

NICHOLAS ENDOWMENT

DECEMBER 31, 2007

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INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

# Nicholas Endowment

## Independent Auditors' Report and Financial Statements

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## Independent Auditors' Report

THE BOARD OF TRUSTEES  
NICHOLAS ENDOWMENT  
Aliso Viejo, California

We have audited the accompanying statement of financial position of **NICHOLAS ENDOWMENT (the Endowment)** as of December 31, 2007, the related statements of activities and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Endowment's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Endowment for the year ended December 31, 2006, were audited by other auditors whose report, dated July 26, 2007, expressed an unqualified opinion on those statements.

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 Nicholas Endowment as of December 31, 2007 and the changes in its net assets and its cash flows for the year ended in conformity with accounting principles generally accepted in the United States of America.

As of September 26, 2008, the amount of remaining and unredeemed Merrill Lynch Structured Notes (identified in Note 5) is approximately 50% of the amount that was outstanding at December 31, 2007. Also, as of September 26, 2008, Bank of America has publically announced its intention to acquire Merrill Lynch. The culmination, non-culmination, of that acquisition may have an impact on the ultimate amount to be realized on the remaining and unredeemed portion of the Merrill Lynch structured notes as of September 26, 2008.

*Hood & Strong LLP*

September 26, 2008

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# Nicholas Endowment

## Statement of Financial Position

<i>December 31,</i>	2007	2006
<b>Assets</b>		
Cash and cash equivalents	\$ 121,590	\$ 34,590
Receivable for securities with settlements pending	140,267	1,533,597
Accrued dividends receivable	7,265	33,087
Property and equipment, net	3,943	5,522
Investments, at fair value	37,311,291	32,566,864
<b>Total assets</b>	<b>\$ 37,584,356</b>	<b>\$ 34,173,660</b>
<b>Liabilities and Net Assets</b>		
<b>Liabilities:</b>		
Accounts payable	\$ 21,012	\$ 28,280
Payables for securities with settlements pending	87,571	59,789
Grants payable	175,000	
<b>Total liabilities</b>	<b>283,583</b>	<b>88,069</b>
<b>Unrestricted Net Assets</b>	<b>37,300,773</b>	<b>34,085,591</b>
<b>Total liabilities and net assets</b>	<b>\$ 37,584,356</b>	<b>\$ 34,173,660</b>

# Nicholas Endowment

## Statement of Activities and Changes in Net Assets

<i>Years Ended December 31,</i>	2007	2006
<b>Revenue:</b>		
Interest and dividend income	\$ 615,449	\$ 482,425
Operating income from alternative investments	318,020	393,075
Net realized gains on sale of investments	2,862,171	1,615,118
Realized gains on sale of investments	495,667	1,784,063
Commission recapture	1,455	12,779
Less: investment management and custodian fees	(207,638)	(210,824)
	4,085,124	4,076,636
Contributions received	26,992	23,834
Total revenue	4,112,116	4,100,470
<b>Expenses:</b>		
Grants	782,343	556,000
Program expenses	23,500	25,910
General and administrative	91,091	88,439
Total expenses	896,934	670,349
<b>Change in Net Assets</b>	3,215,182	3,430,121
<b>Net Assets - Beginning of year</b>	34,085,591	30,655,470
<b>Net Assets - End of year</b>	\$ 37,300,773	\$ 34,085,591

# Nicholas Endowment

## Statement of Cash Flows

<i>Year Ended December 31,</i>	2007	2006
<b>Cash Flows from Operating Activities:</b>		
Change in net assets	\$ 3,215,182	\$ 3,430,121
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Depreciation	1,579	2,207
Realized gains on sale of investments	(2,862,171)	(1,317,494)
Unrealized gains on investments	(495,667)	(1,784,063)
Changes in receivables, prepaid expenses and liabilities - net	1,614,666	(1,489,841)
Net cash provided (used) by operating activities	1,473,589	(1,159,070)
<b>Cash Flows from Investing Activities:</b>		
Transfers from investment to checking		1,119,000
Purchase of investments	(24,098,369)	
Proceeds from sale of investments	22,711,780	
Net cash (used) provided by investing activities	(1,386,589)	1,119,000
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	87,000	(40,070)
<b>Cash and Cash Equivalents - Beginning of year</b>	34,590	74,660
<b>Cash and Cash Equivalents - End of year</b>	\$ 121,590	\$ 34,590

# Nicholas Endowment

## Notes to Financial Statements

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### Note 1 - Nature of Organization:

The Nicholas Endowment (the “Endowment”) was established in 2002 to provide a perpetual base of funding to support organizations and charities. The Endowment awards grants in the areas of science and education, performing and visual arts and other selected causes.

### Note 2 - Summary of Significant Accounting Policies:

a. Basis of Accounting

The financial statements of the Endowment have been prepared on the accrual basis of accounting under accounting principles generally accepted in the United States of America.

b. Cash and Cash Equivalents

Cash and cash equivalents include cash and money market funds with maturities of three months or less when purchased. Cash equivalents exclude money market funds which are part of the funds overseen by the various investment managers.

c. Property and Equipment

Property and equipment are recorded at cost. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets which range from three to five years.

d. Investments

Investments in equity securities with readily determined fair values and all debt instruments are reported at fair value based on quoted market prices as of December 31. Both realized and unrealized gains or losses are included in the Statement of Activities and Changes in Net Assets. The sale and purchase of investments is recorded at the date of trade which can result in either a net receivable or net payable on unsettled investment trades at the balance sheet date.

Short-term investments consist of money market and mutual funds held for investment purposes plus the net amount from settlements pending.

# Nicholas Endowment

## Notes to Financial Statements

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Fair value of investments in stock and other equities include those held in limited partnerships that are invested in a fund of funds and their fair values are recorded at values as determined by the individual fund managers. The ultimate liquidation of these investments is restricted to certain time periods and is generally limited to sale to the fund manager or distributions from the fund. Due to the inherent uncertainty of valuation of nonmarketable and restricted investments, those estimated values may differ significantly from the values that would have been used had a ready market for the securities existed and the differences could be material.

e. Grants

Grants in the amount of \$782,343 for 2007 were unconditional in nature and were recorded at the time they were approved by the Board of Trustees. Conditional grants are those whose disbursement depends upon the occurrence of the specified condition requirements. There were no conditional grants for the year ended December 31, 2007. Grants payable at December 31, 2007 are anticipated to be paid out in 2008.

f. Fair Value of Financial Instruments

The carrying value of financial instruments not otherwise disclosed herein, is comparable to the fair value due to the short-term nature of these financial instruments.

g. Tax Exempt Status

The Endowment is a supporting organization and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and related California code sections.

h. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amount of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

i. Reclassifications

Certain accounts have been reclassified to conform to current year classifications. These reclassifications had no effect on net assets or change in net assets.



# Nicholas Endowment

## Notes to Financial Statements

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j. New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157, Fair Value Measurements (SFAS No. 157), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, except for nonfinancial assets and nonfinancial liabilities of which the effective date has been delayed for one year.

The Endowment is currently evaluating the impact the aforementioned statement will have on the Endowment's financial statements, but does not believe that the adoption of SFAS No. 157 will have a material impact on its financial position and results of operations.

**Note 3 - Description of Net Assets:**

Unrestricted net assets are those that are neither temporarily restricted nor permanently restricted by donor-imposed stipulations. There are no temporarily or permanently restricted net assets.

**Note 4 - Property and Equipment:**

Property and equipment consist of the following at December 31, 2007:

Furniture and equipment	\$ 25,250
Less accumulated depreciation	(21,307)
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	\$ 3,943

# Nicholas Endowment

## Notes to Financial Statements

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### Note 5 - Investments:

The cost and estimated fair values of the Endowment's investments as of December 31, 2007 are as follows:

	Fair Value	Cost
Short-term investments	\$ 444,284	\$ 444,284
Domestic stocks and bonds	13,623,422	9,999,953
Merrill Lynch structured notes	6,936,480	7,200,000
Foreign stocks	2,840,603	2,744,239
Fixed income	5,621,180	5,493,157
Absolute return funds	7,465,160	5,500,000
Limited partnerships	380,162	433,623
	<hr/>	<hr/>
	\$ 37,311,291	\$ 31,815,256

The alternative investments are invested in a fund of funds that may utilize derivative instruments with off-balance sheet risks. However, as of December 31, 2007, none of the funds were directly invested in any derivative financial instruments.

The Endowment had commitments to contribute approximately \$1,066,377 in additional capital to the limited partnerships at December 31, 2007.

### Note 6 - Concentrations of Credit Risk:

The Foundation has identified its financial instruments which are potentially subject to credit risk which consist of cash, money market funds and investments in securities.

To address market risk of investments, the Foundation maintains a formal investment policy that sets out performance criteria, investment guidelines and requires review of the investment managers' performances. Investments are managed by multiple investment managers, who have responsibility for investing the funds in various investment alternatives. An investment consultant is also utilized. The Endowment also has custody agreements with selected banks, which process disbursements at the direction of authorized staff and board. In addition, concentrations of market and credit risk exist for cash and cash equivalents.

# Nicholas Endowment

## Notes to Financial Statements

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### **Note 7 - Related Party Transactions:**

The Endowment has and may continue to have trustees who are employed by organizations that are supported by the Endowment. The Endowment has a conflict of interest policy which covers relationships with trustees. The policy requires annual disclosures and discussion of potential conflicts at meetings, so that trustees may continue to serve the Endowment through their professional knowledge and expertise. Total grants given to these organizations totaled \$150,000 for the year ended December 31, 2007.

The employer of one of the trustees provided facilities and accounting services for the Endowment at no charge to the Endowment. No amounts for such contributed services for 2007 have been recorded in the financial statements.