The William and Flora Hewlett Foundation

Financial Statements
December 31, 2006 and 2005

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 statement of financial position and the related statements of activities and changes in net assets, cash flows present fairly, in all material respects, the financial position of The William and Flora Hewlett Foundation ("Foundation") at December 31, 2006 and 2005, and the 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. 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 audit provides a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

March 2, 2007

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

	December 31, 2006	December 31, 2005
Assets		
Investments, at fair value		
Hewlett-Packard and Agilent common stock	$ 465,334	$ 453,354
Global equities	3,560,392	3,262,171
Private equities, real assets and absolute return	2,199,475	1,512,883
Fixed income	2,557,830	2,522,685
Net payable on forward fixed income transactions	(849,271)	(833,323)
Cash equivalents	331,399	158,484
Net receivable (payable) from unsettled securities purchases and sales	2,960	(14,541)
Other	707	15,835
Total investments	8,268,826	7,077,548
Cash	4,478	4,706
Federal excise tax refund	-	3,199
Collateral under securities lending agreement	179,346	211,120
Prepaid expenses and other assets	4,456	4,759
Receivables	30,086	117
Fixed assets, net of accumulated depreciation and amortization	33,573	34,682
	$ 8,520,765	$ 7,336,131
Liabilities and Net Assets		
Accounts payable and accrued liabilities	$ 15,967	$ 10,903
Accrued post-retirement health care benefit	3,620	3,212
Payable under securities lending agreement	179,346	211,120
Federal excise tax payable currently	1,334	-
Deferred federal excise tax	17,596	9,776
Grants payable	193,727	116,582
Gift payable, net of discount	88,476	83,368
Total liabilities	500,066	434,961
Commitments (Note 3)		
Unrestricted net assets	7,980,613	6,901,053
Temporarily restricted net assets	40,086	117
Total net assets	8,020,699	6,901,170
	$ 8,520,765	$ 7,336,131

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, 2006	2005
Unrestricted Net Assets:		
Net investment revenues and gains:		
Interest, dividends and other	$ 163,619	$ 153,897
Gain on investment portfolio	1,291,749	870,331
Investment management expense	(33,262)	(25,149)
Net investment income	1,422,106	999,079
Federal excise tax expense on net investment income (Note 9)	(25,304)	(8,554)
Net investment revenues	1,396,802	990,525
Expenses:		
Grants awarded, net of cancellations	(287,087)	(177,802)
Change in gift discount (Note 8)	(5,108)	(15,535)
Direct and other charitable activities	(6,118)	(3,101)
Administrative expenses	(18,970)	(17,119)
Total expenses	(317,283)	(213,557)
Income over expenses before net assets released from time restriction	1,079,519	776,968
Net assets released from time restriction (Note 4)	41	4,272
Change in unrestricted net assets	1,079,560	781,240
Temporarily Restricted Net Assets:		
Change in temporarily restricted net assets:		
Change in value of Trust receivable	10	(9)
Gates Foundation contribution	40,000	-
Net assets released from time restriction	(41)	(4,272)
Net change in temporarily restricted net assets	39,969	(4,281)
Change in total net assets	1,119,529	776,959
Net assets at beginning of year	6,901,170	6,124,211
Net assets at end of year	$ 8,020,699	$ 6,901,170

See accompanying notes to the financial statements.

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

	Year Ended December 31, 2006	2005
Cash flows used in operating activities:		
Interest and dividends received	$ 162,450	$ 152,846
Cash paid for federal excise tax	(12,951)	(12,452)
Cash paid to suppliers and employees	(51,258)	(44,025)
Cash contributions received	10,041	4,272
Grants and gift paid	(209,942)	(318,538)
Net cash used in operating activities	(101,660)	(217,897)
Cash flows from investing activities:		
Purchases of fixed assets	(194)	(448)
Proceeds from sale of fixed assets	2	2
Cash received from partnership distributions	409,797	254,022
Proceeds from sale of investments	20,023,221	23,153,697
Purchase of investments	(20,331,394)	(23,188,092)
Net cash from investing activities	101,432	219,181
Net increase in cash	(228)	1,284
Cash at beginning of year	4,706	3,422
Cash at end of year	$ 4,478	$ 4,706

See accompanying notes to the financial statements.

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

	Year Ended December 31, 2006	2005
Reconciliation of change in net assets to net cash used in operating activities:		
Change in total net assets	$ 1,119,529	$ 776,959
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization of property and equipment	1,734	1,956
Amortization of discount on gift payable	5,108	15,535
Loss on sale of fixed assets	1	10
Net unrealized and realized gain on investments	(1,291,749)	(870,331)
Increase in deferred federal excise tax	7,820	2,003
Increase in accrued post-retirement health care benefit	408	296
(Increase) decrease in value of Trust receivable	(10)	9
Changes in operating assets and liabilities:		
(Increase) in interest and dividends receivable	(1,152)	(1,040)
Increase (decrease) in federal excise tax	4,533	(5,901)
Decrease (increase) in prepaid expenses and other assets	303	(1,069)
(Increase) decrease in Gates and other receivable	(29,959)	4,263
Increase in accounts payable and accrued liabilities	4,629	149
Increase (decrease) in grants payable	77,145	(5,736)
Increase (decrease) in gift payable	-	(135,000)
Net cash used in operating activities	$ (101,660)	$ (217,897)

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Supplemental data for non-cash activities:		
Stock contributions received from Hewlett Trust	$ 1	$ 1

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.

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.

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 commercial interest-bearing accounts, 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.

Net Asset Classification

The Foundation's activities and related assets and liabilities are classified as unrestricted and temporarily restricted according to the terms of the various contributions. The Foundation has no permanently restricted net assets.

Unrestricted balances consist of funds undesignated and currently available for all Foundation activities. Temporarily restricted balances consist of funds available for support of the Foundation’s activities, which are expendable only for purposes specified by the donor or within a specified period.

The net assets included in the temporarily restricted class at December 31, 2006 relate mainly to donor-restricted contributions for which the requirements have not yet been met, and time-restricted contributions receivable.

Grants

Grants are accrued when awarded by the Foundation.

Administrative Expenses

Administrative expenses represent those expenses incurred in managing programs funded by the William and Flora Hewlett Foundation. Expenses associated with managing programs funded by other organizations are reimbursed at the time they are incurred.

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 2005 balances to conform to the 2006 presentation of investment assets. In 2006, the Foundation further clarified its investment categories. These reclassifications had no effect on the change in net assets in 2005 or total net assets at December 31, 2005.

(dollars in thousands)

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, commingled funds, the overlay swaps and the covered call program, 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.

Global equities include those held directly by the Foundation and those held in commingled entities including partnerships and trusts. At December 31, 2006 and 2005, global equities held in partnerships and trusts were $1,183,621 and $634,580.

The gain on the Foundation's investment portfolio for the years ended December 31, 2006 and 2005 consists of the following:

	2006	2005
Net realized gain	$ 797,387	$ 464,553
Net unrealized gain	494,362	405,779
	$1,291,749	$ 870,332

Approximately 27 percent of the Foundation's investments at December 31, 2006 were invested with limited partnerships and funds that invest in the securities of companies that may not be immediately liquid, such as venture capital, absolute return and buyout firms, and in real estate limited partnerships or private REITs that have investments in various types of properties. As of December 31, 2006 the Foundation is committed to contribute approximately $1,833,960 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, 2006 and 2005 was $8,391 and $5,770 respectively. The value of cash held at brokers as collateral for variation margin at December 31, 2006 and 2005 was $10,099 and $15,393 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, 2006 and 2005 the net liability for these forward purchases and sales was $849,271 and $833,323 respectively.

Premiums received with respect to open options contracts at December 31, 2006 and 2005 were $1,631 and $628, respectively.

Other investment assets of $707 and $15,835 at December 31, 2006 and 2005, 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, 2006 and 2005 these derivatives included swap contracts, futures contracts, foreign exchange contracts, covered call options 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, 2006 and 2005 are summarized in the following table. This table excludes exposures relating to derivatives held indirectly through commingled funds.

Derivative Financial Instruments	**December, 31, 2006** Fair Value (in thousands)	**2005** Fair Value (in thousands)
- Equity contracts:		
Futures and swap contracts		
Assets	$ 4,896	$ 1,164
Put and call options:		
Liabilities	$ (40)	$ (345)
Covered call options:		
Liabilities	$ (1,477)	
- Fixed income contracts:		
Futures and swap contracts		
Liabilities	$ 371	$ (369)
Put and call options:		
Liabilities	$ (738)	$ (268)
Forward net purchases and sales		
Liabilities	$ (849,271)	$ (833,323)
- Foreign currency contracts:		
Forward contracts		
Unrealized gain on currency contracts	$ 19,537	$ 14,964
Unrealized loss on currency contracts	$ (31,890)	$ (12,217)

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, certificates of deposit 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, 2006 and 2005 was $171,038 and $202,644 respectively. The value of the collateral received at December 31, 2006 and 2005 aggregated $179,346 and $211,120 respectively, of which $179,346 and $211,120 respectively, was received in cash and was invested in accordance with the investment guidelines. The remainder of the collateral, $0 at December 31, 2006 and $0 at December 31, 2005 was received in the form of securities and letters of credit.

At December 31, 2006, the net receivable from unsettled securities purchases and sales includes a receivable from brokers of $177,984 and a payable to brokers of $175,024. At December 31, 2005, the net receivable from unsettled securities purchases and sales included a receivable from brokers of $181,671 and a payable to brokers of $196,212.

The Foundation held 7.1 million shares of Hewlett-Packard Company ("Hewlett-Packard") stock with a market price of $41.19 per share at December 31, 2006. At December 31, 2005, the Foundation held 10.2 million shares with a market price of $28.63 per share. The Foundation held 4.8 million shares of Agilent Company ("Agilent") stock with a market price of $34.85 per share at December 31, 2006, as well as 98 thousand shares of Verigy Company ("Verigy") stock with a market price of $17.75 per share. Verigy is a 2006 spin-off from Agilent. At December 31, 2005, the Foundation held 4.8 million shares of Agilent with a market price of $33.29.

4. Receivables

In 2006 the Foundation entered into an agreement with the Bill and Melinda Gates Foundation to administer a program charged with improving quality education in developing countries. In addition to reimbursing associated administrative expenses, the Bill and Melinda Gates Foundation pledged $40,000 over three years to the William and Flora Hewlett Foundation to do grant-making in this area; this contribution is reported as a change in temporarily restricted net assets during 2006. $10,000 of this pledge was received during 2006, and $30,000 is reported as a receivable at December 31, 2006.

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 2007.

The receivable from the Trust, which was $117 at December 31, 2005, was adjusted for contributions during 2006 and also for expenses or income. During 2006, distributions from the Trust totaled $41, which consisted of cash of $40 and stocks valued at $1. The Trust received net income of $10 during 2006. At December 31, 2006, the value of the remaining assets to be distributed to the Foundation by the Trust was $86. 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, 2006, the assets which the Foundation is entitled to receive are not material and can not be reasonably estimated.

(dollars in thousands)

5. Fixed Assets

Fixed assets consist of the following at December 31, 2006 and 2005:

	2006	2005
Building, land lease and land improvements	$ 34,013	$ 34,013
Furniture and fixtures	4,793	4,776
Computer and office equipment	3,346	2,887
	42,151	41,677
Less accumulated depreciation and amortization	(8,578)	(6,994)
	33,573	34,683

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 5.75%. The obligation, which is unfunded, is $3,620 as of December 31, 2006, as shown in the table below:

	2006	2005
Accumulated post retirement benefit obligation as of January 1	$ 3,213	$ 2,916
Service cost	358	296
Interest cost	158	135
Amortized gain, due to change in actuarial inputs	(70)	(105)
Benefits paid by employer	(39)	(29)
Accumulated post retirement benefit obligation as of December 31	$ 3,620	$ 3,213

Annual expense for the year ended December 31, 2006 was $516 on an on-going basis, and $446 following the amortization of a gain due to the 2006 change in actuarial inputs. Annual expense for the year ended December 31, 2005 was $431.

(dollars in thousands)

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, 2006 are payable as follows:

Year Payable	Amount
2007	$ 157,283
2008	25,856
2009 and thereafter	10,588
	$ 193,727

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 was discounted to a net present value as of December 31, 2005 using a risk-free rate of 5.1%. Payments of $0 and $135,000 were made in 2006 and 2005, respectively. The final payment is expected to be made in 2007.

The gift payable, net of discount, at December 31, 2006 and 2005 is as follows:

	2006	2005
Gift payable	$ 88,476	$ 88,476
Less unamortized discount	-	(5,108)
Gift payable, net of discount	$ 88,476	$ 83,368

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 2005, and paid a 2% excise tax rate in 2006. Each year, current federal excise tax is levied on interest and dividend income and net realized gains of the Foundation; net investment losses do not reduce investment income. At December 31, 2006 and 2005, 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 also generate unrelated business income tax.

(dollars in thousands)

The expense for federal excise tax is as follows:

	2006	2005
Current	$ 17,484	$ 6,551
Deferred	7,820	2,003
	$ 25,304	$ 8,554

The expense for unrelated business income tax is as follows:

	2006	2005
	$ 2,205	$ 151