

S. H. COWELL FOUNDATION

DECEMBER 31, 2008 AND 2007

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, 2008 and 2007, 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, 2008 and 2007, 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.

Hood & Strong LLP

September 9, 2009

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S. H. Cowell Foundation

Statement of Financial Position

<i>December 31,</i>	2008	2007
Assets		
Cash and money market funds	\$ 4,066,535	\$ 4,878,822
Investments in securities	95,956,798	147,943,511
Investments in mineral rights	374,000	374,000
Other investments	12,393,640	15,777,827
Notes receivable	9,294,076	9,018,780
Other assets (including furniture, equipment and leasehold improvements of \$326,663 in 2008 and 2007, net of accumulated depreciation and amortization of \$269,151 in 2008 and \$237,829 in 2007)	705,369	830,218
	<u>\$ 122,790,418</u>	<u>\$ 178,823,158</u>
Liabilities and Unrestricted Net Assets		
Liabilities:		
Current liabilities	\$ 117,489	\$ 559,000
Deferred tax liability		613,392
Total liabilities	117,489	1,172,392
Unrestricted Net Assets	<u>122,672,929</u>	<u>177,650,766</u>
	<u>\$ 122,790,418</u>	<u>\$ 178,823,158</u>

S. H. Cowell Foundation

Statement of Activities and Changes in Net Assets

<i>Year Ended December 31,</i>	2008	2007
Income:		
Interest	\$ 2,829,714	\$ 3,123,540
Dividends	2,235,841	2,107,532
Net realized and unrealized (losses) gains on investments in securities	(48,441,779)	9,358,422
Royalties and other gains and losses related to real properties and mineral rights, net	127,236	537,478
Total income	(43,248,988)	15,126,972
Expenses:		
Personnel and office expenses	1,555,765	1,520,139
Investment advisory and management and custodial fees	556,206	654,429
Legal, accounting and other professional fees	211,260	225,182
Expenses related to activities concerning real properties	102,507	109,239
Other expenses	191,856	244,364
Total expenses	2,617,594	2,753,353
	(45,866,582)	12,373,619
Deferred Tax (Benefit) Expense	(613,392)	47,308
Current Tax (Benefit) Expense	(303,762)	232,000
(Loss) income before grants	(44,949,428)	12,094,311
Grants Authorized	10,036,767	8,082,060
Grants Cancelled	(8,358)	(11,248)
Change in Net Assets	(54,977,837)	4,023,499
Unrestricted Net Assets - Beginning of year	177,650,766	173,627,267
Unrestricted Net Assets - End of year	\$ 122,672,929	\$ 177,650,766

The accompanying notes are an integral part of this statement.

S. H. Cowell Foundation

Statement of Cash Flows

<i>Year Ended December 31,</i>	2008	2007
Cash Flows from Operating Activities:		
Change in net assets	\$ (54,977,837)	\$ 4,023,499
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Depreciation	31,323	31,057
Unrealized losses (gains) on investments	45,887,835	(2,824,438)
Realized losses (gains) on investments	2,553,944	(6,533,984)
Realized gain on real estate and mineral rights, net	(50,000)	(429,728)
Increase (decrease) in:		
Other assets	93,526	(129,486)
Notes receivable	(275,295)	(364,210)
Current liabilities	(441,514)	208,808
Deferred tax liability	(613,392)	47,308
Net cash used by operating activities	(7,791,410)	(5,971,174)
Cash Flows from Investing Activities:		
Proceeds from sale of securities	31,126,790	51,240,118
Purchases of securities	(24,103,907)	(45,471,670)
Proceeds from sale of real estate and mineral rights	50,000	1,329,728
Purchase of partnership interest	(300,000)	(540,000)
Purchases of furniture, equipment, and leaseholds		(12,531)
Partnership distributions	206,240	209,616
Real estate deposits applied		(2,500)
Net cash provided by investing activities	6,979,123	6,752,761
Change in Cash and Equivalents	(812,287)	781,587
Cash and Equivalents - Beginning of year	4,878,822	4,097,235
Cash and Equivalents - End of year	\$ 4,066,535	\$ 4,878,822
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for excise taxes	\$ 110,000	\$ 35,000

S. H. Cowell Foundation

Notes to Financial Statements

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.

The Foundation's mission is to improve the quality of life for children living in poverty in northern and central California. Detailed information about the Foundation's grant making activities can be obtained from the Foundation's website at www.shcowell.org.

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 value based on quoted market prices.

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. Carrying values have been assigned to these interests based upon capitalization of estimated royalty income.

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 taxes refund receivable of \$71,025 and current taxes payable of \$342,737 at December 31, 2008 and 2007, respectively, are included in current liabilities.

h. Net Assets

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

i. Recent Accounting Pronouncements

In May 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 165 "Subsequent Events" (SFAS 165). SFAS 165 is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. SFAS 165 is effective for interim and annual periods ending after June 15, 2009. The Foundation does not believe SFAS 165 will have a material impact on its financial statements.

S. H. Cowell Foundation

Notes to Financial Statements

Financial Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), was issued in July 2006 and establishes standards for the recognition of income taxes for tax positions taken in income tax returns. In December 2008, a FASB Staff Position deferred the effective date for exempt organizations, permitting adoption for years beginning after December 15, 2008. The Foundation has elected to defer the application of FIN 48. The Foundation presently recognizes income tax positions based on management's estimate of whether it is reasonably possible that a liability has been incurred. The Foundation does not expect that the adoption of FIN 48 will have an effect on its financial statements.

Note 2 - Investments:

As of December 31, 2008 and 2007, the composition of investments is as follows:

	<u>2008 Estimated</u>		<u>2007 Estimated</u>	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Securities:				
Equity Securities	\$ 76,136,873	\$ 63,650,704	\$ 78,571,094	\$ 105,229,027
Corporate Notes and Bonds	35,384,967	32,306,094	42,527,571	42,714,484
	111,521,840	95,956,798	121,098,665	147,943,511
Other Investments	12,153,384	12,393,640	12,059,625	15,777,827
Mineral Rights	1	374,000	1	374,000
	<u>\$ 123,675,225</u>	<u>\$ 108,724,438</u>	<u>\$ 133,158,291</u>	<u>\$ 164,095,338</u>

Subsequent to December 31, 2008 the Foundation, with the assistance of a new investment advisor, completed sales and transfers of certain investments to execute a new investment strategy. The market value of the investments at June 30, 2009 was approximately \$103,941,176.

S. H. Cowell Foundation

Notes to Financial Statements

Note 3 - Fair Value Measurements:

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157), which is effective for and was adopted by the Foundation for its fiscal year beginning January 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The new standard provides a consistent definition of fair value which focuses on an exit price between market participants in an orderly transaction as prescribed by SFAS 157. The standard also prioritizes, within the measurement of fair value, the use of market-based information over entity-specific information and establishes a three-level hierarchy for fair value measurements based on the transparency of information used in the valuation of an asset or liability as of the measurement date.

Investments measured and reported at fair value are classified and disclosed in one of the following categories:

- Level I - Inputs are quoted prices are available in active markets for identical investments accessible by the Foundation as of the measurement date. The type of investments in Level I include listed equities held in the name of the Foundation, and excludes listed equities and other securities held indirectly through commingled funds.

- Level II - Inputs are pricing inputs, including broker quotes, are generally those other than exchange quoted prices in active markets, which are either directly or indirectly observable as of the measurement date.

- Level III - Inputs are unobservable for the investment and includes situations where there is little, if any, market data available. The inputs into the determination of fair value require significant management judgment or estimation. Investments that are included in this category generally include privately held investments and partnership interests.

The following table summarizes the valuation of the Foundation's investments by the SFAS 157 fair value hierarchy levels as of December 31, 2008:

	Equities & Fixed Income	Alternative Assets		Total Investment Assets
		Other Investments	Mineral Rights	
Level I	\$ 60,180,237			\$ 60,180,237
Level II	35,776,561			35,776,561
Level III		\$ 12,393,640	\$ 374,000	12,767,640
	\$ 95,956,798	\$ 12,393,640	\$ 374,000	\$ 108,724,438

S. H. Cowell Foundation

Notes to Financial Statements

The following table summarizes the Foundation's level III reconciliation by the SFAS 157 standards as of December 31, 2008:

Investments, at fair value	Other Investments	Mineral Rights	Total Level III
Balance at December 31, 2007	\$ 15,777,827	\$ 374,000	\$ 16,151,827
Total net unrealized (loss) included in net income	(3,477,947)		(3,477,947)
Purchases of portfolio investments	300,000		300,000
Proceeds from sales, redemptions, and distributions	(206,240)		(206,240)
<u>Balance at December 31, 2008</u>	<u>\$ 12,393,640</u>	<u>\$ 374,000</u>	<u>\$ 12,767,640</u>

The amount of total losses for the period included in the statement of activities attributable to the change in unrealized losses relating to assets still held at the reporting date is \$3,477,947.

The Foundation adopted the Statement of Financial Accounting Standards No. 157 (SFAS 157), Fair Value Measurements, on January 1, 2008 for its financial assets and liabilities. As permitted by FASB Staff Position No. 157-2, the Foundation delayed adoption of SFAS 157 for its non-financial assets and non-financial liabilities until the year ending December 31, 2009.

Note 4 - Notes Receivable:

Notes receivable include a note of \$5,500,000 relating to the sale of real property, which is secured by a deed of trust with a 5.5% interest rate. The principal is due June 23, 2010, as renegotiated in June 2008. Interest is due quarterly.

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 \$953,824, net of unamortized discount of \$46,176 at .95%. The principal is due June 10, 2012. Interest is due on the tenth of each month.

S. H. Cowell Foundation

Notes to Financial Statements

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 second draw of \$93,205 was made on March 7, 2007. The third and final draw of \$275,295 was made on February 13, 2008. The related note receivable is \$966,536, net of unamortized discount of \$33,464 at .95%. Interest and principal are due on September 16, 2010.

In October 2006, the Board of Directors approved and made its first recoverable grant (an unsecured loan) in the amount of \$1 million with a 2.5% interest rate. The related note receivable is \$919,891, net of unamortized discount of \$80,109 at 1.2%. 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 second recoverable grant (an unsecured loan) in the amount of \$1 million with a 2.5% interest rate. The related note receivable is \$953,824, net of unamortized discount of \$46,176 at .95%. The principal and last interest payments are due December 21, 2011. Interest is due on the 31st of each December, beginning on December 31, 2007.

Note 5 - 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, 2008 and 2007, the Foundation made charitable distributions in excess of the required minimum. As of December 31, 2008, the Foundation has estimated carry forwards, from those and prior years, to meet future charitable distribution requirements which expire as follows:

2010	\$ 5,335,000
2011	2,670,000
2012	2,009,000
2013	4,138,000
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	\$ 14,152,000

S. H. Cowell Foundation

Notes to Financial Statements

Note 6 - Grants Payable:

Conditional grants which have not been recorded totaled \$6,574,500 at December 31, 2008. When the conditions associated with these grants are satisfied it is anticipated they will be paid out as follows: \$4,264,500 in 2009, \$2,002,000 in 2010, \$186,000 in 2011, \$111,000 in 2012, and \$11,000 in 2013.

Note 7 - 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. Through December 31, 2008, the Foundation has paid \$2,700,000. The remaining \$300,000 reflects the future commitment based on projected capital calls as determined by the limited partnership.

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,	
2009	\$ 139,000
2010	155,000
2011	157,000
	<hr/>
	\$ 451,000

Rental expenses were approximately \$154,000 for the years ended December 31, 2008 and 2007.

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.

S. H. Cowell Foundation

Notes to Financial Statements

Note 8 - 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 2008 and 2007, the Foundation contributed \$155,000 and \$150,000, respectively, to the plan.

Note 9 - 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 Union Bank of California, 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, 2008, deposits were in excess of federal insurance of \$118,000.