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The William and Flora Hewlett Foundation

Financial Statements
December 31, 2009 and 2008

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, changes in net assets and cash flows present fairly, in all material respects, the financial position of The William and Flora Hewlett Foundation (the "Foundation") at December 31, 2009 and 2008, 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 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provides a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

April 22, 2010

The William and Flora Hewlett Foundation
Statements of Financial Position
December 31, 2009 and 2008
(dollars in thousands)

	December 31, 2009	December 31, 2008
Assets		
Cash	$ 6,586	$ 4,824
Investments, at fair value (Notes 3 and 4)	6,809,236	6,156,392
Collateral under securities lending agreement	17,628	80,019
Prepaid expenses and other assets	1,413	4,170
Receivable (Note 5)	3,660	12,330
Fixed assets, net of accumulated depreciation and amortization	30,585	31,300
	$ 6,869,108	$ 6,289,035
Liabilities and Net Assets		
Accounts payable and accrued liabilities	$ 14,037	$ 16,218
Line of credit liability	-	40,000
Accrued post-retirement health care benefit	4,980	4,009
Payable under securities lending agreement	17,628	80,019
Deferred and federal excise tax payable	2,339	-
Grants payable (Note 8)	212,955	260,330
Gifts payable, net of discount (Note 9)	394,968	447,860
Total liabilities	646,907	848,436
Commitments (Note 3)		
Unrestricted net assets	6,206,404	5,423,342
Temporarily restricted net assets	15,797	17,257
Total net assets	6,222,201	5,440,599
	$ 6,869,108	$ 6,289,035

See accompanying notes to the financial statements.

The William and Flora Hewlett Foundation
Statements of Activities and Changes in Net Assets
Years Ended December 31, 2009 and 2008
(dollars in thousands)

	Year Ended December 31, 2009	2008
Unrestricted Net Assets		
Net investment revenues:		
Interest, dividends and other	$ 76,891	$ 104,454
Gain (loss) on investment portfolio	992,250	(2,622,196)
Investment management expense	(23,507)	(31,135)
Net investment income (loss)	1,045,634	(2,548,877)
Tax expense on investment income (Note 11)	(248)	(3,088)
Net investment revenues (losses)	1,045,386	(2,551,965)
Expenses:		
Grants and gift awarded, net of cancellations	(235,100)	(784,522)
Change in gift discount (Note 9)	(7,108)	28,360
Direct and other charitable activities	(9,628)	(14,599)
Administrative expenses	(24,978)	(24,514)
Total expenses	(276,814)	(795,275)
Income (loss) before net assets released from time restriction, and contribution	768,572	(3,347,240)
Net assets released from time restriction	14,477	11,236
Unrestricted contribution	13	-
Net change in unrestricted net assets	783,062	(3,336,004)
Temporarily Restricted Net Assets		
Change in temporarily restricted net assets:		
Gates Foundation contribution	13,000	-
Change in value	17	148
Net assets released from time restriction	(14,477)	(11,236)
Net change in temporarily restricted net assets	(1,460)	(11,088)
Change in total net assets	781,602	(3,347,092)
Net assets at beginning of year	5,440,599	8,787,691
Net assets at end of year	$ 6,222,201	$ 5,440,599

See accompanying notes to the financial statements.

The William and Flora Hewlett Foundation
Statements of Cash Flows
Years Ended December 31, 2009 and 2008
(dollars in thousands)

	Year Ended December 31, 2009	Year Ended December 31, 2008
Cash flows used in operating activities:		
Interest and dividends received	$ 79,220	$ 123,970
Cash received (paid) for federal excise tax	4,000	(8,006)
Cash paid to suppliers and employees	(56,938)	(82,183)
Cash contributions received (paid)	21,683	(11,205)
Grants and gifts paid	(342,475)	(376,979)
Net cash used in operating activities	(294,510)	(354,403)
Cash flows from investing activities:		
Purchases of fixed assets	(822)	(812)
Cash received from partnership distributions	404,318	388,947
Proceeds from sale of investments	49,126,306	47,578,796
Purchase of investments	(49,193,530)	(47,563,524)
Net cash from investing activities	336,272	403,407
Cash flows used in financing activities:		
Cash received from line of credit	-	40,000
Cash paid on line of credit	(40,000)	(90,000)
Net cash used in financing activities	(40,000)	(50,000)
Net increase (decrease) in cash	1,762	(996)
Cash at beginning of year	4,824	5,820
Cash at end of year	$ 6,586	$ 4,824

See accompanying notes to the financial statements.

The William and Flora Hewlett Foundation
Statements of Cash Flows, continued
Years Ended December 31, 2009 and 2008
(dollars in thousands)

	Year Ended December 31, 2009	2008
Reconciliation of change in net assets to net cash used in operating activities:		
Change in total net assets	$ 781,602	$ (3,347,092)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization on fixed assets	1,582	1,663
Loss on disposal of fixed assets	282	310
Change in value of gift payable	7,108	(28,360)
Net unrealized and realized (gain) loss on investments	(992,250)	2,622,196
Increase (decrease) in deferred and federal excise tax	2,339	(21,438)
Increase in accrued post-retirement health care benefit	971	874
(Increase) in value of receivable	(17)	(118)
Changes in operating assets and liabilities:		
Decrease in interest and dividends receivable	2,329	13,070
Decrease (increase) in prepaid expenses and other assets	2,757	(1,674)
Decrease in receivable	8,670	13,330
(Decrease) in accounts payable and accrued liabilities	(2,508)	(14,707)
(Decrease) increase in grants payable	(47,375)	17,544
(Decrease) increase in gift payable	(60,000)	389,999
Net cash used in operating activities	$ (294,510)	$ (354,403)

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 501(c)(3) 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 a 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 equities and fixed income securities in a leveraged form, are traded with a counterparty and are valued at each month end. Equity swaps are valued based on the last reported price of the relevant index or ETF. Fixed income swaps are valued at the last reported sale price, or in the absence of a recorded sale, at a value between the most recent bid and asked prices. 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 are not immediately liquid. Accordingly, their values are based upon guidelines established by the general partners. 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 categorized as investments include money market mutual funds, foreign currency held for investment purposes, and fixed income securities with an original or remaining maturity when purchased of three months or less.

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, 2009 relate to a donor-restricted contribution for which the requirements have not yet been met.

Grants

Grants are accrued when awarded by the Foundation.

Administrative Expenses

Administrative expenses represent those expenses incurred in managing programs funded by the 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 2008 balances to conform to the 2009 presentation of investment assets. These reclassifications had no effect on the change in net assets in 2008 or total net assets at December 31, 2008.

Recent Accounting Pronouncements

In April 2009, FASB issued ASC Topics 820-10-35, 50 and 55 (formerly FAS 157-4), "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased". This provides additional guidance on estimating the fair value of an asset where the level of activity has decreased significantly, and affirms that the objective fair value is the price that would be received to sell the asset in an orderly transaction, even when the market for the asset is not active. The Foundation adopted ASC Topics 820-10-35, 50 and 55 effective January 1, 2009.

In June 2009, FASB ASC 105 was issued, which established the FASB Accounting Standards Codification as the source of authoritative U.S. generally accepted accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. The Foundation has applied this guidance in the preparation of the Foundation's financial statements as of December 31, 2009.

In September 2009, the FASB issued FASB Accounting Standards Update No. 2009-12, Investment in Certain Entities That Calculate Net Asset Value per Share (ASU 2009-12). ASU 2009-12 (formerly FAS 157-g) amends FASB Statement No. 157, Fair Value Measurements, adds disclosures, and provides guidance for estimating the fair value of investments in investment companies that calculate net asset value per share, allowing the Net Asset Value per Share (NAV) to be used as a practical expedient for fair value where investment companies follow the American Institute of Certified Public Accounts (AICPA) Guide in arriving at their reported NAV. The Foundation adopted ASU 2009-12 effective January 1, 2009.

In January 2010, The FASB issued ASU No. 2010-06, Improving Disclosures about Fair Value Measurements. This amends ASC 820 (formerly FAS 157-4) to require additional disclosures. The guidance requires entities to disclose transfers of assets in and out of Levels 1 and 2 of the fair value hierarchy, and the reasons for those transfers. ASU 2010-06 is effective January, 2010. In addition, the guidance requires separate presentation of purchases and sales in the Level 3 asset reconciliation; this is effective January, 2011. The adoption of this guidance is not expected to have a material impact on the Foundation's financial statements.

(dollars in thousands)

3. Investments

The Foundation's investment portfolio, at December 31 consists of the following:

	2009	2008
Investments, at fair value		
Hewlett-Packard and Agilent common stock	$ 361,435	$ 262,031
Global equities	682,172	830,596
Commingled funds	1,488,484	1,292,142
Alternative assets	3,506,966	3,296,434
Fixed income	641,667	1,045,564
Net payable on forward fixed income transactions	(306,634)	(844,080)
Cash equivalents	371,092	394,766
Net receivable from unsettled securities purchases and sales	69,720	(96,179)
Derivatives	(5,666)	(24,882)
Total	$ 6,809,236	$ 6,156,392

Alternative assets consist of private equity, real assets, absolute return and distressed / credit assets, held in partnership or trust format. The commingled funds are primarily global funds invested in long-only equities; assets in these funds are held indirectly by the Foundation in either partnership or trust format.

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 and the overlay swaps, which have separate arrangements related to their legal structure.

Approximately 48 percent of the Foundation's assets are invested (directly or indirectly) in publicly traded 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 or loss on the Foundation's investment portfolio for the years ended December 31, 2009 and 2008 consists of the following:

	2009	2008
Net realized loss	$ (16,647)	$ (208,286)
Net unrealized gain / (loss)	1,008,897	(2,413,910)
	$ 992,250	$ (2,622,196)

Approximately 52 percent of the Foundation's investments at December 31, 2009 were invested with various limited partnerships that invest in the securities of companies that are not 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, 2009 the Foundation is committed to contribute approximately $1,863,932 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.

Legal, tax and regulatory changes could occur during the term of the Foundation's fund investments. The regulatory environment for private equity and hedge funds is evolving, and changes in the regulation of these funds may adversely affect the value of investments held by the Foundation. The Foundation believes that the effect of any future regulatory change on the Foundation's assets would likely not be substantial.

The Foundation maintains a custody account with its primary custodian, The Bank of New York Mellon Corporation (BNY Mellon). Although the Foundation monitors BNY Mellon and believes that it is an appropriate custodian, there is no guarantee that BNY Mellon, or any other custodian that the Foundation may use from time to time, will not become insolvent. The Foundation believes that, in the event of the insolvency of its custodian, some of the Foundation's assets may be unavailable for a period of time, but that it would ultimately have full recovery of its assets.

At December 31, 2009, the Foundation's net receivable from unsettled securities purchases and sales includes a receivable from brokers of $115,759 and a payable to brokers of $46,683. At December 31, 2008, the net receivable from unsettled securities purchases and sales included a receivable from brokers of $1,497,687 and a payable to brokers of $1,593,866.

The Foundation held 4.1 million shares of Hewlett-Packard Company ("Hewlett-Packard") stock with a market price of $51.51 per share at December 31, 2009. At December 31, 2008, the Foundation held 5.1 million shares with a market price of $36.29 per share. The Foundation held 4.8 million shares of Agilent Company ("Agilent") stock with a market price of $31.07 per share at December 31, 2009. At December 31, 2008, the Foundation held 4.8 million shares of Agilent stock with a market price of $15.63 per share.

The Foundation engages in securities lending. During the term of the loan, the Foundation continues to receive any dividends, or amounts equivalent thereto, on the loaned securities. The loans are collateralized by collateral whose par value is at least equal to the market value of the loaned securities. The collateral is adjusted daily based on current market values. Investment of this collateral is in accordance with specified guidelines, and the collateral is marked to fair value daily. Cash collateral received for securities on loan is invested in a separately managed liquidating trust, managed on behalf of the Foundation by the securities lending agent. Income generated from the investment of cash collateral, net of negotiated rebate fees paid to borrowers and transaction costs, is divided 75/25 between the Foundation and the securities lending agent. The Foundation's share of this securities lending income is disclosed with interest, dividends and other income in the statement of activities and changes in net assets. Loans are subject to termination at the option of the borrower or the Foundation. Upon termination of the loan, the borrower returns to the lender securities identical to the loaned securities. The Foundation bears the risk of delay in recovery of, or even loss of rights in, the securities loaned should the borrower of the securities fail financially. The Foundation also bears the risk of loss in the event the securities purchased with cash collateral depreciate in value.

At December 31, 2009 and 2008, the fair value of securities on loan was $16,580 and $76,474, respectively. In connection therewith, the Foundation received cash collateral of $17,628 and $80,019, respectively, which has been invested. As of December 31, 2009 and 2008 the fair value of the Foundation's collateral holdings was $17,466 and $75,087, respectively.

In the year ending December 31, 2009, the Foundation earned $550 in securities lending income, which was offset by a realized loss of $(2,119). In the year ending December 31, 2008, the Foundation earned $1,227 in securities lending income.

Derivative Instruments

In 2008, FASB issued Statement of Financial Accounting Standards No. 161, “Disclosures about Derivative Instruments and Hedging Activities”. In 2009, FAS 161 was updated and reissued as FASB Accounting Standards Codification ASC 815-10-50. The Foundation adopted the provisions of ASC 815-10-50 effective January 1, 2009. This requires enhanced disclosures to provide additional information regarding the accounting treatment for derivatives and hedging activities, the reasons the Foundation’s managers invest using derivative instruments, and the effect derivatives have on the Foundation’s financial statements. It requires qualitative disclosures about the objectives and strategies for using derivative instruments, quantitative disclosures about the fair value of, and gains and losses on, derivative instruments, as well as disclosures about credit-risk-related contingent features in derivative agreements.

The standard enhances the disclosure requirements for derivative instruments and related hedging activities and thus, the adoption of the standard had no impact on the statements of financial position or statements of activities and changes in net assets. The Foundation does not designate any derivative instruments as hedging instruments under ASC 815.

The Foundation transacts in a variety of derivative instruments including futures, swaps and options primarily for trading purposes with each instrument's primary risk exposure being interest rate, credit, foreign exchange, equity or commodity risk. The fair value of these derivative instruments, held in the Foundation’s separately managed accounts, is included in the Investments line item in the statements of financial position with changes in fair value reflected as realized gains (losses) or unrealized gains (losses) on derivatives within the statements of activities and changes in net assets.

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 are used to hedge nondollar exposure in foreign investments, or to take positions in managed currency portfolios; (2) futures and swap contracts are used to rebalance asset categories within the portfolio and to manage market exposures in managed portfolios; and (3) futures contracts, swaps and options are used to hedge or leverage positions in managed portfolios.

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, 2009 and 2008 the net liability for these forward purchases and sales was $306,634 and $844,080, respectively.

Premiums received with respect to open options contracts at December 31, 2009 and 2008 were $17,853 and $13,640, respectively. The total value of investments pledged with respect to options and futures contracts at December 31, 2009 and 2008 was $414,315 and $251,856, respectively. The value of restricted cash held at brokers as collateral for variation margin at December 31, 2009 and 2008 was $(944) and $22,282, respectively.

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.

(dollars in thousands)

The following table lists fair value of derivatives by contract type as included in the statements of financial position at December 31, 2009. This table excludes exposures relating to derivatives held indirectly through commingled funds.

		Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Average Notional / # of Contracts	Fair Value	Average Notional / # of Contracts	Fair Value
Derivatives not designated as hedging instruments under ASC 815					
Interest rate contracts	Investments	$ 256,575	$ 1,841	$ (18,675)	$ (1,095)
Futures-Interest rate contracts*	Investments	2	3,418	(0)	(803)
Credit contracts	Investments	66,425	1,254	95,646	(2,923)
Equity contracts*	Investments	24	1,771	(605)	(9,548)
Foreign exchange contracts	Investments	114,099	74,845	(115,312)	(74,426)
Total derivatives not designated as hedging instruments under ASC 815			$ 83,129		$ (88,795)

* These derivative instruments are reported based on the number of contracts.

Derivatives of $(5,666) and $(24,882) at December 31, 2009 and 2008, respectively, consist of swap contracts, futures contracts, foreign exchange contracts, covered call options, and put and call options.

The following table indicates the gains and losses on derivatives, by contract type, as included in the statements of activities and changes in net assets for the year ended December 31, 2009.

	Location of Gain or (Loss) Recognized as Income on Derivatives	Amount of Gain or (Loss) Recognized as Income on Derivatives
Derivatives not designated as hedging instruments under ASC 815		
Interest rate contracts	Gain (loss) on investment portfolio	$ 28,386
Futures - Interest rate contracts	Gain (loss) on investment portfolio	1,841
Credit contracts	Gain (loss) on investment portfolio	4,043
Equity contracts	Gain (loss) on investment portfolio	4,175
Foreign exchange contracts	Gain (loss) on investment portfolio	(1,963)
Total derivatives not designated as hedging instruments under ASC 815		$ 36,482

Credit Default Swaps

The Foundation's investment managers enter into credit default swaps, generally to simulate long and short bond positions that are either unavailable or considered to be less attractively priced in the bond market. The Foundation managers use these swaps to reduce risk where the Foundation has exposure to the issuer, or to take an active long or short position with respect to the likelihood of an event of default. The reference obligation of the swap can be a single issuer, a "basket" of issuers, or an index. The underlying referenced assets are typically corporate debt, sovereign debt and asset backed securities.

The buyer of a credit default swap is generally obligated to pay the seller a periodic stream of payments over the term of the contract in return for a contingent payment upon the occurrence of a credit event with respect to an underlying reference obligation. If a credit event occurs, the seller typically must pay the contingent payment to the buyer, which is typically the par value (full notional value) of the reference obligation, though the actual payment may be mitigated by terms of the International Swaps and Derivative Agreement ("ISDA"), allowing for netting arrangements and collateral.

The contingent payment may be a cash settlement or a physical delivery of the reference obligation in return for payment of the face amount of the obligation. If the Foundation's investment manager is a buyer and no credit event occurs, the Foundation may lose its investment and recover nothing. However, if a credit event occurs, the buyer typically receives full notional value for a reference obligation that may have little or no value. As a seller, the Foundation receives a fixed rate of income throughout the term of the contract, which typically is between one month and five years, provided that no credit event occurs. If a credit event occurs, the seller may be obligated to pay the buyer an amount up to the full notional value of the reference obligation.

As of December 31, 2009, the Foundation is the buyer ("receiving protection") on a total notional amount of $15,384 and is the seller ("providing protection") on a total notional amount of $88,478. The notional amounts of the swaps are not recorded in the financial statements; however the notional amount does approximate the maximum potential amount of future payments that the Foundation could be required to make if the Foundation were the seller of protection and a credit event were to occur. Those credit default swaps for which the Foundation is providing protection at December 31, 2009 are summarized as follows:

(dollars in thousands)

Written Credit Derivative Contracts	Single Name Credit Default Swaps		Credit Default Swap Index		
Reference Asset:	**Corporate Debt**	**Sovereign Debt**	**Asset Backed Securities**	**Corporate Debt**	**Total**
Fair value of written credit derivatives	$ 163	$ 40	$ (2,134)	$ 182	$ (1,749)
Maximum potential amount of future payments	$ 39,800	$ 6,000	$ 8,785	$ 33,893	$ 88,478
Recourse provisions with 3rd parties to recover any amounts paid under the credit derivative					$ -

Maximum Potential Amount of Future Payments By Contract Term

	0-12 months	1-5 years	5-10 years	Over 10 years	Total
Current rating on underlying :					
AAA		$ 2,240	$ 2,275	$ 8,785	$ 13,300
AA		1,900			1,900
A		31,000			31,000
BBB		23,800	12,978		36,778
<BBB		5,500			5,500
Total	$ -	$ 64,440	$ 15,253	$ 8,785	$ 88,478

4. Valuation of Investments

In 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157), which was effective for the Foundation's fiscal year beginning January 1, 2008. SFAS 157 defined fair value, established a framework used to measure fair value, and expanded disclosures about fair value measurements. The standard prioritized, within the measurement of fair value, the use of market-based information over entity-specific information and established a three-level hierarchy for fair value measurements based on the transparency of information, such as the pricing source, used in the valuation of an asset or liability as of the measurement date. In 2009, SFAS 157 was reissued as FASB Accounting Standards Codification ASC 820.

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

Level I – Quoted prices are available in active markets for identical investments as of the reporting date, without adjustment. The type of investments in Level I include listed equities held in the name of the Foundation, and exclude listed equities and other securities held indirectly through commingled funds.

Level II – 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 reporting date, and fair value is determined through the use of models or other valuation methodologies.

Level III – Pricing inputs are unobservable for the investment and includes situations where there is little, if any, market activity for the investment. Investments that are included in this category generally include privately held investments and securities held in partnership format.

(dollars in thousands)

The following table summarizes the valuation of the Foundation's investments by the ASC 820 (formerly SFAS 157) fair value hierarchy levels as of December 31, 2009:

	Level I	Level II	Level III	Total
Equities and Fixed Income:				
Equity Securities - U.S.	$ 596,084	$ -	$ 325	$ 596,409
Equity Securities - Non-U.S.	447,198			447,198
Corporate Debt Securities		61,912	852	62,764
U.S. Government Securities	476,753	82,512		559,265
Mortgage-Backed Securities		8,988		8,988
Other Fixed Income Securities	337	8,127	2,186	10,650
Commingled Funds [1]		236,138	1,252,346	1,488,484
Cash and Cash Equivalents	67,440	303,652		371,092
Alternative Assets:				
Private Equity			1,103,620	1,103,620
Real Assets			816,783	816,783
Distressed / Credit			1,177,415	1,177,415
Absolute Return / Market Neutral			409,148	409,148
Derivatives - Assets	80,034	3,095		83,129
Assets	**$ 1,667,846**	**$ 704,424**	**$ 4,762,675**	**$ 7,134,945**
Derivatives - Liabilities	(84,775)	(4,020)		(88,795)
Total Investments [2]	**$ 1,583,071**	**$ 700,404**	**$ 4,762,675**	**$ 7,046,150**

[1] These are directional investments, invested mostly in equity portfolios. These funds invest mostly in long only securities, and some invest both long and short. The investments are public securities, and the funds are held in partnership or trust format.

[2] Total investments as shown in this table exclude payables and receivables on pending trades. This net payable at year end 2009 was $(236,914).

(dollars in thousands)

The following table summarizes the Foundation's level III reconciliation by the ASC 820 standards as of December 31, 2009:

	Beginning Balance at December 31, 2008	Realized Gains (Losses)	Change in Unrealized Gains (Losses)	Net Purchases (Sales and Settlements)	Net Transfers In (Out) of Level III	Ending Balance at December 31, 2009
Level III Assets						
Equity Securities U.S.	$ 34,633	$ 152	$ 15,076	$ (151)	$ (49,385)	$ 325
Equity Securities Non-U.S.	478	(5,231)	7,218	(3,074)	609	-
Corporate Debt Securities	8,216	(59)	897	(4,892)	(3,310)	852
U.S. Gov't Securities	-	58	-	(58)	-	-
Mortgage-Backed Securities	-	-	-	-	-	-
Other Fixed Income Securities	7,251	(200)	3,875	(8,693)	(47)	2,186
Commingled Funds	1,266,887	(59,537)	388,810	(108,844)	(234,970)	1,252,346
Cash and Cash Equivalents	1,750	(3,950)	(796)	178,436	(175,440)	-
Private Equity	884,146	25,366	52,902	141,206	-	1,103,620
Real Assets	834,895	17,225	(132,714)	97,377	-	816,783
Distressed / Credit	1,318,858	67,789	115,242	(324,474)	-	1,177,415
Abs. Return / Market Neutral	301,489	(4,559)	62,439	49,779	-	409,148
Total	**$ 4,658,603**	**$ 37,054**	**$ 512,949**	**$ 16,612**	**$ (462,543)**	**$ 4,762,675**

The amount included in the statement of activities for the period which is attributable to the change in unrealized gains related to assets still held at the reporting date is $(9,661).

(dollars in millions)

The Foundation uses the Net Asset Value (NAV) to determine the fair value of all the underlying investments which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company. Per ASU 2009-12, the following table lists investments in other investment companies (in partnership format) by major category:

	Strategy	NAV in funds	# of funds	Remaining Life	$ Amount of Unfunded Commitments	Timing to Draw Down Commitments	Redemption Terms	Redemption Restrictions	Redemption Restrictions In Place at Year End
Private Equity	Venture and buyout, in the U.S and international	$ 1,104	148	1 to10 years	$ 1,064	2 to 10 years	N.A.*	N.A.	N.A.
Real Assets	Real estate and natural resources, primarily in the U.S.	817	83	1 to 12 years	689	2 to 9 years	N.A.*	N.A.	N.A.
Distressed / Credit	Distressed asset funds & credit strategies, globally	1,177	28	1 to 5 years	111	1 year	Ranges between quarterly redemption with 45 days' notice, to annual redemption with 90 days' notice.**	3 funds have lock up provisions of up to 3 years. Side pockets exist for 4 of the funds.	None
Absolute Return - Market Neutral	Global equity and fixed income funds in market neutral strategies	409	8	N.A.	-	N.A.	Ranges between quarterly redemption with 45 days' notice, to annual redemption with 90 days' notice.	1 fund has a lock up provision of 1 year.	None
Commingled funds	Global funds, primarily long-only and primarily in equities	1,488	22	N.A.	-	N.A.	Range from 1 to 45 days' notice.	1 fund has a lock up provision of 1 year.	None
Total		$ 4,995	289		$ 1,864				

* These funds are in private equity structure, with no ability to be redeemed.

** 12 of these funds are in private equity structure, with no ability to be redeemed.

(dollars in thousands)

5. Receivable

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 five years to the William and Flora Hewlett Foundation to do grant-making in this area; this contribution was reported as a change in temporarily restricted net assets during 2006. $8,670 of this pledge was received during 2009 and $13,330 was received during 2008. $3,660 is reported as a receivable at December 31, 2009.

In 2009 the Foundation entered into another agreement with the Bill and Melinda Gates Foundation for further grant-making in this area. The Foundation was pledged and received $13,000. This contribution is reported as a change in temporarily restricted net assets in 2009.

The Foundation is the residual beneficiary of the Hewlett Marital Trust. As of December 31, 2009, the assets which the Foundation is entitled to receive are not material and cannot be reasonably estimated.

6. Fixed Assets

Fixed assets consist of the following at December 31, 2009 and 2008:

	2009	2008
Building, land lease and land improvements	$ 34,360	$ 34,190
Furniture and fixtures	5,461	5,262
Computer and office equipment	2,109	2,147
	41,930	41,599
Less accumulated depreciation and amortization	(11,345)	(10,299)
	$ 30,585	$ 31,300

7. Postretirement Healthcare Benefit

The Foundation adopted Statement No. 158 of the Financial Accounting Standards Board, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans” (SFAS 158) and recognizes the accumulated liability for its postretirement healthcare benefit obligation, effective January 1, 2007. In 2009, SFAS 158 was reissued as FASB ASC 715.

The changes in postretirement healthcare benefit obligation, plan assets, and the amounts recognized in the financial statements are as follows:

(dollars in thousands)

	2009	2008
Change in postretirement healthcare benefit obligation (APBO):		
Postretirement benefit obligation as of January 1	$ 4,009	$ 3,135
Service cost	667	487
Interest cost	283	228
Actuarial loss	65	195
Benefits paid by employer	(44)	(36)
Accrued postretirement benefit cost as of December 31	$ 4,980	$ 4,009

By Foundation policy, the postretirement healthcare benefit plan is not funded.

	2009	2008
Change in plan assets:		
Fair value of plan assets as of January 1	$ -	$ -
Actual return on plan assets	-	-
Company contributions	44	36
Participants contributions	-	-
Benefits paid	(44)	(36)
Fair value of plan assets as of December 31	$ -	$ -

	2009	2008
Amount recognized in Statement of Financial Position as of December 31:		
Accrued postretirement healthcare benefit cost	$ 4,980	$ 4,009
Assets	-	-
Net amount recognized	$ 4,980	$ 4,009

	2009	2008
Amounts included in unrestricted net assets:		
Unrecognized prior service cost	$ -	$ -
Unrecognized net gain	(640)	(743)
Net gain included in unrestricted net assets	$ (640)	$ (743)

(dollars in thousands)

	2009	2008
Net periodic postretirement healthcare benefit cost:		
Service cost	$ 667	$ 487
Interest cost	283	228
Expected return on plan assets	-	-
Amortization of prior service cost	-	-
Amortization of unrecognized net gain	(39)	(120)
Net periodic postretirement healthcare benefit cost:	911	595
Other changes recognized in unrestricted net assets:		
Net loss	104	315
Prior service cost	-	-
Amortization of prior service cost	-	-
Total recognized in unrestricted net assets	104	315
Total recognized net periodic benefit cost and unrestricted net assets	$ 1,015	$ 910

The prior service costs and net actuarial gain expected to be amortized from change in net assets to net periodic benefit expense over the next fiscal year are as follows:

Net actuarial gain	$ 20
Prior service cost	-

Actuarial Assumptions:

The weighted average discount rate assumptions used for the Post Retirement Health Benefit plan are shown below:

	2009	2008
Discount rate to determine benefit obligations	6.00%	6.00%
Discount rate to determine the net periodic benefit cost	6.00%	6.50%

To determine the accumulated postretirement healthcare benefit obligation as of December 31, 2009, a 10% annual rate of increase in per capita costs of covered health care was assumed for 2009-2010, declining gradually to 6% by 2013 and remaining at this rate thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated postretirement healthcare benefit obligation by $875, and the aggregate annual service and interest cost by $185. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated postretirement healthcare benefit obligation by $711, and the aggregate annual service and interest cost by $148.

(dollars in thousands)

Expected contributions:

The Foundation expects to contribute $69 in postretirement healthcare benefits during the fiscal year ending December 31, 2010.

Expected benefit payments:

The following benefit payments, which reflect expected future service, are expected to be paid for the fiscal years ending December 31:

Fiscal Year	Expected Benefit Payments
2010	$ 69
2011	82
2012	122
2013	144
2014	179
2015-2019 (aggregate)	1,447

8. Grants Payable

Grant requests are recorded as grants payable when they are awarded. Some of the grants are payable in installments, generally over a two or three-year period. Grants authorized but unpaid at December 31, 2009 are payable as follows:

Year Payable	Amount
2010	$ 182,003
2011	23,077
2012 and thereafter	7,875
	$ 212,955

9. Gifts Payable

The Foundation made a commitment of $113,000 in August of 2007 to the University of California, Berkeley, over seven years, for a challenge grant to endow 100 faculty chairs and for the creation of an in-house investment company. The obligation was discounted at the date of the gift to a net present value as of December 31, 2009 using a discount rate of 4.33 %. Payments of $10,000 were made in 2009 and 2008.

The Foundation made a commitment of $461,095 in July of 2008 to ClimateWorks Foundation for an initiative to mitigate global climate change. This obligation is expected to be paid over a period of five years and was discounted to a net present value as of December 31, 2009 using a discount rate of 3.19%. Payments of $50,000 and $61,095 were made in 2009 and 2008, respectively.

(dollars in thousands)

The total gifts payable at December 31, net of discount, is as follows:

	2009	2008
Gifts payable	$ 426,000	$ 486,000
Less unamortized discount	(31,032)	(38,140)
Gift payable, net of discount	$ 394,968	$ 447,860

10. Credit Facility

The Foundation has a collateralized revolving line of credit ("LOC") of $200,000 with BNY Mellon. This LOC note does not have an expiration date. At December 31, 2009 and 2008 the outstanding principal balance on the line of credit was $0 and $40,000, respectively. The interest rate on the LOC is variable and is indexed to the one month London Interbank Offered Rate ("Libor").

11. 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 2008. 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, 2009 and 2008, deferred federal excise tax is provided at 1.5%, which is the average effective rate expected to be paid on unrealized gains on investments. The income from certain investments is subject to unrelated business income tax.

	2009	2008
Current federal excise tax expense	$ 1,673	$ 5,302
Deferred federal excise tax expense	-	(20,643)
Excise tax expense	1,673	(15,341)
UBIT - Unrelated business income tax expense	(1,425)	18,429
	$ 248	$ 3,088

The Foundation believes that it has appropriate support for the excise tax positions taken and, as such, does not have any uncertain tax positions that result in a material impact on the Foundation's financial position or statement of activities.

12. Subsequent Events

The Foundation has evaluated subsequent events for the period from December 31, 2009 through April 22, 2010, the date the financial statements were issued.

The Foundation adopted a new arrangement for postretirement healthcare, effective January 1, 2010. As a result there will be a reduction in the Foundation's accumulated benefit obligation of approximately $3 million.

The Foundation entered into an additional credit facility in 2010. This facility is a revolving line of credit ("LOC") of $300,000 with a commercial bank. The interest rate on the LOC is variable and is indexed to the one month London Interbank Offered Rate ("Libor").