

THE ARCA FOUNDATION
FINANCIAL STATEMENTS
DECEMBER 31, 2007 and 2006
Together with Independent Auditors' Report

BERT SMITH
& Co.

Certified Public Accountants and Management Consultants

THE ARCA FOUNDATION
DECEMBER 31, 2007 and 2006

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INDEPENDENT AUDITORS' REPORT

Board of Directors
The Arca Foundation

We have audited the accompanying statements of financial position of the Arca Foundation (the Foundation) as of December 31, 2007 and 2006 and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the management of the Foundation. Our responsibility is to express an opinion on these 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. 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 audits provide 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 Foundation as of December 31, 2007 and 2006, 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.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary schedules of investments and supplementary schedules of grant expenses on pages 9 to 27 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Bert Smith & Co.

March 18, 2008

THE ARCA FOUNDATION
STATEMENTS OF FINANCIAL POSITION
AS OF DECEMBER 31, 2007 and 2006

	2007	2006
Assets		
Cash	\$ 102,384	\$ 139,204
Interest and dividends receivable	92,173	152,463
Federal excise tax refund receivable	44,075	89,876
Investments, at fair value	59,035,375	60,456,726
Prepaid assets and deposits	15,940	26,605
Property and equipment, net	1,830,929	1,881,873
Total Assets	\$ 61,120,876	\$ 62,746,747
 Liabilities and Net Assets		
Liabilities		
Accounts payable and accrued liabilities	\$ 34,725	\$ 42,794
Grants payable	250,000	-
Deferred federal excise tax liability	63,428	76,874
Total Liabilities	348,153	119,668
Net Assets - Unrestricted	60,772,723	62,627,079
Total Liabilities and Net Assets	\$ 61,120,876	\$ 62,746,747

The accompanying notes are an integral part of these financial statements.

THE ARCA FOUNDATION
STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED DECEMBER 31, 2007 and 2006

	2007	2006
Revenue, Gains, and Other Support		
Realized gains from sale of investments, net	\$ 2,269,713	\$ 6,066,186
Dividends	968,401	882,133
Interest	633,305	698,745
Rental income	21,930	21,730
Miscellaneous	2,880	21,193
Unrealized losses on investments, net	<u>(1,342,001)</u>	<u>(112,101)</u>
Total revenue, gains and other support	2,554,228	7,577,886
Expenses:		
Salaries and benefits	305,142	268,158
Investment advisory fees	91,742	104,574
Travel costs	36,471	46,453
Depreciation	63,695	69,231
Miscellaneous	71,272	51,137
Board stipend	40,000	45,075
Utilities	14,253	14,953
Property taxes	22,712	24,927
Auditing and accounting	16,773	22,484
Legal	15,320	15,309
Payroll taxes	14,713	14,904
Annual reports	13,363	14,962
Insurance	13,588	13,094
Dues and postage	2,515	8,718
Furniture and equipment rental	9,581	11,581
Office supplies and expenses	10,275	5,716
Telephone	<u>4,712</u>	<u>4,486</u>
Total expenses	746,127	735,762
Change in Unrestricted Net Assets Before Grant and Federal Excise Tax Benefit	1,808,101	6,842,124
Grant expenses	<u>(3,637,859)</u>	<u>(3,192,680)</u>
Change in Unrestricted Net Assets Before Federal Excise Tax	(1,829,758)	3,649,444
Federal excise tax (expense)/benefit	<u>(24,598)</u>	<u>(22,985)</u>
Change in Unrestricted Net Assets	(1,854,356)	3,626,459
Unrestricted Net Assets, beginning of year	<u>62,627,079</u>	<u>59,000,620</u>
Unrestricted Net Assets, end of year	<u>\$ 60,772,723</u>	<u>\$ 62,627,079</u>

The accompanying notes are an integral part of these financial statements.

THE ARCA FOUNDATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007	2006
Cash Flows from Operating Activities		
Change in unrestricted net assets	\$ (1,854,356)	\$ 3,626,459
<i>Adjustments to reconcile change in unrestricted net assets to net cash used in operating activities:</i>		
Depreciation	63,695	69,231
Net realized and unrealized gains on investments	(927,712)	(5,954,085)
(Decrease) in deferred tax liability	(13,446)	(761)
Increase in receivables	106,091	63,521
Decrease (Increase) in prepaid expenses and deposits	10,665	(166)
(Decrease) Increase in accounts payable and accrued liabilities	(8,069)	10,556
Increase (Decrease) in grants payable	250,000	(25,000)
Total adjustments	(518,776)	(5,836,704)
Net Cash Used In Operating Activities	(2,373,132)	(2,210,245)
Cash Flows from Investing Activities		
Purchase of investments	(25,586,481)	(49,922,266)
Proceeds from sale of investments	27,935,544	52,181,966
Purchases of property and equipment	(12,751)	-
Net Cash Provide by Investing Activities	2,336,312	2,259,700
Net increase (decrease) in cash	(36,820)	49,455
Cash, beginning of year	139,204	89,749
Cash, end of year	\$ 102,384	\$ 139,204

The accompanying notes are an integral part of these financial statements.

THE ARCA FOUNDATION
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2007 AND 2006

NOTE 1. NATURE OF OPERATIONS

The Arca Foundation, formerly known as the Nancy Reynolds Bagley Foundation (the Foundation), is a private, not-for-profit, charitable organization based in Washington, D.C. The Foundation was established in 1952.

The purpose of the Foundation is to support not-for-profit organizations in the United States whose work encourages a more open foreign policy based on respect for international law, human rights and the sovereignty of all nations. The Foundation also supports projects concerned with domestic social change. The Foundation's main source of revenue is investment income.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed are described below to enhance the usefulness of the financial statements to the reader.

♦ ***Basis of Presentation***

Financial presentation follows the recommendations of the Financial Accounting Standards Board. Under those standards for Not-for-profit Organizations, the Foundation is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted net assets, and permanently restricted net assets.

♦ ***Basis of Accounting***

The financial statements of the Foundation have been prepared on the accrual basis of accounting. Under this basis, revenue is recognized when accrued and expenses are recognized as incurred.

♦ ***Cash***

Cash represents demand deposits on hand at financial institutions.

♦ ***Investments***

Investments are carried at fair value. Fair value is determined by quoted market prices. Unrealized gains and losses on investments resulting in market fluctuations are included in the statement of activities in the period in which the fluctuations occur. Realized gains and losses on the sale of securities are determined on the basis of cost of certificates delivered from specific lots, or the "identified cost" basis. Dividend income is recorded on the dividend date. Interest income is recorded on the accrual basis of accounting.

♦ ***Financial Instruments and Credit Risk***

Financial instruments that potentially subject the Foundation to concentrations of credit risk consist principally of investments held at a creditworthy financial institution. By policy, these investments are kept within limits designed to prevent risks caused by concentration.

♦ *Furniture and Equipment*

Furniture and equipment are recorded at cost. The Foundation capitalizes all expenditures for furniture and equipment over \$2,500. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. When assets are sold or otherwise disposed of, the asset cost and related accumulated depreciation are removed from the accounts, and any gain or loss is included in the statement of activities. Repairs and maintenance are charged to expense when incurred.

Building and Building improvements	39 years
Furniture and equipment	3-5 years

♦ *Unrestricted Net Assets*

Unrestricted net assets are available for use in general operations.

♦ *Grants*

Grant awards are disbursed to organizations upon approval of the Board, and subsequent notification to the trustee. The Foundation records grants payable upon approval and fulfillment of conditions, if applicable.

♦ *Tax-exempt Status*

The Foundation is classified as a private foundation exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC) and the applicable laws of the District of Columbia. As such, the Foundation is not subject to federal or state income taxes. However, the Foundation is subject to federal excise taxes on net investment income.

The Foundation follows the policy of providing for federal excise taxes on net appreciation (both realized and unrealized) on investments. The deferred provision for federal excise tax represents taxes provided on net unrealized appreciation (depreciation) on investments.

♦ *Functional Allocation of Expenses*

The cost of providing various program and supporting services have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among program and supporting services benefited.

♦ *Use of Estimates*

Management uses estimates and assumptions in preparing financial statements in conformity with generally accepted accounting principles in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, 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 these estimates.

NOTE 3. CONCENTRATION OF CREDIT RISK

Financial instruments which potentially subject the Foundation to concentrations of credit risk consist primarily of cash and investments.

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

NOTE 4. INVESTMENTS

The estimated fair value and cost of the Foundation's investments as of December 31, 2007 and 2006 are as follows:

	<u>2007</u> <u>Fair Value</u>	<u>2007</u> <u>Cost</u>	<u>2006</u> <u>Fair Value</u>	<u>2006</u> <u>Cost</u>
Short-term investments	\$ 1,349,992	\$ 1,349,992	\$ 1,655,773	\$ 1,655,773
Treasury bonds and notes	1,974,330	1,933,926	1,430,626	1,445,451
U.S. agency bonds	6,520,737	6,479,247	6,423,550	6,498,547
U.S. corporate bonds	5,483,731	5,461,773	5,302,359	5,358,817
Common stocks	18,212,623	16,303,718	45,644,418	37,810,698
Mutual Funds	25,493,962	21,163,961	-	-
Total	<u>\$ 59,035,375</u>	<u>\$ 52,692,617</u>	<u>\$ 60,456,726</u>	<u>\$ 52,769,286</u>

NOTE 5. PROPERTY AND EQUIPMENT

Property and equipment consists of:

	<u>2007</u>	<u>2006</u>
Land	\$ 218,750	\$ 218,750
Building	656,250	656,250
Building improvements	1,247,531	1,234,781
Software	120,359	120,359
Total	<u>2,242,890</u>	<u>2,230,140</u>
Less: Accumulated depreciation	<u>(411,961)</u>	<u>(348,267)</u>
Total	<u>\$ 1,830,929</u>	<u>\$ 1,881,873</u>

Depreciation expense for the years ended December 31, 2007 and 2006 was \$63,695 and \$69,231, respectively.

NOTE 6. FUNCTIONAL EXPENSES

The following is a breakdown of the Foundation's functional expenses for the years ended December 31:

	<u>2007</u>	<u>2006</u>
Program:		
Grant programs	\$ 3,838,761	\$ 3,408,198
Support:		
Management and general	<u>569,823</u>	<u>543,229</u>
Total	<u>\$ 4,408,584</u>	<u>\$ 3,951,427</u>

Grant Program: The Foundation's general purpose is to support not-for-profit organizations within the United States whose work encourages a more open foreign policy based on respect for international law, human rights and the sovereignty of all nations. The Foundation also supports projects concerned with domestic social changes.

Management and General: This supporting service category includes the functions necessary to secure proper administrative functioning of the Foundation, maintain an adequate work environment, and manage the financial responsibilities of the Foundation.

NOTE 7. FEDERAL EXCISE TAXES

The Foundation is subject to federal excise tax imposed on private foundations on net investment income. The current excise tax rate is two percent. A reduction of the tax to 1% can be achieved by meeting qualifications under Section 4940(e) of the IRC. The Foundation qualified for a 1% excise tax rate for the year ended December 31, 2007.

The deferred tax liability arises from unrealized appreciation (depreciation) on investments. The deferred federal excise taxes on unrealized appreciation (depreciation) on investments were recorded at 1% excise tax rate in 2006. The deferred portion of income tax expense will only be paid when the unrealized gains become realized.

Federal excise tax expense consists of the following at December 31:

<u>Federal Excise Tax Expense</u>	<u>2007</u>	<u>2006</u>
Current	\$ 38,045	\$ 23,746
Change in Deferred	<u>(13,447)</u>	<u>(761)</u>
Total	<u>\$ 24,598</u>	<u>\$ 22,985</u>

NOTE 8. PENSION PLAN

The Foundation maintains a defined contribution pension plan (the Plan) in accordance with Section 403(b) of the Internal Revenue Code. The Foundation contributes 5% of each eligible employee's annual compensation to the Plan. Foundation employees may also contribute to the Plan. Employees are immediately vested in employer contributions. The amount of employer pension expense was \$10,305 and \$7,878 for the year ended December 31, 2007 and 2006, respectively. The Plan is administered by Wachovia Securities.

NOTE 9. RELATED PARTY TRANSACTION

The Foundation entered into the following related party transaction during the year ended December 31, 2007 and 2006. The Brenn Foundation, a foundation with a common member of management, rents six hundred and eight square feet of the Foundation's headquarters for an indefinite term. The arrangement also includes utilities, cleaning service, and use of kitchens and conference rooms. The rent is paid on a monthly basis. The Foundation recognized, as a result of this arrangement, rental income of \$21,930 and \$21,280 as of December 31, 2007 and 2006, respectively.

During the year ended December 31, 2007 and 2006, the Foundation made grant disbursements of \$300,000 and \$705,000, respectively, to organizations that have common board members with the Foundation.

NOTE 10. SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION

	<u>2007</u>	<u>2006</u>
Cash paid during the year for income taxes	<u>\$ 82,120</u>	<u>\$ 113,622</u>

SUPPLEMENTARY SCHEDULES

The Arca Foundation
Supplementary Schedule of Investments
December 31, 2007

Principal / Shares	Investment Security	Fair Value	Cost
Short-Term Investments			
1,346,992	Prime Money Market Funds	<u>\$ 1,349,992</u>	<u>\$ 1,349,992</u>
	Total short-term investments	<u>1,349,992</u>	<u>1,349,992</u>
Treasury Bonds and Notes			
45,000	US Treasury Bond 7.875% February 15, 2021	60,574	59,678
200,000	US Treasury Bond 7.625% February 15, 2025	274,436	263,472
110,000	US Treasury Notes 4.75% February 15, 2037	115,207	108,088
1,225,000	US Treasury Notes 3.625% May 15, 2013	1,233,036	1,226,675
65,000	US Treasury Notes 4.75% May 15, 2014	69,133	64,624
205,000	US Treasury Note 5.125% May 15, 2016	221,943	211,389
	Total Treasury Bonds and Notes	<u>1,974,330</u>	<u>1,933,926</u>
U.S. Agency Bonds			
137,755	Federal Home Loan Mortgage Corp 6% June 01, 2017	142,171	149,583
228,861	Federal Home Loan Mortgage Corp 5% August 01, 2036	223,359	216,703
267,890	Federal Home Loan Mortgage Corp 6% September 01, 2036	272,082	265,211
260,412	Federal Home Loan Mortgage Corp 5% April 01, 2036	254,316	247,798
196,594	Federal Home Loan Mortgage Corp 5.5% April 01, 2036	196,455	191,987
305,083	Federal Home Loan Mortgage Corp 5% July 01, 2036	297,941	286,206
138,115	Federal Home Loan Mortgage Corp 5% May 01, 2037	134,795	130,671
74,611	Federal Home Loan Mortgage Corp 6.5% November 01, 2013	76,913	81,381
123,399	Federal Home Loan Mortgage Corp 7% October 01, 2032	129,293	135,173
239,966	Federal Home Loan Mortgage Corp 5.5% December 01, 2033	330,247	336,569

The Arca Foundation
Supplementary Schedule of Investments
December 31, 2007

Principal / Shares	Investment Security	Fair Value	Cost
166,218	Federal Home Loan Mortgage Corp 5.5% December 01, 2019	169,027	171,828
320,000	Federal Home Loan Bank 5% February 20, 2009	323,981	320,480
400,000	Federal National Mortgage Assn 5% October 15, 2011	416,516	402,765
400,000	Federal Ntl Mtg Assn NTS SER 1 Call 5/19/09 @100 5.625% May 19, 2011	112,349	111,220
91,645	Federal National Mortgage Assn 6% April 01, 2034	93,452	93,384
168,008	Federal National Mortgage Assn 5.5% December 01, 2035	168,045	166,826
63,944	Federal National Mortgage Assn 6% March 01, 2037	65,005	63,664
239,329	Federal National Mortgage Assn 6.5% November 1, 2033	247,414	260,078
370,000	Federal Ntl Mtg Assn NTS Call 1/9/09 @100 5.5% July 09, 2010	375,491	370,118
335,319	Federal National Mortgage Assn 5% February 1, 2019	338,434	348,286
312,718	Federal National Mortgage Assn 6% December 01, 2033	318,882	330,839
70,526	Federal National Mortgage Assn 5.5% January 1, 2019	71,975	72,123
87,207	Federal National Mortgage Assn 6.5% July 01, 2034	89,879	91,874
82,524	Federal National Mortgage Assn Pool #809882-(31406GXX0)	82,620	83,453
211,149	Federal National Mortgage Assn 5.5% November 01, 2035	211,195	208,889
164,946	Federal National Mortgage Assn 5.5% March 01, 2036	164,983	160,694
108,352	Federal National Mortgage Assn 6% April 01, 2036	110,149	108,309
169,062	Federal National Mortgage Assn 6% April 01, 2036	171,972	169,207
66,950	Federal National Mortgage Assn 6% April 01, 2036	68,102	66,030
158,195	Federal National Mortgage Assn 6% June 01, 2036	160,918	156,564
347,406	Federal National Mortgage Assn 6% May 01, 2037	353,169	342,985

