PRICEWATERHOUSECOOPERS

The William and Flora Hewlett Foundation

Financial Statements
December 31, 2005 and 2004

PRICEWATERHOUSECOOPERS

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Report of Independent Auditors

To the Board of Directors of
The William and Flora Hewlett Foundation

In our opinion, the accompanying statements of financial position and the related statements of activities and changes in net assets and of cash flows present fairly, in all material respects, the financial position of The William and Flora Hewlett Foundation ("the Foundation") at December, 31, 2005 and 2004, and the changes in its net assets and it cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. 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 of these statements 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

San Francisco, California
March 3, 2006

The William and Flora Hewlett Foundation
Statements of Financial Position
(dollars in thousands)

	December 31, 2005	December 31, 2004
Assets		
Investments, at fair value		
Hewlett-Packard and Agilent common stock	$ 453,354	$ 330,690
Other public domestic equities	2,243,327	2,311,713
Public international equities	1,988,577	1,725,343
Private equities	1,260,111	938,939
Fixed income	1,805,724	1,578,450
Net payable on forward fixed income transactions	(833,323)	(608,295)
Cash equivalents	158,484	120,796
Net (payable) receivable from unsettled securities purchases and sales	(14,541)	113
Other	15,835	28,045
Total investments	7,077,548	6,425,794
Cash	4,706	3,422
Federal excise tax refund	3,199	-
Collateral under securities lending agreement	211,120	15,691
Prepaid expenses and other assets	4,759	3,690
Distribution receivable from Hewlett Trust	117	4,398
Fixed assets, net of accumulated depreciation and amortization	34,682	36,173
	$ 7,336,131	$ 6,489,168
Liabilities and Net Assets		
Accounts payable and accrued liabilities	$ 10,903	$ 10,724
Accrued post-retirement health care benefit	3,212	2,916
Payable under securities lending agreement	211,120	15,691
Federal excise tax payable currently	-	2,702
Deferred federal excise tax	9,776	7,773
Grants payable	116,582	122,318
Gift payable, net of discount	83,368	202,833
Total liabilities	434,961	364,957
Commitments (Note 3)		
Unrestricted net assets	6,901,053	6,119,813
Temporarily restricted net assets	117	4,398
Total net assets	6,901,170	6,124,211
	$ 7,336,131	$ 6,489,168

See accompanying notes to the financial statements.

The William and Flora Hewlett Foundation
Statements of Activities and Changes in Net Assets
(dollars in thousands)

	Year Ended December 31, 2005	2004
Unrestricted Net Assets:		
Net investment revenues and gains:		
Interest, dividends and other	$ 153,897	$ 133,847
Gain on investment portfolio	870,331	633,671
Investment management expense	(25,149)	(21,729)
Net investment income	999,079	745,789
Net federal excise tax expense on net investment income (Note 9)	(8,554)	(7,145)
Net investment revenues	990,525	738,644
Expenses:		
Grants awarded, net of cancellations	(177,802)	(168,773)
Change in gift discount (Note 8)	(15,535)	(11,936)
Direct and other charitable activities	(3,101)	(4,110)
Cumulative effect of adopting FAS No. 106, post-retirement health care benefits	-	(2,426)
Administrative expenses	(17,119)	(16,429)
Total expenses	(213,557)	(203,674)
Income over expenses before net assets released from time restriction	776,968	534,970
Net assets released from time restriction (Note 4)	4,272	363,008
Change in unrestricted net assets	781,240	897,978
Temporarily Restricted Net Assets:		
Temporarily restricted revenues:		
Change in value of Trust receivable	(9)	41,584
Net assets released from time restriction	(4,272)	(363,008)
Change in temporarily restricted net assets	(4,281)	(321,424)
Change in total net assets	776,959	576,554
Net assets at beginning of year	6,124,211	5,547,657
Net assets at end of year	$ 6,901,170	$ 6,124,211

See accompanying notes to the financial statements.

The William and Flora Hewlett Foundation
Statements of Cash Flows
(dollars in thousands)

	Year Ended December 31, 2005	2004
Cash flows used in operating activities:		
Interest and dividends received	$ 152,846	$ 134,225
Cash paid for federal excise tax	(12,452)	(2,063)
Cash paid to suppliers and employees	(44,025)	(36,478)
Cash contributions received	4,272	15,000
Grants and gift paid	(318,538)	(267,477)
Net cash used in operating activities	(217,897)	(156,793)
Cash flows from investing activities:		
Purchases of fixed assets	(448)	(437)
Proceeds from sale of fixed assets	2	-
Cash received from partnership distributions	254,022	170,270
Proceeds from sale of investments	23,153,697	16,588,019
Purchase of investments	(23,188,092)	(16,597,786)
Net cash from investing activities	219,181	160,066
Net increase in cash	1,284	3,273
Cash at beginning of year	3,422	149
Cash at end of year	$ 4,706	$ 3,422

See accompanying notes to the financial statements.

The William and Flora Hewlett Foundation
Statements of Cash Flows
(dollars in thousands)

	Year Ended December 31, 2005	2004
Reconciliation of change in net assets to net cash used in operating activities:		
Change in total net assets	$ 776,959	$ 576,554
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization of property and equipment	1,956	1,956
Amortization of discount on gift payable	15,535	11,936
Unrealized loss on program related investment	-	82
Loss on sale of fixed assets	10	-
Net unrealized and realized gain on investments	(870,331)	(633,671)
Increase in deferred federal excise tax	2,003	2,606
Increase in accrued post-retirement health care benefit	296	2,916
(Increase) decrease in value of Trust receivable	9	(41,584)
Changes in operating assets and liabilities:		
(Increase) decrease in interest and dividends receivable	(1,040)	432
(Increase) decrease in federal excise tax	(5,901)	2,476
Decrease (increase) in prepaid expenses and other assets	(1,069)	187
Decrease in receivable from Hewlett Trust	4,263	15,000
Increase in accounts payable and accrued liabilities	149	3,021
Decrease in grants payable	(5,736)	(19,704)
Decrease in gift payable	(135,000)	(79,000)
Net cash used in operating activities	$ (217,897)	$ (156,793)
Supplemental data for non-cash activities:		
Stock contributions received from Hewlett Trust	$ 1	$ 347,963

See accompanying notes to the financial statements.

1. The Organization

The William and Flora Hewlett Foundation (the "Foundation") is a private foundation incorporated in 1966 as a non-profit charitable organization. The Foundation's grantmaking activities are concentrated in the program areas of education, environment, performing arts, population and global development. More detailed information regarding the Foundation's charitable activities can be obtained from the Foundation's website at www.hewlett.org or by requesting a copy of its annual report.

2. Significant Accounting Policies

Basis of presentation

The accompanying financial statements have been prepared on the accrual basis of accounting.

Investments

Investments in stocks and bonds which are listed on national securities exchanges, quoted on NASDAQ or on the over-the-counter market are valued at the last reported sale price or in the absence of a recorded sale, at the value between the most recent bid and asked prices. Futures, forwards, swaps and options which are traded on exchanges are valued at the last reported sale price or, if they are traded over-the-counter at the most recent bid price. Index and credit swaps, which gain exposure to domestic equities and fixed income securities in a leveraged form, are traded with a counterparty and are valued at each month end. Short-term investments are valued at amortized cost, which approximates market value. Since there is no readily available market for investments in limited partnerships, such investments are valued at amounts reported to the Foundation by the general partners of such entities. The investments of these limited partnerships, such as venture capital, buyout firms and real estate partnerships, include securities of companies that may not be immediately liquid. Accordingly, their values are based upon guidelines established by the general partners. The December 31 valuation of certain of the investments in limited partnerships are based upon the value determined by each partnership's general partner as of September 30 and adjusted for cash flows that occurred during the quarter ended December 31. Management believes this method provides a reasonable estimate of fair value. These values may differ significantly from values that would have been used had a readily available market existed for such investments, and the differences could be material to the change in net assets of the Foundation.

Investment transactions are recorded on trade date. Realized gains and losses on sales of investments are determined on the specific identification basis. Investments donated to the Foundation are initially recorded at market value on the date of the gift.

Foreign currency amounts are translated into U.S. dollars based upon exchange rates as of December 31. Transactions in foreign currencies are translated into U.S. dollars at the exchange rate prevailing on the transaction date.

Cash equivalents consist of money market mutual funds and foreign currency held for investment purposes.

Cash

Cash consists of funds held in a commercial interest-bearing account, for operating expenses.

Fixed assets

Fixed assets are recorded at cost and depreciated using the straight-line basis over their estimated useful lives. The headquarters building and associated fixtures are generally depreciated using the straight-line basis over ten to fifty years. Furniture and computer and office equipment are depreciated over estimated useful lives of three to ten years.

Grants

Grants are accrued when awarded by the Foundation.

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 amounts of assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of changes in net assets during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to the 2004 balances to conform to the 2005 presentation. These reclassifications had no effect on the change in net assets in 2004 or total net assets at December 31, 2004.

3. Investments

The investment goal of the Foundation is to maintain or grow its asset size and spending power in real (inflation adjusted) terms with risk at a level appropriate to the Foundation's program objectives. The Foundation diversifies its investments among various financial instruments and asset categories, and uses multiple investment strategies. As a general practice, except for the Foundation's holdings in Hewlett-Packard and Agilent stock and certain index swaps, all financial assets of the Foundation are managed by external investment management firms selected by the Foundation. All financial assets of the Foundation are held in custody by a major commercial bank, except for assets invested with partnerships and commingled funds, which have separate arrangements related to their legal structure.

The majority of the Foundation's assets are invested in equities, which are listed on national exchanges, quoted on NASDAQ, or in the over-the-counter market; treasury and agency bonds of the U.S. government; and investment grade corporate bonds for which active trading markets exist. Net realized and unrealized gains and losses on investments are reflected in the Statements of Activities and Changes in Net Assets.

(dollars in thousands)

The gain on the Foundation's investment portfolio for the years ended December 31, 2005 and 2004 consists of the following:

	2005	2004
Net realized gain	$ 464,553	$ 394,084
Net unrealized gain	405,779	239,587
	$ 870,332	$ 633,671

Approximately 18 percent of the Foundation's investments at December 31, 2005 were invested with various limited partnerships that invest in the securities of companies that may not be immediately liquid, such as venture capital and buyout firms, and in real estate limited partnerships or private REITs that have investments in various types of properties. As of December 31, 2005 the Foundation is committed to contribute approximately $1,594,900 in additional capital in future years to various partnerships.

Investment securities are exposed to various risks, such as changes in interest rates or credit ratings and market fluctuations. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is possible that the value of the Foundation's investments and total net assets balance could fluctuate materially.

The investments of the Foundation include a variety of financial instruments involving contractual commitments for future settlements, including futures, swaps, forwards and options which are exchange traded or are executed over-the-counter. Some investment managers retained by the Foundation have been authorized to use certain financial derivative instruments in a manner set forth by either the Foundation's written investment policy, specific manager guidelines or partnership/fund agreement documents. Specifically, financial derivative instruments may be used for the following purposes: (1) currency forward contracts and options may be used to hedge nondollar exposure in foreign investments, or to take positions in managed currency portfolios; (2) futures and swap contracts may be used to rebalance asset categories within the portfolio or to manage market exposures in managed portfolios; and (3) futures contracts, swaps and options may be used to hedge or leverage positions in managed portfolios. Financial derivative instruments are recorded at fair value in the Statements of Financial Position with changes in fair value reflected in the Statements of Activities and Changes in Net Assets.

The total value of investments pledged with respect to options and futures contracts at December 31, 2005 and 2004 was $5,770 and $7,210 respectively. The value of cash held at brokers as collateral for variation margin at December 31, 2005 and 2004 was $15,393 and $12,613 respectively.

Certain of the Foundation's managers purchase or sell fixed income securities on a delayed delivery or forward settled basis. These transactions involve a commitment by the Foundation to purchase or sell securities for a predetermined price or yield, with payment and delivery taking place beyond the customary settlement period, from about 1 to 3 months. When purchasing a security on a delayed delivery basis, the Foundation assumes the rights and risks of ownership of the security, including the risk of price and yield fluctuations, and reflects such fluctuations in its net assets. The manager may dispose of or renegotiate a delayed delivery transaction after it is entered into, and may sell the securities before they are delivered, which may result in a capital gain or loss. At December 31, 2005 and 2004 the net liability for these forward purchases and sales was $833,323 and $608,295 respectively.

Premiums received with respect to open options contracts at December 31, 2005 and 2004 were $628 and $143, respectively.

Other investment assets of $15,835 and $28,045 at December 31, 2005 and 2004, respectively, consist of a parcel of land held for investment purposes, receivables for interest and dividends, and certain derivatives held at fair market value. At December 31, 2005 and 2004 these derivatives included swap contracts, futures contracts, foreign exchange contracts and put and call options, as shown in the table on the following page.

In the opinion of the Foundation's management, the use of financial derivative instruments in its investment program is appropriate and customary for the investment strategies employed. Using those instruments reduces certain investment risks and may add value to the portfolio. The instruments themselves, however, do involve investment and counterparty risk in amounts greater than what are reflected in the Foundation's financial statements. Management does not anticipate that losses, if any, from such instruments would materially affect the financial position of the Foundation.

Fair values of the Foundation's derivative financial instruments at December 31, 2005 and 2004 are summarized in the following table. This table excludes exposures relating to derivatives held indirectly through commingled funds.

Derivative Financial Instruments	December 31, 2005 Fair Value (in thousands)	December 31, 2004 Fair Value (in thousands)
- Equity contracts:		
Futures and swap contracts		
Assets	$ 1,164	$ 14,624
Put and call options:		
Liabilities	$ (345)	$ -
- Fixed income contracts:		
Futures and swap contracts		
Liabilities	$ (369)	$ (724)
Put and call options:		
Liabilities	$ (268)	$ (72)
Forward net purchases and sales		
Liabilities	$ (833,323)	$ (608,295)
- Foreign currency contracts:		
Forward contracts		
Unrealized gain on currency contracts	$ 14,964	$ 1,913
Unrealized loss on currency contracts	$ (12,217)	$ (2,858)

The Foundation's custodian maintains a securities lending program on behalf of the Foundation, and maintains collateral at all times in excess of the value of the securities on loan. Investment of this collateral is in accordance with specified guidelines; these investments include A1-rated commercial paper, repurchase agreements, asset backed securities and floating rate notes. Income earned on these transactions is included in net investment revenue in the Statements of Activities and Changes in Net Assets. The value of securities on loan at December 31, 2005 and 2004 was $202,644 and $14,946 respectively. The value of the collateral received at December 31, 2005 and 2004 aggregated $211,120 and $15,691 respectively, of which $211,120 and $15,691 respectively, was received in cash and was invested in accordance with the investment guidelines. The remainder of the collateral, $0 at December 31, 2005 and $0 at December 31, 2004 was received in the form of securities and letters of credit.

At December 31, 2005, the net receivable from unsettled securities purchases and sales includes a receivable from brokers of $182,062 and a payable to brokers of $196,603. At December 31, 2004, the net receivable from unsettled securities purchases and sales included a receivable from brokers of $51,662 and a payable to brokers of $51,549.

The Foundation held 10.2 million shares of Hewlett-Packard Company ("Hewlett-Packard") stock with a market price of $28.63 per share at December 31, 2005. At December 31, 2004, the Foundation held 10.2 million shares with a market price of $20.97 per share. The Foundation held 4.8 million shares of Agilent Company ("Agilent") stock with a market price of $33.29 per share at

(dollars in thousands)

December 31, 2005. At December 31, 2004, the Foundation held 4.8 million shares with a market price of $24.10.

4. Distributions Receivable from the William R. Hewlett Trusts

Upon the death of William R. Hewlett on January 12, 2001, the Foundation became the residuary beneficiary of the William R. Hewlett Revocable Trust ("the Trust") and is entitled to receive the trust assets remaining after payment of expenses of administration and federal and state estate taxes. The Trust is expected to be fully distributed during 2006.

The receivable from the Trust, which was $4,398 at December 31, 2004, was adjusted for contributions during 2005 and also for expenses. During 2005, distributions from the Trust totaled $4,272, which consisted of cash of $4,271 and warrants valued at $1. The Trust paid expenses of $9 during 2005. At December 31, 2005, the value of the remaining assets to be distributed to the Foundation by the Trust was $117. These assets consist of cash and cash equivalents and are reflected in the financial statements as temporarily restricted net assets because the distribution will be received in the future.

The Foundation is also the residuary beneficiary of the Hewlett Marital Trust. As of December 31, 2005, the assets which the Foundation is entitled to receive are not material and can not be reasonably estimated.

5. Fixed Assets

Fixed assets consist of the following at December 31, 2005 and 2004:

	2005	2004
Building, land lease and land improvements	$ 34,013	$ 33,927
Furniture and fixtures	4,776	4,593
Computer and office equipment	2,887	2,910
	41,677	41,430
Less accumulated depreciation and amortization	(6,994)	(5,257)
	$ 34,683	$ 36,173

(dollars in thousands)

6. Postretirement Healthcare Benefits

The Foundation implemented Statement of Financial Accounting Standards (SFAS) No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" effective January 1, 2004 and recognizes the accumulated liability for its postretirement healthcare benefit obligation, using a discount rate of 5.5%. The obligation, which is unfunded, is $3,213 as of December 31, 2005, as shown in the table below:

	2005	2004
Accumulated post retirement benefit obligation as of January 1	$ 2,916	$ 2,426
Service cost	296	356
Interest cost	135	159
Amortized gain, due to change in actuarial inputs	(105)	-
Benefits paid by employer	(29)	(25)
Accumulated post retirement benefit obligation as of December 31	$ 3,213	$ 2,916

Annual expense for the year ended December 31, 2005 was $431 on an on-going basis, and $325 following the amortization of a gain due to the 2005 change in actuarial inputs. Annual expense for the year ended December 31, 2004 was $515.

7. Grants Payable

Grant requests are recorded as grants payable when they are awarded. Some of the grants are payable in installments, generally over a three-year period. Grants authorized but unpaid at December 31, 2005 are payable as follows:

Year Payable	Amount
2006	$ 102,937
2007	13,208
2008 and thereafter	437
	$ 116,582

8. Gift Payable

The Foundation pledged a gift of $400,000 in April of 2001 to Stanford University for the School of Humanities and Sciences and for the undergraduate education program. The gift will be paid over a period of seven years and is discounted to a net present value as of December 31, 2005 using a risk-free rate of 5.1%. Payments of $135,000 and $79,000 were made in 2005 and 2004, respectively.

(dollars in thousands)

The gift payable, net of discount, at December 31, 2005 and 2004 is as follows:

	2005	2004
Gift payable	$ 88,476	$ 223,476
Less unamortized discount	(5,108)	(20,643)
Gift payable, net of discount	$ 83,368	$ 202,833

9. Federal Excise and Unrelated Business Income Tax

The William and Flora Hewlett Foundation is a private foundation and qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code and corresponding California provisions. Private foundations are subject to a federal excise tax on net investment income and may reduce their federal excise tax rate from 2% to 1% by exceeding a certain payout target for the year. The Foundation qualified for the 1% tax rate in both 2005 and 2004. Each year, current federal excise tax is levied on interest and dividend income of the Foundation; net investment losses do not reduce investment income. At December 31, 2005 and 2004, deferred federal excise tax is provided at 1.33%, which is the average effective rate expected to be paid on unrealized gains on investments. Certain investments may also generate unrelated business income tax.

The expense for federal excise tax is as follows:

	2005	2004
Current	$ 6,551	$ 4,539
Deferred	2,003	2,606
	$ 8,554	$ 7,145