Financial Statements

REPORT OF INDEPENDENT AUDITORS

To the Board of Trustees of
The Andrew W. Mellon Foundation:

In our opinion, the accompanying balance sheets and the related statements of activities and cash flows present fairly, in all material respects, the financial position of The Andrew W. Mellon Foundation (the "Foundation") at December 31, 2008 and 2007, 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. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

May 26, 2009

The Andrew W. Mellon Foundation

Balance Sheets

December 31, 2008 and 2007

	2008	2007
	(in thousands)	
ASSETS		
Investments		
Marketable securities	$ 1,846,098	$ 3,378,517
Limited liquidity investments	2,393,535	2,692,836
	4,239,633	6,071,353
Payable from unsettled securities purchases, net	(106,354)	(87,089)
	4,133,279	5,984,264
Cash	3,375	2,676
Collateral under securities loan agreement	167,205	486,749
Investment and other income receivable	5,330	7,470
Other assets	978	1,188
Taxes receivable	3,544	4,817
Property, at cost, less accumulated depreciation of $14,916 and $12,379 at December 31, 2008 and 2007, respectively	49,852	52,701
Total assets	$ 4,363,563	$ 6,539,865
LIABILITIES AND NET ASSETS		
Liabilities		
Grants payable	$ 52,693	$ 4,289
Accrued expenses	4,864	6,473
Payable under securities loan agreement	171,684	486,749
Deferred federal excise tax	—	23,100
Long term debt	44,350	44,000
Total liabilities	273,591	564,611
Net assets (unrestricted)	4,089,972	5,975,254
Total liabilities and net assets	$ 4,363,563	$ 6,539,865

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

The Andrew W. Mellon Foundation

Statements of Activities
Years Ended December 31, 2008 and 2007

	2008	*2007*
	(in thousands)	
INVESTMENT RETURN (LOSS)		
Gain (loss) on investments		
Realized, net	$ 148,523	$ 684,367
Unrealized, net	(1,729,036)	51,358
Interest	23,678	19,871
Dividends	29,604	44,390
Other income	131	559
	(1,527,100)	800,545
Less: Investment management expenses	(15,881)	(20,697)
Net investment return (loss)	(1,542,981)	779,848
EXPENSES		
Program grants and contributions, net	315,337	292,507
Grantmaking operations	15,277	14,590
Direct charitable activities	3,455	5,288
Investment operations	5,539	4,898
Current provision for taxes	2,533	5,649
Other expenses	160	205
	342,301	323,137
Change in net assets	(1,885,282)	456,711
Net assets (unrestricted) at beginning of year	5,975,254	5,518,543
Net assets (unrestricted) at end of year	$ 4,089,972	$ 5,975,254

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

The Andrew W. Mellon Foundation

Statements of Cash Flows

Years Ended December 31, 2008 and 2007

	2008	2007
	(in thousands)	
Cash flow from investment income and operations		
Change in net assets	$ (1,885,282)	$ 456,711
Adjustments to reconcile change in unrestricted net assets to net cash used by investment income and operations		
Realized gain on investments, net	(148,523)	(684,367)
Unrealized loss (gain) on investments, net	1,752,136	(52,258)
Decrease in investment and other income receivable	2,140	2,935
Decrease (increase) in other assets	210	(128)
Increase (decrease) in grants payable	48,404	(7,071)
Decrease in accrued expenses	(1,609)	(136)
Depreciation and amortization expense	2,637	2,657
(Decrease) increase in deferred federal excise tax payable	(23,100)	900
Decrease (increase) in net taxes receivable	1,273	(8,571)
Net effect of bond amortization	1,032	6,784
Total adjustments	1,634,600	(739,255)
Net cash used by investment income and operations	(250,682)	(282,544)
Cash flow from investing activities		
Proceeds from sales of marketable securities		
Short-term	1,423,046	1,116,531
Other	4,172,816	4,319,850
Receipts from limited liquidity investments	635,378	476,246
Capital gain distributions received	26,634	53,591
Net returns on financial instruments	(7,771)	(1,161)
Purchases of marketable securities		
Short-term	(1,494,800)	(1,054,849)
Other	(3,426,740)	(3,989,391)
Purchases of limited liquidity investments	(1,078,009)	(637,000)
Disposals of property	477	631
Net cash provided by investing activities	251,031	284,448
Cash flow from financing activities		
Bond proceeds	44,350	—
Bond redemption	(44,000)	—
Net cash provided by financing activities	350	—
Net increase in cash	699	1,904
Cash		
Beginning of year	2,676	772
End of year	$ 3,375	$ 2,676
Supplemental disclosure of noncash investing activities		
Distributions of securities received from limited liquidity investments	$ 16,605	$ 27,276

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

The Andrew W. Mellon Foundation

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Andrew W. Mellon Foundation (the "Foundation") is a not-for-profit corporation under the laws of the State of New York. The Foundation makes grants in five core program areas: higher education; museums and art conservation; performing arts; libraries and scholarly communication; and conservation and the environment. In addition to grantmaking activities, Foundation staff engage in research in areas that support the Foundation's mission, principally on issues that relate to higher education.

The financial statements of the Foundation have been prepared in conformity with generally accepted accounting principles. The significant accounting policies followed are described below.

Investments

Effective January 1, 2008, the Foundation adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements ("FAS 157"). FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FAS 157 also established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FAS 157 are as follows:

Level 1 Inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities that the Foundation has the ability to access at the measurement date.

Level 2 Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly, including inputs in markets that are not considered to be active.

Level 3 Inputs that are unobservable.

Inputs are used in applying the various valuation techniques and refer to the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, liquidity statistics and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The Foundation considers observable data to be that market data which is readily available and reliable and provided by independent sources. The categorization of a financial instrument within the hierarchy is therefore based upon the pricing transparency of the instrument and does not necessarily correspond to the Foundation's perceived risk of that instrument.

Investments whose values are based on quoted market prices in active markets are classified as Level 1 and include active listed equities, options, and certain short-term fixed income investments. The Foundation does not adjust the quoted price for such instruments, even in situations where the Foundation holds a large position and a sale of all its holdings could reasonably impact the quoted price.

Investments that trade in markets that are not considered to be active, but are valued based on quoted market prices, dealer quotations, or alternative pricing sources are classified as Level 2. These include certain U.S. government and sovereign obligations, government agency obligations, investment grade corporate bonds and less liquid equity securities.

Investments classified as Level 3 have significant unobservable inputs, as they trade infrequently or not at all. The inputs into the determination of fair value are based upon the best information in the circumstance and may require significant management judgment. All of the Foundation's limited liquidity investments are classified as Level 3. These investments are primarily made under agreements to participate in limited partnerships and are generally subject to certain withdrawal restrictions. Values for these partnerships, which may include investments in both nonmarketable and market-traded securities, are provided by the general partner and may be based on recent transactions, cash flow forecasts, appraisals and other factors. Market values may be discounted for concentration of ownership. Because of the inherent uncertainty of valuing the investments in such partnerships and certain of the underlying investments held by the partnerships, the Foundation's estimate of fair value may differ significantly from the values that would have been used had a ready market for the investments existed. The financial statements of the limited partnerships are audited annually by independent auditing firms. Investments in these partnerships may be illiquid, and thus there can be no assurance that the Foundation will be able to realize the value of such investments in a timely manner.

Realized gains and losses on investments in securities are calculated based on the first-in, first-out identification method. Included in payable from unsettled securities purchases in the accompanying balance sheets are receivables from unsettled securities sales of $148.6 million and $57.0 million at December 31, 2008 and 2007, respectively.

Grants

Grant appropriations include both conditional and unconditional grants. Unconditional grants are expensed when appropriated. Certain grants are approved by the Trustees subject to the grantee fulfilling specific conditions, most frequently that all or a portion of the grant funds be matched in a specified ratio. Such conditional grants are considered commitments and are not recorded as expense until the Foundation determines that the material conditions of the grant are substantially met or such meeting of conditions is probable.

Substantially all grants payable are due within one year and are recorded at face value.

Taxes

The Foundation qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code and, accordingly, is not subject to federal income taxes. However, the Foundation is subject to a federal excise tax. The Foundation follows the policy of providing for federal excise tax on the net appreciation (both realized and unrealized) of investments. The deferred federal excise tax in the accompanying financial statements represents tax provided on the net unrealized appreciation of investments. Under federal tax law the Foundation cannot carry forward realized losses resulting from the sale of investments. The Foundation is subject to income tax at corporate rates on certain income that is considered unrelated business income under the Internal Revenue Code.

Property

Property primarily consists of land held at cost, and buildings and their improvements located in New York City. These buildings are depreciated on a straight-line basis over their useful lives, generally twenty-five to twenty-eight years. Building improvements are depreciated over the remaining useful life of the building.

Notes to Financial Statements, (continued)

Investment Return

Investment return includes income and realized and unrealized gains or losses on all investments. Unrealized gain or loss comprises the change in unrealized appreciation or depreciation on marketable securities and the limited liquidity investments, net of deferred federal excise tax provided on such unrealized appreciation. Realized gains or losses include gains or losses realized on the sale of marketable securities and the Foundation's share of the operating results of the partnership investments, whether distributed or undistributed.

Expenses

Grantmaking operations include all costs related to appropriating, paying and administering grants. Direct charitable activities are the active programs conducted by the Foundation or supported by it and include expenditures for ARTstor Inc. ("ARTstor") and Ithaka Harbors, Inc. ("Ithaka"), which are independent not-for-profit entities, and expenditures for research. Investment operations include the costs of supervising the Foundation's investment portfolio. Current provision for taxes includes federal and state taxes. Other expenses include certain expenses that the Foundation is not permitted to report either as an expense of distribution or an expense of earning income.

Salaries and benefits are allocated to each activity listed above, and also to core administration, based on estimates of the time each staff member devoted to that activity. Core administration expenses are then prorated among the activities listed above on the basis of the direct salary allocations. Identifiable costs, such as consultants, are charged directly to each activity.

Amounts for program grants, grantmaking operations, and direct charitable activities shown on the Statement of Activities will not agree with the amounts on the Foundation's Form 990PF, the federal excise tax return, because a cash basis is required for reporting the expenses of distribution for tax purposes as contrasted with the accrual basis used in preparing the accompanying financial statements.

The administrative expenses of distribution, including direct charitable activities, were $18.7 million (6.7% of appropriated program grants) in 2008 compared to $19.9 million (6.9% of appropriated program grants) in 2007. The decrease in administrative expenses in 2008 is primarily due to lower interest expense. The Foundation's grantmaking expenses in 2008 were $15.3 million (5.5% of appropriated program grants), compared to $14.6 million (5.1% of appropriated program grants) in 2007.

Investment management expenses are the direct costs of portfolio management, including fees for investment management, custody, and advisory services.

The Foundation's expenses by natural classification are as follows for 2008 and 2007:

	2008	2007
	(in thousands)	
Program grants and contributions, net	$315,337	$292,507
Salaries, pensions and benefits	13,828	13,012
Other operating expenses	10,603	11,969
Current provision for taxes	2,533	5,649
	$342,301	$323,137

Use of Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

Reclassifications

Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

NOTE 2—INVESTMENTS:

Marketable securities held at December 31, 2008 and 2007 are summarized as follows:

	December 31, 2008		*December 31, 2007*	
	Market Value	*Cost*	*Market Value*	*Cost*
	(in thousands)			
Equities	$1,203,382	$ 1,548,702	$2,513,023	$2,018,796
Fixed income	418,465	431,055	690,404	659,178
Short-term	243,626	243,582	171,712	171,658
Derivative financial instruments	(19,375)	(14,612)	3,378	(1,286)
	$1,846,098	$2,208,727	$3,378,517	$2,848,346

The classification of investments by level within the valuation hierarchy as of December 31, 2008 is as follows:

	Total	*Quoted Prices (Level 1)*	*Significant Observable Inputs (Level 2)*	*Significant Unobservable Inputs (Level 3)*
	(in thousands)			
Marketable securities	$1,846,098	$1,080,755	$582,466	$ 182,877
Limited liquidity investments	2,393,535	—	—	2,393,535
Payable from unsettled securities purchases, net	(106,354)	(106,354)	—	—
	$4,133,279	$974,401	$582,466	$2,576,412

The reconciliation of activity for level 3 investments for the year ended December 31, 2008 is as follows:

	Marketable Securities	*Limited Liquidity Investments*
	(in thousands)	
Balance as of December 31, 2007	$ 203,400	$2,692,836
Net realized gains	16,850	196,472
Income (losses)	418	(62,434)
Purchases	83,601	1,078,008
Distributions	—	(655,560)
Net unrealized losses	(121,392)	(855,787)
Balance as of December 31, 2008	$ 182,877	$2,393,535

Net unrealized losses included in the statements of activities for investments held at December 31, 2008 are $121.4 million for marketable securities and $716.8 million for limited liquidity investments, respectively.

Notes to Financial Statements, (continued)

Through certain investment managers, the Foundation is a party to a variety of forward contracts, options, swaps and other derivative financial instruments, all of which are carried at fair value. The extent of the Foundation's involvement in these instruments is determined by the composition of the investment portfolio and the Foundation's expectations as to the direction and volatility of equity and fixed income markets as well as other economic factors. These transactions involve elements of market risk in excess of amounts reflected in the accompanying balance sheets. Changes in the market value of these financial instruments are recognized currently in the statements of activities.

Through certain investment managers, the Foundation purchases and sells forward currency contracts whereby the Foundation agrees to exchange one currency for another on an agreed-upon date at an agreed-upon exchange rate to minimize the exposure of certain of its marketable securities to adverse fluctuations in financial and currency markets. As of December 31, 2008 and 2007, the Foundation had forward currency contracts with notional amounts totaling $26.1 million and $16.6 million, respectively. At December 31, 2008, approximately $26.1 million in assets and $26.2 million in liabilities related to open foreign currency contracts, at market value, are included in derivative financial instruments. At December 31, 2007, approximately $16.6 million in assets and $16.5 million in liabilities related to open foreign currency contracts, at market value, are included in derivative financial instruments.

Through a securities lending program managed by its investment custodian, the Foundation loans certain stocks and bonds included in its investment portfolio to qualified investors. The custodian has indemnified the program against counterparty risk and also maintains collateral in excess of the value of the securities on loan. As of December 31, 2008, cash instruments received as collateral and reinvested in other fixed income investments declined by $ 4.5 million as a result of unrealized losses due to market declines. The Foundation has reflected this decline in the accompanying financial statements. The Foundation's gross securities loaned to certain investors at December 31, 2008 and 2007 amounted to approximately $169 million and $474 million, respectively. The collateral held by the Foundation is measured as a Level 2 asset.

Financial instruments such as those described above involve, to varying degrees, elements of market risk and credit risk in excess of the amounts recorded on the balance sheet. Market risk represents the potential loss the Foundation faces due to the decrease in the value of financial instruments. Credit risk represents the maximum potential loss the Foundation faces due to possible non-performance by obligors and counterparties as to the terms of their contracts.

Management does not anticipate that losses, if any, resulting from its market or credit risks would materially affect the financial position and operations of the Foundation.

Pursuant to its limited partnership agreements, the Foundation is committed to contribute approximately $1.49 billion as of December 31, 2008 in additional capital over the next ten years. Unpaid commitments at December 31, 2007 were $1.45 billion.

The Foundation invests in a variety of fixed income securities and contractual instruments, which by their nature are interest rate sensitive. Changes in interest rates will affect the value of such securities and contractual instruments.

NOTE 3—BONDS PAYABLE:

At December 31, 2008, the Foundation had outstanding $44.4 million of taxable term bonds ("the Bonds") with a maturity date of December 1, 2032. These Bonds were issued in June 2008. Bond interest is reset weekly by the Foundation's Bond agent. Bond holders have the right to tender their Bonds to the Bond agent weekly, and the agent has an obligation to remarket such bonds. Bonds that cannot be remarketed must be redeemed by the Foundation. The Foundation believes that the market value of the Bonds approximates the book value.

In connection with the 2008 Bond offering, the Foundation entered into a $30 million dedicated line of credit agreement. Borrowings, if any, under this line of credit are to be used solely to fund redemption requirements of the Bonds. The line of credit agreement expires on September 8, 2011. This facility has an annual commitment fee on unfunded commitments of 0.20%. As of December 31, 2008, there were no borrowings outstanding under the line of credit.

At December 31, 2007, the Foundation had outstanding $44.0 million of auction rate taxable term bonds. In March 2008, in response to the turmoil in the credit markets, the Foundation redeemed all of these bonds at par. The redemption resulted in a 2008 loss of $407 thousand resulting from the write-off of unamortized deferred debt costs.

The average interest rate applicable in 2008 was 3.2% and in 2007 was 5.4%. Interest incurred in 2008 and 2007 was $1.1 million and $2.4 million, respectively.

NOTE 4—TAXES:

The Internal Revenue Code imposes an excise tax on private foundations equal to 2 percent of net investment income (principally interest, dividends, and net realized capital gains, less expenses incurred in the production of investment income). This tax is reduced to 1 percent when a foundation meets certain distribution requirements under Section 4940(e) of the Internal Revenue Code. The Foundation was subject to the 1 percent rate in 2008 and in 2007. Certain income defined as unrelated business income by the Code may be subject to tax at ordinary corporate rates.

The provision for taxes consists of a current provision for the federal excise taxes on net investment income and federal and state taxes on unrelated business income and a deferred provision on the change in unrealized appreciation of investments. The current tax provision for 2008 comprises $2.8 million of federal excise tax on net investment income. The current tax provision for 2007 comprises $5.7 million of federal excise tax on net investment income. Federal and state taxes on unrelated business income were immaterial in 2008 and 2007. The change in unrealized depreciation reflected on the statements of activities includes a benefit for deferred taxes based on net unrealized depreciation of investments at 2 percent. In 2008, the Foundation incurred cumulative net unrealized losses which depleted the cumulative unrealized gains and resulted in a benefit for deferred taxes of $23.1 million. Taxes paid in 2008 and 2007 were $1.3 million and $14.2 million, respectively.

On February 1, 2008, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48-2, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 for Certain Nonpublic Enterprises ("FIN 48")*, which allowed the Foundation to defer the adoption of FIN 48 until annual periods beginning after December 15, 2007. The Foundation elected to take advantage of this deferral. On December 30, 2008, the FASB issued FSP No. FIN 48-3, deferring the effective date of adoption of FIN 48 for non-public enterprises. Adoption of FIN 48 is required for annual periods beginning after December 15, 2008. Based on its continued analysis, the Foundation believes that the adoption of FIN 48 will not have a material impact on its financial statements.

Notes to Financial Statements, (continued)

NOTE 5—GRANTS, CONTRIBUTIONS, AND COMMITMENTS:

The following table of grant activity by major program area includes all grant appropriations approved during 2008. Grants payable and committed at December 31, 2007 have been restated to reflect cancellations of $1.6 million.

	Payable and Committed December 31, 2007	*2008 Grants and Commitments*		*Payable and Committed December 31, 2008*
		Appropriated	*Paid*	
		(in thousands)		
Conservation and the Environment	$ 4,171	$ 13,337	$ 12,671	$ 4,837
Museums and Art Conservation	15,470	29,920	25,562	19,828
Performing Arts	6,482	41,671	37,299	10,854
Higher Education and Scholarship	61,239	159,563	159,274	61,528
Libraries and Scholarly Communication	7,955	33,264	31,356	9,863
Public Affairs	—	50	50	—
Other (1)	484	480	480	484
Program grants and commitments - totals	95,801	278,285	266,692	107,394
Contributions and matching gifts	—	787	787	—
	$95,801	$279,072	$267,479	$107,394

(1) Other is primarily comprised of grants made to certain grantees that were directly affected by Hurricane Katrina.

Grant and grant commitment activity is summarized below.

	2008	2007
	(in thousands)	
Grants Payable		
Grants payable at January 1	$ 4,289	$ 11,360
Grant expense	315,883	293,128
Less grants paid	(267,479)	(300,199)
Grants payable at December 31	$ 52,693	$ 4,289
Net Grant Expense		
Unconditional grants	$ 225,857	$ 225,886
Conditional grants meeting conditions for expense	90,026	67,242
	315,883	293,128
Less grant refunds	(546)	(621)
Net grant expense at December 31	$ 315,337	$ 292,507
Grant Commitments		
Grant commitments at January 1	$ 91,512	$ 99,378
Less commitments cancelled	—	(1,620)
Conditional grants appropriated	53,215	60,996
Less grants meeting conditions for expense	(90,026)	(67,242)
Grant commitments at December 31	$ 54,701	$ 91,512

NOTE 6—OTHER SERVICES:

Pursuant to agreements between the Foundation and Ithaka and ARTstor, the following services and arrangements have been provided:

- Ithaka provides information technology services to the Foundation. In 2008 and 2007, Ithaka charged $918 thousand and $943 thousand, respectively, to the Foundation for these services.
- The Foundation provides office space, free of charge, to Ithaka and ARTstor in a building owned by the Foundation in New York City. Effective April 1, 2009, the building lease between the Foundation, Ithaka and ARTstor was extended through December 31, 2014. Under the terms of this lease office space will be provided rent free; however, Ithaka and ARTstor will assume certain building operation costs previously paid by the Foundation.