

Pacific Forest  
and Watershed  
Lands  
**Stewardship  
Council**

**AUDIT REPORT**  
**FOR THE YEARS ENDED**  
**DECEMBER 31, 2006 AND 2005**

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LAUTZE & LAUTZE  
CPAs & FINANCIAL ADVISORS

## INDEPENDENT AUDITORS' REPORT

The Board of Directors  
Pacific Forest and Watershed Lands Stewardship Council

We have audited the accompanying statements of financial position of the *Pacific Forest and Watershed Lands Stewardship Council* as of December 31, 2006 and 2005, and the related statements of activities, functional expenses, and cash flows for the years then ended. These financial statements are the responsibility of the *Pacific Forest and Watershed Lands Stewardship Council'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 *Pacific Forest and Watershed Lands Stewardship Council* as of December 31, 2006 and 2005, and the changes in 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 Francisco, California  
March 15, 2007

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**STATEMENTS OF FINANCIAL POSITION**

	December 31,	
	2006	2005
<b>ASSETS</b>		
Assets:		
Cash and cash equivalents	\$ 413,605	\$ 852,032
Grants receivable (Note 2)	61,193,210	68,468,129
Prepaid expenses	75,118	63,145
Accrued interest	47,595	74,703
Investments (Note 3)	23,181,825	16,545,946
Property and equipment, net (Note 4)	93,119	116,467
Total assets	\$ 85,004,472	\$ 86,120,422
<b>LIABILITIES AND NET ASSETS</b>		
Liabilities:		
Accounts payable and accrued expenses	\$ 334,941	\$ 245,169
Grants payable (Note 8)	550,000	-
Total liabilities	884,941	245,169
Commitments (Note 8)		
Temporarily restricted net assets (Note 5)	84,119,531	85,875,253
Total liabilities and net assets	\$ 85,004,472	\$ 86,120,422

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**STATEMENT OF ACTIVITIES**  
**For the Year Ended December 31, 2006**

	Unrestricted	Temporarily Restricted	Total
Support and revenue:			
Grants	\$ -	\$ 2,725,081	\$ 2,725,081
Investment income (Note 3)	-	1,299,193	1,299,193
	-	4,024,274	4,024,274
Net assets released from restrictions (Note 5)	5,779,996	(5,779,996)	-
Total support and revenue	5,779,996	(1,755,722)	4,024,274
Expenses:			
Salaries, wages and benefits	835,004	-	835,004
Rent	45,138	-	45,138
Office supplies and expenses	64,373	-	64,373
Newsletters and public notices	46,932	-	46,932
Consultants and professional services	2,047,634	-	2,047,634
Grant awards	2,110,000	-	2,110,000
Accounting	48,275	-	48,275
Legal	345,084	-	345,084
Conferences, meetings and training	39,363	-	39,363
Travel and entertainment	40,294	-	40,294
Insurance	73,783	-	73,783
Depreciation and amortization	30,768	-	30,768
Investment fees	49,457	-	49,457
Excise taxes	3,891	-	3,891
Total expenses	5,779,996	-	5,779,996
Change in net assets	-	(1,755,722)	(1,755,722)
Net assets:			
Beginning of year	-	85,875,253	85,875,253
End of year	\$ -	\$ 84,119,531	\$ 84,119,531

See notes to financial statements.

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**STATEMENT OF ACTIVITIES**  
**For the Year Ended December 31, 2005**

	Unrestricted	Temporarily Restricted	Total
Support and revenue:			
Grants	\$ -	\$ 3,044,630	\$ 3,044,630
Investment income (Note 3)	-	598,022	598,022
	-	3,642,652	3,642,652
Net assets released from restrictions (Note 5)	2,779,659	(2,779,659)	-
Total support and revenue	2,779,659	862,993	3,642,652
Expenses:			
Salaries, wages and benefits	504,707	-	504,707
Rent	33,660	-	33,660
Office supplies and expenses	47,753	-	47,753
Newsletters and public notices	19,684	-	19,684
Consultants and professional services	1,541,217	-	1,541,217
Accounting	118,821	-	118,821
Legal	222,359	-	222,359
Conferences, meetings and training	21,467	-	21,467
Travel and entertainment	31,179	-	31,179
Insurance	164,082	-	164,082
Depreciation and amortization	22,199	-	22,199
Investment fees	36,022	-	36,022
Excise taxes	16,509	-	16,509
	2,779,659	-	2,779,659
Total expenses	2,779,659	-	2,779,659
Change in net assets	-	862,993	862,993
Net assets:			
Beginning of year	-	85,012,260	85,012,260
End of year	\$ -	\$ 85,875,253	\$ 85,875,253

See notes to financial statements.

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**STATEMENTS OF CASH FLOWS**

	For the Years Ended December 31,	
	2006	2005
Cash flows from operating activities:		
Change in net assets	\$ (1,755,722)	\$ 862,993
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	30,768	22,199
Realized and unrealized gains on investments	(87,619)	(14,153)
Present value discount on grants receivable	(2,725,081)	(3,044,631)
Decrease (increase) in assets:		
Grants receivable	10,000,000	10,000,000
Prepaid expenses	(11,973)	76,268
Accrued interest	27,108	(74,042)
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	89,772	(55,538)
Grants payable	550,000	-
Net adjustments	7,872,975	6,910,103
Net cash provided by operating activities	6,117,253	7,773,096
Cash flows from investing activities:		
Purchase of property and equipment	(7,420)	(138,666)
Proceeds from sale of investments	117,360,423	90,920,001
Purchase of investments	(123,908,683)	(97,761,794)
Net cash used by investing activities	(6,555,680)	(6,980,459)
Net increase (decrease) in cash	(438,427)	792,637
Cash and cash equivalents:		
Beginning of year	852,032	59,395
End of year	\$ 413,605	\$ 852,032

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**STATEMENT OF FUNCTIONAL EXPENSES**  
**For the Year Ended December 31, 2006**

	<u>Land Conservation</u>	<u>Youth Investment</u>	<u>Total</u>
Expenses:			
Salaries, wages and benefits	\$ 525,627	\$ 309,377	\$ 835,004
Rent	31,597	13,541	45,138
Office supplies and expenses	45,321	19,052	64,373
Newsletters and public notices	32,852	14,080	46,932
Consultants and professional services	1,774,254	273,380	2,047,634
Grant awards	-	2,110,000	2,110,000
Accounting	33,793	14,482	48,275
Legal	309,527	35,557	345,084
Conferences, meetings and training	25,183	14,180	39,363
Travel and entertainment	27,027	13,267	40,294
Insurance	51,648	22,135	73,783
Depreciation and amortization	21,538	9,230	30,768
Investment fees	34,623	14,834	49,457
Excise taxes	2,723	1,168	3,891
	<u>2,915,713</u>	<u>2,864,283</u>	<u>5,779,996</u>
Total expenses	<u>\$ 2,915,713</u>	<u>\$ 2,864,283</u>	<u>\$ 5,779,996</u>

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**STATEMENT OF FUNCTIONAL EXPENSES**  
**For the Year Ended December 31, 2005**

	<u>Land Conservation</u>	<u>Youth Investment</u>	<u>Total</u>
Expenses:			
Salaries, wages and benefits	\$ 287,192	\$ 217,515	\$ 504,707
Rent	23,378	10,282	33,660
Office supplies and expenses	33,373	14,380	47,753
Newsletters and public notices	13,779	5,905	19,684
Consultants and professional services	1,359,467	181,750	1,541,217
Accounting	83,174	35,647	118,821
Legal	155,651	66,708	222,359
Conferences, meetings and training	14,517	6,950	21,467
Travel and entertainment	21,051	10,128	31,179
Insurance	114,857	49,225	164,082
Depreciation and amortization	15,540	6,659	22,199
Investment fees	25,216	10,806	36,022
Excise taxes	11,556	4,953	16,509
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Total expenses	<u>\$ 2,158,751</u>	<u>\$ 620,908</u>	<u>\$ 2,779,659</u>

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**NOTES TO FINANCIAL STATEMENTS**  
**For the Years Ended December 31, 2006 and 2005**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Purpose and Organization**

The Pacific Forest and Watershed Lands Stewardship Council (the Stewardship Council) is a private foundation that was established in 2004. Its mission is to protect and enhance watershed lands and uses, and invest in efforts to improve the lives of young Californians through connections with the outdoors. The Stewardship Council brings together the expertise of leading conservation, natural resource management, business, and public officials to undertake a historic conservation effort for California. A unique and collaborative endeavor, the Stewardship Council's Board of Directors unites a broad range of interests to guide the development and execution of a Land Conservation Program and a Youth Investment Program to benefit current and future generations of Californians.

Through its Youth Investment Program, the Stewardship Council will distribute between \$2.0 and \$2.5 million in youth grants in 2007 and will work with park and youth program providers to bring new opportunities to underserved youth. This funding is part of a ten-year \$30 million commitment that will support efforts to invest in parks and youth programs in both urban and rural areas of Northern and Central California.

The Stewardship Council is also tasked with ensuring the permanent protection of over 140,000 acres of land for the benefit of the citizens of California. To accomplish this objective, the Stewardship Council is developing a Land Conservation Plan that will recommend how the beneficial public uses of this land can best be conserved. The work will include developing an understanding of the unique characteristics of each area, existing and potential uses, and the range of interests within each community that should be considered.

The Stewardship Council's mission statement is as follows:

The Stewardship Council protects and enhances watershed lands and uses, and invests in efforts to improve the lives of young Californians through connections with the outdoors.

**Basis of Presentation**

The financial statements of the Stewardship Council 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.

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**NOTES TO FINANCIAL STATEMENTS**  
**For the Years Ended December 31, 2006 and 2005**

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

**Financial Statement Format**

The Stewardship Council 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 Stewardship Council's operations. A portion of these net assets may be designated by the Board of Directors 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 Stewardship Council does not presently have any assets meeting the definition of Unrestricted and Permanently Restricted.

**Fair Value of Financial Instruments**

The carrying amounts of cash and cash equivalents, and accounts payable approximate fair value because of the short maturity of these instruments. The carrying amounts of long-term receivables approximate fair value as these receivables are discounted using a comparable risk-free rate based on the prevailing rates.

**Cash and Cash Equivalents**

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

**Investments**

The Stewardship Council reports investments in marketable securities with readily determinable fair values and all investments in debt securities at their fair values in the statement of financial position. The fair values of marketable securities are determined based on market quotations. Debt securities are carried at estimated fair value as provided by the investment managers. Realized gains and losses on the sale of securities are determined on the specific-identification method. Income earned, and realized and unrealized gains and losses on investment transactions are included as temporarily restricted income in the year earned. The Stewardship Council satisfies the distribution requirements set for private foundations through grants to other non-profit organizations and operations of the Land Conservation and Youth Investment programs.

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**NOTES TO FINANCIAL STATEMENTS**  
**For the Years Ended December 31, 2006 and 2005**

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

**Revenue Recognition**

Support and revenue consist mainly of grants from Pacific Gas and Electric Company. Grants receivable are recorded as temporarily restricted support when the grant is made; such receivables are subject to an allowance for uncollectible amounts. Grants receivable, which are due beyond one accounting cycle, are recorded at the present value of the grant. The interest portion earned in future periods is recorded as grant income in the periods earned.

The satisfaction of a donor-imposed restriction on a grant is recognized when the corresponding expenditures are incurred or when the time restriction expires. This occurs by increasing one class of net assets and decreasing another in the statement of activities. Such transactions are recorded as *net assets released from restrictions* and are reported separately from other transactions.

**Income Taxes**

The Stewardship Council 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. The Stewardship Council satisfies this distribution requirement through grants to other non-profit organizations and operations of the Land Conservation and Youth Investment programs.

The Stewardship Council paid excise tax of \$2,720 and \$16,509 during the years ended December 31, 2006 and 2005, respectively.

**Property and Equipment**

The Stewardship Council capitalizes acquisitions of property and equipment with a cost or value in excess of \$1,000. Purchased assets are recorded at cost; donated assets are recorded at estimated fair value or appraised value at the date of acquisition. Depreciation is calculated using the straight-line method of accounting over estimated useful lives ranging from 3 to 10 years.

**Concentrations of Risk**

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

The grants receivable are due from Pacific Gas and Electric Company.

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**NOTES TO FINANCIAL STATEMENTS**  
**For the Years Ended December 31, 2006 and 2005**

**2. GRANTS RECEIVABLE**

Grants receivable are comprised of the following at December 31:

	2006	2005
Grants receivable from Pacific Gas and Electric Company	\$ 70,000,000	\$ 80,000,000
Less unamortized discount	(8,806,790)	(11,531,871)
	61,193,210	68,468,129
Less current maturities	(7,609,117)	(7,274,919)
	\$ 53,584,093	\$ 61,193,210

As of December 31, 2006, grants receivable, before the unamortized discount, are expected to be received as follows:

Less than one year	\$ 10,000,000
One to five years	50,000,000
Thereafter	10,000,000
Gross grants receivable	\$ 70,000,000

Grants receivable due after one year are stated at their present values. The Stewardship Council has discounted receivables at a comparable risk-free rate of 4.5%. Amortization of the present value discount will be recognized as grant income over the period from the date the grants were made to the date of collection. The Stewardship Council has not recorded any allowance for uncollectible grants receivable.

**3. INVESTMENTS**

An investment manager has been retained to manage the investment portfolio based on guidelines established by the Stewardship Council's Board of Directors. Investments, stated at fair value, are comprised of the following:

	2006		2005	
	Cost	Fair Value	Cost	Fair Value
Commercial paper	\$ 8,069,611	\$ 8,169,041	\$ 6,998,524	\$ 7,039,098
Corporate obligations	3,002,639	2,998,966	4,183,277	4,156,848
Municipal bonds	-	-	2,799,995	2,800,000
Asset backed securities	8,257,610	8,264,134	-	-
Other investments	3,749,700	3,749,684	2,550,000	2,550,000
	\$ 23,079,560	\$ 23,181,825	\$ 16,531,796	\$ 16,545,946

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**NOTES TO FINANCIAL STATEMENTS**  
**For the Years Ended December 31, 2006 and 2005**

**3. INVESTMENTS (CONTINUED)**

Investment income for the years ended December 31 consists of the following:

	2006	2005
Interest income	\$ 1,211,574	\$ 583,869
Realized and unrealized gains on investments	87,619	14,153
	\$ 1,299,193	\$ 598,022

**4. PROPERTY AND EQUIPMENT, NET**

Property and equipment consists of the following at December 31, 2006:

	2006	2005
Office equipment	\$ 71,331	\$ 68,546
Furniture and fixtures	42,644	38,009
Leasehold improvements	32,111	32,111
	146,086	138,666
Less accumulated depreciation	(52,967)	(22,199)
	\$ 93,119	\$ 116,467

For the years ended December 31, 2006 and 2005, depreciation and amortization expense was \$30,768 and \$22,199, respectively.

**5. TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets at December 31 are comprised of the following:

	2006	2005
Grants restricted for project support:		
Land Conservation Program	\$ 59,793,248	\$ 59,891,970
Youth Investment Program	24,326,283	25,983,283
	\$ 84,119,531	\$ 85,875,253

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**NOTES TO FINANCIAL STATEMENTS**  
**For the Years Ended December 31, 2006 and 2005**

**5. TEMPORARILY RESTRICTED NET ASSETS (CONTINUED)**

Net assets were released from donor restrictions by incurring expenses satisfying the purpose or expiration of time restrictions specified by donors as follows:

	2006	2005
Land Conservation Program	\$ 2,915,713	\$ 2,158,751
Youth Investment Program	2,864,283	620,908
	\$ 5,779,996	\$ 2,779,659

**6. RETIREMENT PLAN**

The Stewardship Council has contracted with a Professional Employer Organization (PEO) to outsource its HR administration and compliance, which includes a 401(k) Plan (the Plan). The Plan covers all employees with 1,000 hours of service and who have reached the age of twenty-one. Under the safe harbor provision, the Stewardship Council will match 100% of the employee's contributions up to 3% of compensation per pay period and an additional 50% of the amount of contributions that exceed 3% for such payroll period but that do not exceed 5% of the employee's payroll for the period. The Stewardship Council's contributions were \$19,221 in 2006 and \$2,225 in 2005.

**7. RELATED PARTY TRANSACTIONS**

During the years ended December 31, 2006 and 2005, the Stewardship Council paid expenses of approximately \$8,300 and \$167,000 respectively, to a company in which the Executive Director held an equity interest until October 2005.

**8. COMMITMENTS**

The Stewardship Council leases its office facilities under an operating lease agreement, which expires in March 2008. Under the terms of the lease agreement, the Stewardship Council is to pay a monthly base rental of \$3,672. Lease payments are charged to expense over the lease term as they become payable.

The Stewardship Council's future minimum lease commitments on the office space for the years ending December 31 are as follows:

2007	\$ 44,064	
2008	11,016	
	\$ 55,080	

Rent expense amounted to \$45,138 in 2006 and \$33,660 in 2005.

**PACIFIC FOREST AND WATERSHED LANDS STEWARDSHIP COUNCIL**  
**NOTES TO FINANCIAL STATEMENTS**  
**For the Years Ended December 31, 2006 and 2005**

**8. COMMITMENTS (CONTINUED)**

The Stewardship Council has committed to distribute between \$2,000,000 and \$2,500,000 in Youth Grants during 2007 via a competitive application process. During 2006, the Stewardship Council announced the recipients of its inaugural year of grants, totaling \$2,110,000. Of this amount, the Stewardship Council paid \$1,560,000 during 2006, and will pay the remaining \$550,000 in 2007.