



ANNUAL REPORT 2003

Report on Finances

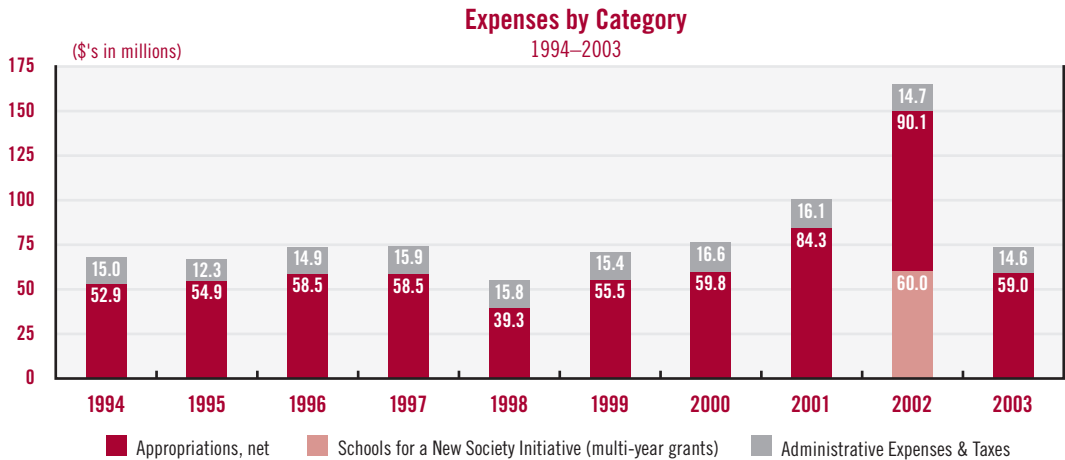
Financial Highlights

Appropriations and Expenses

For the ten years ended September 30, 2003, the Corporation awarded 2,869 grants totaling \$673.3 million and incurred expenses of \$125.8 million for direct charitable activities

and administration expenses, excluding investment expenses, and \$25.5 million for taxes, for a total of \$824.6 million.

The graph below illustrates the growth in expenses by category over the ten-year period ended September 30, 2003.



Each year the trustees appropriate funds to be used for grants and for projects administered by the officers. Many of the grants involve multiyear commitments. In the fiscal year ended September 30, 2003, 57 percent of the appropriated funds were paid within the fiscal year. Appropriations, net of refunds and cancellations, totaled \$59 million, compared to \$150.1 million in the preceding year. The decrease in appropriations for 2003 is largely attributable to the awarding of grants in 2002 totaling \$60 million under the Corporation's School for a New Society Initiative.

Program management and direct charitable activities expenses were \$10.3 million in the fiscal year ended September 30, 2003, compared with \$10.8 million in the previous fiscal year. Included in these amounts, are direct

charitable activities of \$2.6 million in 2003 and \$2.7 million in 2002. Direct charitable activities are services provided directly to other exempt organizations, governmental bodies, and the general public. Such services include providing technical assistance to grantees and potential grantees, conducting educational conferences and research, publishing and disseminating educational materials, and serving on boards of other charitable organizations or public commissions.

General administration expenses were \$2.9 million in 2003 and \$3.3 million in 2002.

The schedule below breaks down total expenses, excluding appropriations and taxes, into categories for the year ended September 30, 2003.

	Program management and direct charitable activities	Investment	General administration	Total
Salaries	\$ 4,792,193	\$ 826,867	\$1,336,481	\$ 6,955,541
Investment advisory and custody fees paid directly	—	3,586,292	—	3,586,292
Employee benefits	1,927,562	192,210	505,375	2,625,147
Rent	948,309	195,544	478,916	1,622,769
Publications	603,501	—	—	603,501
Travel	518,276	42,736	10,488	571,500
Office expenses	293,787	56,741	120,351	470,879
Consultants	389,385	—	65,937	455,322
Legal and accounting services	—	245,647	196,130	441,777
Conferences and meetings	299,623	13,472	13,796	326,891
Amortization and depreciation	104,958	—	53,006	157,964
Computer equipment and services	97,171	17,061	27,355	141,587
Trustees' honoraria and expenses	107,316	—	30,211	137,527
Other	172,372	18,659	46,610	237,641
TOTAL	\$10,254,453	\$5,195,229	\$2,884,656	\$18,334,338*

* In FY2002, total expenses, excluding appropriations and taxes, were \$19.8 million, which included \$5.7 million of investment expenses.

Taxes

Under the provisions of the Tax Reform Act of 1969, Carnegie Corporation as a private foundation is subject to a federal excise tax of 2 percent on income and realized capital gains. However, under the Tax Reform Act of 1984, the rate is reduced to 1 percent if the foundation maintains its average expense rate of the previous five years and, in addition, spends the tax savings. The Corporation met the requirements for the reduced tax rate in both 2003 and 2002. Excise tax expense for FY2003 was \$.6 million. During 2003, the Corporation had unrelated business income of \$2.4 million from certain investment partnership activities. Taxes of \$.9 million on this income are calculated using applicable corporate tax rates. Deferred tax liability represents the potential tax (at 2 percent) on gains as yet unrealized as well as a book to tax timing difference.

Audit by Independent Accountants

The bylaws provide that the Corporation's accounts are to be audited each year by an independent public accountant. Accordingly, the firm of KPMG LLP audited the Corporation's financial statements for the fiscal year ended September 30, 2003. The Corporation's financial statements, together with the independent auditors' report, appear on the following pages.

Independent Auditors' Report

The Board of Trustees
Carnegie Corporation of New York:

We have audited the accompanying balance sheets of Carnegie Corporation of New York as of September 30, 2003 and 2002, and the related statements of changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Corporation'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 Carnegie Corporation of New York as of September 30, 2003 and 2002, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

KPMG LLP
New York, New York

December 12, 2003

Balance Sheets

as of September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Assets		
Cash	\$ 178,528	\$ 19,356
Investments-note 3	1,823,041,443	1,610,668,740
Refundable taxes-note 5	392,495	929,630
Grants receivable	—	15,636,000
Prepaid expenses and other assets	67,343	77,400
Fixed assets-note 4	635,123	402,398
Total assets	<u>\$ 1,824,314,932</u>	<u>\$1,627,733,524</u>
Liabilities and net assets		
Liabilities		
Grants payable	\$ 82,995,081	\$ 108,132,177
Accounts payable and other liabilities	3,436,414	4,275,045
Deferred taxes payable	3,277,513	—
Total liabilities	<u>89,709,008</u>	<u>112,407,222</u>
Net assets		
Unrestricted	1,599,269,056	1,364,353,434
Temporarily restricted	—	15,636,000
Permanently restricted	135,336,868	135,336,868
Total net assets	<u>1,734,605,924</u>	<u>1,515,326,302</u>
Total liabilities and net assets	<u>\$ 1,824,314,932</u>	<u>\$1,627,733,524</u>

See accompanying notes to financial statements.

Statements of Changes in Net Assets

for the years ended September 30, 2003 and 2002

	2003	2002
Changes in unrestricted net assets		
Revenues		
Investment income		
Interest and dividends	\$ 23,702,209	\$ 28,612,381
Income from partnerships, net	29,726,662	3,242,869
Net realized gain on investment transactions	8,240,996	12,006,350
Total realized investment income	61,669,867	43,861,600
Less investment expenses paid directly	5,195,229	5,737,287
Net realized investment income	56,474,638	38,124,313
Grant income	10,000,000	19,364,000
Fees for technical assistance and evaluation services	1,000,000	—
Total unrestricted revenues	67,474,638	57,488,313
Expenses		
Grant appropriations	54,835,721	146,799,656
Appropriations for projects administered by officers	4,125,833	3,291,845
Program management and direct charitable activities	10,254,453	10,830,602
General administration	2,884,656	3,302,484
Provision for taxes, net-note 5	1,507,559	607,427
Total expenses	73,608,222	164,832,014
Deficiency of unrestricted revenues over expenses	(6,133,584)	(107,343,701)
Increase in unrealized appreciation (depreciation) of investments, net of related deferred federal excise tax of \$3,010,976 in 2003 and \$ -0- in 2002-note 5	241,049,206	(50,045,838)
Increase (decrease) in unrestricted net assets	234,915,622	(157,389,539)
Changes in temporarily restricted net assets		
Grant (returned) income	(15,636,000)	15,636,000
(Decrease) increase in temporarily restricted net assets	(15,636,000)	15,636,000
Increase (decrease) in net assets	219,279,622	(141,753,539)
Net assets, beginning of year	1,515,326,302	1,657,079,841
Net assets, end of year	\$ 1,734,605,924	\$1,515,326,302

See accompanying notes to financial statements.

Statements of Cash Flows

for the years ended September 30, 2003 and 2002

	2003	2002
Cash flows from operating activities		
Increase (decrease) in net assets	\$ 219,279,622	\$ (141,753,539)
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities		
Increase in unrealized (appreciation) depreciation of investments	(244,060,182)	50,045,838
Net realized gain on investment transactions	(8,240,996)	(12,006,350)
Depreciation and amortization	157,964	155,793
Change in deferred federal excise tax	3,277,513	—
Total adjustments	(248,865,701)	38,195,281
Change in refundable taxes, grants receivable, prepaid expenses and other asset	16,183,192	(16,120,722)
Change in grants payable and accounts payable and other liabilities	(25,975,727)	57,976,423
Net cash used in operating activities	(39,378,614)	(61,702,557)
Cash flows from investing activities		
Proceeds from sales or redemptions of investments	879,679,340	1,249,517,370
Purchases of investments	(839,750,865)	(1,187,678,254)
Purchases of fixed assets	(390,689)	(133,162)
Net cash provided by investing activities	39,537,786	61,705,954
Change in cash	159,172	3,397
Cash, beginning of year	19,356	15,959
Cash, end of year	\$ 178,528	\$ 19,356

See accompanying notes to financial statements.

Notes to Financial Statements

September 30, 2003 and 2002

(1) ORGANIZATION:

Carnegie Corporation of New York (the Corporation) is a philanthropic grantmaking foundation that was created by Andrew Carnegie in 1911 to promote the advancement and diffusion of knowledge and understanding. The Corporation has a policy of selecting a few areas at a time in which to concentrate its grants. The Corporation is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accompanying financial statements have been prepared on the accrual basis of accounting.

Fixed assets are stated at cost. Depreciation is calculated on a straight-line basis over the estimated lives of the related assets ranging from five to ten years. Leasehold improvements are amortized over the remaining life of the lease.

Grant appropriations, including multi-year grants, are recorded as an expense and a payable when grants are approved and communicated to the grantees.

For purposes of the statements of cash flows, cash includes all cash held in bank accounts at September 30, 2003 and September 30, 2002.

The resources of the Corporation consist of permanently restricted, temporarily restricted and unrestricted net assets. Permanently restricted net assets represent the original sums received from Andrew Carnegie who, by the terms of the conveying instrument, stipulated that the principal may never be expended. Unrestricted net assets are not subject to donor imposed restrictions.

On October 2, 2001, the Corporation was awarded a \$25,000,000 multi-year grant by another private foundation to support urban high school reform through the Corporation's Schools for a New Society initiative. The entire \$25,000,000 was recorded as grant income in fiscal year 2002 with \$15,636,000 as temporarily restricted. In fiscal year 2003, the Corporation and the other private foundation mutually agreed to amend the grant agreement whereby the Corporation would serve as the fiscal agent for the benefit of specified school districts participating in the initiative (\$12,636,000) and provide technical assistance and evaluation services to said districts (\$3,000,000). In the accompanying financial statements, \$1,000,000 was recorded as revenue for fees for technical assistance and evaluation services.

The fair value of investments has been determined as indicated in note 3. The carrying amounts of the Corporation's other financial instruments approximate fair value because of their short maturity.

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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Notes to Financial Statements

September 30, 2003 and 2002

(3) INVESTMENTS:

Readily marketable investments are reported at fair value on the basis of quoted market prices. Limited partnerships and similar interests are reported at fair value based on financial statements and other information received from the partnerships. The general partner determines the fair value of securities using quoted market prices, if available, or using other valuation methods, including independent appraisals. Investments in limited partnerships and similar interests totaled \$1,045,756,978 at September 30, 2003 and \$914,474,217 at September 30, 2002.

Investments are composed of the following at September 30, 2003 and 2002:

	2003		2002	
	Cost	Fair Value	Cost	Fair Value
Equities	\$ 669,594,749	\$ 748,915,114	\$ 777,336,835	\$ 657,164,230
Fixed income	292,509,453	297,618,883	241,882,051	257,278,087
Real estate	165,956,094	191,238,770	209,157,972	234,047,752
Absolute return	348,347,693	391,577,729	301,589,852	308,023,841
Private equity	191,503,902	189,111,750	174,640,837	154,705,550
Due from/to brokers, net	4,580,764	4,579,197	(427,413)	(550,720)
Total	\$1,672,492,655	\$1,823,041,443	\$1,704,180,134	\$1,610,668,740

Included in the table above is accrued investment income of \$1,956,673 and \$1,861,832 at September 30, 2003 and 2002, respectively.

At September 30, 2003, the Corporation had unfunded commitments of approximately \$253 million in various limited partnership investments.

As a result of its investing strategies, the Corporation is a party to index futures contracts. The Corporation's fixed income investment manager uses treasury index futures contracts to manage the duration of the fixed income portfolio. Changes in the market value of these futures contracts are recognized currently in the statements of changes in net assets, using the marked-to-market method. However, index futures contracts involve, to varying degrees, elements of market risk and credit risk in excess of the amounts recorded on the balance sheets. Market risk represents the potential loss the Corporation faces due to the decrease in the value of the financial instruments in the table below. Credit risk represents the potential loss the Corporation faces due to the inability of counterparties to meet the terms of their contracts.

Notes to Financial Statements

September 30, 2003 and 2002

The table below summarizes the long and short exchange-traded financial futures positions at September 30, 2003, and September 30, 2002:

	2003		2002	
	Net number of contracts-long/(short)	Contract Value (in \$ millions)	Net number of contracts-long/(short)	Contract Value (in \$ millions)
Index future contracts				
30-year Treasury bond	99	11.1	240	27.4
10-year Treasury note	222	25.4	221	24.7
5-year Treasury note	(285)	(32.3)	(67)	(7.6)
2-year Treasury note	10	2.2	—	—

The margin requirements on deposit with third-party safekeeping banks for index futures contracts were approximately \$.8 million at September 30, 2003 and 2002. The partnerships in which the Corporation invests may also hold index futures and options. These positions are not included in the table above.

The Corporation permits its investment managers to use forward foreign exchange contracts to manage the currency risk inherent in owning securities denominated in foreign currencies. In a forward foreign currency transaction, the Corporation agrees to exchange one currency for another on an agreed-upon date at an agreed-upon exchange rate. At September 30, 2003 and 2002, the Corporation held forward currency buy contracts with notional amounts totaling \$4.2 million and \$1.2 million, respectively. Such contracts involve, to varying degrees, risks of loss arising either from the potential change in market prices or from the possible inability of counterparties to meet the terms of their contracts. Forward foreign currency contracts are carried in the balance sheets at market value. Changes in the value of forward foreign currency contracts are recognized as increases or decreases in unrealized appreciation or depreciation until such contracts are closed.

The Corporation's investment advisors monitor the financial condition of the firms used for futures and forward foreign currency trading in order to minimize the risk of loss. Exposure limits are placed on firms relative to their credit worthiness. Management does not anticipate that losses, if any, resulting from credit or market risk would have a material adverse effect on the financial statements.

Notes to Financial Statements

September 30, 2003 and 2002

(4) FIXED ASSETS:

Fixed assets are composed of the following at September 30, 2003 and 2002:

	2003	2002
Leasehold improvements	\$ 4,148,526	\$ 3,893,816
Furniture and equipment	3,389,744	3,253,765
	7,538,270	7,147,581
Less accumulated depreciation and amortization	(6,903,147)	(6,745,183)
Total	<u>\$ 635,123</u>	<u>\$ 402,398</u>

(5) TAXES:

The Corporation is liable for federal excise taxes of two percent of its net investment income, as defined, which includes realized capital gains, for the year. However, this tax is reduced to one percent if certain conditions are met. The Corporation met the requirements for the reduced tax in 2003 and 2002. Therefore, current taxes are estimated at one percent of net investment income, as defined.

Deferred taxes represent two percent of unrealized appreciation of investments at September 30, 2003, as qualification for the one percent tax is not determinable until the fiscal year in which gains are realized. Because of unrealized losses incurred in 2002, the Corporation had no deferred tax liability.

During 2003 and 2002, the Corporation had unrelated business income of \$2,446,600 and \$348,600, respectively, from certain investment partnership activities. Federal and state taxes of \$823,200 in 2003 and \$100,700 in 2002 on this income are calculated using applicable corporate tax rates and are included in the provision for taxes.

The Corporation paid estimated federal excise taxes of \$625,000 in 2003 and \$1,250,000 in 2002. In 2003, the Corporation also paid estimated federal and state unrelated business income taxes of \$798,000. In 2002, the Corporation paid estimated federal unrelated business income tax of \$255,000.

Notes to Financial Statements

September 30, 2003 and 2002

(6) BENEFIT PLANS:

The Corporation purchases annuities for qualifying employees under the terms of a noncontributory, defined contribution retirement plan with Teachers Insurance and Annuity Association and College Retirement Equities Fund. Retirement plan expense for the years ended September 30, 2003 and 2002 was \$979,300 and \$947,000, respectively.

In addition, the Corporation has a noncontributory defined benefit annuity plan to supplement the basic plan described above. This plan is also administered by Teachers Insurance and Annuity Association and College Retirement Equities Fund. Contributions to this plan are based on actuarial calculations. No contribution was required in 2003 or 2002. At December 31, 2002, the assets of the plan exceeded the actuarial present value of accumulated plan benefits by approximately \$1,127,000.

In addition, the Corporation provides certain medical benefits to its retirees. The cost of providing these benefits was \$147,100 in 2003 and \$127,100 in 2002, on a pay-as-you-go basis.

(7) LEASES:

The Corporation occupies office space at 437 Madison Avenue under a lease agreement expiring December 31, 2013.

The following is a schedule of the future minimum lease payments at September 30, 2003.

Fiscal year ending September 30	
2004	\$ 1,604,000
2005	1,604,000
2006	1,604,000
2007	1,604,000
2008	1,627,000
2009-2014	<u>8,890,000</u>
	<u>\$16,933,000</u>

Rental expense for 2003 and 2002, including escalations, was \$1,580,200 and \$1,425,300, respectively.