(1,025,893)
Cash and Equivalents - Beginning of year	4,472,589	5,498,482
Cash and Equivalents - End of year	\$ 4,097,235	\$ 4,472,589
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for excise taxes	\$ 132,000	\$ 394,000

Note 1 - Nature of Organization and Summary of Significant Accounting Policies:

a. Nature of Organization

The S. H. Cowell Foundation (the Foundation) is a public benefit corporation created under the will of S. H. Cowell and is classified as a private non-operating foundation.

Principal and income of the Foundation may be distributed by the Directors exclusively for religious, charitable, scientific, literary, or educational purposes.

b. Basis of Presentation

The financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

c. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

d. Cash and Equivalents

For purposes of the statement of cash flows, cash equivalents include money market funds.

e. Investments

Investments in securities are stated at fair market value based on quoted market prices.

Investments in real property are stated at fair value based on appraisals made approximately every five years or purchase option agreements.

Other investments consist of investments in a limited liability company, a foreign company and a limited partnership (The Companies). The Companies are accounted for under the equity method of accounting and stated at fair value, with fair value determined by The Companies. Under the equity method, investments are carried at cost, adjusted for allowable share of The Companies' income and loss, additional investments and cash distributions from The Companies. The Companies' principal assets are investments in various financial instruments, mutual funds and other investments which are valued at fair value.

S. H. Cowell Foundation

Notes to Financial Statements

Certain mineral rights have been retained in property sold and nominal carrying values have been assigned to these interests.

In 2004, the Foundation entered a purchase option agreement under which it agreed to sell the property discussed in Note 4 for \$900,000. In light of this agreement, the fair value of the property has been decreased by \$230,000 in 2005.

f. Grants

Grants are characterized as either conditional or unconditional. Conditional grants are those that depend upon the occurrence of a specified future and uncertain event to bind the Foundation. These grants are not reflected in the financial statements until the period in which the conditions upon which they depend are substantially met, that is, when they become unconditional.

If no conditions are specified, the grant is recognized upon approval by the Foundation's board as an unconditional grant.

g. Income Taxes

As a private foundation, the organization is subject to a maximum 2% excise tax on net investment income, including realized gains. Normally, the excise tax is at 2% but it may be 1% depending on the amount of grants paid over the minimum required distributions.

Income tax regulations also require that certain minimum distributions be made in accordance with a specified formula. The Foundation is in compliance with those regulations.

Federal income tax laws for private foundations require estimated taxes on a quarterly basis. Current tax expense is \$218,000 for the year ended December 31, 2006. Current taxes payable at December 31, 2006 are \$143,700 and are included in current liabilities.

h. Unrestricted Net Assets

The Foundation's net assets are unrestricted and not subject to any donor imposed restrictions of either a temporary or permanent nature.

S. H. Cowell Foundation

Notes to Financial Statements

Note 2 - Disclosures about Fair Value of Financial Instruments:

The following represents an estimate of the fair value of each class of financial instruments for which it is practicable to estimate that value as of December 31, 2006 and 2005:

	2006 Estimated		2005 Estimated	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Cash and Money Market Funds	\$ 4,097,235	\$ 4,097,235	\$ 4,472,589	\$ 4,472,589
Securities:				
Equity Securities	79,525,116	106,003,613	83,912,555	101,326,520
Corporate Notes and Bonds	40,821,509	40,620,146	38,476,881	38,904,146
Other Investments	11,729,240	13,190,719	11,239,950	11,269,571
Real Property	1	1,274,000	1	1,366,250

As indicated in Note 1e, the fair value of other investments is determined by the Companies involved, and underlying cost is \$11,729,240 and \$11,239,950 as of December 31, 2006 and 2005, respectively.

Investment management fees for the other investments are not recorded separately but are netted against the investment value. The estimated management fees for 2006 netted against the other investments value was \$131,000.

Note 3 - Notes Receivable:

Notes receivable include a note of \$5,500,000 relating to the sale of real property, and is secured by a deed of trust with a 6.5% interest rate, principal and interest due through June 22, 2008, as renegotiated in April 2006.

In addition, the Board of Directors approved and made its first program related investment loan in 2005 in the amount of \$1 million with a 2.5% interest rate. The related note receivable is \$870,560, net of unamortized discount of \$129,440 at 2%. The principal is due June 10, 2012. Interest is due on the tenth of each month.

Prior to 2006, Board of Directors approved a \$1 million program related investment loan to establish a line of credit, at 2.5% annual interest, allowing the principal to be re-lent to a sub-borrower. The first draw of \$631,500 was made on August 30, 2006. The related note receivable is \$528,403, net of unamortized discount of \$103,097 at 2.2% Interest and principal are due on September 16, 2010.

S. H. Cowell Foundation

Notes to Financial Statements

In October 2006, the Board of Directors approved and made its first recoverable grant in the amount of \$1 million with a 2.5% interest rate. The related note receivable is \$858,704, net of unamortized discount of \$141,296 at 2.2%. The principal is due November 1, 2013. Interest is due on the first of each November, beginning on November 1, 2007.

In December 2006, the Board of Directors approved and made a recoverable grant in the amount of \$1 million with a 2.5% interest rate. The related note receivable is \$896,903, net of unamortized discount of \$103,097 at 2.2%. The principal and last interest payment are due December 21, 2011. Interest is due on the 31st of each December, beginning on December 31, 2007.

Note 4 - Investment in Real Property:

During 2005, the Foundation entered into an option agreement to sell 377.324 acres of unimproved property in northern El Dorado County near the town of Cool. It is anticipated that the option will be exercised in 2007 for a sales price of \$900,000.

Note 5 - Future Real Estate Proceeds:

In October 1997, the Foundation sold property in Santa Cruz County, California for a lump sum of \$7,000,000, plus additional future consideration. The estimated future consideration at that time was \$1,080,000 to be paid over an indefinite period. This amount is contingent upon sale of the subdivided property, known as Graham Hill Estates, by the purchaser and may increase in amount depending upon the selling price of the individual subdivided properties. During 2006 and 2005, sales of the lots consisted of the following:

	2006	2005
Number of Lots Sold	16	29
Percentage of sales received by the Foundation	\$ 819,069	\$ 1,144,220
<u>Minimum amount due (decrease in receivable)</u>	<u>(288,000)</u>	<u>(522,000)</u>
<u>Amount received in excess of original contract</u>	<u>\$ 531,069</u>	<u>\$ 622,220</u>

The amount received in excess of original contract is reported under royalties and other gains and losses related to real properties.

S. H. Cowell Foundation

Notes to Financial Statements

Note 6 - Federal Excise Taxes:

The Foundation is exempt from federal and state income taxes. However, in accordance with the provisions of the Tax Reform Act of 1969, the Foundation is classified as a private foundation subject to excise tax on net investment income.

The Tax Reform Act of 1984 requires that certain minimum distributions be made in accordance with a specified formula. For the years ended December 31, 2006 and 2005, the Foundation made charitable distributions in excess of the required minimum. As of December 31, 2006, the Foundation has estimated carryforwards to meet future charitable distribution requirements which expire as follows:

2007	\$ 1,438,000
2010	5,335,000
2011	5,391,000
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	\$ 12,164,000

Note 7 - Grants and Grants Payable:

Grants of \$8,938,158 and cancellations of \$79,002 are reflected in the financial statements for the year ended December 31, 2006.

Conditional grants which have not been recorded totaled \$5,738,600 at December 31, 2006. When the conditions associated with these grants are satisfied it is anticipated they will be paid out as follows: \$4,378,600 in 2007 and \$1,360,000 in 2008.

Note 8 - Commitments and Contingencies:

Investment Commitment

The Foundation has committed a total maximum of \$3,000,000 to a limited partnership as part of its investment strategies. To date, the Foundation has paid \$2,010,000. The remaining \$990,000 reflects the future commitment based on projected capital calls as determined by the limited partnership.

S. H. Cowell Foundation

Notes to Financial Statements

Leases

The Foundation leases its office space under an operating lease which was renegotiated in 2004 and expires in 2011. Minimum payments under this obligation are as follows.

Year Ending December 31,	
2007	\$ 130,000
2008	135,000
2009	139,000
2010	155,000
Thereafter	157,000
	<hr/>
	\$ 716,000

Rental expenses were approximately \$152,000 and \$220,000 for the years ended December 31, 2006 and 2005, respectively.

The Foundation is also committed under various agreements, contracts, etc., covering future periods which collectively are not material to its financial position or results of operations. Additionally, the Foundation leases various of its properties under which it receives monthly or annual rents and royalties, covering month-to-month or extended year terms.

Note 9 - Related Party Transactions:

In 2005, two Directors were partners in a law firm that rendered various legal services to the Foundation. The Foundation paid this firm approximately \$17,225 for the year ended December 31, 2005 for general legal services as well as real property related matters.

Note 10 - Pension Plan:

The Foundation maintains a defined contribution plan for which substantially all employees are eligible. The Foundation contributes a percentage of eligible salaries to the plan. In 2006 and 2005, the Foundation contributed \$137,000 and \$134,000, respectively, to the plan.

Note 11 - Concentration of Risk - Assets Held in a Fiduciary Capacity:

Investments in securities are diversified into various stocks and other investment securities in order to limit the concentration of market risk. Investments are held by Bank of New York, who has custodianship responsibilities for the investments.

The Foundation has financial instruments that are potentially subject to credit risk. The credit risk consists of demand deposits. The Foundation maintains its demand deposits at Wells Fargo Bank. At December 31, 2006, deposits were in excess of federal insurance of \$302,000.