

# FINANCIAL PROFILE & FINANCIAL STATEMENTS AND SCHEDULE

**READER'S NOTE:** In this section, any discussion of spending levels or endowment amounts is on a cash or cash-equivalent basis. Therefore, the funding amounts presented do not reflect the impact of capitalization, depreciation, or other non-cash items.

## FINANCIAL PROFILE *for the year ending June 30, 2006*

The Carnegie Institution of Washington completed fiscal year 2006 in strong financial condition due to the excellent returns of the diversified investments within its endowment; a disciplined spending policy that balances today's needs with the long-term requirements of the institution and the interests of future scientists; and the support of organizations and individuals who recognize the wisdom of nurturing basic science.

The primary source of support for the institution's activities continues to be its endowment. This reliance on institutional funding provides an important degree of independence in the research activities of the institution's scientists.

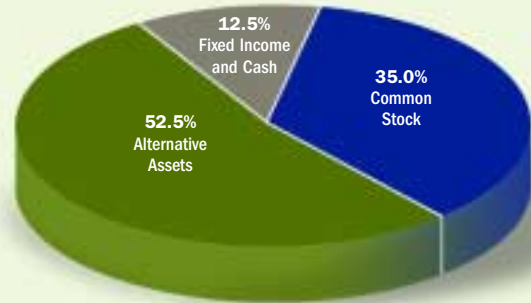
As of June 30, 2006, the endowment was valued at over \$724 million and had a total annual return, net of management fees, of 16%. During the last decade, the endowment has more than doubled, growing from \$338 million to more than \$724 million. Carnegie's endowment has returned an annualized 11.7% over the trailing five years for the period ending June 30, 2006.

For a number of years, under the direction of the finance committee of the board, Carnegie's endowment has been allocated among a broad spectrum of asset classes, including fixed-income instruments (bonds); equities (stocks); absolute return investments; real estate partnerships; private equity; and natural resources partnerships. The goal of this diversified approach is to generate attractive overall performance and minimize the volatility that would exist in a less diversified portfolio.

The finance committee of the board regularly examines the asset allocation of the endowment and readjusts the allocation, as appropriate. The institution relies upon external managers and partnerships to conduct the investment activities and it employs a commercial bank to maintain custody.

**Asset Class Target**

Common Stock	35.0%
Alternative Assets	52.5%
Fixed Income and Cash	12.5%



The chart above shows the target allocation of the institution's endowment among the asset classes it uses as of June 30, 2006.

Carnegie's investment goals are to provide high levels of current support to the institution and to maintain the long-term spending power of its endowment.

Carnegie has pursued a long-term policy of bringing its budgeted spending rate down in a gradual fashion from 6+ % in 1992 to 5.10% in 2005-06 and to 5.00% for the coming year. Carnegie's spending policy averages the total market value of the endowment for the three most recently completed fiscal years and develops a budget that spends at a set percentage of this three-year market value. The following figure depicts actual spending as a percentage of ending market value and compares that amount with the budgeted spending rate based on the three-year average.

**BUDGETED AND ACTUAL SPENDING RATES**



Within Carnegie's endowment, there are a number of "Funds" that provide support either in a general way or targeted to a specific purpose. These funds reflect a portion of the generous support provided to the institution. The largest of these is the Andrew Carnegie Fund, valued at over \$642 million today. This fund was begun with an original gift of \$10 million. Mr. Carnegie later made additional gifts totaling another \$12 million during his lifetime.

**PRINCIPAL FUNDS UNDER ACTIVE INVESTMENT MANAGEMENT**

(FY 2006; includes \$724 million of endowment and other assets)

Andrew Carnegie	\$642,177,675
Mellon Matching	15,781,373
Astronomy Funds	13,875,892
Capital Campaign	9,894,997
Anonymous	9,421,232
Anonymous Matching	9,208,751
Wood	7,938,776
Golden	6,041,542
Science Education Fund	3,534,665
Colburn	2,422,607
McClintock Fund	2,294,304
Endowed Fellowships	1,839,904
Bush Bequest	1,828,200
Starr Fellowship	1,049,848
Roberts	597,198
Lundmark	438,386
Hollaender	355,909
Forbush	195,125
Hale	173,210
Green Fellowship	169,285
Harkavy	165,235
Endowed Observatories Positions	151,020
<b>Total</b>	<b>\$729,555,134</b>

In future years Carnegie anticipates continuing to pursue an investment policy which seeks to maximize expected returns while minimizing volatility, a spending policy that meets immediate needs while also focusing on achieving intergenerational equity, and a development approach that increases the base of institutional support.

# FINANCIAL STATEMENTS

## INDEPENDENT AUDITORS' REPORT

### **The Audit Committee of the Carnegie Institution of Washington:**

We have audited the accompanying statements of financial position of the Carnegie Institution of Washington (Carnegie) as of June 30, 2006 and 2005, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of Carnegie's management. 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 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 Carnegie Institution of Washington as of June 30, 2006 and 2005, and its changes in net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

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

**KPMG LLP**

Washington, D.C.

March 27, 2007

**STATEMENTS OF FINANCIAL POSITION**

June 30, 2006 and 2005

	2006	2005
<b>Assets</b>		
Cash and cash equivalents	\$677,851	186,133
Accrued investment income	236,931	196,512
Contributions receivable, net (note 2)	6,262,208	7,459,804
Accounts receivable and other assets	13,821,588	8,673,414
Bond proceeds held by trustee (note 6)	292,688	4,920,242
Investments (notes 3 and 13)	729,555,134	641,071,595
Property and equipment, net (notes 4, 5 and 6)	163,103,621	159,218,202
<b>Total assets</b>	<b>913,950,021</b>	<b>821,725,902</b>
<b>Liabilities and Net Assets</b>		
Liabilities:		
Accounts payable and accrued expenses	\$5,513,044	7,173,434
Deferred revenue (note 5)	37,305,764	34,914,748
Broker payable	—	204,718
Bonds payable (note 6)	65,194,134	64,710,315
Accrued postretirement benefits (note 8)	17,958,000	15,625,000
<b>Total liabilities</b>	<b>125,970,942</b>	<b>122,628,215</b>
Net assets (note 9):		
Unrestricted:		
Invested in property and equipment, net	66,712,191	66,792,849
Held for managed investment	603,409,368	524,262,300
Undesignated	32,507,942	32,446,383
<b>Total unrestricted net assets</b>	<b>702,629,501</b>	<b>623,501,532</b>
Temporarily restricted	30,765,782	36,086,697
Permanently restricted	54,583,796	39,509,458
<b>Total net assets</b>	<b>787,979,079</b>	<b>699,097,687</b>
Commitments and contingencies (notes 8, 10, 11 and 12)		
<b>Total liabilities and net assets</b>	<b>913,950,021</b>	<b>821,725,902</b>

See accompanying notes to financial statements.

## STATEMENTS OF ACTIVITIES

Years ended June 30, 2006 and 2005

	Unrestricted	Temporarily Restricted	Permanently Restricted
<b>Revenues and support:</b>			
External revenue:			
Grants and contracts	\$30,590,596	—	—
Contributions and gifts (note 13)	906,375	5,964,402	1,513,670
Net losses on disposals of property	(9,290)	—	—
Gain (loss) on interest rate swap agreements (note 7)	2,718,086	—	—
Other income	2,897,577	—	—
Net external revenue	37,103,344	5,964,402	1,513,670
Investment income, net (note 3)	117,798,640	5,664,924	39,430
Net assets released from restrictions (note 9)	6,007,638	(6,007,638)	—
Matching of endowment (note 9)	(2,578,635)	(10,942,603)	13,521,238
<b>Total revenues and other support</b>	<b>158,330,987</b>	<b>(5,320,915)</b>	<b>15,074,338</b>
<b>Expenses:</b>			
Program expenses:			
Terrestrial Magnetism	10,667,105	—	—
Observatories	21,191,344	—	—
Geophysical Laboratory	13,101,603	—	—
Embryology	10,374,852	—	—
Plant Biology	10,617,264	—	—
Global Ecology	3,801,733	—	—
Other programs	603,602	—	—
Total program expenses	70,357,503	—	—
Administrative and general expenses	8,845,515	—	—
<b>Total expenses</b>	<b>79,203,018</b>	<b>—</b>	<b>—</b>
Change in net assets	79,127,969	(5,320,915)	15,074,338
Net assets at beginning of year	623,501,532	36,086,697	39,509,458
<b>Net assets at end of year</b>	<b>\$702,629,501</b>	<b>30,765,782</b>	<b>54,583,796</b>

See accompanying notes to financial statements.

2006		2005		
TOTAL	Unrestricted	Temporarily Restricted	Permanently Restricted	TOTAL
30,590,596	30,441,132	—	—	30,441,132
8,384,447	1,024,221	6,528,348	258,502	7,811,071
(9,290)	(15,971)	—	—	(15,971)
2,718,086	(1,630,883)	—	—	(1,630,883)
2,897,577	2,461,285	—	—	2,461,285
44,581,416	32,279,784	6,528,348	258,502	39,066,634
123,502,994	68,602,358	7,958,402	—	76,560,760
—	4,310,056	(4,310,056)	—	—
—	—	—	—	—
168,084,410	105,192,198	10,176,694	258,502	115,627,394
10,667,105	10,410,336	—	—	10,410,336
21,191,344	17,476,880	—	—	17,476,880
13,101,603	12,428,988	—	—	12,428,988
10,374,852	7,156,120	—	—	7,156,120
10,617,264	10,802,853	—	—	10,802,853
3,801,733	3,238,612	—	—	3,238,612
603,602	826,901	—	—	826,901
70,357,503	62,340,690	—	—	62,340,690
8,845,515	7,027,710	—	—	7,027,710
79,203,018	69,368,400	—	—	69,368,400
88,881,392	35,823,798	10,176,694	258,502	46,258,994
699,097,687	587,677,734	25,910,003	39,250,956	652,838,693
<b>787,979,079</b>	<b>623,501,532</b>	<b>36,086,697</b>	<b>39,509,458</b>	<b>699,097,687</b>

## STATEMENTS OF CASH FLOWS

Years ended June 30, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Change in net assets	\$88,881,392	46,258,994
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Depreciation	7,581,749	7,175,082
Net gains on investments	(112,570,866)	(68,562,395)
Contributions of stock	(1,498,816)	(1,408,922)
Losses on disposals of property	9,290	15,971
Amortization of bond issuance costs and discount	46,076	39,957
Contributions and investment income restricted for long-term investment	(2,734,850)	(3,694,970)
(Increase) decrease in assets:		
Receivables	(3,950,578)	(553,149)
Accrued investment income	(40,419)	(97,468)
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	(1,865,108)	3,262,243
Deferred revenue	2,391,016	219,730
Accrued postretirement benefits	2,333,000	1,955,000
<b>Net cash used in operating activities</b>	<b>(21,418,114)</b>	<b>(15,389,927)</b>
Cash flows from investing activities:		
Acquisition of property and equipment	(3,092,859)	(5,050,401)
Construction of telescope, facilities, and equipment	(8,387,529)	(16,545,615)
Proceeds from sales of property and equipment	3,930	—
Investments purchased	(178,788,118)	(541,308,692)
Proceeds from investments sold or matured	204,374,261	560,978,123
Proceeds from sales of investments by bond trustee	4,627,554	13,288,949
<b>Net cash provided by investing activities</b>	<b>18,737,239</b>	<b>11,362,364</b>
Cash flows from financing activities:		
Retirement of 1993 Series A Bonds	(17,500,000)	—
Proceeds from bond issuance	18,300,000	—
Bond issuance costs capitalized	(362,257)	—
Proceeds from contributions and investment income restricted for:		
Investment in endowment	40,000	300,000
Investment in property and equipment	2,694,850	3,394,970
<b>Net cash provided by financing activities</b>	<b>3,172,593</b>	<b>3,694,970</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>491,718</b>	<b>(332,593)</b>
Cash and cash equivalents at beginning of year	186,133	518,726
<b>Cash and cash equivalents at end of year</b>	<b>\$677,851</b>	<b>186,133</b>
Supplementary cash flow information:		
Cash paid for interest	\$2,240,950	2,170,122
Noncash activity – contributions of stock	1,498,816	1,408,922

See accompanying notes to financial statements.

# NOTES TO FINANCIAL STATEMENTS

## **(1) Organization and Summary of Significant Accounting Policies**

### **(a) Organization**

The Carnegie Institution of Washington (Carnegie) conducts advanced research and training in the sciences. It carries out its scientific work in six research centers located throughout the United States and at an observatory in Chile. The centers are the Departments of Embryology, Plant Biology, Global Ecology, Terrestrial Magnetism, the Geophysical Laboratory, and the Observatories.

Income from investments represents approximately 73% and 66% of Carnegie's total revenues for the years ended June 30, 2006 and 2005, respectively. Carnegie's other income is primarily from gifts and federal grants and contracts.

### **(b) Basis of Accounting and Presentation**

The financial statements are prepared on the accrual basis of accounting.

### **(c) Investments and Cash Equivalents**

Carnegie's debt and equity investments are reported at fair value based on quoted market prices, or with respect to alternative investments, at estimated values provided by the general partners of limited partnerships or other external investment managers. These estimated values are reviewed and evaluated by Carnegie. Due to the inherent uncertainties of these estimates, these values may differ from the values that would have been reported had a ready market for such investments existed.

All investments are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statements of activities. All changes in fair value are recognized in the statements of activities.

Carnegie considers all highly liquid debt instruments purchased with remaining maturities of 90 days or less to be cash equivalents. Money market and other highly liquid instruments held by investment managers are reported as investments.

### **(d) Income Taxes**

Carnegie has been recognized by the Internal Revenue Service as exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code (the Code) except for amounts from unrelated business income. Carnegie is also an educational institution within the meaning of Section 170(b)(1)(A)(ii) of the Code. The Internal Revenue Service has classified Carnegie as other than a private foundation, as defined in Section 509(a) of the Code.

### **(e) Fair Value of Financial Instruments**

Financial instruments of Carnegie include cash equivalents, receivables, investments, bond proceeds held by trustee, accounts and broker payables, and bonds payable. The fair value of investments in debt and equity securities is based on quoted market prices. The fair value of investments in limited partnerships is based on information provided by the general partners as discussed in note 1(c) above.

The fair value of the 1993 Series A bonds payable is based on quoted market prices. The fair value of the 1993 Series B, 2002 revenue and 2006 refunding revenue bonds payable is estimated to be the carrying value, since these bonds bear adjustable market rates (see note 6).

Interest rate swap agreements are entered into by Carnegie to mitigate the risk of changes in interest rates associated with variable interest rate indebtedness. Carnegie applies the provisions of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This standard requires certain derivative financial instruments to be recorded at fair value.

The fair values of cash equivalents, receivables, bond proceeds held by trustee, and accounts and broker payables approximate their carrying values based on their short maturities.

**(f) Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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. Actual results could differ from those estimates.

**(g) Property and Equipment**

Carnegie capitalizes expenditures for land, buildings and leasehold improvements, telescopes, scientific and administrative equipment, and projects in progress. Routine replacement, maintenance, and repairs are charged to expense. Depreciation is computed on a straight-line basis, generally over the following estimated useful lives:

- **Buildings and telescopes** – 50 years
- **Leasehold improvements** – lesser of 25 years or the remaining term of the lease
- **Scientific and administrative equipment** – 2-10 years, based on scientific life of equipment

**(h) Contributions**

Contributions are classified based on the existence or absence of donor-imposed restrictions. Contributions are classified in categories of net assets as follows:

**Unrestricted** – includes all contributions received without donor-imposed restrictions on use or time.

**Temporarily restricted** – includes contributions with donor-imposed restrictions as to purpose of gift and/or time period expended.

**Permanently restricted** – generally includes endowment gifts in which donors stipulate that the corpus be invested in perpetuity. Only the investment income generated from endowments may be spent. Certain endowments require that a portion of the investment income be reinvested in perpetuity.

Contributions include unconditional promises to give. In instances where such promises are to be received after one year or more from the date of the gift, they are recorded at a discounted amount at an appropriate risk free rate commensurate with the expected collection period. Amortization of the discount is recorded as additional contribution revenue. Satisfaction of donor-imposed restrictions are reported as releases of restrictions in the statements of activities.

Gifts of long-lived assets, such as buildings or equipment, are considered unrestricted when placed in service. Cash gifts restricted for investment in long-lived assets are released from restriction when the asset is acquired or as costs are incurred for asset construction.

**(i) Grants**

Carnegie records revenues on grants from federal agencies only to the extent that reimbursable expenses are incurred. Accordingly, funds received in excess of reimbursable expenses are recorded as deferred revenue, and expenses in excess of reimbursements are recorded as accounts receivable. Reimbursement of indirect costs is based upon provisional rates which are subject to subsequent audit by Carnegie's federal cognizant agency, the National Science Foundation.

**(j) Allocation of Costs**

The costs of providing programs and supporting services have been summarized in the statements of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited. Fundraising expenses of \$797,890 and \$615,996 for the years ended June 30, 2006 and 2005, respectively, have been included in administrative and general expenses in the accompanying statements of activities.

**(k) Reclassifications**

Certain reclassifications have been made to the 2005 amounts to conform to the 2006 presentation.

## (2) Contributions Receivable

Contributions receivable are summarized as follows at June 30, 2006:

<b>Unconditional promises expected to be collected in:</b>	
Less than one year	\$1,574,373
One year to five years	5,357,101
	<b>6,931,474</b>
<b>Less:</b>	
Allowance for uncollectible amounts	(25,004)
Discount to present value	(644,262)
	<b>\$6,262,208</b>

Pledges receivable as of June 30, 2006 and 2005 were discounted based on the estimated risk free rate of return on the pledge date at rates ranging from 2.54% to 6.00%. The allowance for uncollectible amounts and discount to present value were \$6,000 and \$533,938, respectively as of June 30, 2005.

## (3) Investments

Investments at fair value consisted of the following at June 30, 2006 and 2005:

	<b>2006</b>	<b>2005</b>
Time deposits and money market funds	\$43,584,622	55,825,078
Debt securities	69,802,874	68,048,149
Equity securities	181,100,396	160,682,208
Limited real estate partnerships	49,533,103	35,810,745
Limited partnerships	385,534,139	320,705,415
	<b>\$729,555,134</b>	<b>641,071,595</b>

Investment income, net consisted of the following for the years ended June 30, 2006 and 2005:

	<b>2006</b>	<b>2005</b>
Interest and dividends	\$11,907,701	9,024,867
Net realized gains	28,839,585	48,633,590
Net unrealized gains	83,731,281	19,928,805
Less investment management expenses	(975,573)	(1,026,502)
	<b>\$123,502,994</b>	<b>76,560,760</b>

As of June 30, 2006 and 2005, the fair value for approximately \$606.3 million and \$527.4 million of Carnegie's investments has been estimated by the general partners or fund managers in the absence of readily ascertainable values as of that date.

#### (4) Property and Equipment

Property and equipment placed in service consisted of the following at June 30, 2006 and 2005:

	2006	2005
Buildings and improvements	\$85,156,340	54,750,109
Scientific equipment	31,600,760	30,314,342
Telescopes	92,439,734	92,277,742
Construction in progress	5,590,511	30,630,550
Administrative equipment	2,649,493	2,594,566
Land	817,117	817,117
Art	38,105	38,105
	<b>218,292,060</b>	<b>211,422,531</b>
Less accumulated depreciation	(55,188,439)	(52,204,329)
	<b>\$163,103,621</b>	<b>159,218,202</b>

Construction in progress consisted of the following at June 30, 2006 and 2005:

	2006	2005
Buildings	\$169,562	26,717,890
Scientific equipment	5,420,949	3,912,660
Telescope	—	—
	<b>\$5,590,511</b>	<b>30,630,550</b>

At June 30, 2006 and 2005, approximately \$80.3 million and \$82.8 million, respectively, of property and equipment, net of accumulated depreciation, was located in Las Campanas, Chile. During construction in 2006 and 2005, Carnegie capitalized interest costs of approximately \$33,000 and \$562,000, respectively, as construction in progress.

#### (5) Magellan Consortium

During the year ended June 30, 1998, Carnegie entered into an agreement (Magellan Agreement) with four universities establishing a consortium to build and operate the Magellan telescopes. The two Magellan telescopes are located on Manqui Peak, Las Campanas in Chile. The first telescope, with a cost of approximately \$41.7 million, was placed in service during 2001. The other, with a cost of approximately \$30.1 million, was placed in service in 2003.

The university members of the consortium, by contribution to the construction and operating costs of Magellan, acquire rights of access and oversight as described in the Magellan Agreement. Total contributions by the university members for construction, which amounted to \$36.0 million, covered approximately 50% of the total construction costs. These monies were used by Carnegie to finance part of the Magellan Telescopes' construction costs. The contributions were recorded as deferred revenue and are being recognized ratably as income over the remaining estimated useful lives of the telescopes. As of June 30, 2006 and 2005, the deferred revenue totaled \$31.5 million and \$31.7 million, respectively.

## (6) Bonds Payable

### (a) 1993 California Educational Facilities Authority Revenue Bonds

On November 1, 1993, Carnegie issued \$17.5 million each of 1993 Series A and 1993 Series B California Educational Facilities Authority Revenue tax-exempt bonds. Bond proceeds were used to finance the Magellan telescope project and the renovation of the facilities of the Observatories at Pasadena. Series A bonds were redeemed on March 14, 2006 for \$17,500,000 plus accrued interest. The balances outstanding at June 30, 2006 and 2005, on the 1993 Series A issue totaled \$0 and \$17,500,000, respectively, and on the 1993 Series B issue totaled \$17,500,000 and \$17,500,000, respectively.

Series B bonds bear interest at variable money market rates (ranging from 2.25% to 3.64% during the year) in effect from time to time, up to a maximum of 12% over the applicable money market rate period of between 1 and 270 days and have a stated maturity of October 1, 2023. At the end of each money market rate period, 1993 Series B bondholders are required to offer the bonds for repurchase at the applicable money market rate. When repurchased, the Series B bonds are resold at the current applicable money market rate and for a new rate period.

Carnegie is not required to repay the 1993 Series B bonds until the October 1, 2023, maturity date. Sinking fund redemptions begin in 2019 in installments for 1993 Series B as follows.

<b>Due October 1</b>	
2019	\$3,100,000
2020	3,400,000
2021	3,600,000
2022	3,600,000
2023	3,800,000

The fair value of 1993 Series B bonds payable at June 30, 2006 and 2005 is estimated to approximate carrying value as the mandatory tender dates on which the bonds are repriced are generally within three months of year end. The fair value of the 1993 Series A bonds payable at June 30, 2005, based on quoted market prices was estimated at \$20.8 million.

Standby credit facilities have been established with SunTrust Bank in the aggregate amount of \$17,500,000 for the period ending March 31, 2007. Carnegie pays 0.15% per annum on the amount of the available commitment, payable quarterly in arrears. SunTrust Bank has the option to extend the agreement, but Carnegie is not required to maintain a liquidity facility for any bonds. The standby credit facility has not been used as of June 30, 2006.

### (b) 2002 Maryland Health and Higher Education Facilities Authority Revenue Bond

On October 23, 2002, the Maryland Health and Higher Education Facilities Authority (MHHEFA) issued \$30 million of its Revenue Bonds on behalf of Carnegie. Bond proceeds are being used to construct and equip a new facility for Carnegie's Department of Embryology on the Johns Hopkins Homewood Campus in Baltimore, Maryland. Construction began in April 2003, and the facility was occupied in September 2005.

The balance outstanding at June 30, 2006 and 2005 on the Carnegie 2002 Series totaled \$29.8 million and \$29.7 million, respectively. The balance outstanding is net of unamortized bond issue costs. Bond proceeds held by the trustee and unexpended at June 30, 2006 and 2005 totaled \$0 and \$4.9 million, respectively.

The bonds were issued in the weekly mode and bear interest at a variable rate determined by the remarketing agent, Lehman Brothers. The rates fluctuated between 2.03% and 3.97% during the year ended June 30, 2006 (see note 7). The rate at June 30, 2006 was 3.95%. Rates on remarketed bonds are selected in such a manner that the selling price will closely approximate the face value, but under no circumstances will the rate exceed 12% per annum. Interest is payable on the first business day of each month. Bonds in the weekly mode are subject to redemption at the request of Carnegie on any interest payment date. Bonds in weekly mode can be changed to daily, commercial paper, term rate or fixed rate mode at the request of Carnegie. Bonds are subject to mandatory tender for purchase prior to any change in the interest rate mode.

Scheduled maturities and sinking fund requirements are as follows:

**Due October 1**

2033	\$6,000,000
2034	6,000,000
2035	6,000,000
2036	6,000,000
2037	6,000,000

**\$30,000,000**

Standby credit facilities have been established with SunTrust Bank in the aggregate amount of \$30,000,000 as of June 30, 2003, for a period of 364 days. Carnegie pays 0.15% per annum on the amount of the available commitment, payable quarterly in arrears. SunTrust Bank has extended the agreement through March 31, 2007, but Carnegie is not required to maintain a liquidity facility for any bonds. The standby credit facility has not been used as of June 30, 2006.

**(c) 2006 California Educational Facilities Authority Refunding Revenue Bonds**

On February 9, 2006 Carnegie issued 2006 Series A California Educational Facilities Authority Refunding Revenue tax-exempt bonds totaling \$18,300,000. Bond proceeds were used to refund all outstanding 1993 Series A California Educational Facilities Authority Revenue tax-exempt bonds that were used to finance the Magellan telescope project and the renovation of the facilities of the Observatories at Pasadena and to pay certain costs incurred in connection with the issuance of the bonds.

The balance outstanding, net of unamortized bond issue costs and bond discount, at June 30, 2006 is \$17,943,862. Bond proceeds held by the trustee and unexpended at June 30, 2006 totaled \$121,904.

The bonds were issued in the weekly mode and bear interest at a variable rate determined by the remarketing agent, Lehman Brothers. The rates fluctuated between 3.00% and 3.93% during the year ended June 30, 2006 (see note 7). The rate at June 30, 2006 was 3.92%. Rates on remarketed bonds are selected in such a manner that the selling price will closely approximate the face value, but under no circumstances will the rate exceed 12% per annum. Interest is payable on the first business day of each month and upon change in interest rate mode. Bonds in the weekly mode are subject to redemption at the request of Carnegie on any interest payment date. Bonds in weekly mode can be changed to daily, commercial paper, term rate or fixed rate mode at the request of Carnegie. Bonds are subject to mandatory tender for purchase prior to any change in the interest rate mode.

Carnegie is not required to repay the 2006 Series A bonds until the October 1, 2040 maturity date. Standby credit facilities have been established with SunTrust Bank in the aggregate amount of \$18,300,000 for the period ending March 31, 2007. Carnegie pays 0.15% per annum on the amount of the available commitment, payable quarterly in arrears. SunTrust Bank has the option to extend the agreement, but Carnegie is not required to maintain a liquidity facility for any bonds. The standby credit facility has not been used as of June 30, 2006.

## (7) Interest Rate Swap Agreements

### (a) 2002 Maryland Health and Higher Education Facilities Authority Revenue Bonds

Carnegie entered into a swap agreement with an effective date of October 23, 2002. This swap agreement relates to \$15 million face amount of its Series 2002 Maryland Health and Higher Education Facilities Authority Revenue Bonds (see note 6). The agreement provides for Lehman Brothers Special Financing Inc. to receive 3.717% in interest on a notional amount of \$15 million and to pay interest at a floating rate of 68% of the three-month LIBOR rate, reducing on the dates and in the amounts as follows:

10/01/2033	\$3,000,000
10/01/2034	3,000,000
10/01/2035	3,000,000
10/01/2036	3,000,000

The interest rate swap agreement described above is a derivative instrument that is required to be recorded at fair value. The estimated fair value at year end was an asset of \$418,647 in 2006 and a liability of \$1,456,776 in 2005. These amounts are included in accounts receivable and accounts payable and accrued expenses, respectively, on the accompanying statements of financial position. The change in fair value for the years ended June 30, 2006 and 2005 was a gain of \$1,875,423 and a loss of \$1,630,883, respectively, and is reported as other income or loss.

### (b) 2006 Series A California Educational Facilities Authority Refunding Revenue Bonds

Carnegie entered into a swap agreement with an effective date of February 15, 2006. This swap agreement relates to \$18.3 million face amount of its 2006 Series A California Educational Facilities Authority Refunding Revenue tax-exempt bonds (see note 6). The agreement provides for Lehman Brothers Special Financing Inc. to receive 3.603% in interest on a notional amount of \$18.3 million and to pay interest at a floating rate of 68% of the three-month LIBOR rate.

The interest rate swap agreement described above is a derivative instrument that is required to be recorded at fair value. The estimated fair value at year end was an asset of \$842,663 in 2006. This amount is included in accounts receivable on the accompanying statements of financial position. The change in fair value for the year ended June 30, 2006 was a gain of \$842,663 and is reported as other income or loss.

## (8) Employee Benefit Plans

### (a) Retirement Plan

Carnegie has a noncontributory, defined contribution, money-purchase retirement plan in which all U.S. personnel are eligible to participate. After one year of participation, an individual's benefits are fully vested. The Plan has been funded through individually owned annuities issued by Teachers' Insurance and Annuity Association (TIAA) and College Retirement Equities Fund (CREF). Contributions made by Carnegie totaled approximately \$3.3 million and \$3.1 million for the years ended June 30, 2006 and 2005, respectively.

### (b) Postretirement Benefits Plan

Carnegie provides postretirement medical benefits to all employees who retire after age 55 and have at least 10 years of service. Cash payments made by Carnegie for these benefits totaled approximately \$452,000 and \$623,000 for the years ended June 30, 2006 and 2005, respectively.

The expense for postretirement benefits for the years ended June 30, 2006 and 2005 consists of the following:

	2006	2005
Service cost – benefits earned during the year	\$1,512,000	1,151,000
Interest cost on projected benefit obligation	1,078,000	1,184,000
Amortization of gain	195,000	243,000
Postretirement benefit cost	<b>\$2,785,000</b>	<b>2,578,000</b>

The 2006 postretirement benefits expense was approximately \$2,333,000 more than the cash expense of \$452,000 and the 2005 postretirement benefits expense was approximately \$1,955,000 more than the cash expense of \$623,000. The postretirement benefits expense was allocated among program and supporting services expenses in the accompanying statements of activities.

The reconciliation of the Plan's funded status to amounts recognized in the financial statements at June 30, 2006 and 2005 follows:

	2006	2005
<b>Change in benefit obligation:</b>		
Benefit obligation at beginning of year	\$20,807,000	19,200,000
Service cost	1,512,000	1,151,000
Interest cost	1,078,000	1,184,000
Plan amendments	(293,000)	—
Actuarial loss	(3,941,000)	(105,000)
Benefits paid	(452,000)	(623,000)
Benefit obligation at end of year	<b>18,711,000</b>	<b>20,807,000</b>
<b>Change in plan assets:</b>		
Fair value of plan assets at beginning of year	—	—
Actual return on plan assets	—	—
Contribution to plan	452,000	623,000
Benefits paid	(452,000)	(623,000)
Fair value of plan assets at end of year	—	—
Funded status	(18,711,000)	(20,807,000)
Unrecognized net actuarial loss (gain)	1,046,000	5,182,000
Unrecognized prior service cost	(293,000)	—
Accrued benefit cost	<b>\$(17,958,000)</b>	<b>(15,625,000)</b>

The present value of the benefit obligation as of June 30, 2006 was determined using an assumed discount rate of 6.25%. The present value of the benefit obligation as of June 30, 2005 was determined using an assumed discount rate of 5.25%. Carnegie's policy is to fund postretirement benefits as claims and administrative fees are paid.

For measurement purposes, a 10% annual rate of increase in medical claims was assumed for 2006; the rate of increase was assumed to decrease over the next three years at 1% per year, then in increments of 0.50% for the next five years, eventually reaching 5.5% in 2013. The healthcare cost trend rate assumption has a significant effect on the amounts reported. An one-percentage point change in assumed annual healthcare cost trend rate would have the following effects:

	<b>One-percentage point increase</b>	<b>One-percentage point decrease</b>
Effect on total of service and interest cost components	\$899,000	(675,000)
Effect on postretirement benefit obligation	3,275,000	(2,592,000)

The measurement date used to determine postretirement benefit obligations is July 1.

Carnegie expects to contribute approximately \$558,000 to its postretirement benefit plan during the year ended June 30, 2006.

The following benefit payments (net of retiree contributions), which reflect expected future service, are expected to be paid in future years ending June 30:

2007	\$558,000
2008	658,000
2009	741,000
2010	798,000
2011-2014	5,153,000

On December 8, 2003, the President signed into law the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act). Under the Medicare Prescription Drug Program, as proposed under the Act, groups who offer retiree prescription drug coverage at least actuarially equivalent to Medicare Plan D are eligible for a subsidy. In 2004, the Financial Accounting Standards Board issued SFAS No. 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003, which is effective for fiscal years beginning after June 15, 2004, with early adoption encouraged.

Carnegie has adopted this standard in 2005. Based on the Carnegie Plan amendments effective July 1, 2005, the prescription drug benefits offered by Carnegie were determined to not be actuarially equivalent to Medicare Plan D, and the effects of the Act, excluding the subsidy, do not have a significant impact on the per capita claims cost.

**(9) Net Assets****(a) Temporarily Restricted Net Assets**

Temporarily restricted net assets were available to support the following donor-restricted purposes at June 30, 2006 and 2005:

	<b>2006</b>	<b>2005</b>
Specific research programs	\$16,605,270	13,782,554
Equipment acquisition and construction	12,813,990	20,102,408
Passage of time	1,346,522	2,201,735
	<b>\$30,765,782</b>	<b>36,086,697</b>

**(b) Permanently Restricted Net Assets**

Permanently restricted net assets consisted of endowed gifts, the income from which is available to support the following donor-restricted purposes at June 30, 2006 and 2005:

	<b>2006</b>	<b>2005</b>
Specific research programs	\$14,819,077	14,799,327
Operation of Maxine Singer Building	15,000,000	—
Equipment acquisition and construction	2,764,719	2,710,13
General support (Carnegie endowment)	22,000,000	22,000,000
	<b>\$54,583,796</b>	<b>39,509,458</b>

**(c) Net Assets Released from Restrictions and Matching of Endowment**

During 2006 and 2005, Carnegie met donor-imposed requirements on certain gifts and, therefore, released temporarily restricted net assets as follows:

	<b>2006</b>	<b>2005</b>
Specific research programs	\$4,386,403	2,126,126
Equipment acquisition and construction	1,620,235	2,139,930
Passage of time	1,000	44,000
	<b>\$6,007,638</b>	<b>4,310,056</b>

During 2006, Carnegie allocated \$2,578,635 of unrestricted net assets and \$10,942,603 of temporarily restricted net assets to establish an endowment for the Maxine Singer Building to match a donor's contribution. This amount is included as operation of Maxine Singer Building in permanently restricted net assets and as matching of endowment on the accompanying statements of activities.

## **(10) Commitments**

Carnegie entered into a contract with the University of Arizona for the construction of a secondary mirror and support system for the second telescope in the Magellan project. The original amount of the contract was approximately \$590,000; \$318,000 remained outstanding on June 30, 2006.

Carnegie has outstanding commitments to invest approximately \$117.7 million in limited partnerships at June 30, 2006.

## **(11) Lease Arrangements**

Carnegie leases a portion of the land it owns in Las Campanas, Chile to other organizations. These organizations have built and operate telescopes on the land. Most of the lease arrangements are not specific and some are at no cost to the other organizations. The value of the no-cost leases could not be determined and is not considered significant and, accordingly, contributions have not been recorded in the financial statements.

Carnegie also leases a portion of one of its laboratories to another organization for an indefinite term. Rents to be received under the agreement are approximately \$680,000 annually, adjusted for CPI increases.

Carnegie leases land and buildings for various research departments. The monetary terms of the leases are considerably below fair value; however, these terms were developed considering other nonmonetary transactions between Carnegie and the lessors. The substance of the transactions indicates arms-length terms between Carnegie and the lessors.

## **(12) Contingencies**

Costs charged to the federal government under cost-reimbursement grants and contracts are subject to government audit. Therefore, all such costs are subject to adjustment. Management believes that adjustments, if any, would not have a significant effect on the financial statements.

## **(13) Related Party Transactions**

Carnegie recorded contributions from its trustees, officers and directors of \$2,217,102 and \$2,419,419, for the years ended June 30, 2006 and 2005, respectively.

A trustee of Carnegie is also the Chairman of an investment entity with which Carnegie has invested \$103 million and \$64.3 million in four of its investment funds, as of June 30, 2006 and 2005, respectively.

**SCHEDULES OF EXPENSES**

Years ended June 30, 2006 and 2005

	<b>2006</b>		
	<b>Carnegie Funds</b>	<b>Federal and Private Grants</b>	<b>Total Expenses</b>
Personnel costs:			
Salaries	\$16,351,247	5,846,475	22,197,722
Fringe benefits and payroll taxes	10,762,045	2,743,411	13,505,456
<b>Total personnel costs</b>	<b>27,113,292</b>	<b>8,589,886</b>	<b>35,703,178</b>
Fellowship grants and awards	2,115,590	929,264	3,044,854
Depreciation	7,581,749	—	7,581,749
General Expenses:			
Educational and research supplies	7,999,243	2,065,686	10,064,929
Building maintenance and operation	3,186,777	176,889	3,363,666
Travel and meetings	1,298,785	807,656	2,106,441
Publications	23,256	59,442	82,698
Shop	133,911	9,646	143,557
Telephone	197,719	3,752	201,471
Books and subscriptions	259,984	—	259,984
Administrative and general	8,923,535	375,871	9,299,406
Facilities construction	2,422,558	—	2,422,558
Interest	2,354,287	—	2,354,287
Subcontracts	88,207	4,471,903	4,560,110
Shipping and postage	162,132	14,875	177,007
Insurance, taxes, and professional fees	2,712,539	168,288	2,880,827
Equipment	3,927,191	1,390,001	5,317,192
Fundraising expense	797,890	—	797,890
<b>Total general expenses</b>	<b>34,488,014</b>	<b>9,544,009</b>	<b>44,032,023</b>
<b>Total direct costs</b>	<b>71,298,645</b>	<b>19,063,159</b>	<b>90,361,804</b>
Indirect costs:			
Grants and contracts	(11,400,788)	11,400,788	—
<b>Total costs</b>	<b>59,897,857</b>	<b>30,463,947</b>	<b>90,361,804</b>
Capitalized scientific equipment and facilities	(10,029,303)	(1,129,483)	(11,158,786)
<b>Total expenses</b>	<b>\$49,868,554</b>	<b>29,334,464</b>	<b>79,203,018</b>

See accompanying independent auditors' report.

## 2005

Carnegie Funds	Federal and Private Grants	Total Expenses
15,223,153	5,651,882	20,875,035
10,449,769	2,590,285	13,040,054
25,672,922	8,242,167	33,915,089
2,382,882	861,146	3,244,028
7,175,082	—	7,175,082
2,407,908	2,325,483	4,733,391
2,735,676	199,704	2,935,380
1,087,848	910,420	1,998,268
33,481	50,210	83,691
117,856	8,743	126,599
195,912	3,211	199,123
258,211	—	258,211
2,176,597	3,853,590	6,030,187
14,211,686	—	14,211,686
1,859,438	—	1,859,438
152,192	4,331,717	4,483,909
108,677	15,406	124,083
2,198,587	236,356	2,434,943
3,825,763	2,008,182	5,833,945
615,996	—	615,996
31,985,828	13,943,022	45,928,850
67,216,714	23,046,335	90,263,049
(7,400,796)	7,400,796	—
59,815,918	30,447,131	90,263,049
(19,061,636)	(1,833,013)	(20,894,649)
<b>40,754,282</b>	<b>28,614,118</b>	<b>69,368,400</b>