

# FINANCIAL PROFILE & FINANCIAL STATEMENTS

## FINANCIAL PROFILE *for the year ending June 30, 2005*

**READER'S NOTE:** In this section, any discussion of spending levels or endowment amounts are 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.

The primary source of support for Carnegie Institution of Washington's activities continues to be its endowment. This reliance has led to an important degree of independence in the research program of the institution. This independence is anticipated to continue as a mainstay of Carnegie's approach to science in the future.

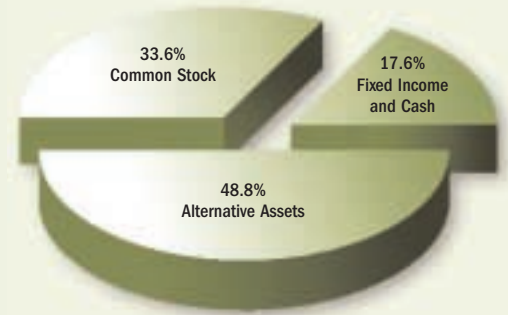
At June 30, 2005, the endowment was valued at over \$635 million and had a total return (net of management fees) of 16.6%. The annualized five-year return for the endowment was 10.5%.

For a number of years, Carnegie's endowment has been allocated among a broad spectrum of asset classes. This includes fixed-income instruments (bonds), equities (stocks), absolute return investments, real estate partnerships, private equity, and natural resources partnerships. The goal of diversifying the endowment into alternative assets is to reduce the volatility inherent in an undiversified portfolio while generating attractive overall performance.

In its private equity allocation, the institution accepts a higher level of risk in exchange for a higher expected return. By entering into real estate partnerships, the institution holds part of its endowment in high-quality commercial real estate, deriving both the possibility of capital appreciation and income in the form of rent from tenants. Along with the oil and gas partnership, this asset class provides an effective hedge against inflation. Finally, through its investments in absolute return partnerships and hedge funds, the institution seeks to achieve long-term returns similar to those of traditional U.S. equities with reduced volatility and risk.

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.

	Target Allocation	Actual Allocation
Common Stock	35.0%	33.6%
Alternative Assets	52.5%	48.8%
Fixed Income and Cash	12.5%	17.6%



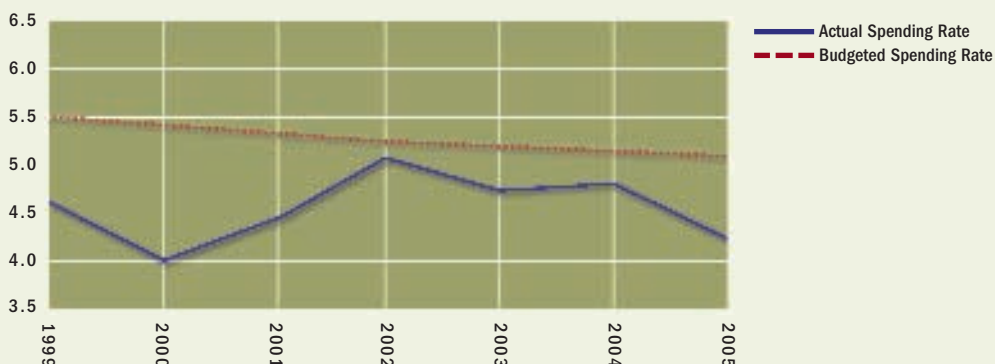
The above chart shows the allocation of the institution's endowment among the asset classes it uses as of June 30, 2005.

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. To achieve this objective, it employs a budgeting methodology that provides for:

- averaging the total market value of the endowment for the three most recent fiscal years, and
- developing a budget that spends at a set percentage (spending rate) of this three-year market average.

Since the early 1990s, this budgeted spending rate has been declining in a phased reduction, moving towards an informal goal of a spending rate of 4.5%. For the 2004-2005 fiscal year, the rate was budgeted at 5.10%. While Carnegie has been reducing this budgeted rate by between 5 and 10 basis points a year, there has also been continuing, significant growth in the size of the endowment. The result has been that, for the 2004-2005 fiscal year, the actual spending rate (the ratio of annual spending from the endowment to actual endowment value at the conclusion of the fiscal year in which the spending took place) was 4.29%.

## BUDGETED AND ACTUAL SPENDING RATES



Within Carnegie's endowment, there are a number of "Funds" that provide support either in a general way or in a targeted way, with a specific, defined purpose. The largest of these is the Andrew Carnegie Fund, begun with the original gift of \$10 million. Mr. Carnegie later made additional gifts totaling another \$12 million during his lifetime. Together these gifts are now valued at over \$563 million.

## PRINCIPAL FUNDS UNDER ACTIVE INVESTMENT MANAGEMENT

(Includes \$635 million of endowment and other assets)

	FY 2005
Andrew Carnegie	\$563,226,808
Mellon Matching	13,642,655
Astronomy Funds	12,133,834
Anonymous	8,830,089
Anonymous Matching	8,104,407
Capital Campaign	9,311,421
Wood	7,027,095
Golden	5,212,774
Science Education Fund	3,214,365
Colburn	2,166,880
McClintock Fund	2,030,893
Bush Bequest	1,580,437
Endowed Fellowships	1,643,670
Starr Fellowship	952,857
Roberts	541,551
Lundmark	397,745
Hollaender	307,675
Forbush	176,965
Hale	149,736
Green Fellowship	146,343
Harkavy	142,842
Endowed Obs positions	130,553
<b>Total</b>	<b>\$641,071,595</b>

# 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, 2005 and 2004, 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 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 Carnegie'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 Carnegie Institution of Washington as of June 30, 2005 and 2004, and its 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.

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 schedule 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.

The logo for KPMG LLP, featuring the letters 'KPMG' in a stylized, bold, black font, followed by 'LLP' in a smaller, simpler black font.

November 29, 2005  
Washington, D.C.

**STATEMENTS OF FINANCIAL POSITION**

June 30, 2005 and 2004

	2005	2004
<b>Assets</b>		
Cash and cash equivalents	\$186,133	518,726
Accrued investment income	196,512	99,044
Contributions receivable, net (note 2)	7,459,804	7,155,007
Accounts receivable and other assets	8,673,414	8,425,062
Bond proceeds held by trustee (note 6)	4,920,242	18,209,191
Investments (notes 3 and 14)	641,071,595	590,769,709
Property and equipment, net (notes 4, 5 and 6)	159,218,202	144,813,240
<b>Total assets</b>	<b>\$821,725,902</b>	<b>769,989,979</b>
<b>Liabilities and Net Assets</b>		
Liabilities:		
Accounts payable and accrued expenses	\$7,173,434	4,115,909
Deferred revenue (note 5)	34,914,748	34,695,018
Broker payable	204,718	—
Bonds payable (note 6)	64,710,315	64,670,359
Accrued postretirement benefits (note 8)	15,625,000	13,670,000
<b>Total liabilities</b>	<b>122,628,215</b>	<b>117,151,286</b>
Net assets (note 9):		
Unrestricted:		
Invested in property and equipment, net	66,792,849	63,657,053
Held for managed investments	524,262,300	491,619,513
Undesignated	32,446,383	32,401,168
<b>Total unrestricted net assets</b>	<b>623,501,532</b>	<b>587,677,734</b>
Temporarily restricted	36,086,697	25,910,003
Permanently restricted	39,509,458	39,250,956
<b>Total net assets</b>	<b>699,097,687</b>	<b>652,838,693</b>
Commitments and contingencies (notes 10,11 and 12)		
<b>Total liabilities and net assets</b>	<b>\$821,725,902</b>	<b>769,989,979</b>

See accompanying notes to financial statements.

## STATEMENTS OF ACTIVITIES

Years ended June 30, 2005 and 2004

	2005			
	Unrestricted	Temporarily Restricted	Permanently Restricted	TOTAL
Revenues and support:				
External revenue:				
Grants and contracts	30,441,132	—	—	30,441,132
Contributions and gifts (note 13)	1,024,221	6,528,348	258,502	7,811,071
Net losses on disposals of property	(15,971)	—	—	(15,971)
Other gains (losses)	830,402	—	—	830,402
Net external revenue	32,279,784	6,528,348	258,502	39,066,634
Investment income, net (note 3)	68,602,358	7,958,402	—	76,560,760
Other (note 9):				
Net assets released from restrictions	4,310,056	(4,310,056)	—	—
Matching of endowment	—	—	—	—
<b>Total revenues and other support</b>	<b>105,192,198</b>	<b>10,176,694</b>	<b>258,502</b>	<b>115,627,394</b>
Expenses:				
Program expenses:				
Terrestrial Magnetism	10,410,336	—	—	10,410,336
Observatories	17,476,880	—	—	17,476,880
Geophysical Laboratory	12,428,988	—	—	12,428,988
Embryology	7,156,120	—	—	7,156,120
Plant Biology	10,802,853	—	—	10,802,853
Global Ecology	3,238,612	—	—	3,238,612
Other programs	826,901	—	—	826,901
Total program expenses	62,340,690	—	—	62,340,690
Administrative and general expenses	7,027,710	—	—	7,027,710
<b>Total expenses</b>	<b>69,368,400</b>	<b>—</b>	<b>—</b>	<b>69,368,400</b>
Change in net assets	35,823,798	10,176,694	258,502	46,258,994
Net assets at beginning of year	587,677,734	25,910,003	39,250,956	652,838,693
<b>Net assets at end of year</b>	<b>\$623,501,532</b>	<b>36,086,697</b>	<b>39,509,458</b>	<b>699,097,687</b>

See accompanying notes to financial statements.

2004			
Unrestricted	Temporarily Restricted	Permanently Restricted	TOTAL
22,458,366	—	—	22,458,366
1,246,482	5,335,795	106,696	6,688,973
(318,211)	—	—	(318,211)
3,968,740	—	—	3,968,740
27,355,377	5,335,795	106,696	32,797,868
80,749,277	6,015,449	—	86,764,726
9,649,191	(9,649,191)	—	—
(223,500)	—	223,500	—
117,530,345	1,702,053	330,196	119,562,594
9,562,368	—	—	9,562,368
12,807,318	—	—	12,807,318
11,903,842	—	—	11,903,842
6,347,077	—	—	6,347,077
10,371,832	—	—	10,371,832
2,336,303	—	—	2,336,303
1,161,863	—	—	1,161,863
54,490,603	—	—	54,490,603
6,475,422	—	—	6,475,422
60,966,025	—	—	60,966,025
56,564,320	1,702,053	330,196	58,596,569
531,113,414	24,207,950	38,920,760	594,242,124
<b>587,677,734</b>	<b>25,910,003</b>	<b>39,250,956</b>	<b>652,838,693</b>

## STATEMENTS OF CASH FLOWS

Years ended June 30, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Change in net assets	\$46,258,994	58,596,569
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Depreciation	7,175,082	7,794,105
Net gains on investments	(68,562,395)	(80,363,758)
Contributions of stock	(1,408,922)	(1,261,267)
Losses on disposals of property	15,971	318,211
Amortization of bond issuance costs and discount	39,957	46,574
Contributions and investment income restricted for long-term investment	(3,694,970)	(1,708,636)
(Increase) decrease in assets:		
Receivables	(553,149)	(141,267)
Accrued investment income	(97,468)	(376)
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	3,262,243	(967,990)
Deferred revenue	219,730	(828,847)
Accrued postretirement benefits	1,955,000	2,311,000
<b>Net cash used in operating activities</b>	<b>(15,389,927)</b>	<b>(16,205,682)</b>
Cash flows from investing activities:		
Acquisition of property and equipment	(5,050,401)	(9,333,952)
Construction of telescope, facilities, and equipment	(16,545,615)	(10,423,095)
Proceeds from sales of property and equipment	—	27,323
Investments purchased	(541,308,692)	(260,313,717)
Proceeds from investments sold or matured	560,978,123	283,192,446
Proceeds from sales of investments by bond trustee	13,288,949	11,327,438
<b>Net cash provided by investing activities</b>	<b>11,362,364</b>	<b>14,476,443</b>
Cash flows from financing activities:		
Bond issuance costs capitalized	—	(91,887)
Proceeds from contributions and investment income restricted for:		
Investment in endowment	300,000	360,025
Investment in property and equipment	3,394,970	1,348,611
<b>Net cash provided by financing activities</b>	<b>3,694,970</b>	<b>1,616,749</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(332,593)</b>	<b>(112,490)</b>
Cash and cash equivalents at beginning of year	518,726	631,216
<b>Cash and cash equivalents at end of year</b>	<b>\$186,133</b>	<b>518,726</b>
Supplementary cash flow information:		
Cash paid for interest	\$2,170,122	1,917,108
Noncash activity – contributions of stock	1,408,922	1,261,267

See accompanying notes to financial statements.

# NOTES TO FINANCIAL STATEMENTS

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

### 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, Terrestrial Magnetism, Global Ecology, the Geophysical Laboratory, and the Observatories. Income from investments represented approximately 67% and 73% of Carnegie's total revenues for the years ended June 30, 2005 and 2004, respectively. Carnegie's other sources of income are primarily gifts and federal grants and contracts.

### Basis of Accounting and Presentation

The financial statements are prepared on the accrual basis of accounting. Contribution revenue is classified according to the existence or absence of donor-imposed restrictions. Satisfaction of donor-imposed restrictions are reported as releases of restrictions in the statements of activities.

### 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 investment securities 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.

### 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.

### 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 (*Investments and Cash Equivalents*) 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 and 2002 revenue bonds payable is estimated to be the carrying value, since these bonds bear adjustable market rates (see note 6).

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.

### 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 that affect reported amounts and disclosures in the financial statements. Actual results could differ from those estimates.

### 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

### 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 one year or more from the date of 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.

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.

### Grants

Carnegie records revenues on grants from federal agencies 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.

### Allocation of Costs

The costs of providing programs and administration have been summarized in the statements of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited. Fundraising expenses of \$615,996 and \$647,977 for the years ended June 30, 2005 and 2004, respectively, have been included in administrative and general expenses in the accompanying statements of activities.

### Reclassifications

Certain reclassifications have been made to the 2004 amounts to conform to the 2005 presentation.

## (2) Contributions Receivable

Contributions receivable are summarized as follows at June 30, 2005:

<b>Unconditional promises expected to be collected in:</b>	
Less than one year	\$3,039,013
One year to five years	4,960,729
	<b>7,999,742</b>
<b>Less:</b>	
Allowance for uncollectible amounts	(6,000)
Discount to present value	(533,938)
	<b>\$7,459,804</b>

Pledges receivable as of June 30, 2005 and 2004 were discounted at rates ranging from 2.54% to 4.13%. The allowance for uncollectible amounts and discount to present value were \$8,500 and \$397,322, respectively, as of June 30, 2004.

## (3) Investments

Investments at fair value consisted of the following at June 30, 2005 and 2004:

	<b>2005</b>	<b>2004</b>
Time deposits and money market funds	\$55,825,078	51,168,508
Debt mutual funds	—	26,596
Debt securities	68,048,149	86,251,775
Equity securities	160,682,208	150,678,506
Limited real estate partnerships	35,810,745	39,575,148
Limited partnerships	320,705,415	263,069,177
	<b>\$641,071,595</b>	<b>590,769,709</b>

Investment income, net consisted of the following for the years ended June 30, 2005 and 2004:

	<b>2005</b>	<b>2004</b>
Interest and dividends	\$9,024,867	7,487,625
Net realized gains	48,633,590	41,020,315
Net unrealized gains	19,928,805	39,343,443
Less investment management expenses	(1,026,502)	(1,086,658)
	<b>\$76,560,760</b>	<b>86,764,726</b>

As of June 30, 2005 and 2004, respectively, the fair value for approximately \$434.3 million and \$361.3 million of Carnegie's limited real estate partnership and limited partnership investments has been estimated by the general partners 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, 2005 and 2004:

	<b>2005</b>	<b>2004</b>
Buildings and improvements	\$54,750,109	53,023,675
Scientific equipment	30,314,342	37,953,848
Telescopes	92,277,742	81,634,844
Construction in progress	30,630,550	14,880,288
Administrative equipment	2,594,566	2,370,705
Land	817,117	787,896
Art	38,105	38,105
	<b>211,422,531</b>	<b>190,689,361</b>
Less accumulated depreciation	(52,204,329)	(45,876,121)
	<b>\$159,218,202</b>	<b>144,813,240</b>

Construction in progress consisted of the following at June 30, 2005 and 2004:

	<b>2005</b>	<b>2004</b>
Buildings	\$26,717,890	12,009,263
Scientific equipment	3,912,660	2,871,025
	<b>\$30,630,550</b>	<b>14,880,288</b>

At June 30, 2005 and 2004, approximately \$82.8 million and \$84.2 million, respectively, of construction in progress and other property, net of accumulated depreciation, was located in Las Campanas, Chile. During construction in 2005 and 2004, Carnegie capitalized interest costs of approximately \$562,000 and \$615,000, 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 are expected to cover 50% of the total expected costs. As of June 30, 2005, \$36.0 million has been received. These monies are being used by Carnegie to finance part of the Magellan Telescopes' construction costs. As of June 30, 2005 and 2004, the excess of university members' contributions over operating costs totaled approximately \$31.7 million and \$32.5 million, respectively, and is included in deferred revenue in the accompanying statements of financial position. The deferred revenue is being recognized ratably as income over the remaining estimated useful lives of the telescopes.

#### (6) Bonds Payable

##### 1993 California Educational Facilities Authority Revenue Bonds

On November 1, 1993, Carnegie issued \$17.5 million each of Series A and 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. The

balances outstanding at June 30, 2005 and 2004, on the Series A issue totaled \$17,500,000 and \$17,500,000, respectively, and on the Series B issue totaled \$17,500,000 and \$17,500,000, respectively. The balances outstanding are net of unamortized bond issue costs and bond discount.

Series A bonds bear interest at 5.6% payable in arrears semiannually on each April 1 and October 1 and upon maturity on October 1, 2023. Series B bonds bear interest at variable money market rates (ranging from 0.97% to 2.53% during the year, and 2.12% at June 30, 2005) 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, 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 Series A and B bonds until the October 1, 2023, maturity date. Sinking fund redemptions begin in 2019 in installments for both series. The fair value of Series A bonds payable at June 30, 2005 and 2004, based on quoted market prices is estimated at \$20.8 million and \$19.1 million respectively. The fair value of Series B bonds payable at June 30, 2005 and 2004 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.

### 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 August 2005.

The balance outstanding at June 30, 2005 and 2004 on the Carnegie 2002 Series totaled approximately \$29.7 million. The balance outstanding is net of unamortized bond issue costs. Bond proceeds held by the trustee and unexpended at June 30, 2005 and 2004 totaled approximately \$4.9 million and \$18.2 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 .99% and 3.00% during the year ended June 30, 2005 (see note 7). The rate at June 30, 2005 was 2.40%. 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:

	<b>Due October 1</b>
2033	\$6,000,000
2034	6,000,000
2035	6,000,000
2036	6,000,000
2037	6,000,000
	<b>\$30,000,000</b>

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, 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, 2005.

## (7) Interest Rate Swap Agreement

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:

	<b>October 1</b>
2033	\$3,000,000
2034	3,000,000
2035	3,000,000
2036	3,000,000

The interest rate swap agreement was 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 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 a liability of \$1,456,776 in 2005 and an asset of \$174,107 in 2004. These amounts are included in accounts payable and accrued expenses and accounts receivable, respectively, on the accompanying statements of financial position. The change in fair value for the years ended June 30, 2005 and 2004 was a loss of \$1,630,883 and a gain of \$1,420,726, respectively, and is reported as other income or loss.

## (8) Employee Benefit Plans

### 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 \$3.2 million and \$3.0 million for the years ended June 30, 2005 and 2004, respectively.

### 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 \$623,000 and \$532,000 for the years ended June 30, 2005 and 2004, respectively.

The expense for postretirement benefits for the years ended June 30, 2005 and 2004 consists of the following:

	<b>2005</b>	<b>2004</b>
Service cost—benefits earned during the year	\$1,151,000	1,233,000
Interest cost on projected benefit obligation	1,184,000	1,214,000
Amortization of gain	243,000	396,000
Postretirement benefit cost	<b>\$2,578,000</b>	<b>2,843,000</b>

The 2005 postretirement benefits expense was approximately \$1,955,000 more than the cash expense of \$623,000, and the 2004 postretirement benefits expense was approximately \$2,311,000 more than the cash expense of \$532,000. 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, 2005 and 2004 follows:

	2005	2004
<b>Change in benefit obligation:</b>		
Benefit obligation at beginning of year	\$19,200,000	20,531,000
Service cost	1,151,000	1,233,000
Interest cost	1,184,000	1,214,000
Actuarial loss	(105,000)	(3,246,000)
Benefits paid	(623,000)	(532,000)
Benefit obligation at end of year	<b>20,807,000</b>	<b>19,200,000</b>
<b>Change in plan assets:</b>		
Fair value of plan assets at beginning of year	—	—
Actual return on plan assets	—	—
Contribution to plan	623,000	532,000
Benefits paid	(623,000)	(532,000)
Fair value of plan assets at end of year	—	—
Funded status	(20,807,000)	(19,200,000)
Unrecognized net actuarial loss	5,182,000	5,530,000
Accrued benefit cost	<b>\$(15,625,000)</b>	<b>(13,670,000)</b>

The present value of the benefit obligation as of June 30, 2005 was determined using an assumed discount rate of 5.25%. The present value of the benefit obligation as of June 30, 2004 was determined using an assumed discount rate of 6.25%. Carnegie's policy is to fund postretirement benefits as claims and administrative fees are paid.

For measurement purposes, an 11% annual rate of increase in medical claims was assumed for 2005; the rate of increase was assumed to decrease over the next eight years, eventually reaching 5.5% in 2013 and remain at that level thereafter. The healthcare cost trend rate assumption has a significant effect on the amounts reported. A 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	\$786,000	(481,000)
Effect on postretirement benefit obligation	3,996,000	(3,118,000)

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

Carnegie expects to contribute approximately \$539,000 to its postretirement benefit plan during the year ended June 30, 2005.

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

2006	\$539,000
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

### Temporarily Restricted Net Assets

Temporarily restricted net assets were available to support the following purposes at June 30, 2005 and 2004:

	<b>2005</b>	<b>2004</b>
Specific research programs	\$13,782,554	21,862,442
Equipment acquisition and construction	20,102,408	1,839,320
Passage of time	2,201,735	2,208,241
	<b>\$36,086,697</b>	<b>25,910,003</b>

### Permanently Restricted Net Assets

Permanently restricted net assets consisted of endowed gifts, the income from which is available to support the following purposes at June 30, 2005 and 2004:

	<b>2005</b>	<b>2004</b>
Specific research programs	\$14,799,327	14,322,737
Equipment acquisition and construction	2,710,131	2,704,719
General support (Carnegie endowment)	22,000,000	22,000,000
	<b>\$39,509,458</b>	<b>39,027,456</b>

### Net Assets Released from Restrictions and Clarification of Donor Intent

During 2005 and 2004, Carnegie met donor-imposed requirements on certain gifts and, therefore, released temporarily restricted net assets as follows:

	<b>2005</b>	<b>2004</b>
Specific research programs	\$2,126,125	3,686,708
Equipment acquisition and construction	2,139,930	4,114,912
Passage of time	44,000	1,847,571
	<b>\$4,310,055</b>	<b>9,649,191</b>

During 2004, Carnegie allocated \$223,500 of unrestricted net assets to establish a Plant Biology endowment fund to match a donor's contribution. This amount is included as specific research programs 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 amount of the original contract was approximately \$590,000, \$448,552 of which remained outstanding at June 30, 2005.

Carnegie entered into a contract with Johns Hopkins University for the construction of the Singer Building at the Department of Embryology. As of June 30, 2005, approximately \$3.5 million remained outstanding under this contract.

Carnegie entered into a contract on July 1, 2005 for the construction of a new experiment building at the Broad Branch Road facility for approximately \$2.1 million.

Carnegie entered into a contract for the construction of scientific equipment for approximately \$2.3 million. As of June 30, 2005, the outstanding balance was approximately \$1.3 million. Carnegie has outstanding commitments to invest approximately \$96.1 million in limited partnerships at June 30, 2005.

### **(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, in-kind 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 \$2,419,419 and \$4,655,832, for the years ended June 30, 2005 and 2004, respectively.

**SCHEDULES OF EXPENSES**

Years ended June 30, 2005 and 2004

	2005		
	Carnegie Funds	Federal and Private Grants	Total Expenses
Personnel costs:			
Salaries	\$15,223,153	5,651,882	20,875,035
Fringe benefits and payroll taxes	10,449,769	2,590,285	13,040,054
Total personnel costs	25,672,922	8,242,167	33,915,089
Fellowship grants and awards	2,382,882	861,146	3,244,028
Depreciation	7,175,082	—	7,175,082
General expenses:			
Educational and research supplies	2,360,464	6,644,457	9,004,921
Building maintenance and operation	3,550,364	3,745,749	7,296,113
Travel and meetings	1,087,849	910,420	1,998,269
Publications	33,481	50,210	83,691
Shop	117,856	8,743	126,599
Telephone	195,911	3,212	199,123
Books and subscriptions	258,211	—	258,211
Administrative and general	1,794,191	319,955	2,114,146
Facilities construction	14,211,686	—	14,211,686
Interest	1,859,438	—	1,859,438
Printing and copying	61,195	332	61,527
Shipping and postage	108,677	15,406	124,083
Insurance, taxes, and professional fees	1,937,423	236,356	2,173,779
Equipment	3,793,086	2,008,182	5,801,268
Fundraising expense	615,996	—	615,996
Total general expenses	31,985,828	13,943,022	45,928,850
Total direct costs	67,216,714	23,046,335	90,263,049
Indirect costs:			
Grants and contracts	(7,400,796)	7,400,796	—
Total costs	59,815,918	30,447,131	90,263,049
Capitalized scientific equipment and facilities	(19,061,636)	(1,833,013)	(20,894,649)
<b>Total expenses</b>	<b>\$40,754,282</b>	<b>28,614,118</b>	<b>69,368,400</b>

See accompanying independent auditors' report.

2004		
Carnegie Funds	Federal and Private Grants	Total Expenses
14,475,943	4,780,166	19,256,109
10,009,374	2,238,258	12,247,632
24,485,317	7,018,424	31,503,741
1,966,003	948,967	2,914,970
7,794,105	—	7,794,105
2,438,265	5,232,412	7,670,677
8,409,920	117,067	8,526,987
1,021,637	746,156	1,767,793
40,854	31,977	72,831
99,989	23,649	123,638
201,400	5,631	207,031
342,961	—	342,961
1,299,174	186,264	1,485,438
8,530,528	—	8,530,528
1,771,130	—	1,771,130
77,751	—	77,751
169,309	24,681	193,990
2,759,936	72,450	2,832,386
1,724,656	1,673,942	3,398,598
647,977	—	647,977
29,535,487	8,114,229	37,649,716
63,780,912	16,081,620	79,862,532
(6,376,746)	6,376,746	—
57,404,166	22,458,366	79,862,532
(17,424,577)	(1,471,930)	(18,896,507)
<b>39,979,589</b>	<b>20,986,436</b>	<b>60,966,025</b>