

THE VALLEY FOUNDATION

FINANCIAL STATEMENTS

**For the Years Ended
September 30, 2006 and 2005**

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LAUTZE & LAUTZE
CPAs & FINANCIAL ADVISORS

INDEPENDENT AUDITORS' REPORT

Board of Trustees
The Valley Foundation
Los Gatos, California

We have audited the accompanying statements of financial position of *The Valley Foundation* (the Foundation) as of September 30, 2006 and 2005, and the related statements of activities and changes in net assets and statements of cash flows for the years then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of *The Valley Foundation* as of September 30, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

San Jose, California
November 7, 2006

THE VALLEY FOUNDATION
STATEMENTS OF FINANCIAL POSITION

	September 30,	
	2006	2005
<u>Assets</u>		
Cash and cash equivalents	\$ 1,886,041	\$ 1,100,234
Investments in securities - at fair market value:		
U.S Government, corporate, and municipal obligations (cost \$14,204,197 in 2006 and \$12,526,885 in 2005)	14,649,247	13,081,935
Common stocks (cost \$27,633,197 in 2006 and \$27,644,986 in 2005)	37,626,520	34,551,546
Real estate investment trust and other real asset funds (cost \$5,166,806 in 2006 and \$7,935,310 in 2005)	11,182,669	14,381,526
Investment in limited liability companies - at market value (cost \$5,090,172 in 2006 and \$4,102,190 in 2005)	4,513,191	3,493,168
Income receivable	47,558	44,767
Prepaid federal excise taxes	19,455	-
Other assets	4,515	4,012
	\$ 69,929,196	\$ 66,657,188
<u>Liabilities and Net Assets</u>		
Grants payable (Note 2 and 4)	\$ 3,774,000	\$ -
Federal excise taxes payable	-	28,863
Deferred federal excise tax	165,000	126,000
	3,939,000	154,863
Commitments (Note 4)		
Net assets, unrestricted	65,990,196	66,502,325
	\$ 69,929,196	\$ 66,657,188

THE VALLEY FOUNDATION
STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

	For The Years Ended	
	September 30,	
	<u>2006</u>	<u>2005</u>
Income:		
Unrealized gain on investments	\$ 2,539,329	\$ 3,575,244
Realized gain on sale of investments	3,458,964	5,102,930
Dividends	1,162,358	1,258,055
Interest	724,709	834,269
	<u>7,885,360</u>	<u>10,770,498</u>
Expenditures and expenses:		
Program grants (Note 2)	7,610,011	3,956,844
Investment expenses	383,399	323,785
Administrative expenses	315,656	298,272
Federal excise tax expense on net investment income (Note 3)	88,423	102,170
	<u>8,397,489</u>	<u>4,681,071</u>
Change in net assets	(512,129)	6,089,427
Net assets, unrestricted, beginning of year	<u>66,502,325</u>	<u>60,412,898</u>
Net assets, unrestricted, end of year	<u><u>\$ 65,990,196</u></u>	<u><u>\$ 66,502,325</u></u>

THE VALLEY FOUNDATION
STATEMENTS OF CASH FLOWS

	For The Years Ended	
	September 30,	
	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Changes in net assets	\$ (512,129)	\$ 6,089,427
Adjustments to reconcile changes in net assets to net cash used by operating activities:		
Deferred taxes	39,000	35,000
Depreciation	2,083	1,912
Unrealized gain on investments	(2,539,329)	(3,575,244)
Realized gain on sale of investments	(3,458,964)	(5,102,930)
Increase in assets:		
Income receivable and other assets	(5,377)	(8,995)
Prepaid federal excise taxes refund	(19,455)	-
Increase in liabilities:		
Grants payable	3,774,000	-
Federal excise tax payable	(28,863)	19,804
Net adjustments	<u>(2,236,905)</u>	<u>(8,630,453)</u>
Net cash used by operating activities	<u>(2,749,034)</u>	<u>(2,541,026)</u>
Cash flows from investing activities:		
U.S. government, corporate, and municipal obligations:		
Purchase of investments	(6,458,079)	(3,095,657)
Proceeds from sale or maturity of investments	4,731,495	3,303,706
Common stocks:		
Purchase of investments	(6,060,593)	(27,600,015)
Proceeds from sale or maturity of investments	6,838,900	31,286,355
Real estate investment trust and other real asset funds:		
Purchase of investments	(428,900)	(383,738)
Proceeds from sale or maturity of investments	5,900,000	658,783
Investment in limited liability companies:		
Purchase of investments	(987,982)	(1,406,242)
Net cash provided by investing activities	<u>3,534,841</u>	<u>2,763,192</u>
Net increase in cash and cash equivalents	785,807	222,166
Cash and cash equivalents:		
Beginning of year	<u>1,100,234</u>	<u>878,068</u>
End of year	<u>\$ 1,886,041</u>	<u>\$ 1,100,234</u>
Cash paid during the year for:		
Federal excise tax	<u>\$ 97,799</u>	<u>\$ 47,366</u>

THE VALLEY FOUNDATION
NOTES TO FINANCIAL STATEMENTS
For The Years Ended September 30, 2006 and 2005

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Purpose and Organization

The Valley Foundation (the Foundation), incorporated in 1984, is a California non-profit public benefit corporation, organized and operated exclusively for charitable, educational and scientific purposes. In accordance with the Foundation's Articles of Incorporation, a majority of the Foundation's disbursed funds must be expended for health care and medical services for lower income households in order for the Foundation to remain exempt from income taxes.

Basis of Presentation

The financial statements of the Foundation have been prepared on the accrual basis. The significant accounting policies that follow are described to enhance the usefulness of the financial statements to the reader.

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 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.

Financial Statement Format

The Foundation classifies its net assets and activities into one of three categories: unrestricted, temporarily restricted, and permanently restricted. A description of these categories is as follows:

Unrestricted: Those net assets and activities, which represent the portion of expendable funds, that are available to support the Foundation's operations. A portion of these net assets may be designated by the Board of Trustees for specific purposes.

Temporarily Restricted: Those net assets and activities which are donor-restricted for (a) support of specific operating activities; (b) investment for a specified term; (c) use in a specified future period; or (d) acquisition of long-lived assets.

Permanently Restricted: Those net assets and activities which are permanently donor-restricted for holdings of (a) assets donated with stipulations that they be used for a specified purpose, be preserved, and not be sold; or (b) assets donated with stipulations that they be invested to provide a permanent source of income.

The Foundation does not presently have any assets meeting the definition of Temporarily or Permanently Restricted.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, receivables, and payables approximate fair value because of the short maturity of these instruments.

THE VALLEY FOUNDATION
NOTES TO FINANCIAL STATEMENTS
For The Years Ended September 30, 2006 and 2005

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Cash and Cash Equivalents

Cash consists of funds held in a commercial account, for operating expenses. Cash equivalents consist of a money market mutual fund held for investment purposes.

Investments

Investments in securities and bonds are presented in the financial statements at fair market value. Fair market value is based on the closing sales or bid prices as of the last business day of the Foundation's fiscal year. The Foundation's investment managers invest in debt and equity securities based upon investment criteria approved by the Foundation's trustees. Investment transactions are executed by and investment assets are in custody of a commercial trust and investment company.

Since there is no readily available market for investments in the limited liability companies, such investments are valued at amounts reported to the Foundation by each entity's investment advisor. The investments of these limited liability companies, such as venture capital, buyout firms, real estate, oil and gas, timber and other non-marketable assets both domestic and foreign, include securities of companies that may not be immediately liquid. Accordingly, their values are based upon guidelines established by investment advisors. The September 30 valuations of the investments in limited liability companies are based upon the value determined by each entity's investment advisor as of June 30 and adjusted for cash flows that occurred during the quarter ended September 30. 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.

Revenue Recognition

Interest and dividend income is recognized as revenue when earned. Investment transactions are recorded on trade date. Realized gains and losses on sales of investments are determined on the specific identification basis. The Foundation records all investments at fair value, as described above, with unrealized gains and losses included in the statement of activities.

Income Taxes

The Foundation is a qualified organization exempt from federal and California income taxes under the provisions of Sections 501(c)(3) of the Internal Revenue Code and 23701d of the California Revenue and Taxation Code.

The Foundation has been determined by the Internal Revenue Service to be an exempt private foundation within the meaning of Section 501(c)(3) of the Internal Revenue Code and is subject to a federal excise tax of 1% or 2% on its net investment income (as defined) based upon the level of program grants made. Such federal excise tax provision was at the 1% rate for the years ended September 30, 2006 and 2005.

At September 30, 2006 and 2005, deferred federal excise tax is provided at 1%, which is the effective rate expected to be paid on unrealized gains on investments.

THE VALLEY FOUNDATION
NOTES TO FINANCIAL STATEMENTS
For The Years Ended September 30, 2006 and 2005

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Concentrations of Risk

The Foundation maintains its cash in bank accounts, which at times exceed federally insured limits. The Foundation has not experienced any losses in these accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

2. **PROGRAM GRANTS**

The composition of program grants is as follows:

	2006	2005
Grants payments approved during the year	\$ 3,840,544	\$ 3,956,844
Grants payable in future years (net of present value discount of \$226,000)	3,774,000	-
Return of unused grants	(4,533)	-
Net grants expensed during the year	\$ 7,610,011	\$ 3,956,844

The grant payable is recorded at the present value using a discount rate of 2.34% (the five year treasury real yield rate). The present value discount will be recognized in program grants expense over the period from the date the grant was made to the date of final payment.

3. **FEDERAL EXCISE TAX EXPENSE ON NET INVESTMENT INCOME**

Federal excise tax is consists of the follow:

	2006	2005
Current	\$ 49,423	\$ 67,170
Deferred	39,000	35,000
	\$ 88,423	\$ 102,170

THE VALLEY FOUNDATION
NOTES TO FINANCIAL STATEMENTS
For The Years Ended September 30, 2006 and 2005

4. **COMMITMENTS**

The Foundation leases its facility under an operating lease agreement expiring August 2008, which requires monthly payments ranging from \$3,150 to \$3,250. The following is a schedule of minimum future lease payments:

<u>Year Ending September 30,</u>	<u>Amount</u>
2007	\$ 37,900
2008	<u>35,750</u>
	<u>\$ 73,650</u>

For the years ended September 30, 2006 and 2005, rent expense was \$36,800 and \$35,800, respectively.

The Foundation leases a copier under an operating lease agreement expiring October 2009, which requires monthly payments of \$490. The following is a schedule of minimum future lease payments:

<u>Year Ending September 30,</u>	<u>Amount</u>
2007	\$ 5,880
2008	5,880
2009	<u>490</u>
	<u>\$ 12,250</u>

For the years ended September 30, 2006 and 2005, copier lease expense was \$5,880 and \$490, respectively.

As of September 30, 2006, the Foundation is committed to contributing \$3,647,500 of additional capital in future years to its investments in limited liability companies.

As of September 30, 2006, the Foundation had one grant payable in the amount of \$25,000 on the condition that the grantees raise matching funds from sources other than the Foundation.

The Foundation is committed to contributing \$5,000,000 in total grant funding to one specific charitable organization. As of September 30, 2006, \$1,000,000 of the grant has been paid to the charitable organization. The remaining balance of \$4,000,000 is due to the grantee in future years.

5. **DONOR ADVISED FUNDS**

The Foundation has a donor advised fund at a community foundation. The fund was established from Foundation funds transferred to the community foundation. Investments in the fund at the community foundation totaled \$228,204 and \$78,114 at September 30, 2006 and 2005, respectively. However, as use of the funds is subject to approval by the community foundation, the assets are not reflected in the accompanying statement of financial position.

During the years ended September 30, 2006 and 2005, the Foundation transferred \$200,000 and \$0 to the community foundation and directed grants of \$49,910 and \$200,500, respectively.