

INDEPENDENT AUDITOR'S REPORT

Board of Directors
The Wallace Alexander Gerbode Foundation

I have audited the accompanying statements of financial position of The Wallace Alexander Gerbode Foundation (the Foundation) as of December 31, 2003 and 2002, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Foundation's management. My responsibility is to express an opinion on these financial statements based on my audits.

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

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of December 31, 2003 and 2002, 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.

Nini Charles McCone

April 30, 2004

THE WALLACE ALEXANDER GERBODE FOUNDATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2003 and 2002

THE WALLACE ALEXANDER GERBODE FOUNDATION

STATEMENTS OF FINANCIAL POSITION

	<u>December 31,</u>	
	<u>2003</u>	<u>2002</u>
ASSETS		
Cash and cash equivalents	\$ 558,249	\$ 358,304
Grant receivable		150,000
Accrued interest and dividends	41,867	43,515
Federal excise tax refund receivable	7,999	11,804
Deferred federal excise tax asset		41,305
Investments	67,118,941	57,892,228
Program-related investments, net	879,746	656,991
Equipment and improvements, net	<u>18,662</u>	<u>24,963</u>
TOTAL ASSETS	<u>\$ 68,625,464</u>	<u>\$ 59,179,110</u>
LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable	\$ 48,747	\$ 53,136
Deferred compensation	99,354	99,354
Unconditional promises to give	1,219,166	2,568,981
Deferred federal excise tax liability	<u>56,438</u>	
TOTAL LIABILITIES	1,423,705	2,721,471
NET ASSETS, UNRESTRICTED	<u>67,201,759</u>	<u>56,457,639</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 68,625,464</u>	<u>\$ 59,179,110</u>

See notes to financial statements

THE WALLACE ALEXANDER GERBODE FOUNDATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2003 and 2002

THE WALLACE ALEXANDER GERBODE FOUNDATION

STATEMENTS OF ACTIVITIES

	<u>Year ended December 31,</u>	
	<u>2003</u>	<u>2002</u>
SUPPORT AND REVENUE		
Contribution	\$ 190,661	\$ 300,000
Return on investments	13,220,219	(7,471,266)
Return on program-related investments	241,110	(19,273)
Interest income	<u>1,700</u>	<u>5,554</u>
TOTAL SUPPORT AND REVENUE	13,653,690	(7,184,985)
EXPENSES		
Program services:		
Program grants awarded	1,771,438	5,360,582
Program grants management	346,961	317,232
Direct charitable activities	130,440	132,757
Program-related investment management	<u>12,416</u>	<u>11,123</u>
Total program services	2,261,255	5,821,694
Management and general expenses:		
General administration	115,682	82,548
Investment expenses	407,085	415,817
Federal excise tax (benefit)	<u>125,548</u>	<u>(63,448)</u>
Total management and general expenses	<u>648,315</u>	<u>434,917</u>
TOTAL EXPENSES	<u>2,909,570</u>	<u>6,256,611</u>
CHANGE IN UNRESTRICTED NET ASSETS	10,744,120	(13,441,596)
UNRESTRICTED NET ASSETS		
Beginning of year	<u>56,457,639</u>	<u>69,899,235</u>
End of year	<u>\$ 67,201,759</u>	<u>\$ 56,457,639</u>

See notes to financial statements

THE WALLACE ALEXANDER GERBODE FOUNDATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2003 and 2002

THE WALLACE ALEXANDER GERBODE FOUNDATION

STATEMENTS OF CASH FLOWS

	<u>Year ended December 31,</u>	
	<u>2003</u>	<u>2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 10,744,120	\$ (13,441,596)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	10,367	12,810
Loss on disposition of equipment	748	
Net realized and unrealized (gains) losses on investments	(11,946,956)	9,199,854
Unrealized gain on program-related equity investment	(242,441)	
Losses on program-related partnership investments	9,331	27,273
Contribution of stock options	(190,661)	
Decrease (increase) in assets:		
Accrued interest and dividends	1,648	(9,658)
Grant receivable	150,000	(150,000)
Federal excise tax refund receivable	3,805	8,238
Deferred federal excise tax asset	41,305	(41,305)
Increase (decrease) in liabilities:		
Accounts payable	(4,389)	21,127
Unconditional promises to give	(1,349,815)	1,381,481
Deferred federal excise tax liability	56,438	(35,381)
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>(2,716,500)</u>	<u>(3,027,157)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of equipment and improvements	(4,814)	(5,089)
Disposition of program-related investments	10,355	
Purchases of investments	(30,203,092)	(1,784,110)
Proceeds from sale of investments	<u>33,113,996</u>	<u>4,851,164</u>
NET CASH FLOWS FROM INVESTING ACTIVITIES	<u>2,916,445</u>	<u>3,061,965</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	199,945	34,808
CASH AND CASH EQUIVALENTS		
Beginning of year	<u>358,304</u>	<u>323,496</u>
End of year	<u>\$ 558,249</u>	<u>\$ 358,304</u>

See notes to financial statements

THE WALLACE ALEXANDER GERBODE FOUNDATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2003 and 2002

NOTE A - GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Wallace Alexander Gerbode Foundation (the Foundation) is interested in programs and projects offering potential for significant impact. The primary focus is on the San Francisco Bay Area (counties of Alameda, Contra Costa, Marin, San Francisco and San Mateo) and Hawaii. The Foundation's interests generally fall under the following categories: arts and culture, environment, population, reproductive rights, citizen participation/building communities/inclusiveness, strength of the philanthropic process and the nonprofit sector, and Foundation-initiated special projects.

Basis of Presentation

The Foundation reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. All net assets of the Foundation are unrestricted.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents includes all highly liquid investments with an initial maturity of three months or less, except for investment portfolio cash management funds, which are included in investments.

Equipment and Improvements

Equipment and improvements are stated at historical cost. The Foundation capitalizes all acquisitions of office equipment in excess of \$500. Depreciation of office equipment is recorded on a straight-line basis over estimated useful lives. Amortization of leasehold improvements is provided over the life of the lease.

Program Grants

Unconditional grants to be paid by the Foundation are accrued and recognized as expense at the time the grants are approved by the Board of Trustees. Conditional grants are recognized when the conditions on which they depend are substantially met.

THE WALLACE ALEXANDER GERBODE FOUNDATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2003 and 2002

NOTE A - GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statement of financial position. Unrealized gains and losses are included in the change in net assets.

Functional Classification of Expenses

Supporting service expenses have been allocated between general administration expenses, investment expenses, program management expenses and direct charitable activities based on specific identification and, secondarily, in proportion to the percentage of time spent by the Foundation's employees on each function.

Contributions

Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire (that is, when a stipulated time restriction ends or purpose restriction is accomplished) in the reporting period in which the revenue is recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Federal Excise Taxes

The Foundation is a private foundation and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and from California franchise and/or income taxes under Section 23701(d) of the California Revenue and Taxation Code.

THE WALLACE ALEXANDER GERBODE FOUNDATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2003 and 2002

NOTE B - INVESTMENTS

Investments are stated at fair value and are summarized as follows:

	December 31, 2003		
	<u>Cost</u>	<u>Market</u>	<u>Unrealized Appreciation (Depreciation)</u>
Cash management funds	\$ 1,792,335	\$ 1,792,335	\$ -
Equity securities	45,290,666	50,320,261	5,029,595
Debt securities	<u>14,392,165</u>	<u>15,006,345</u>	<u>614,180</u>
	<u>\$ 61,475,166</u>	<u>\$ 67,118,941</u>	<u>\$ 5,643,775</u>
	December 31, 2002		
	<u>Cost</u>	<u>Market</u>	<u>Unrealized Appreciation (Depreciation)</u>
Cash management funds	\$ 1,709,555	\$ 1,709,555	\$ -
Equity securities	43,465,371	38,475,603	(4,989,768)
Debt securities	<u>16,847,818</u>	<u>17,707,070</u>	<u>859,252</u>
	<u>\$ 62,022,744</u>	<u>\$ 57,892,228</u>	<u>\$ (4,130,516)</u>

The following schedule summarizes investment return for the year ended December 31:

	<u>2003</u>	<u>2002</u>
Interest and dividends	\$ 1,273,263	\$ 1,788,441
Net realized and unrealized gains (losses)	11,946,956	(9,199,854)
Other investment income (loss)		<u>(59,853)</u>
Total investment return	<u>\$ 13,220,219</u>	<u>\$ (7,471,266)</u>

THE WALLACE ALEXANDER GERBODE FOUNDATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2003 and 2002

NOTE C - PROGRAM-RELATED INVESTMENTS

The Foundation's program-related investments are as follows at December 31:

	<u>2003</u>	<u>2002</u>
Notes receivable	\$ 400,000	\$ 400,000
Partnership interests	237,305	256,991
Equity investment	<u>250,000</u>	<u>250,000</u>
	887,305	906,991
Less allowance for unrealized loss	<u>(7,559)</u>	<u>(250,000)</u>
	<u>\$ 879,746</u>	<u>\$ 656,991</u>

Notes receivable consists of unsecured loans at an interest rate of 2%, which mature in 2005 and are deemed fully collectible. The Foundation has the option to convert a program-related investment into a grant should collectibility become uncertain. Limited partnership interests are accounted for by the equity method. The return on program-related investments is as follows:

	<u>2003</u>	<u>2002</u>
Interest on notes receivable	\$ 8,000	\$ 8,000
Partnership gains (losses)	(9,331)	(27,273)
Unrealized gain on equity investment	<u>242,441</u>	<u> </u>
	<u>\$ 241,110</u>	<u>\$ (19,273)</u>

The unrealized gain on the equity investment reflects the consideration given to security holders in an anticipated merger, which took place in February 2004.

NOTE D - EQUIPMENT AND IMPROVEMENTS

Equipment and improvements are as follows at December 31:

	<u>2003</u>	<u>2002</u>
Office equipment	\$ 74,392	\$ 76,417
Leasehold improvements	<u> </u>	<u>8,670</u>
	74,392	85,087
Less accumulated depreciation	(55,730)	(52,004)
Less accumulated amortization	<u> </u>	<u>(8,120)</u>
	<u>\$ 18,662</u>	<u>\$ 24,963</u>

THE WALLACE ALEXANDER GERBODE FOUNDATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2003 and 2002

NOTE E - PROMISES TO GIVE

Unconditional promises to give are payable in:

	<u>2003</u>	<u>2002</u>
Less than one year	\$ 1,219,166	\$ 1,777,315
One to five years		<u>791,666</u>
	<u>\$ 1,219,166</u>	<u>\$ 2,568,981</u>

Conditional promises to give at December 31 consist of grants that are conditional upon the Foundation's approval of progress to date:

2003	\$ 690,000
2002	\$ 855,000

NOTE F - CONTRIBUTION

During 2002 another private foundation made a contribution of \$300,000 to the Foundation. In accordance with requirements imposed by IRC Section 4942(g)(3), the Foundation redistributed the full amount of the contribution by making grants out of corpus (rather than income) within the prescribed time period, so that the contribution could be treated as a qualifying distribution to the donor foundation under the pass-through exception rules.

NOTE G - PROGRAM GRANTS

The Foundation awarded grants in the following program areas during the year ended December 31:

	<u>2003</u>	<u>2002</u>
Community affairs	\$ 761,000	\$ 1,363,111
Arts and culture	440,050	1,033,100
Environment	495,000	840,000
Philanthropic process	<u>77,916</u>	<u>2,131,430</u>
	1,773,966	5,367,641
Less recoveries of prior year grants	<u>(2,528)</u>	<u>(7,059)</u>
	<u>\$ 1,771,438</u>	<u>\$ 5,360,582</u>

THE WALLACE ALEXANDER GERBODE FOUNDATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2003 and 2002

NOTE H - FEDERAL EXCISE TAXES AND DISTRIBUTION REQUIREMENTS

In accordance with the applicable provisions of the Internal Revenue Code, the Foundation is a private foundation and qualifies as a tax-exempt organization. Private foundations are liable for an excise tax of 2% (1% if minimum payout requirements prescribed by the Internal Revenue Code are met) on net investment income, excluding unrealized gains, as defined. The Foundation qualified for the 1% rate during the years ended December 31, 2003 and 2002. Deferred excise taxes arise primarily from unrealized tax basis gains on investments and are calculated at the effective rate expected to be paid by the Foundation.

The provision for (benefit from) current and deferred federal excise taxes was as follows for the years ended December 31:

	<u>2003</u>	<u>2002</u>
Current	\$ 27,805	\$ 13,238
Deferred	<u>97,743</u>	<u>(76,686)</u>
Total	\$ <u>125,548</u>	\$ <u>(63,448)</u>
 Federal excise taxes paid	 \$ <u>24,000</u>	 \$ <u>5,000</u>

The Foundation is subject to distribution requirements of the Internal Revenue Code. Accordingly, it must distribute within one year after the end of each fiscal year, 5 percent of the fair value of its investment assets, as defined. The investments includable for the 5 percent distribution requirement are based on average monthly balances and are exclusive of those investments deemed to be held for charitable activities or other program-related investments. In determining qualifying distributions, grant payments are considered on a cash basis and certain expenses are considered as qualifying distributions. The Foundation has complied with distribution requirements through December 31, 2003.

NOTE I - PENSION PLAN

The Foundation has a defined contribution employee pension plan that covers employees who meet specific service requirements. The assets of this plan are not reflected in the accompanying financial statements. The pension plan is administered by the Foundation. Total expenses incurred by the Foundation under this pension plan were \$51,613 and \$43,797 in 2003 and 2002, respectively. The total vested benefits equaled the plan assets as of December 31, 2003 and 2002.

NOTE J - CONCENTRATION OF CREDIT RISK

The Foundation has money market funds at financial institutions that are not insured by the Federal Deposit Insurance Corporation or the Securities Investor Protection Corporation. As of December 31, 2003 and 2002, the Foundation's money market funds were \$2,350,500 and \$2,067,727, respectively.

THE WALLACE ALEXANDER GERBODE FOUNDATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2003 and 2002

NOTE K - LEASE COMMITMENTS

The Foundation leases office space under a non-cancellable operating lease that expires in 2013. Rent expense includes the base rent and a pro rata share of building and office operating expenses. Rent expense under the lease for the year ended December 31, 2003 was \$5,320. Minimum future rental payments under the lease are as follows:

Year ended December 31:

2004	\$ 63,840
2005	66,880
2006	69,920
2007	72,960
2008	<u>76,000</u>
	349,600
Thereafter	<u>425,600</u>
	\$ <u>775,200</u>