CARNEGIE INSTITUTION OF WASHINGTON

Financial Statements and Schedule

June 30, 2008 and 2007

(With Independent Auditors' Report Thereon)

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

The Audit Committee
Carnegie Institution of Washington:

We have audited the accompanying statements of financial position of the Carnegie Institution of Washington (Carnegie) as of June 30, 2008 and 2007, 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, 2008 and 2007, and its changes in net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in note 2 to the financial statements, Carnegie reflected the impact of the Uniform Prudent Management of Institutional Funds Act on its endowment as of July 1, 2007 in the accompanying financial statements.

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

March 10, 2009

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CARNEGIE INSTITUTION OF WASHINGTON

Statements of Financial Position

June 30, 2008 and 2007

Assets		**2008**	**2007**
Cash and cash equivalents	$	957,861	1,896,601
Accrued investment income		138,050	265,104
Contributions receivable, net (note 3)		6,885,460	4,928,969
Accounts receivable and other assets		6,474,614	12,685,334
Bond proceeds held by trustee (note 7)		121,904	122,106
Investments (notes 4, 14 and 15)		895,939,989	838,384,075
Property and equipment, net (notes 5, 6, and 7)		162,108,756	164,296,421
Total assets	$	1,072,626,634	1,022,578,610
Liabilities and Net Assets			
Liabilities:			
Accounts payable and accrued expenses (note 8 and 15)	$	27,217,376	10,308,534
Deferred revenue (note 6)		36,539,753	34,987,592
Bonds payable (note 7)		65,303,339	65,248,695
Accrued postretirement benefits (note 9)		14,486,199	14,327,973
Total liabilities		143,546,667	124,872,794
Net assets (notes 2 and 10):			
Unrestricted		264,490,808	814,958,725
Temporarily restricted		609,844,386	27,990,125
Permanently restricted		54,744,773	54,756,966
Total net assets		929,079,967	897,705,816
Commitments and contingencies (notes 9, 11, 12, and 13)			
Total liabilities and net assets	$	1,072,626,634	1,022,578,610

See accompanying notes to financial statements.

CARNEGIE INSTITUTION OF WASHINGTON

Statements of Activities

Years ended June 30, 2008 and 2007

	2008				2007			
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues and support:								
External revenue:								
Grants and contracts	$ 33,051,740	—	—	33,051,740	31,280,089	—	—	31,280,089
Contributions and gifts (note 14)	713,216	9,406,411	107,577	10,227,204	1,967,795	2,200,622	128,209	4,296,626
Net losses on disposals of property	(49,772)	—	—	(49,772)	(22,822)	—	—	(22,822)
Other income (note 8)	(18,624,082)	—	—	(18,624,082)	7,075,827	—	—	7,075,827
Net external revenue	15,091,102	9,406,411	107,577	24,605,090	40,300,889	2,200,622	128,209	42,629,720
Investment income, net (note 4)	25,747,268	55,472,235	25,917	81,245,420	135,374,238	5,523,675	44,961	140,942,874
Net assets released from restrictions (note 10)	35,078,878	(35,078,878)	—	—	10,499,954	(10,499,954)	—	—
Total revenues and other support	75,917,248	29,799,768	133,494	105,850,510	186,175,081	(2,775,657)	173,170	183,572,594
Expenses:								
Program expenses:								
Terrestrial magnetism	11,635,917	—	—	11,635,917	11,083,178	—	—	11,083,178
Observatories	18,455,315	—	—	18,455,315	17,816,485	—	—	17,816,485
Geophysical laboratory	14,125,190	—	—	14,125,190	13,096,369	—	—	13,096,369
Embryology	8,593,858	—	—	8,593,858	8,635,996	—	—	8,635,996
Plant biology	10,518,171	—	—	10,518,171	9,928,992	—	—	9,928,992
Global ecology	4,263,800	—	—	4,263,800	3,936,862	—	—	3,936,862
Other programs	661,776	—	—	661,776	609,667	—	—	609,667
Total program expenses	68,254,027	—	—	68,254,027	65,107,549	—	—	65,107,549
Administrative and general expenses	6,853,537	—	—	6,853,537	7,967,307	—	—	7,967,307
Total expenses	75,107,564	—	—	75,107,564	73,074,856	—	—	73,074,856
Change in net assets before adoption of FASB Statement No. 158 and net asset reclassification based on endowment legislation	809,684	29,799,768	133,494	30,742,946	113,100,225	(2,775,657)	173,170	110,497,738
Effect of adoption of recognition provisions of FASB Statement No. 158 (note 9)	—	—	—	—	(771,001)	—	—	(771,001)
Pension related changes other than net periodic postretirement benefit cost (note 9)	631,205	—	—	631,205	—	—	—	—
Net asset reclassification based on recently enacted endowment legislation (note 2)	(551,908,806)	552,054,493	(145,687)	—	—	—	—	—
Change in net assets	(550,467,917)	581,854,261	(12,193)	31,374,151	112,329,224	(2,775,657)	173,170	109,726,737
Net assets at beginning of year	814,958,725	27,990,125	54,756,966	897,705,816	702,629,501	30,765,782	54,583,796	787,979,079
Net assets at end of year	$ 264,490,808	609,844,386	54,744,773	929,079,967	814,958,725	27,990,125	54,756,966	897,705,816

See accompanying notes to financial statements.

CARNEGIE INSTITUTION OF WASHINGTON

Statements of Cash Flows

Years ended June 30, 2008 and 2007

		2008	2007
Cash flows from operating activities:			
Change in net assets	$	31,374,151	109,726,737
Adjustments to reconcile increase in net assets to net cash used in operating activities:			
Depreciation		8,495,566	8,451,572
Net gains on investments		(74,010,578)	(127,182,818)
Contributions of stock		(548,871)	(726,048)
Losses on disposals of property		—	22,822
Amortization of bond issuance costs and discount		54,644	54,561
Contributions and investment income restricted for long-term investment		(803,968)	(604,255)
(Increase) decrease in assets:			
Receivables		4,254,229	2,469,493
Accrued investment income		127,054	(28,173)
Increase (decrease) in liabilities:			
Accounts payable and accrued expenses		16,908,842	4,795,490
Deferred revenue		1,552,161	(2,318,172)
Accrued postretirement benefits		158,226	(3,630,027)
Net cash used in operating activities		(12,438,544)	(8,968,818)
Cash flows from investing activities:			
Acquisition of property and equipment		(4,596,938)	(5,592,208)
Construction of telescope, facilities, and equipment		(1,710,963)	(4,074,986)
Investments purchased		(235,974,543)	(197,202,783)
Proceeds from investments sold or matured		252,978,078	216,282,708
Proceeds from sales of investments by bond trustee		202	170,582
Net cash provided by investing activities		10,695,836	9,583,313
Cash flows from financing activities:			
Proceeds from contributions and investment income restricted for:			
Investment in endowment		153,968	58,980
Investment in property and equipment		650,000	545,275
Net cash provided by financing activities		803,968	604,255
Net increase (decrease) in cash and cash equivalents		(938,740)	1,218,750
Cash and cash equivalents at beginning of year		1,896,601	677,851
Cash and cash equivalents at end of year	$	957,861	1,896,601
Supplementary cash flow information:			
Cash paid for interest	$	1,900,866	2,259,504
Noncash activity – contributions of stock		548,871	726,048

See accompanying 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 77% and 78% of Carnegie's total revenues for the years ended June 30, 2008 and 2007, 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 financial statements. 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.

On July 1, 2007, Carnegie adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 requires that a tax position be recognized or derecognized based on a 'more-likely-than-not' threshold. This applies to positions taken or expected to be taken in a tax return. The implementation of FIN 48 had no impact on the statement of financial

position or statement of activities. Carnegie does not believe its financial statements include (or reflect) any uncertain tax positions.

(e) Fair Value of Financial Instruments

Financial instruments of Carnegie include cash equivalents, receivables, investments, bond proceeds held by trustee, accounts payable, 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 B, 2002 revenue and 2006 Series A refunding revenue bonds payable is estimated to be the carrying value, since these bonds bear adjustable market interest rates (see note 7).

Interest rate and commodity swap agreements are entered into by Carnegie to mitigate the risk of changes in interest rates associated with variable interest rate indebtedness and changes in the price of crude oil and natural gas. 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 payable 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
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 stipulated 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 $981,567 and $986,921 for the years ended June 30, 2008 and 2007, respectively, have been included in administrative and general expenses in the accompanying statements of activities.

(k) Recently Issued Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, established a framework for the measurement of fair value, and enhances

(Continued)

disclosures about fair value measurements. The statement does not require any new fair value measures. The statement is effective for fair value measures already required or permitted by other standards for fiscal years beginning after November 15, 2007. Carnegie is required to adopt SFAS No. 157 beginning on July 1, 2008. Carnegie is evaluating the impact of adopting SFAS No. 157 on its activities and financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of SFAS No. 115*, which allows an entity the irrevocable option to elect fair value measurement for certain financial assets and financial liabilities on a contract-by-contract basis. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Carnegie has the option to adopt SFAS No. 159 beginning on July 1, 2008. Carnegie is evaluating the impact of adopting SFAS No. 159 on its activities and financial position.

(2) Recently Enacted Endowment Legislation

Through January 22, 2008, Carnegie's management and investment of donor-restricted endowment funds was subject to the provisions of the Uniform Management of Institutional Funds Act (UMIFA). In 2006, the Uniform Law Commission approved the model act, Uniform Prudent Management of Institutional Funds Act (UPMIFA) that serves as a guideline to states to use in enacting legislation. Among UPMIFA's most significant changes is the elimination of UMIFA's important concept of historic dollar value threshold, the amount below which an organization could not spend from the donor-restricted endowment fund in favor of a more robust set of guidelines about what constitutes prudent spending.

Effective January 23, 2008, the District of Columbia enacted UPMIFA, the provisions of which apply to endowment funds existing on or established after that date. Based on its interpretation of the provisions of UPMIFA, Carnegie is required to act prudently when making decisions to spend or accumulate donor-restricted endowment assets and in doing so to consider a number of factors including the duration and preservation of its donor-restricted endowment funds. As a result of this interpretation, Carnegie classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment. The remaining portion of the endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by Carnegie in a manner consistent with the standard of prudence prescribed by UPMIFA. Based on Carnegie's interpretation of UPMIFA, Carnegie reclassified approximately $552 million from unrestricted net assets to temporarily restricted net assets for donor-restricted endowment funds that have not been appropriated for expenditure in the statement of activities as of July 1, 2007.

In August 2008, FASB Staff Position No. FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act and Enhanced Disclosures for all Endowment Funds (FSP)*, was issued, and its guidance is effective for fiscal years ending after December 15, 2008. A key component of that FSP is a requirement to classify the portion of a donor-restricted endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets until appropriated for expenditure. Carnegie already presents its donor-restricted endowment fund in this manner, as discussed above. The

FSP also requires expanded disclosures for all endowment funds. Carnegie will adopt the FSP for the year ending June 30, 2009.

(3) Contributions Receivable

Contributions receivable are summarized as follows at June 30, 2008:

Unconditional promises expected to be collected in:		
Less than one year	$	2,511,994
One year to five years		4,928,127
		7,440,121
Less:		
Allowance for uncollectible amounts		(11,860)
Discount to present value		(542,801)
	$	6,885,460

Pledges receivable as of June 30, 2008 and 2007 were discounted based on the estimated risk-free rate of return on the pledge date at rates ranging from 2% to 6%. The allowance for uncollectible amounts and discount to present value were $9,000 and $532,099, respectively, as of June 30, 2007.

(4) Investments

Investments at fair value consisted of the following at June 30, 2008 and 2007:

		2008	2007
Time deposits and money market funds	$	13,855,014	55,747,235
Debt securities		50,304,571	60,903,866
Equity securities		193,504,869	258,914,200
Limited real estate partnerships		70,914,636	60,021,824
Limited partnerships		567,360,899	402,796,950
	$	895,939,989	838,384,075

Investment income, net consisted of the following for the years ended June 30, 2008 and 2007:

		2008	2007
Interest and dividends	$	8,177,520	14,815,286
Net realized gains		29,984,015	44,807,683
Net unrealized gains		44,026,563	82,375,135
Less investment management expenses		(942,678)	(1,055,230)
	$	81,245,420	140,942,874

As of June 30, 2008 and 2007, the fair value for approximately $789 million and $600.7 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.

(5) Property and Equipment

Property and equipment placed in service consisted of the following at June 30, 2008 and 2007:

		2008	2007
Buildings and improvements	$	87,575,983	87,068,913
Scientific equipment		41,581,390	39,728,988
Telescopes		93,338,387	92,839,386
Construction in progress		5,192,630	4,191,108
Administrative equipment		2,914,018	2,942,167
Land		817,117	817,117
Art		70,805	70,805
		231,490,330	227,658,484
Less accumulated depreciation		(69,381,574)	(63,362,063)
	$	162,108,756	164,296,421

Construction in progress consisted of scientific equipment of approximately $5.2 million and $4.2 million at June 30, 2008 and 2007, respectively.

At June 30, 2008 and 2007, approximately $76.4 million and $77.9 million, respectively, of property and equipment, net of accumulated depreciation, was located in Las Campanas, Chile.

(6) 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, 2008 and 2007, the deferred revenue totaled $29.5 million and $30.3 million, respectively.

(7) Bonds Payable

(a) 1993 California Educational Facilities Authority Revenue Bonds

On November 1, 1993, Carnegie issued $17.5 million of 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. The balances outstanding at June 30, 2008 and 2007, on the 1993 Series B issue totaled $17.5 million and $17.5 million, respectively.

Series B bonds bear interest at variable money market rates (ranging from 3.5% 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:

Due October 1:	
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, 2008 and 2007 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.

Standby credit facilities have been established with SunTrust Bank in the aggregate amount of $17,500,000 for the period ending January 31, 2010. 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, 2008.

(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 were 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, 2008 and 2007 on the Carnegie 2002 Series totaled $29.8 million and $29.8 million, respectively. The balance outstanding is net of unamortized bond issue costs.

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 1.13% and 4.05% during the year ended June 30, 2008 (see note 8). The rate at June 30, 2008 was 1.6%. 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 January 31, 2010, 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, 2008.

(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, 2008 and 2007 is $18.0 million and $18.1 million, respectively. Bond proceeds held by the trustee and unexpended at June 30, 2008 and 2007 totaled $121,904 and $122,106, 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 1.03% and 4.10% during the year ended June 30, 2008 (see note 8). The rate at June 30, 2008 was 1.35%. 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 12.00% 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 January 31, 2010. 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, 2008.

(8) Interest Rate and Commodity 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 7). The agreement provides for Lehman Brothers Special Financing Inc. (see note 15b) 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:

October 1:		
2033	$	3,000,000
2034		3,000,000
2035		3,000,000
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 a liability of $873,044 and a receivable of $437,046 in 2008 and 2007, respectively. These amounts are included in accounts payable and accrued expenses in 2008 and accounts receivable in 2007 on the accompanying statements of financial position. The change in fair value for the years ended June 30, 2008 and 2007 was a loss of $1,310,090 and a gain of $18,399, respectively, and is reported as other income.

(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 7). The agreement provides for Lehman Brothers Special Financing Inc. (see note 15b) 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 a liability of $777,875 and a receivable of $871,297 in 2008 and 2007, respectively. These amounts are included in accounts payable and accrued expenses in 2008 and accounts receivable in 2007 on the accompanying statements of financial position. The change in fair value for the years ended June 30, 2008 and 2007 was a loss of $1,649,172 and a gain of $28,634, respectively, and is reported as other income.

(c) Commodity Swaps

Carnegie entered into a series of fixed-floating commodity swaps with Lehman Brothers Commodity Services (see note 15b) and J. Aron & Company for NYMEX West Texas Intermediate Crude Oil (WTI - Oil) and NYMEX Natural Gas.

For WTI-Oil, the floating price for each determination period will be the average of the closing settlement price(s) on the NYMEX for the Nearby Light Crude Futures Contract. For natural gas, the floating price for each determination period will be the average of the closing settlement prices for the pricing days for the NYMEX Natural Gas Henry Hub Futures Contract for the reference month.

If, with respect to each determination period, the fixed price exceeds the floating price, the fixed price payer shall pay Carnegie the difference between the two such amounts multiplied by the quantity, and if the floating price exceeds the fixed price, Carnegie will pay the fixed price payer the difference between the two such amounts multiplied by the quantity. If the prices are equal, no payment shall be made.

The commodity swap agreements described above are derivative instruments that are required to be recorded at fair value. The estimated fair value at year end was a liability of $20,691,170 and $1,837,536 at June 30, 2008 and 2007, respectively. This amount is included in accounts payable and accrued expenses on the accompanying statements of financial position. The change in fair value for the years ended June 30, 2008 and 2007 was a loss of $18,853,634 and $1,837,536, respectively, and is reported as other income.

(9) 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 $3.6 million and $3.5 million for the years ended June 30, 2008 and 2007, 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 $332,000 and $451,000 for the years ended June 30, 2008 and 2007, respectively.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS No. 158), which amends SFAS No. 87, *Employers' Accounting for Pensions*, and SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. This Statement requires companies to recognize an asset or liability for the overfunded or underfunded status of their benefit plan in their financial statements. Carnegie adopted the recognition of the funded status provisions of SFAS No. 158 at June 30, 2007. The impact of adoption for the postretirement benefits plan resulted in an increase to the liability on the statement of financial position of approximately $771,000 and a decrease to unrestricted and total net assets reported in the accompanying statement of activities for the same amount.

The expense for postretirement benefits for the years ended June 30, 2008 and 2007 consists of the following:

		2008	2007
Service cost – benefits earned during the year	$	632,939	1,179,000
Interest cost on projected benefit obligation		841,543	1,152,000
Amortization of prior service costs		(18,000)	(18,000)
Amortization of gain		(334,602)	—
Postretirement benefit cost	$	1,121,880	2,313,000

The 2008 postretirement benefits expense was approximately $789,402 more than the cash expense of $332,478 and the 2007 postretirement benefits expense was approximately $1,862,120 more than the cash expense of $450,880. 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, 2008 and 2007 follows:

		2008	2007
Change in benefit obligation:			
Benefit obligation at beginning of year	$	14,327,973	18,711,000
Service cost		632,939	1,179,000
Interest cost		841,543	1,152,000
Actuarial gain		(983,807)	(6,263,147)
Benefits paid		(332,449)	(450,880)
Benefit obligation at end of year		14,486,199	14,327,973
Change in plan assets:			
Fair value of plan assets at beginning of year		—	—
Actual return on plan assets		—	—
Contribution to plan		332,449	450,880
Benefits paid		(332,449)	(450,880)
Fair value of plan assets at end of year		—	—
Funded status		(14,486,199)	(14,327,973)

Pension related changes other than net periodic postretirement benefit cost under SFAS No. 158 consisted of net actuarial gain of approximately $649,000 and amortization of prior service cost of approximately $18,000.

(Continued)

The net gain and prior service cost that will be amortized into net periodic benefit cost over the next fiscal year:

		2008	2007
Unrecognized net actuarial gain	$	(281,564)	(334,602)
Unrecognized prior service cost		(18,000)	(18,000)
	$	(299,564)	(352,602)

The unrecognized net gain and prior service cost remaining as of June 30, 2008 is approximately $5,866,000 and $257,000, respectively.

The present value of the benefit obligation as of June 30, 2008 and 2007 was determined using an assumed discount rate of 6.5% and 6.00%, respectively. The present value of the net periodic postretirement benefit cost as of June 30, 2008 and 2007 was determined using an assumed discount rate of 6.0% and 6.25%, respectively. Carnegie's policy is to fund postretirement benefits as claims and administrative fees are paid.

For measurement purposes, a 10.50% annual rate of increase in medical claims was assumed for 2008; the rate of increase was assumed to decrease at 1% per year, eventually reaching 5% in 2015. 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:

		One-percentage point increase	One-percentage point decrease
Effect on total of service and interest cost components	$	302,074	(233,724)
Effect on postretirement benefit obligation		2,118,724	(1,718,175)

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

Carnegie expects to contribute approximately $586,000 to its postretirement benefit plan during the year ended June 30, 2009.

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

2009	$ 586,106
2010	635,836
2011	646,732
2012	726,342
2013	793,604
2014 – 2017	4,859,986

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 FASB 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 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.

(10) Net Assets

(a) Unrestricted Net Assets

Unrestricted net assets consisted of the following at June 30, 2008 and 2007:

	2008	2007
Board-designated quasi-endowments	$ 90,800,760	83,717,098
Undesignated	173,690,048	731,241,627
	$ 264,490,808	814,958,725

(b) *Temporarily Restricted Net Assets*

Temporarily restricted net assets were available to support the following donor-restricted purposes at June 30, 2008 and 2007:

	2008	2007
Endowment assets available for future appropriation	$ 546,471,681	—
Specific research programs	49,555,121	13,403,149
Equipment acquisition and construction	10,661,145	14,565,976
Passage of time	3,156,439	21,000
	$ 609,844,386	27,990,125

(c) *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, 2008 and 2007:

	2008	2007
Specific research programs	$ 14,476,150	14,881,872
Operation of Maxine Singer Building	15,000,050	15,000,050
Equipment acquisition and construction	2,764,719	2,764,719
General support (Carnegie endowment)	22,110,325	22,110,325
	$ 54,351,244	54,756,966

(d) *Net Assets Released from Restrictions*

During 2008 and 2007, Carnegie met donor-imposed requirements on certain gifts and, therefore, released temporarily restricted net assets as follows:

	2008	2007
Appropriation of endowment assets	$ 29,845,575	—
Specific research programs	4,379,740	6,845,955
Equipment acquisition and construction	853,563	1,671,901
Passage of time	—	1,982,098
	$ 35,078,878	10,499,954

(Continued)

(11) 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; $55,654 remained outstanding on June 30, 2008.

Carnegie has outstanding commitments to invest approximately $153.7 million in limited partnerships at June 30, 2008.

(12) 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 $742,000 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 arm’s-length terms between Carnegie and the lessors.

(13) 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.

(14) Related-Party Transactions

Carnegie recorded contributions from its trustees, officers, and directors of $2,601,961 and $997,595, for the years ended June 30, 2008 and 2007, respectively.

A trustee of Carnegie is also the Chairman of an investment entity with which Carnegie has invested $199 million and $108 million in four of its investment funds, as of June 30, 2008 and 2007, respectively. Another trustee of Carnegie is the Managing Director of an investment entity with which Carnegie has invested $31.8 million and $32.5 million in one of its investment funds, as of June 30, 2008 and 2007, respectively.

(Continued)

(15) Subsequent Events

(a) Investment Performance

Since June 30, 2008, through the date of the issuance of these financial statements, the value of Carnegie's investments has declined from the fair values as of June 30, 2008 that are reflected in these statements of financial position. This decline in the value of investments is consistent with the general trend in the financial markets during this period, and is also consistent with the experience of other endowments at institutions of higher education and nonprofit organizations. During this period, Carnegie held sufficient cash and bond funds so as to meet all ongoing operational requirements, debt obligations, and investment obligations, thereby avoiding the need for any liquidation of equity and alternative investments at otherwise unfavorable terms. Carnegie anticipates being able to meet future requirements in a similar manner and to make the other financial adjustments necessitated by the decline in investment value during this period.

(b) Swap Agreements

On December 10, 2008, Carnegie terminated its two interest rate swap agreements with Lehman Brothers Special Financing, Inc. based upon an event of default under the Master Agreement due to the bankruptcy filing by Lehman Brothers Holdings Inc. Under the termination, Carnegie made payment to Lehman Brothers Special Financing, Inc. of the required close-out amounts of approximately $8.5 million. In addition, on December 10, 2008, Carnegie entered into a separate transaction with Barclay's Bank PLC to replace the two interest rate swaps that were terminated. The replacement off-market swaps with Barclay's Bank PLC are identical in terms of notional amounts and interest rates to the swaps previously held with Lehman Brothers Special Financing, Inc.

On October 1, 2008, Carnegie terminated its fixed-floating commodity swaps with Lehman Brothers Commodity Services for NYMEX West Texas Intermediate Crude Oil (WTI - Oil) and NYMEX Natural Gas based upon an event of default under the Master Agreement due to the bankruptcy filing by Lehman Brothers Holdings Inc. Under the termination, Carnegie made payment to Lehman Brothers Commodity Services, Inc. of the required close-out amounts of approximately $1.5 million. In addition, on October 1, 2008, Carnegie entered into a separate transaction with J. Aron & Company to replace the commodity swaps with Lehman Brothers Commodity Services, Inc. that were terminated.

Schedule

CARNEGIE INSTITUTION OF WASHINGTON

Schedules of Expenses

Years ended June 30, 2008 and 2007

	2008			2007		
	Carnegie funds	**Federal and private grants**	**Total expenses**	**Carnegie funds**	**Federal and private grants**	**Total expenses**
Personnel costs:						
Salaries	$ 17,765,445	6,554,523	24,319,968	16,884,338	6,174,862	23,059,200
Fringe benefits and payroll taxes	9,395,828	3,157,681	12,553,509	10,029,716	2,901,245	12,930,961
Total personnel costs	27,161,273	9,712,204	36,873,477	26,914,054	9,076,107	35,990,161
Fellowship grants and awards	2,312,603	1,388,780	3,701,383	2,185,315	1,186,236	3,371,551
Depreciation	8,495,566	—	8,495,566	8,451,572	—	8,451,572
General expenses:						
Educational and research supplies	2,899,443	1,648,962	4,548,405	4,098,035	1,793,759	5,891,794
Building maintenance and operation	3,922,926	489,363	4,412,289	3,388,537	70,425	3,458,962
Travel and meetings	1,533,452	1,132,603	2,666,055	1,140,710	943,059	2,083,769
Publications	48,616	92,778	141,394	55,538	59,978	115,516
Shop	218,308	1,816	220,124	138,261	6,434	144,695
Telephone	181,361	21,396	202,757	193,316	3,979	197,295
Books and subscriptions	333,532	2,477	336,009	367,092	1,348	368,440
Administrative and general	1,627,464	492,028	2,119,492	3,891,314	424,712	4,316,026
Facilities construction	—	934	934	111,069	—	111,069
Interest	1,442,726	—	1,442,726	2,571,350	—	2,571,350
Subcontracts	41,762	5,970,206	6,011,968	4,290	3,328,586	3,332,876
Shipping and postage	151,311	44,159	195,470	122,616	15,967	138,583
Insurance, taxes, and professional fees	2,423,133	6,054	2,429,187	2,693,403	229,467	2,922,870
Equipment	4,178,002	2,251,836	6,429,838	4,345,830	3,396,040	7,741,870
Fundraising expense	981,567		981,567	986,921	—	986,921
Total general expenses	19,983,603	12,154,612	32,138,215	24,108,282	10,273,754	34,382,036
Total direct costs	57,953,045	23,255,596	81,208,641	61,659,223	20,536,097	82,195,320
Indirect costs:						
Grants and contracts	(10,057,087)	10,057,087	—	(10,470,301)	10,470,301	—
Total costs	47,895,958	33,312,683	81,208,641	51,188,922	31,006,398	82,195,320
Capitalized scientific equipment and facilities	(4,920,756)	(1,180,321)	(6,101,077)	(5,878,491)	(3,241,973)	(9,120,464)
Total expenses	$ 42,975,202	32,132,362	75,107,564	45,310,431	27,764,425	73,074,856

See accompanying independent auditors' report.