The William and Flora Hewlett Foundation

Financial Statements as of and for the Years Ended December 31, 2017 and 2016

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Report of Independent Auditors

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

We have audited the accompanying financial statements of The William and Flora Hewlett Foundation ("The Foundation"), which comprise the statements of financial position as of December 31, 2017 and 2016, and the related statements of activities and changes in net assets and of cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Foundation's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The William and Flora Hewlett Foundation as of December 31, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

May 31, 2018

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The William and Flora Hewlett Foundation

Statements of Financial Position

December 31, 2017 and 2016

(dollars in thousands)

		2017		2016
Assets				
Cash	$	6,220	$	8,374
Investments, at fair value (Notes 3 and 4)		9,854,507		8,986,273
Prepaid expenses and other assets		5,227		4,269
Property and equipment, net (Note 5)		22,924		23,803
Total assets	$	9,888,878	$	9,022,719
Liabilities and Net Assets				
Accounts payable and accrued liabilities	$	10,338	$	10,116
Accrued postretirement health care benefit (Note 6)		7,763		7,346
Deferred federal excise tax payable		51,399		38,381
Grants payable (Note 7)		204,190		225,933
Total liabilities		273,690		281,776
Net assets, unrestricted		9,615,188		8,740,943
Total liabilities and net assets	$	9,888,878	$	9,022,719

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, 2017 and 2016

(dollars in thousands)

	2017	2016
Revenue		
Interest, dividends and other income	$ 68,559	$ 56,696
Gain on investment portfolio (Note 3)	1,287,666	426,909
Investment management expense	(13,725)	(12,605)
Net investment income	1,342,500	471,000
Tax expense on investment income (Note 9)	(16,264)	(10,111)
Net investment revenue	1,326,236	460,889
Expense		
Grants awarded, net of cancellations	(407,525)	(414,987)
Direct and other charitable activities	(7,342)	(10,177)
Administrative expenses	(37,266)	(34,813)
Post-retirement plan - actuarial gain	142	411
Total expense	(451,991)	(459,566)
Change in net assets, unrestricted	874,245	1,323
Net assets, unrestricted		
Beginning of year	8,740,943	8,739,620
End of year	$ 9,615,188	$ 8,740,943

See accompanying notes to the financial statements.

The William and Flora Hewlett Foundation

Statements of Cash Flows
Years Ended December 31, 2017 and 2016
(dollars in thousands)

	2017	2016
Cash flows used in operating activities:		
Interest and dividends received	$ 69,226	$ 66,700
Cash paid for taxes	(3,295)	(10,218)
Cash paid to suppliers and employees	(57,347)	(54,797)
Grants paid	(429,268)	(415,688)
Net cash used in operating activities	(420,684)	(414,003)
Cash flows from investing activities:		
Purchases of property and equipment	(235)	(147)
Cash received from partnership distributions	362,785	321,170
Proceeds from sale of investments	30,896,028	26,947,931
Purchase of investments	(30,840,048)	(26,855,421)
Net cash from investing activities	418,530	413,533
Cash flows from financing activities:		
Cash received from lines of credit	70,000	120,000
Cash paid on lines of credit	(70,000)	(120,000)
Net cash from financing activities	-	-
Net change in cash	(2,154)	(470)
Cash, beginning of year	8,374	8,844
Cash, end of year	$ 6,220	$ 8,374

See accompanying notes to the financial statements.

The William and Flora Hewlett Foundation

Statements of Cash Flows

Years Ended December 31, 2017 and 2016

(dollars in thousands)

	2017	2016
Reconciliation of change in net unrestricted assets to net cash used in operating activities:		
Change in total net assets	$ 874,245	$ 1,323
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Post-retirement plan - actuarial gain	(142)	(411)
Depreciation and amortization	1,114	1,390
Net unrealized and realized gain on investments	(1,287,666)	(426,909)
Increase in deferred federal excise tax payable	13,018	882
Increase in accrued postretirement health care benefit	559	685
Changes in operating assets and liabilities:		
Decrease in interest and dividends receivable	667	10,004
(Increase) in prepaid expenses and other	(958)	(1,105)
Increase in accounts payable and accrued liabilities	222	839
(Decrease) in grants payable	(21,743)	(701)
Net cash used in operating activities	$ (420,684)	$ (414,003)

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, global development and population, and advancing the field of philanthropy. 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 and in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Investments

To the extent available, the Foundation's investments are recorded at fair value based on quoted prices in active markets. The Foundation's investments that are listed on any U.S. or non-U.S. recognized exchanges are valued based on readily available market quotations. When such inputs do not exist, fair value measurements are based on the best available information and usually require a degree of judgment. Futures, forwards, swaps and options that 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. For alternative investments, which are principally limited partnership investments in private equity, real assets, fixed income, absolute return and distress/credit funds, the value is primarily based on the net asset value (NAV) of the underlying investments. The NAV is reported by external investment managers, including general partners, in accordance with their policies as described in their respective financial statements and offering memoranda. These investments are generally less liquid than other investments. For these, the value reported may differ from the values that would have been reported had a ready market for these investments existed, and the difference could be material to the change in net assets of the Foundation.

Investment transactions are recorded on a trade-date basis. 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.

Property and Equipment

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

Net Asset Classification

The Foundation's net assets are all classified as unrestricted. The Foundation has no temporarily or permanently restricted net assets.

Grant Expense

Grant expense is recognized in the period when the grant award is approved by the Foundation.

Taxes

The Foundation is exempt from federal income taxes under Section 501(c)(3) and is classified as a private foundation under Section 509(a) of the Internal Revenue Code. The Foundation is subject to federal excise taxes and taxes on unrelated business income.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to the 2016 investment disclosures to conform to the presentation of the 2017 investment disclosures. These reclassifications had no effect on the total investments, total assets or investment fair value balances for the year ended December 31, 2016.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02 *Leases*, amending the ASC 842. This update requires lessees to recognize operating and financing lease liabilities and corresponding right-of use assets on the statement of financial position. The new guidance is effective for the Foundation beginning January 1, 2020. The Foundation is currently evaluating the impact that this guidance will have on its financial statements.

In August 2016, the FASB issued ASU 2016-14 *Presentation of Financial Statements of Not-for-Profit Entities*, amending the ASC 958. This update changes the presentation of certain information in the financial statements and footnote disclosures of not-for-profit (NFP) entities. The update also changes the way that NFP entities classify net assets. The new guidance is effective for the Foundation for the year beginning January 1, 2018. The Foundation is currently evaluating the impact that this guidance will have on its financial statements.

In January 2017, the FASB issued ASU 2017-02 *Not-for-Profit Entities – Consolidation*. This update reconfirms the presumption that a NFP entity that is a general partner of a for-profit limited partnership or similar entity controls the limited partnership. The amendments in this update also add guidance on when an NFP limited partner should consolidate a for-profit limited partnership. The new guidance is effective for the Foundation for the year beginning January 1, 2017. There was no impact to the financial statements.

In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which is intended to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost by requiring bifurcation of net benefit cost. The new guidance is effective for the Foundation beginning January 1, 2019 and early adoption is permitted. The Foundation is currently evaluating the impact the new guidance will have on the financial statements.

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, 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. These financial assets have separate arrangements related to their legal structure.

(dollars in thousands)

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

	2017	2016
Investments, at fair value		
Public equities	$ 3,341,849	$ 2,905,328
Alternative assets	5,705,408	5,198,848
Fixed income	1,049,015	889,112
Net payable on forward fixed income transactions	(694,961)	(747,819)
Cash equivalents	428,312	658,498
Net receivable from investments	24,589	83,542
Derivatives	295	(1,236)
Total	$ 9,854,507	$ 8,986,273

Approximately 42% of the Foundation's assets at December 31, 2017 and 2016 were 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.

Alternative assets consist of private equity, real assets, fixed income, absolute return and distress/ credit assets, held in partnership or trust format. Approximately 58% of the Foundation's investments at December 31, 2017 and 2016 were invested with various limited partnerships and managers that invest in the securities of companies that are not immediately liquid, such as venture capital and buyout firms, and real estate limited partnerships that have investments in various types of properties. At December 31, 2017 and 2016, the Foundation's commitment to contribute additional capital in future years to various partnerships was approximately $1,788,863 and $1,886,154, respectively.

Net realized and unrealized gains on investments are reflected in the statements of activities and changes in net assets. The net gain on the Foundation's investment portfolio for the years ended December 31, 2017 and 2016 consists of the following:

	2017	2016
Net realized gain	$ 447,809	$ 260,788
Net unrealized gain	839,857	166,121
	$ 1,287,666	$ 426,909

Investment securities are exposed to various risks, such as interest rate, market, and credit risks. 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 Foundation's holdings in limited partnerships entail liquidity risk. The underlying investments held within these partnerships are generally in privately held companies. There is no readily available market for such privately held companies, and investments in those may be subject to legal restrictions on transfer. As a result, there is no assurance that the Foundation will be able to realize liquidity for such investments in a specified time frame.

The Foundation maintains a custody account with a major custodian bank. Although the Foundation monitors and believes that it is an appropriate custodian, there is no guarantee that the custodian, or any other custodian that the Foundation may use from time to time, will not become insolvent.

The Foundation holds repurchase agreement and reverse repurchase agreement securities in its investment portfolio. The Foundation held both repurchase agreements and reverse repurchase agreements in 2017 and 2016. These securities are held in separately managed accounts, and the majority of these securities are in the distress/credit portion of the portfolio. In a repurchase agreement, the Foundation buys a security from another party (usually a financial institution) with the agreement that it be sold back in the future at an agreed upon price. In a reverse repurchase agreement, the Foundation sells a security to another party (usually a financial institution) with the agreement that it be bought back in the future at an agreed upon price. Repurchase and reverse repurchase agreements subject the Foundation to counterparty risk, meaning that the Foundation could lose money if the other party fails to perform under the terms of the agreement. For repurchase agreements, the Foundation mitigates this risk by ensuring that its repurchase agreements are collateralized by U.S. government agency securities and treasury securities. For reverse repurchase agreements, the Foundation mitigates this risk by ensuring that it receives cash in exchange for the security. All collateral is held by the custodian and is monitored daily to ensure that it continues to meet the terms of the repurchase agreements. Investments in repurchase and reverse repurchase agreements are also based on a review of the credit quality of the counterparty.

At December 31, 2017, the Foundation's net receivable from investments included a receivable from brokers of $64,088 and a payable to brokers of $39,499. At December 31, 2016, the net receivable from investments included a receivable from brokers of $134,740 and a payable to brokers of $51,198.

Derivative Instruments

The Foundation transacts in a variety of derivative instruments including futures, forwards, swaps and options primarily for trading purposes with each instrument's primary risk exposure being interest rate, credit, foreign exchange or equity 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 investment portfolio in the statements of activities and changes in net assets.

The Foundation does not designate any derivative instruments as hedging instruments under U.S. GAAP.

For certain derivatives, the Foundation has a master netting arrangement which allows the counterparty to the transactions to net applicable collateral held on behalf of the Foundation against applicable liabilities of the Foundation to the counterparty.

Some investment managers retained by the Foundation have been authorized to use certain financial derivative instruments in a manner set forth by 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 non-dollar 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 investment 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, typically from 1 to 3 months. If a security is purchased on a delayed delivery basis, the Foundation assumes the rights and risks of ownership of the security at the time of the purchase, including the risk of price and yield fluctuations. Subsequently, the Foundation reflects such fluctuations in its net assets. The investment 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 realized gain or loss. At December 31, 2017, the Foundation's net liability for these forward purchases and sales included a receivable from investment managers of $187,691 and a payable to investment managers of $882,652. At December 31, 2016, the net liability for these forward purchases and sales included a receivable from investment managers of $170,576 and a payable to investment managers of $918,395.

Net premiums (received) or paid with respect to open options contracts at December 31, 2017 and 2016 were $(53) and $74, respectively. The total value of investments pledged with respect to options and futures contracts at December 31, 2017 and 2016 was $0. The value of restricted cash held at brokers as collateral for variation margin at December 31, 2017 and 2016 was $7,720 and $44,694, 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 from such instruments would materially affect the financial position of the Foundation.

(dollars in thousands)

The following table lists the fair value of derivative assets and liabilities, and repurchase and reverse repurchase agreements, by contract type. These are included and reported as investments in the statement of financial position at December 31, 2017. The table excludes exposures relating to derivatives held indirectly through commingled funds.

	Assets			Liabilities					
	Average Notional	Average # of Contracts	Gross Amounts of Recognized Assets	Average Notional	Average # of Contracts	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Collateral Pledged / (Received) [1]	Net Amount
Derivatives not designated as hedging instruments under ASC 815									
Interest rate contracts	167,026	11,426	$ 3,887	158,133	(58,933)	$ (7,309)	$ (3,422)	$ 3,422	$ -
Futures - Interest rate contracts	-	-	2,288	-	2	(2,386)	(98)	98	-
Credit contracts	244,165	-	4,739	30,250	(2,380)	(306)	4,433	-	4,433
Equity contracts	3,412	23,904	855	165	(34,581)	(947)	(92)	92	-
Foreign exchange contracts	97,808	-	76,876	(97,738)	-	(77,402)	(526)	526	-
Total derivatives			$ 88,645			$ (88,350)	$ 295	$ 4,138	$ 4,433
Repurchase agreements			$ 60,600			$ -	$ 60,600	$ (60,600)	-
Reverse repurchase agreements			-			(87,597)	(87,597)	87,597	-
Total offsetting financial instruments			$ 149,245			$ (175,947)	$ (26,702)	$ 31,135	$ 4,433

[1] Excess collateral pledged / received is not shown for financial reporting purposes.

(dollars in thousands)

The following table lists the fair value of derivative assets and liabilities, and repurchase and reverse repurchase agreements, by contract type. These are included and reported as investments in the statement of financial position at December 31, 2016. The table excludes exposures relating to derivatives held indirectly through commingled funds.

	Assets			Liabilities					
	Average Notional	Average # of Contracts	Gross Amounts of Recognized Assets	Average Notional	Average # of Contracts	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Collateral Pledged / (Received) [1]	Net Amount
Derivatives not designated as hedging instruments under ASC 815									
Interest rate contracts	66,985	529,732	$ 6,481	302,585	(209,763)	$ (14,427)	$ (7,946)	$ 7,946	$ -
Futures - Interest rate contracts	-	1	3,219	-	-	(3,644)	(425)	425	-
Credit contracts	335,094	-	8,360	64,705	(1,740)	(2,379)	5,981	-	5,981
Equity contracts	6,839	18,842	746	733	(35,812)	(724)	22	-	22
Foreign exchange contracts	192,405	-	179,117	(192,105)	-	(177,985)	1,132	-	1,132
Total derivatives			$ 197,923			$ (199,159)	$ (1,236)	$ 8,371	$ 7,135
Repurchase agreements			$ 62,700			$ -	$ 62,700	$ (62,700)	-
Reverse repurchase agreements			-			(100,271)	(100,271)	100,271	-
Total offsetting financial instruments			$ 260,623			$ (299,430)	$ (38,807)	$ 45,942	$ 7,135

[1] Excess collateral pledged / received is not shown for financial reporting purposes.

(dollars in thousands)

The following table indicates the gains and losses recognized as income on derivatives, by contract type. These are included and reported as part of gain on investment portfolio in the statement of activities and changes in net assets for the year ended December 31, 2017.

	Change in Unrealized Gain or (Loss)	Realized Gain or (Loss)
Derivatives not designated as hedging instruments under ASC 815		
Interest rate contracts	$ (25)	$ 837
Futures - Interest rate contracts	508	1,220
Credit contracts	(2,409)	2,674
Equity contracts	350	2,107
Foreign exchange contracts	(1,658)	(895)
Total gain (loss) on derivatives, net	$ (3,234)	$ 5,943

The following table indicates the gains and losses recognized as income on derivatives, by contract type. These are included and reported as part of gain on investment portfolio in the statement of activities and changes in net assets for the year ended December 31, 2016.

	Change in Unrealized Gain or (Loss)	Realized Gain or (Loss)
Derivatives not designated as hedging instruments under ASC 815		
Interest rate contracts	$ 2,616	$ (3,879)
Futures - Interest rate contracts	207	(4,411)
Credit contracts	4,199	2,441
Equity contracts	(1,886)	16,014
Foreign exchange contracts	458	(3,060)
Total gain (loss) on derivatives, net	$ 5,594	$ 7,105

Credit Default Swaps

The Foundation's investment managers enter into credit default swaps. Credit default swaps are used 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 fixed periodic 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 (equal to the notional amount less recovery value of the security or underlying securities) 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 Foundation may be obligated to pay the buyer an amount up to the full notional value of the reference obligation.

As of December 31, 2017 and 2016, the Foundation is the buyer ("receiving protection") on a total notional amount of $8,205 and $0, respectively, and is the seller ("providing protection") on a total notional amount of $219,600 and $488,118, respectively. 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.

(dollars in thousands)

Those credit default swaps for which the Foundation was providing protection at December 31, 2017 are summarized as follows:

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	$ (2)	$ 6	$ 19	$ 4,689	$ 4,712
Maximum potential amount of future payments	$ 4,100	$ 5,100	$ 4,000	$ 206,400	$ 219,600
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	$ -	$ -	$ -	$ 4,000	$ 4,000
AA		8,500			8,500
A					-
BBB		197,800			197,800
<BBB	1,100	8,200			9,300
Total	$ 1,100	$ 214,500	$ -	$ 4,000	$ 219,600

(dollars in thousands)

Those credit default swaps for which the Foundation was providing protection at December 31, 2016 are summarized as follows:

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	$ 548	$ (387)	$ (1,583)	$ 7,403	$ 5,981
Maximum potential amount of future payments	$ 50,385	$ 27,100	$ 49,531	$ 361,102	$ 488,118
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	$ -	$ -	$ -	$ 31,231	$ 31,231
AA		25,000	3,500		28,500
A	17,595	32,477			50,072
BBB	8,925	315,566		18,300	342,791
<BBB		35,524			35,524
Total	$ 26,520	$ 408,567	$ 3,500	$ 49,531	$ 488,118

4. Valuation of Investments

U.S. GAAP has established a framework to measure fair value and defined the required disclosures about fair value measurements. FASB Accounting Standards Codification ASC 820 on Fair Value Measurements favors the use of market-based information over entity-specific information. The standard prescribes 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 as of the measurement date.

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

Level I – Investments whose values are based on quoted market prices in active markets for identical securities are classified as Level I. The type of investments in Level I include listed equities, derivatives and U.S. Treasury securities.

Level II – Investments that trade in markets that are not actively traded, but are valued based on quoted market prices, dealer quotations, or alternative pricing sources for similar assets or liabilities are classified as Level II. These investments include certain U.S. government and sovereign obligations, government agency obligations, derivatives and certain limited marketable securities. In instances where valuation models are used, inputs can include market prices for reference securities, yield curves, exchange rates or interest rates.

Level III – Investments classified as Level III have significant unobservable pricing inputs, as they trade infrequently or not at all. The inputs into the determination of fair value of these investments are based upon the best information in the circumstances, including the use of models, and may require significant management judgment. Investments in this category include certain thinly traded securities for which quoted market prices are not readily available.

NAV – Investments include privately held investments and securities held in partnership or trust format, and for these the Net Asset Value (NAV) as a practical expedient has been used. These investments have not been classified in the fair value hierarchy and the amounts presented are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of financial position.

(dollars in thousands)

The following table summarizes the valuation of the Foundation's investments by the ASC 820 fair value hierarchy levels as of December 31, 2017:

	Level I	Level II	Level III	NAV	Total
Public Equities	$ 436,211	$ 448	$ 18,860	$ 2,886,330	$ 3,341,849
Fixed Income [1]	726,177	245,456		77,382	1,049,015
Cash Equivalents	292,506	135,455	351		428,312
Alternative Assets:					
Private Equity				2,498,582	2,498,582
Real Assets				854,435	854,435
Distress / Credit		251,163	16,935	1,156,099	1,424,197
Absolute Return				928,194	928,194
Derivatives - Assets	80,759	7,886			88,645
	$ 1,535,653	**$ 640,408**	**$ 36,146**	**$ 8,401,022**	**$10,613,229**
Derivatives - Liabilities	(84,438)	(3,912)			(88,350)
	$ 1,451,215	**$ 636,496**	**$ 36,146**	**$ 8,401,022**	10,524,879
Accrued Income and Net Payables and Receivables					(670,372)
Total Investments					**$ 9,854,507**

[1] Within the fixed income portion of portfolio, the Foundation holds certain asset-backed securities which are traded on a to be announced (TBA) basis. At December 31, 2017, the fair value of the long and short positions of these TBA securities were $241,823 and ($3,995), respectively.

The William and Flora Hewlett Foundation
Notes to Financial Statements
December 31, 2017 and 2016
(dollars in thousands)

The following table summarizes the valuation of the Foundation's investments by the ASC 820 fair value hierarchy levels as of December 31, 2016:

	Level I	Level II	Level III	NAV	Total
Public Equities	$ 480,430	$ 9,311	$ 18,390	$ 2,397,197	$ 2,905,328
Fixed Income [1]	523,787	353,815		11,510	889,112
Cash Equivalents	488,687	169,461	350		658,498
Alternative Assets:					
Private Equity				2,231,296	2,231,296
Real Assets				760,294	760,294
Distress / Credit		200,674	22,634	1,153,355	1,376,663
Absolute Return				830,595	830,595
Derivatives - Assets	183,528	14,395			197,923
	$ 1,676,432	**$ 747,656**	**$ 41,374**	**$ 7,384,247**	**$ 9,849,709**
Derivatives - Liabilities	(189,998)	(9,161)			(199,159)
	$ 1,486,434	**$ 738,495**	**$ 41,374**	**$ 7,384,247**	9,650,550
Accrued Income and Net Payables and Receivables					(664,277)
Total Investments					**$ 8,986,273**

[1] Within the fixed income portion of portfolio, the Foundation holds certain asset-backed securities which are traded on a to be announced (TBA) basis. At December 31, 2016, the fair value of the long and short positions of these TBA securities were $205,818 and ($0), respectively.

(dollars in thousands)

The following two tables summarize the Foundation's Level III reconciliation by the ASC 820 standards as of and for the years ended December 31, 2017 and 2016:

	Beginning Balance at January 1, 2017	Realized Gains (Losses)	Change in Unrealized Gains (Losses)	Purchases and Other Acquisitions	Sales and Other Dispositions	Transfers Into Level III	Transfers (Out) of Level III	Ending Balance at December 31, 2017
Level III Assets								
Public Equities	$ 18,390	$ -	$ 470	$ -	$ -	$ -	$ -	$ 18,860
Cash Equivalents	350		1			1,029	(1,029)	351
Distress / Credit	22,634	3,333	(2,125)		(6,907)			16,935
Total	**$ 41,374**	**$ 3,333**	**$ (1,654)**	**$ -**	**$ (6,907)**	**$ 1,029**	**$ (1,029)**	**$ 36,146**

	Beginning Balance at January 1, 2016	Realized Gains (Losses)	Change in Unrealized Gains (Losses)	Purchases and Other Acquisitions	Sales and Other Dispositions	Transfers Into Level III	Transfers (Out) of Level III	Ending Balance at December 31, 2016
Level III Assets								
Public Equities	$ 42,658	$ (2,661)	$ 4,992	$ 12,488	$ (29,309)	$ 1,621	$ (11,399)	$ 18,390
Cash Equivalents	345		325	491	(735)	1,022	(1,098)	350
Distress / Credit	19,448	6,443	(3,257)					22,634
Total	**$ 62,451**	**$ 3,782**	**$ 2,060**	**$ 12,979**	**$ (30,044)**	**$ 2,643**	**$ (12,497)**	**$ 41,374**

Transfers In (Out) include investments which have been reclassified to Level I and II as the Foundation has the ability to redeem these at NAV in the near term or pricing inputs became observable. This also includes situations where pricing inputs became unobservable for certain Level II investments. All transfer amounts are based on the fair value as of the date of the event or change in circumstances that caused the transfer.

The amount included in the Statement of Activities and Changes in Net Assets for the period which is attributable to the change in unrealized gains (losses) related to assets still held at December 31, 2017 and 2016 was ($4,224) and ($2,972), respectively.

(dollars in millions)

The Foundation uses the NAV as a practical expedient 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.

The following table lists investments in investment funds (in partnership or trust format) by major category as of December 31, 2017:

	Strategy	Fair Value	Remaining Life (Years)	Unfunded Commitments	Redemption Terms
Public Equities	Global funds, primarily long-only in equities	$ 2,886	0 to 3	$ 18	Generally, lock up provisions ranging from 0 to 3 years. After initial lock up expires, daily to annual redemptions are available with 1 to 90 days prior notice.
Fixed Income	Global private fixed income fund	77	0 to 7	124	Not eligible for redemption
Private Equity	Global venture and buyout	2,499	0 to 14	920	Not eligible for redemption
Real Assets	Real estate and natural resources, primarily in the U.S.	855	0 to 14	570	Not eligible for redemption
Distress / Credit	Global distressed asset funds and credit strategies	1,156	0 to 12	157	Funds that are in private equity structure are not eligible for redemption. Generally, lock up provisions ranging from 0 to 2 years. After initial lock up expires, daily to annual redemptions are available with 7 to 180 days prior notice.
Absolute Return	Global equity and fixed income funds in market neutral strategies	928	0 to 2	-	Generally, lock up provisions ranging from 0 to 2 years. After initial lock up expires, monthly to annual redemptions are available with 5 to 90 days prior notice.
Total		$ 8,401		$ 1,789	

(dollars in millions)

The following table lists investments in investment funds (in partnership or trust format) by major category as of December 31, 2016:

	Strategy	Fair Value	Remaining Life (Years)	Unfunded Commitments	Redemption Terms
Public Equities	Global funds, primarily long-only in equities	$ 2,397	0 to 3	$ 18	Generally, lock up provisions ranging from 0 to 3 years. After initial lock up expires, monthly to annual redemptions are available with 10 to 90 days prior notice.
Fixed Income	Global private fixed income fund	12	0 to 8	189	Not eligible for redemption
Private Equity	Global venture and buyout	2,231	0 to 14	928	Not eligible for redemption
Real Assets	Real estate and natural resources, primarily in the U.S.	760	0 to 14	414	Not eligible for redemption
Distress / Credit	Global distressed asset funds and credit strategies	1,153	0 to 12	337	Funds that are in private equity structure are not eligible for redemption. Generally, lock up provisions ranging from 0 to 3 years. After initial lock up expires, daily to annual redemptions are available with 7 to 180 days prior notice.
Absolute Return	Global equity and fixed income funds in market neutral strategies	831	0 to 3	-	Generally, lock up provisions ranging from 0 to 3 years. After initial lock up expires, daily to annual redemptions are available with 7 to 90 days prior notice.
Total		$ 7,384		$ 1,886	

(dollars in thousands)

5. Property and Equipment, Net

Property and equipment consist of the following at December 31, 2017 and 2016:

	2017	2016
Building, land lease and land improvements	$ 34,357	$ 34,357
Furniture and fixtures	6,053	5,970
Computer and office equipment	3,277	3,125
	43,687	43,452
Less accumulated depreciation and amortization	(20,763)	(19,649)
	$ 22,924	$ 23,803

6. Benefit Plans

Retirement Plans

The Foundation sponsors a 403(b) defined contribution plan for its eligible employees. Foundation contributions to the plan totaled $2,271 and $2,171 in 2017 and 2016, respectively.

The Foundation also has an unfunded 457(b) deferred compensation plan. Subject to statutory limits, the Foundation contributes to the plan on behalf of eligible employees that did not receive their full contributions to the defined contribution plan due to Internal Revenue Service limits. In relation to this plan, at December 31, 2017 and 2016 the Foundation held assets of $2,448 and $1,858, respectively, which are included in Prepaid expenses and other assets. These assets are designated by the Foundation to pay future 457(b) plan liabilities. The corresponding liability of $2,448 and $1,858, respectively, are included in accrued liabilities.

Postretirement Health Care Benefits

The Foundation provides health care benefits to retired employees and their eligible dependents. Net periodic benefit costs totaled $652 and $746 in 2017 and 2016, respectively. The liability for postretirement benefit obligations was $7,763 and $7,346 as of December 31, 2017 and 2016, respectively.

	2017	2016
Discount rate to determine benefit obligations	3.56%	4.09%
Discount rate to determine the net periodic benefit cost	4.09%	4.33%

(dollars in thousands)

7. Grants Payable

At December 31, 2017 and 2016, grants payable totaled $204,190 and $225,933, respectively. Grants payable activity consisted of the following:

	2017	2016
Grants payable balance, beginning of year	$ 225,933	$ 226,634
Awards	409,055	417,779
Payments	(429,864)	(416,982)
Cancellations and adjustments	(934)	(1,498)
Grants payable balance, end of year	$ 204,190	$ 225,933

Grants authorized but unpaid at December 31, 2017 are payable as follows:

Year Payable	Amount
2018	$ 166,155
2019	34,053
2020	3,882
2021	100
	$ 204,190

8. Credit Facilities

The Foundation has a collateralized revolving line of credit ("LOC") of $300,000, and a two-year committed revolving LOC of $200,000. At December 31, 2017 and 2016, there were no outstanding principal balances. The interest rate on these lines of credit is variable and is indexed to the one month London Interbank Offered Rate ("LIBOR").

9. Federal Excise and Unrelated Business Income Tax

The 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's provision for current federal excise tax is based on a 1% rate on net investment income in 2017 and 2016. Each year the current federal excise tax is levied on interest and dividend income and net realized gains of the Foundation.

(dollars in thousands)

At December 31, 2017 and 2016, deferred federal excise tax is provided at 2%, the maximum rate which could be paid on unrealized gains on investments.

The Foundation is also subject to current federal and state unrelated business income (UBI) tax, in connection with certain of its limited partnership interests.

	2017	2016
Current federal excise tax expense	$ 3,228	$ 4,435
Deferred federal excise tax expense	13,018	929
Excise tax expense	16,246	5,364
Unrelated business income (UBI) tax expense	18	4,747
Tax expense on investment income	$ 16,264	$ 10,111

The Foundation believes that it has appropriate support for the excise and other 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 change in total net assets.

10. Subsequent Events

The Foundation has evaluated subsequent events for the period from December 31, 2017 through May 31, 2018, the date the financial statements were issued, and believes no additional disclosures are required in the financial statements.