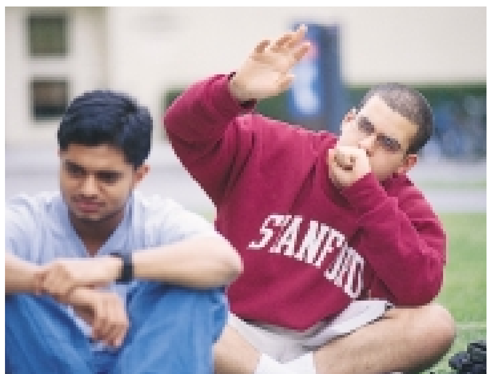
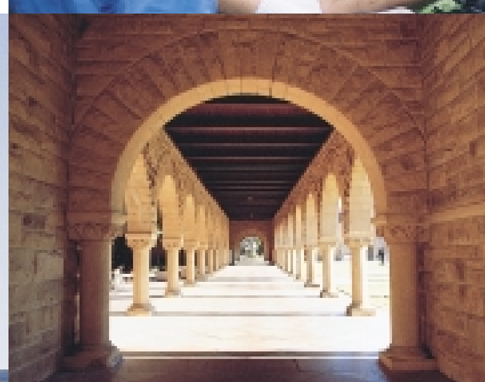
STANFORD UNIVERSITY ANNUAL REPORT 1999





STANFORD UNIVERSITY

Since its opening in 1891, Stanford University has become one of the world's great universities, with excellences in areas ranging from the humanities to the social sciences to engineering and the sciences. The University's spirit comes from its California location and from its founders, Leland and Jane Stanford, who, within weeks of the 1884 death of their only child, committed their wealth to doing something for "other people's" children.

They created a university that, from the outset, was untraditional: co-educational when most were all-male; non-denominational when most were associated with a religious organization; and avowedly practical, producing "cultured and useful citizens" when most were concerned only with the former. The Founding Grant states the Stanfords' intent "to qualify students for personal success and direct usefulness in life; and to promote the public welfare by exercising an influence on behalf of humanity and civilization, teaching the blessings of liberty regulated by law, and inculcating love and reverence for the great principles of government as derived from the inalienable rights of man to life, liberty, and the pursuit of happiness."

Today, Stanford University is a research-intensive university organized into seven schools: Earth Sciences, Education, Engineering, Graduate School of Business, Humanities and Sciences, Law, and Medicine. In addition, more than two dozen institutes and research centers–such as the Hoover Institution on War, Revolution, and Peace; the Institute for International Studies; and the Stanford Linear Accelerator Center–attract renowned scholars and world leaders. The University's rigorous curriculum encourages students to think critically and communicate effectively so that they may participate in the search for knowledge. At Stanford, teaching, learning, and research are part of a single enterprise.

ENROLLMENT (1999):	14,219
Undergraduate students:	6,594
Graduate students:	7,625

DEGREES AWARDED (1998-1999):	
Bachelor's:	1,687
Master's:	2,070
Doctoral:	839

THE STANFORD PROFESSORIATE:	1,640
Nobel Laureates:	15
Pulitzer Prize Winners:	3
Congressional Medal of Honor:	1
MacArthur Fellows:	22
National Medal of Science Winners:	19
National Medal of Technology Winners:	3
American Academy of Arts and Sciences Members:	211
National Academy of Sciences Members:	117
National Academy of Engineering Members:	75
American Philosophical Society Members:	40
National Academy of Education Members:	26
Wolf Foundation Prize Winners:	6
Koret Foundation Prize Winners:	4
Presidential Medal of Freedom Recipients:	2

On the cover: The David Packard Electrical Engineering Building, juxtaposed with the arches of the Main Quadrangle, completes Stanford's new Science and Engineering Quadrangle. Above, students in Stanford Introductory Studies benefit from small classes and direct interaction with senior faculty members.

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Stanford was awarded the 1999 Governor's Historic Preservation Award. Among the buildings recently renovated were, from top to bottom, the Bing Wing of the Cecil H. Green Library, the Iris & B. Gerald Cantor Center for Visual Arts, and Frank Lloyd Wright's Hanna House.

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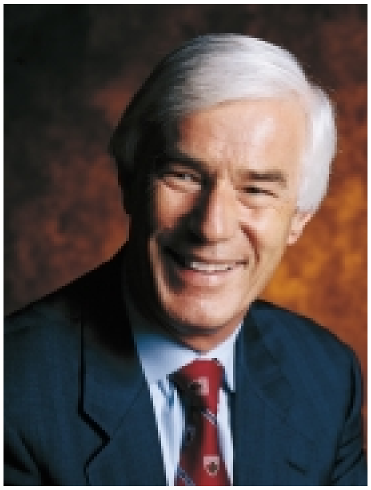
FROM THE **PRESIDENT**

A strong endowment ensures a strong **Stanford**

Stanford University is a wondrously varied institution–rich in talent and educational opportunities; rich in research and scholarship; rich in athletic challenges and artistic creativity; rich in loyalty of alumni and friends; and rich in past and present contributions to California, the nation, and the world. In addition to unmatched intellectual and academic resources, Stanford is fortunate to have one of the largest financial endowments among U. S. institutions of higher education.



As of August 31, 1999, the value of the endowment was $6.2 billion, an impressive sum even by the standards of today's strong economy. To some, this suggests that Stanford is also rich financially, and on the basis of endowment value alone, that would seem a reasonable conclusion.

Yet as Stanford's president for almost eight years, I know this conclusion is misleading. Every year the University faces increasingly severe budget pressures due to one basic fact–despite appearances, Stanford is actually underfunded from an endowment perspective. Stanford's endowment, while clearly large, is less than half that of Harvard, and approximately three-quarters that of Yale or Princeton. This disparity affects both our current allocation of resources and Stanford's future opportunities. As I prepare to leave this office and return to teaching, I can think of no more important financial issue before us than to communicate clearly to Stanford alumni, friends, donors, parents, and other supporters why we need to be concerned about the size of the endowment.

If you plant for a year, grow rice.
If you plant for a decade, grow trees.
If you plant for a century, grow educated men and women.
— Chinese proverb

We must increase the size of the University's endowment for five critical reasons:

1 **To maintain access to Stanford for the most talented undergraduates.** Stanford is one of only a few private American colleges and universities that admit students without regard to their ability to pay, and then makes it possible for them to attend through generous financial aid programs. In the 1998-99 academic year, approximately 70% of Stanford undergraduates received some form of financial aid from a variety of internal and external sources. Stanford provided scholarship aid totaling approximately $47.3 million. Of that amount, about $34.9 million came from Stanford restricted sources, including endowment income or other donations (such as The Stanford Fund), and an additional $12.4 million came from general funds. The latter amount strains the University budget because general funds must support most day-to-day operating expenses, from faculty and staff salaries to utilities and insurance. In order to continue our commitment to need-blind admissions, Stanford must be able to support a greater percentage of scholarship aid with endowment income.

2

To ensure that recent improvements to undergraduate education at Stanford become permanent. Enhancements to the undergraduate program, described on page 7, have initially relied on general funds and one-time gifts for startup resources. Between 1994 and 2000, the budget for undergraduate education initiatives grew from $4 million to $14 million, with $6 million coming from general funds. Although these funds are an appropriate source of seed money for academic innovation, in order for such programs to become permanent, income from endowment gifts designated for support of undergraduate education must take over so that seed money can be available for other initiatives. The work of the University is work that cannot be done unless it is continuously reconsidered. Programmatic renewal and innovation are the lifeblood of the institution, but neither is possible without sustained support from endowment funding.

Stanford is one of only a few private American colleges and universities that admit students without regard to their ability to pay.

3

To continue attracting the highest caliber faculty and graduate students. Soaring rental rates and home prices in the local real estate market are threatening the University's ability to recruit and retain outstanding faculty and students. The area surrounding the University is among the most expensive residential real estate markets in the country, where even the most modest home costs at least half a million dollars. Stanford has a long history of providing housing assistance for faculty to aid in recruitment and retention; however, in recent years, the University has had to increase its spending in this area significantly. Stanford's current balance of loans outstanding for housing assistance programs is $134.6 million, a figure that has more than doubled since 1992-93. And in fiscal year 1998-99, Stanford committed an additional $10 million to ensure that the high-caliber faculty on which the University depends would not be deterred from coming here, or from staying, by the high cost of housing.

Graduate students, who more typically rent than own homes, are being squeezed by rising rental rates, which in Santa Clara County have climbed 38% in just the past three years. In the coming year, Stanford will use more than $3 million in general funds to subsidize 349 off-campus rental apartments for 609 graduate students to help address this problem, even as we work aggressively to increase the supply of graduate student housing on campus. To meet the financial challenges posed by these extraordinary costs and still support the day-to-day expenses of the University, Stanford needs increased endowment income.

4

To reduce the University's reliance on federal funding. In 1997, Stanford launched an ambitious new program known as Stanford Graduate Fellowships, as described on page 8. Our goal is to raise $200 million in endowment funds for this initiative. The payout from these restricted funds will provide annual support for a minimum of 300 graduate students in the sciences and engineering when the program is fully implemented. While Stanford's overall revenue from government grants and contracts has grown over the past decade (as shown on page 18), individual grant renewal periods are often out of sync with University research programs or an individual student's doctoral pursuits. The endowment support we are seeking would equal roughly half our current federal funding for research assistantships, allowing the University to become much more self-reliant in this area.

5

To ensure that Stanford's contributions to the great stream of blessings that has flowed to society from research-intensive universities will continue. Universities promote the public welfare through the increase of knowledge. This understanding was inherent in Jane and Leland Stanford's founding gift, which established the endowment on which the University depends today and to which so many others have given over the years. While few of the University's supporters could have envisioned the extent to which students from Stanford, ideas from Stanford, and in many cases, breakthroughs from Stanford would shape the close of this century, all shared a deep commitment to supporting the continued search for knowledge that is our mission.

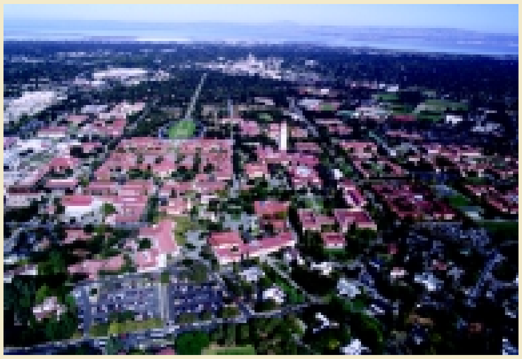
If we are to increase Stanford's endowment so that the search can continue, we have the responsibility and the challenge to explain in the clearest manner possible what role endowment plays in the complex financial life of the University. Below are answers to questions most often asked by alumni, students, donors, friends, and other supporters of Stanford.

What exactly is the endowment?

Stanford's endowment is an accumulation of primarily gift funds set aside and invested to support the University's teaching and research missions in perpetuity. The original endowment was created in 1885 by Leland and Jane Stanford. Over the last 115 years, thousands of other donors who have wanted to provide enduring support for the University have added their own gifts. Today the endowment is comprised of 5,600 individual principal funds, each with a designated purpose, linked to an additional 5,600 parallel funds that hold the income the principal funds generate. By law, most of the endowment funds are required to be invested in perpetuity; only the income and related gains may be used to support each gift's purpose.

Is Stanford's land part of the endowment?

Yes. The land Jane and Leland Stanford gave the University through their original donation is part of the endowment, with the restriction that it can never be sold. The Stanfords intended their property to provide an ongoing source of income to help support the institution. Because the land cannot be sold, the current value of the endowment does not reflect the present market value of comparable land without this restriction. It does, however, reflect the market value of certain properties that have been commercially developed to provide the type of support the Stanfords envisioned, such as the Stanford Shopping Center and Stanford Research Park.



The land Jane and Leland Stanford gave the University is part of the endowment, with the restriction that it can never be sold.

What role does the endowment play in University financing?

Each year, the Board of Trustees approves a payout for the endowment. These funds, which flow to the budget from interest and gains on endowment principal, provide an essential source of income for Stanford. However, because Stanford's endowment is actually less than it should be for the size and scope of its academic and research programs, endowment income provided by the payout ranks only fourth among the University's principal sources of operating revenue, behind government grants and contracts, gifts and non-government grants, and student tuition and fees.

In fiscal year 1998-99, endowment income covered 16% of the University's total operating expenses. Approximately 75% of this amount was designated by donors for specific purposes, including student financial aid (22%) and teaching or research activities in Stanford's seven schools and related departments (53%). Only about 25% of endowment payout did not have a restricted purpose. These critical funds are the University's most flexible source of income to meet current day-to-day expenses, as well as to fund future initiatives.

How does Stanford manage its endowment?

Approximately $6.0 billion of the endowment is invested in shares of the Merged Endowment Pool (MEP), which operates similarly to a mutual fund. The remaining endowment is invested in specific assets, such as real estate and living trusts. Stanford Management Company (SMC) is responsible for managing the endowment on behalf of the University, including investing the funds in the MEP. The goals of SMC are to provide stable budgetary support and to preserve the long-term value of the endowment for future generations. SMC establishes a strategic asset allocation, manages the risk associated with investments, and identifies value-adding strategies. Details of the current endowment investment profile and results are provided beginning on page 15.

How does market volatility affect Stanford financially?

The University takes a long-term view of managing its resources and employs specific measures to protect the budget from year-to-year extremes in the financial markets. First, we use a diversified approach in making MEP investments, as described in the Stanford Management Company report on page 15, with the goal of managing risk even as we seek optimal returns. Second, we apply a "smoothing" formula to the endowment payout to buffer the annual budget from market volatility. In periods of unusually high returns, smoothing reduces the actual payout. In down markets, smoothing increases the actual payout, so that in either case, year-to-year fluctuations are minimized. However, smoothing cannot protect the institution from a prolonged market downturn, which over time, would create significant financial pressures. We have established a reserve to provide a prudent level of protection should this occur.

If the University needs more money, why not spend more of the endowment?

A university's endowment is not a checking account, but rather a trust fund. We, the current generation, are trustees for all future Stanford generations. Common sense and, in many cases, the law, do not allow us to spend the endowment's principal. And our duty to future generations does not allow us to spend even all of the interest, dividends, and capital gains; we must reinvest enough to ensure that the endowment is not eaten away by inflation.

Historically, financial markets have performed in cycles. In periods such as the present one, when the market is strong and endowment returns above average, it is easy to lose sight of the fact that positive returns are not guaranteed. Over the past 35 years, the real (i.e., inflation-adjusted) annual return on Stanford's endowment has averaged only 6.15%, a figure that compares very favorably with the returns of other university endowments but does not provide for substantial reinvestment relative to a payout rate in the range of 4 to 5%. A closer look at endowment returns from 1964 to 1982 reveals that the compounded real return on Stanford's endowment in this 18-year period was only about 1%, and in eight years, returns were actually negative. When that occurs (and the cyclical nature of the market indicates that it will occur again), it is vital to be able to draw upon previously reinvested gains to provide the current year's endowment payout.

Is Stanford using the financial gains from the recent strong market?

Yes. The percentage of the University's total expenses supported by endowment income has grown from 12% in 1996 to a budgeted 16% in 2000.

How does Stanford compare to other top universities from an endowment perspective?

According to figures published by the National Association of College and University Business Officers, in FY98, Stanford ranked 21st in a comparison of endowment value per student at private U.S. colleges and universities. Princeton had the third-highest figure, while Harvard ranked fifth and Yale eleventh. Although Stanford has less endowment than its peers, we do more with what we have. Among the private universities with which we most compete, Stanford aspires to excellences across the widest spectrum of endeavor—arts, humanities, social sciences, and athletics; medicine, law, business, sciences, and engineering; and college, graduate, and professional teaching, learning, and research.

I believe one of the most important challenges the University faces at the close of the 20th century is to address the imbalance between Stanford's endowment resources and the remarkable breadth of its academic and research programs. While the University's overall financial position is very strong, we cannot afford to overlook this critical financial imperative.

INVESTING IN **UNDERGRADUATE EDUCATION**

Since 1995, Stanford has engaged in a program unprecedented among research-intensive universities to improve the first two years of the undergraduate experience.

Called Stanford Introductory Studies (SIS), the program has its roots in the Commission on Undergraduate Education appointed in 1993 by President Gerhard Casper. In their report, members said, "At the heart of the University's various activities, the source of its central values and fundamental aspirations, is the search for knowledge. The most important aim of undergraduate education is to involve students in this search, where teaching and learning, instruction and research, the communication and discovery of knowledge are combined in a single enterprise."

Russell Fernald, the Benjamin Scott Crocker Professor of Human Biology and Professor of Psychology, is a recipient of a Bing Teaching Prize and the Cox Medal for mentoring undergraduates. He is among the senior faculty members who teach a sophomore seminar as part of Stanford Introductory Studies. His class, "Studies of Animal Behavior," explores how animal behavior offers insights into evolutionary adaptations and guides students in learning how to evaluate original research.

The resulting Stanford Introductory Studies emphasizes small-group experiences with the University's most senior faculty members that help students create mentoring relationships, select a major, and participate in research and honors projects.

Among the new programs are:

- Freshman Seminars, which allow first-year students to work with senior faculty in classes of no more than 16 students;
- Sophomore Dialogues, which are tutorials enrolling no more than five students, and Sophomore Seminars, which include no more than 12 students;
- a new Freshman/Sophomore College, which allows students to live together while exploring a range of topics in the liberal arts and sciences; and
- Sophomore College, which consists of 12-student seminars held two weeks prior to the start of fall quarter.

Students in Lecturer Benjamin Robinson's Introduction to the Humanities course, "Great Works," benefit from Stanford Introductory Studies' emphasis on small classes and direct interaction with faculty.

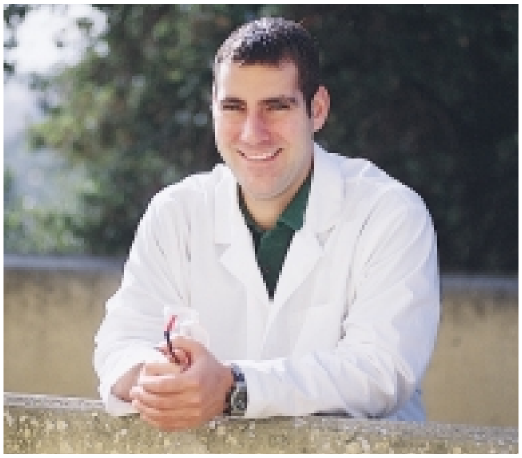
Initiatives to enhance undergraduate education have come and gone at Stanford and other colleges and universities. What makes SIS different is the more than $25 million in seed money resulting from gifts by several donors (including trustee Peter Bing), donations to The Stanford Fund, and University funds provided by the president and provost. In addition, SIS is distinguished by the overwhelmingly positive experiences reported by senior faculty members. Efforts are now under way to raise endowment gifts for these programs, thus providing a source of continuous funding and ensuring their future.

Says President Casper, "I do not know of any other research-intensive university that has, in a similarly short period of time, undertaken as great an allocation and reallocation of resources to enhance undergraduate teaching. I believe these programs help position Stanford to offer the best undergraduate education available anywhere."

INVESTING IN **GRADUATE EDUCATION**

What began as informal conversations among President Gerhard Casper and members of the Stanford faculty has turned into one of the most successful graduate programs in the nation. The president asked, "What is the most important need at the University?"

In response, faculty lamented the dependence of university graduate education on federal funding. If graduate education is vital to the future of universities, to the success of our economy, and is a primary mission of research-intensive universities, they argued, is it wise to leave it vulnerable to the vagaries of the political process?



Third-year chemistry Graduate Fellow Marc Scanio is studying organic chemistry with Paul Wender, the Francis W. Bergstrom Professor of Chemistry. His research explores a new reaction that can aid in the synthesis of biologically active, complex molecules important in medicines. A graduate of the University of Michigan, he was an intern at Parke-Davis Pharmaceuticals before coming to Stanford.

The conversations resulted in the Stanford Graduate Fellowship Program, a first-of-its-kind opportunity for students to pursue graduate education independent of restrictions and confident of ongoing support. Graduate students, particularly those in the sciences, have traditionally pursued research and study aided by funding restricted to specific projects or faculty grants. Stanford Graduate Fellowships free students to explore, much like entrepreneurs, research subjects that cannot necessarily compete for grants, but that may yield significant discoveries.

President Casper, who has made the Stanford Graduate Fellowships one of the University's top priorities, committed $10 million in discretionary funds to cover the first two years of the program. At the same time, a $200 million endowment drive was launched in April 1997, starting with $100 million in matching funds provided by a small group of donors to create an incentive for other donors. Under this program, gifts are matched on a one-to-one basis. The endowment is more than three-quarters raised and beginning to provide crucial funding. Donors include undergraduate and graduate alumni, friends, corporations, and foundations. Corporations, which typically do not make gifts of endowment, have cited the role graduate students play in basic research, technological innovation, technology transfer, and economic growth as reasons for contributing.

Now in its third year, Stanford Graduate Fellowships is being emulated by other research universities, according to Dean of Research Charles Kruger. Of the 102 fellows admitted for the fall of 1999, 54 were in the School of Engineering, 25 in the School of Humanities and Sciences, 14 in the School of Medicine, five in the School of Earth Sciences, and four in the School of Education.

"I believe that what Stanford and other universities do is directly related to the success of the nation's economy," says Kruger, adding, "To the extent, for instance, that Stanford has been a catalyst in the creation of Silicon Valley, it is in a very significant way due to the work of the people we have educated."

Graduate student Karen Butler, who is working in the Human-Computer Interaction Program with Professor of Computer Science Terry Winograd, is a Hewlett-Packard Graduate Fellow. A graduate of Harvard, she earned her master's degree at the University of London, where she was a Marshall Scholar. Before coming to Stanford, she worked for a company developing interactive learning products and is now researching learning and training applications.

FROM THE
BOARD OF TRUSTEES CHAIR
Rebuilding strength from adversity

Stanford recently observed a 10-year anniversary that is inauspicious at best: the Loma Prieta earthquake. No one who was on campus on October 17, 1989, will forget the 7.1-magnitude temblor that damaged more than 200 Stanford buildings.

Green Library West, now called the Bing Wing, was reopened in 1999, a decade after it was closed because of damage caused by the Loma Prieta earthquake.

The Loma Prieta earthquake has served as a reminder of the importance of our "physical endowment"–the 8,180 acres of land and 678 buildings entrusted to our care. In the coming years, Stanford will increasingly seek to build appropriate resources in support of its "human endowment"—the students and faculty whose relationship is the fundamental purpose of the University. But, as trustees, we must assiduously sustain the "sandstone arches and cloisters and the red-tiled roofs against the azure sky" that are integral to the Stanford experience. In this effort, we are indebted to the hundreds of alumni and friends, as well as the Federal Emergency Management Agency, whose support has helped rebuild Stanford stronger and safer than before. Indeed, a plaque has been placed in the inner Quad in their honor.

Leland and Jane Stanford wisely decreed in their Founding Grant that the lands they gave to the University should never be sold, but rather used to further academic objectives. Our founders took great care in the campus plan and construction of Stanford, engaging the best architects of their time and closely supervising their work and that of contractors and artisans. Our actions in managing our land and buildings are continuously guided by the purpose and legacy of the Stanfords, who created a model for university design unlike anything seen before in America.

Over the past 10 years, we have restored and renewed our facilities to meet the changing nature of teaching, learning, and research. More than two-thirds of the construction investment has involved renovation, repair, or seismic strengthening of current space. The other one-third has added new buildings for expanding and evolving programs.

Among the historically significant buildings that have been enhanced are Memorial Church and large portions of the Main Quad, Encina Hall, the Leland Stanford Junior Museum (now part of the Iris & B. Gerald Cantor Center for Visual Arts), and Frank Lloyd Wright's Hanna House. The State of California recognized Stanford for "outstanding achievements in the field of historic preservation" with the Governor's Historic Preservation Award for 1999.

Most recently, Stanford reopened the Bing Wing of the Cecil H. Green Library, the old main library. Formerly known as Green Library West, the wing honors trustee Peter Bing and Helen Bing, who made the major gift in restoring the library following an initial gift from Mel and Joan Lane.

As the University continues into its second century, campus planning and development has realized plans dating almost to the beginnings of Stanford that called for a science quadrangle to be built west of the Main Quad. The Science and Engineering Quadrangle and the Serra Mall were completed and inaugurated in the fall. The quad includes the David Packard Electrical Engineering Building, honoring the 1934 Stanford graduate who co-founded Hewlett-Packard and whose gift, along with that of Bill Hewlett, made the quad possible.

The campus continues to grow and evolve. In the near future, we look forward to opening the Center for Clinical Sciences Research adjacent to the Medical School and the new Frances C. Arrillaga Alumni Center near Frost Amphitheater.

Stanford is blessed with a physical endowment second to none. We will work to protect and enhance that endowment as we invest in the faculty and students it serves.

Robert M. Bass

Robert Bass
Chair, Stanford Board of Trustees

DISCUSSION OF **FINANCIAL RESULTS**

Stanford University's strong financial performance in fiscal year 1998-99 (FY99) is reflected in this year's financial statements. The University's academic and research programs benefited from another year of essential support from current donors and from the ongoing resources provided by previous gifts to the endowment. As described in the "Report from the Stanford Management Company" on page 15, this year's favorable investment environment produced exceptional returns, providing both increased support for operations and investment for the future.

Stanford continues to experience both the benefits and costs associated with Silicon Valley. Growth in technology companies helped fuel the year's strong financial markets. Stanford's role in advancing technology was highlighted in October 1999, when former Stanford electrical engineering professor and entrepreneur Jim Clark pledged $150 million to the University. Clark is the founder of Silicon Graphics, Netscape, Healtheon, and myCFO. His gift will be instrumental in establishing the James H. Clark Center for Biomedical Engineering and Sciences. It is the single largest gift in Stanford history since the Founding Grant and among the largest gifts ever in higher education.

The University's financial strength fosters Stanford's pioneering spirit and its unique combination of leading-edge research, high-quality educational programs, and unmatched physical environment.

At the same time, Silicon Valley's economic boom has created housing shortages (as President Casper notes on page 3) and a highly competitive employment market, which together are putting significant financial pressure on Stanford's housing and compensation programs for faculty and staff. The University is actively seeking solutions to these problems, including increasing the supply of on-campus housing and enhancing recruitment and retention programs.

The University made significant progress in a number of areas central to Stanford's teaching and research missions during FY99. Highlights of the year included:

- **Continued strength in undergraduate applications.** Nearly 18,000 students applied for the Class of 2003, enabling Stanford to be highly selective in offering admission to 15% of the total applicant pool.
- **Another record year for donations to Stanford.** Total giving reached $319.6 million, making this the fourth consecutive year in which the University announced gifts exceeding $300 million.
- **Successful integration of the Stanford Alumni Association with the University.** As reflected in the financial statements, the Stanford Alumni Association (SAA) became part of the University at the start of FY99. The integration is providing expanded resources for alumni programming and the construction of a dedicated new facility on campus for alumni activities.
- **Completion of major capital projects.** As described by Board Chair Robert Bass on page 9, this year we completed major renovations and new construction projects that represent a renewal of the University's physical infrastructure, including the Bing Wing of the Cecil H. Green Library, the Science and Engineering Quadrangle, and the Iris & B. Gerald Cantor Center for Visual Arts. Visitors to Stanford frequently comment that the campus has not looked better in a very long time.
- **Start of construction of the Sand Hill Road projects.** Roadway and circulation improvements were completed and a new 1,500-space parking garage at Stanford Shopping Center opened shortly after year-end. Work began on public utilities and road and parking areas for Stanford West Apartments. Plans for development of a seniors housing project are under way.

- **Initial steps for approval of a new Community Plan and General Use Permit.** Stanford is seeking permission to build new academic facilities and housing for students, faculty, and staff over a 10-year period after the current General Use Permit expires near the end of 2000. In November 1999, the University submitted a Draft Community Plan and General Use Permit Application to Santa Clara County for approval.
- **Issuance of bonds to support the University's capital plan and development of additional on-campus housing.** Stanford issued $160 million in new bonds and notes during FY99 and refinanced another $90 million of outstanding debt.

Following is a review of the FY99 financial activities:

STATEMENT OF ACTIVITIES

The Statement of Activities, which details operating revenues and expenses and other non-operating changes during the year, shows an increase in the University's net assets of $1.7 billion in FY99 compared to $240 million in FY98. FY99 was a year of exceptionally strong performance in the equity markets. The change in net assets is a direct result of swings in the financial market pendulum from a significant stock market decline at the end of FY98 to exceptional investment performance just one year later, highlighted by an extraordinary return on venture capital investments. Total investment returns of $1.8 billion were recognized in FY99, while only $194 million were recognized in FY98. See the "Report from the Stanford Management Company" on page 15 for further details.

Unrestricted Net Assets

Results of Operations

Operating activities include all revenues and expenses that are used to support current year teaching and research efforts and other University priorities. Compared to FY98, total revenues increased 13.5% to $1.8 billion and total operating expenses increased 9.6% to $1.6 billion. Operations resulted in an excess of revenues over expenses of $149 million in FY99, compared to $81 million in FY98, due almost entirely to increased revenue from investments. Nearly half of this surplus was budgeted to paying debt principal and to funding facilities construction. The remainder is designated or committed through donor preference for specific school or departmental purposes and for support of specific University initiatives.

Highlights of the operating activities are summarized below:

- Student income increased 4.7% to $278 million in FY99. Contributing to this increase were the undergraduate tuition rate increase of 3.8% and the room and board rate increase of 2.8%. Student enrollment also increased slightly. Offsetting tuition and room and board revenues is need- and merit-based aid for undergraduate and graduate students, which increased during FY99 by 4.8% to a total of $72 million.
- In total, sponsored research support decreased by $1.9 million, or 0.3%, caused primarily by a reduction in SLAC activities. SLAC expenses decreased by $16.5 million, or 8.8%, due to the completion of the "B-Factory" construction project. University direct cost reimbursement increased $6.8 million due to increased levels of research activity in the Schools of Medicine and Engineering. While the indirect cost rate remained relatively flat, indirect cost revenues increased by $7.8 million, or 8.0%, due to an increased direct cost base.
- Endowment income and gains distributed for operations covered 16.2% of total operating expenses for FY99, up from 15.6% for FY98. To protect the value of the endowment, Stanford has a policy governing this amount, which is established by the Board of Trustees through an annual target payout rate. For FY99 and FY98, the target payout rate reflects a base of 4.75% plus .5% to support the renewal of campus buildings and infrastructure. During FY99, the payout to operations from the endowment was $262 million, compared to $230 million in FY98. This 14% increase was primarily the result of growth in the endowment base due to exceptional market performance and strong donor support over the past several years. (See Notes 1 and 10 to the financial statements.)
- The exceptional market performance also produced an excellent return on other investments, including investments in the expendable funds pool (EFP). Total return on investments in the EFP was 15.5% in FY99, or $125 million. In accordance with the University's EFP policy, $70 million of the EFP return was used to support operations while the remaining $55 million was invested in the endowment. Higher returns in FY99 resulted in an additional $30 million of EFP income available for current operations. Additionally, performance of specific investments paralleled the overall

UCSF STANFORD HEALTH CARE

In fall 1999, Stanford University and the Regents of the University of California decided to terminate the affiliation of Stanford University Medical Center and the University of California-San Francisco Medical Center. The affiliation, which began in 1997, joined Stanford Health Services with the UCSF Medical Center to create UCSF Stanford Health Care, an unprecedented partnership of private and public university medical centers.

The goals of this endeavor were to enable both universities to train new generations of physicians, conduct pioneering medical research, and provide high-quality patient services despite extraordinary financial pressures brought about by managed care and declining government reimbursement rates. Stanford remains committed to these fundamental goals of academic medicine.

During FY99, it became clear that full integration of the two medical centers would not be achieved by the September 1, 1999 target date established in the original agreements. UCSF Stanford Health Care had made significant progress in a number of areas, including consolidating financial services and purchasing, correcting deficiencies in information technology, pursuing joint contracting, and combining some clinical programs, including children's services. However, the organization had failed to achieve a new common culture that would support the requirement that physicians at the two institutions would join their practices, share risks, and pool financial rewards.

At the same time, forces beyond the control of UCSF Stanford Health Care have greatly increased financial pressures on all academic medical centers. The negative impacts of the Balanced Budget Act of 1997 have been much worse than expected, resulting in a projected $85 million reduction in federal funding over the next four years for Stanford Hospital and Clinics alone. In addition, the State of California continues to expect academic medical centers to bear much of the costs of providing medical care for the poor. Despite this significant added financial pressure, Stanford Hospital and Clinics and the Lucile Salter Packard Children's Hospital will continue the University's long history of contributing to the public good by providing medical care for the indigent.

The operations of UCSF Medical Center will be returned to the control of the Regents and the operations of Stanford University Medical Center will be returned to the control of Stanford Health Services, with a target completion by mid-2000.

With medical education, research, and patient care services at Stanford entirely in its own hands, the University will use its resources and more than a century of health care experience to set a future course. While the evolution of the American health care system is far from over and will continue to present formidable challenges, Stanford's goal of assuring that its historic and critical role as an academic medical center will continue remains unchanged.

market performance, contributing another $71 million to the increase in other investment income.

- Auxiliary activities include housing and dining services, intercollegiate athletics, the Stanford Alumni Association, and certain patient care services provided by the School of Medicine. Auxiliaries are expected to generate sufficient revenues to cover their expenses. The increase in auxiliary revenues and expenses is due primarily to the activities of the SAA, which was combined with the University effective September 1, 1998.

- Total operating expenses increased $142.4 million, or 9.6%, in FY99. In addition to increased expenses resulting from the integration of the SAA with the University, operating expenses increased due to a wide range of new University initiatives and additional sponsored research activity.

Other Changes in Unrestricted Net Assets

Under FASB rules, the majority of the income and gains on the endowment are reported as unrestricted, even though the University manages these resources in accordance with donors' restrictions, legal requirements, and contractual obligations. (See Notes 1 and 10 to the financial statements.)

Stanford's investment strategy utilizes dividends, interest, rental income, and previously recognized gains on the endowment to fund the payout to operations. In years of average or better market performance, the University's market gains exceed the amount of the predetermined payout. For example, in FY99, the endowment's total return was $1.5 billion, more than covering the $262 million of income and gains distributed to operations. As a result, the University reinvested $1.3 billion of endowment returns. In FY98, however, the endowment's total return was $155 million, significantly less than the $230 million necessary to meet the payout to operations. In order to fill the gap in FY98, the University utilized $75 million of previously reinvested unrestricted gains. This most recent example illustrates the impact of the cyclical nature of financial market performance on the University's finances. As noted by President Casper on page 6, it is essential that the University invest endowment gains for the future and, at the same time, seek to increase the size of the endowment.

In FY99, the University recorded a $24.8 million decrease in its investment in related health care entities. This includes Stanford's 50% interest in the FY99 UCSF Stanford Health Care results of operations, as well as certain other transactions resulting from the merger of the hospitals, clinics, and faculty practices of UCSF and SHS. In November 1999, the University and the Regents of the University of California decided to terminate the affiliation. (See page 12 and Note 2 to the financial statements.)

In connection with the integration of SAA into the University, a $23.5 million contribution from SAA was recorded.

TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets decreased by $30 million, or 9.4%, to $289 million in FY99. The decrease was primarily a result of the release from restrictions of $152 million to unrestricted net assets to cover capital expenditures and other restricted activities. Offsetting this decrease was $86 million in new gifts and pledges and $29 million in investment income from living trusts.

PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets increased by $241 million, or 14.3%, to $1.9 billion during FY99. The increase was due primarily to the reinvestment of endowment returns of $101.6 million, the receipt of $99.6 million in new gifts and pledges for the endowment, and $31.5 million in investment income from living trusts.

FINANCIAL POSITION

The Statement of Financial Position reflects strong investment returns, reinvestment of a significant portion of earnings in the endowment, strong donor support, and continued efforts toward the renewal of the University's physical infrastructure. In FY99, total assets increased 19.3% to $11.2 billion, while total liabilities increased 7.3% to $2.2 billion.

- Total investments, primarily consisting of endowment assets and the EFP, increased by $1.8 billion, or 29.1%, to $7.9 billion.
- Plant facilities (net of accumulated depreciation) grew 14.7% to nearly $1.7 billion. This increase reflects the significant construction activity associated with the University's renewal of its physical infrastructure, which is described by Board Chair Robert Bass on page 9.
- Notes and bonds payable increased 17.2%, or $165 million, to $1.1 billion in FY99. The continuing favorable interest rate climate has allowed the University to continue to support the capital plan and improve its capital structure within the guidelines of the Debt Policy approved by the Board of Trustees in December 1997. The policy monitors the amount and type of debt Stanford may incur. It is intended to ensure the University's long-term liquidity and financial flexibility, as well as its access to credit at the most attractive rates. During FY99, the University issued:
    - $110 million of CEFA Revenue Bonds, which will finance certain costs of faculty and staff housing, campus roadways, and other capital and financing projects.
    - $50 million of taxable Medium Term Notes, which will be used for general corporate purposes, including the repayment of outstanding obligations and the financing of capital improvements programs.

- $90 million of CEFA Revenue Bonds as part of a plan to refinance existing CEFA bonds, saving the University $5 million in future debt service outlays.

- Net assets of the endowment increased $1.5 billion, or 31.2%, to $6.2 billion. In addition to new gifts of $92 million and transfers to the endowment of $104 million, endowment returns of $1.3 billion were reinvested.

CONCLUSION

The University's financial strength fosters Stanford's pioneering spirit and its unique combination of leading-edge research, high-quality educational programs, and unmatched physical environment. We will continue to build on this solid financial foundation to meet current needs and, at the same time, protect and increase the University's resources for future generations. Stanford is well positioned to respond with effective and innovative solutions to challenges presented by rising Silicon Valley costs and continuing changes in the financing of academic medical centers.

We look forward to working with the many dedicated faculty members, staff, Trustees, and other friends of the University to sustain the ongoing search for knowledge that is Stanford's mission.

Mariann Byerwalter

Mariann Byerwalter
Vice President for Business Affairs and
Chief Financial Officer

M. Suzanne Calandra

M. Suzanne Calandra
Controller

REPORT FROM THE **STANFORD MANAGEMENT COMPANY**

The Stanford Management Company (SMC) was established in 1991 to manage Stanford's financial and real estate investment assets. SMC is a division of the University with oversight by a Board of Directors appointed by the University Board of Trustees. The SMC board consists of at least three trustees, several investment and real estate professionals, and University representatives. SMC directs approximately $7.9 billion of endowment and trust assets, working capital, temporarily invested expendable funds, and commercial real estate investments, including the Stanford Research Park. These assets are managed by external equity investment managers, internal fixed income and cash managers, and internal and external real estate managers.

ENDOWMENT ASSET ALLOCATION

SMC oversees the University's $6.2 billion endowment. Given the perpetual nature of the University, the strategic investment horizon is very long-term. SMC's objective is to develop and execute an investment strategy that generates optimal total return (income plus price appreciation) relative to the risk taken. The result is that most of Stanford's endowment ($6.0 billion referred to as the Merged Endowment Pool) is invested in multiple asset classes.

The asset classes of the Merged Endowment Pool and their target allocations at August 31, 1999 follow.

Asset Class	Strategic Allocation	Range Allocation
Domestic Stocks	30%	26% to 34%
International Stocks	23%	19% to 29%
Alternative Investments	18%	12% to 24%
Real Estate Equity	16%	10% to 22%
Domestic Fixed Income	8%	5% to 15%
International Fixed Income	0%	0% to 5%
Inflation Hedge	5%	3% to 7%
Cash	0%	0% to 10%
	100%	

Alternative Investments include venture capital, buyouts, natural resources, and absolute return strategies; Real Estate Equity includes the Stanford Shopping Center, as well as other diversified real estate investments. The Inflation Hedge asset class is invested in collateralized commodities and inflation-linked bonds.

ENDOWMENT PERFORMANCE

The 1998-99 fiscal year witnessed a strong recovery from the Asian financial crisis and domestic market correction that occurred during the summer of 1998. The U.S. economy powered ahead, providing a favorable backdrop for equities worldwide. Market leadership in the United States was resumed by growth stocks, particularly Internet and other technology issues. This environment supported significant appreciation in the endowment, which had a total return for the year of 36.3%. In the eight years since SMC's founding, the Merged Endowment Pool, which began the period at $1.92 billion, has paid out $1.25 billion in support of the University budget while growing to $6.0 billion.

Endowment performance is assessed by comparing the total return for the endowment investment portfolio first to inflation to measure real return and then to comparable benchmarks to measure the effectiveness of SMC's management.

ENDOWMENT PERFORMANCE COMPARED TO INFLATION

Viewing the performance of Stanford's multi-asset strategy in a long-term context, the table below illustrates annual returns for various periods ending August 31, 1999. Stanford's real return objective is 6.25%, net of management fees. If this real return target is achieved over time, the real value of the endowment will be maintained net of annual payouts to support endowed activities. The real return (net of management fees) has substantially exceeded the 6.25% target in all recent periods.

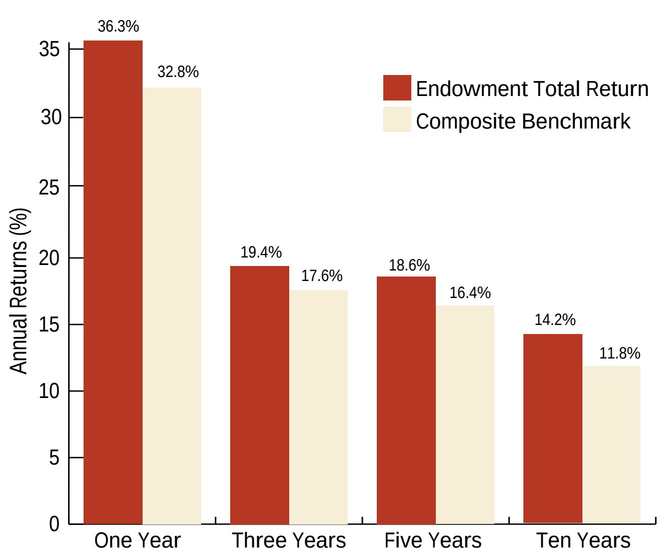
	One Year	Three Years	Five Years	Ten Years
Nominal				
Endowment Return	36.3%	19.4%	18.6%	14.2%
GDP Deflator (1)	1.5%	1.5%	1.7%	2.2%
Real Endowment Return	34.8%	17.9%	16.9%	12.0%

(1) The Gross Domestic Price (GDP) deflator, a measure of inflation, is through the quarter ending June 30, 1999.

ENDOWMENT PERFORMANCE COMPARED TO BENCHMARKS

To evaluate the performance of the investment managers selected by Stanford, benchmarks that are appropriate measures for each individual asset class are chosen. For example, the benchmark for the Domestic Stocks asset class is the Russell 3000 Index. The composite benchmark return is a blending of the benchmark returns for each asset class weighted by the strategic allocations. Actual performance (net of management fees) is compared to the composite benchmark for periods ending August 31, 1999.

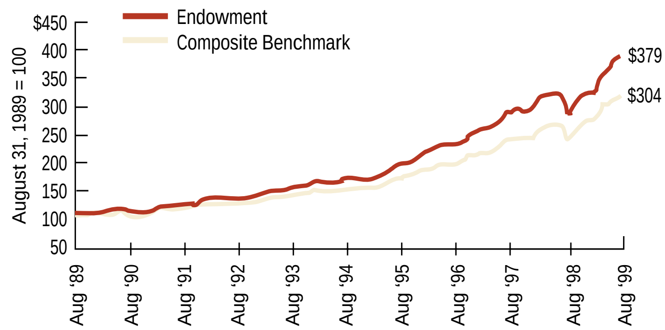
Endowment Versus Benchmark



Stanford's long-term performance advantage demonstrates the University's effectiveness in implementing the multi-asset class approach through superior manager selection.

The cumulative return chart compares the growth of $100 in Stanford's endowment with that of the composite benchmark over the past 10 years.

Stanford Merged Pool Versus Composite Benchmark



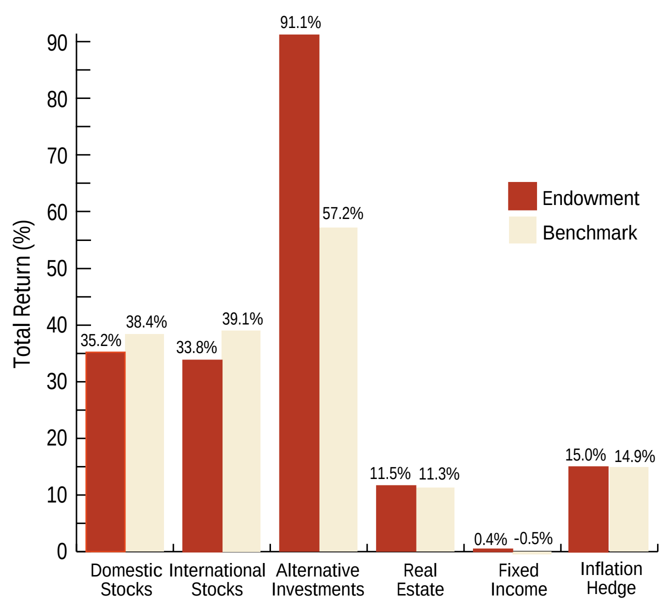
Ten Years Ended August 31, 1999

The performance advantage during this 10-year period relative to benchmark returns has added in excess of $650 million to the value of the endowment.

INDIVIDUAL ASSET CLASS PERFORMANCE

The powerful recovery of both domestic and international stocks during the fiscal year was overshadowed only by the dramatic return by alternative investments. The following graphs show individual asset class returns relative to their benchmarks.

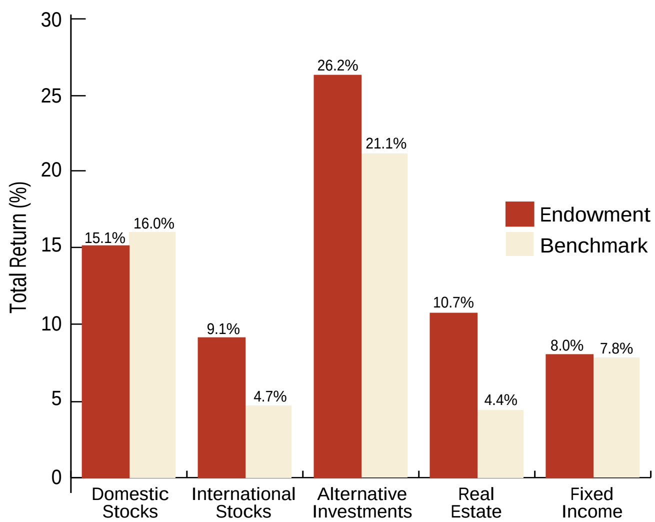
Individual Asset Class Performance



During the fiscal year, growth stocks (led particularly by the technology sector) continued to outperform value stocks. Stanford's domestic stock portfolio is deliberately overweighted in value stocks to offset the growth-oriented characteristics of the venture capital partnerships held in Alternative Investments. Within those partnerships, private technology companies completed initial public offerings at a record pace, giving Stanford's venture capital funds an extraordinary return of 232% for the fiscal year.

Over a 10-year period, each asset class exceeded its benchmark, except Domestic Stocks, where over-weighting of value stocks held back results. The total endowment return of 14.2% outdistanced the benchmark's 11.8% return.

Ten-Year Asset Class Returns Versus Benchmark



While gratified to report the above results, SMC's Board of Directors and its management team will continue to innovate in ways expected to enhance overall endowment return. Our goal remains providing increased support for the University's programs.

Next year's report will be signed by a new CEO because I have decided to step down, and a search is under way for my successor. It has been a rare privilege to work with the extraordinary people who make up SMC and its Board in the service of the world's finest and most exciting university.

Laurance R. Hoagland, Jr.
CEO, Stanford Management Company

DECADE **IN REVIEW**

FISCAL YEARS ENDED AUGUST 31

(in thousands of dollars)

	1999	1994	1989
Financial:			
Principal sources of operating revenues:			
Student tuition and fees	$ 289,333	$ 232,415	$ 154,400
Government grants and contracts	565,992	472,939	400,135
Gifts and non-government grants	320,909	226,122	188,636
Endowment income in support of operations	261,605	159,068	67,785
Principal purposes of expenditures:			
Instruction and departmental research	541,169	386,571	276,204
Organized research (direct costs)	538,117	413,887	335,934
Libraries	75,904	56,479	47,413
Student financial aid	72,328	66,246	47,140
Administration, development and general	193,589	128,461	88,375
Financial position highlights:			
Investments at fair value	7,869,888	3,688,500	2,270,098
Construction in progress	266,545	53,784	51,824
Plant facilities, net of accumulated depreciation	1,451,885	945,583	628,785
Net assets of related health care entities	451,613	271,134	202,573
Notes and bonds payable	1,126,293	678,224	356,070
Total net assets	8,937,664	4,563,589	3,296,058
Students:			
Enrollment: *			
Undergraduate	6,594	6,561	6,505
Graduate	7,625	7,470	6,849
Degrees conferred:			
Bachelor's degrees	1,687	1,730	1,618
Advanced degrees	2,909	2,707	2,499
Annual undergraduate tuition rate	$ 22,110	$ 17,775	$ 13,569
Faculty:			
Members of the Academic Council	1,364	1,398	1,325

* Enrollment for Autumn Quarter immediately following fiscal year end.

CONSOLIDATED STATEMENT OF **FINANCIAL POSITION**

AT AUGUST 31, 1999 AND 1998

(in thousands of dollars)

	1999	1998
ASSETS		
Cash and cash equivalents (Note 1)	$ 488,932	$ 725,922
Accounts receivable (Note 3)	182,703	150,523
Inventories and prepaid expenses	50,535	46,853
Pledges receivable (Note 6)	177,101	172,305
Student loans receivable	73,851	71,117
Other loans receivable (primarily faculty mortgages) (Note 4)	141,332	112,344
Investments at fair value (Note 5)	7,869,888	6,097,186
Net assets of related health care entities (Note 2)	451,613	476,431
Plant facilities, net of accumulated depreciation (Note 7)	1,718,430	1,498,329
Collections of works of art (Note 7)	-	-
Total assets	**$ 11,154,385**	**$ 9,351,010**
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	$ 424,540	$ 421,121
Liabilities under security agreements (Note 9)	343,015	382,679
Income beneficiary share of living trust investments (Note 10)	274,455	253,644
Notes and bonds payable (Note 8)	1,126,293	960,951
U.S. Government refundable loan funds	48,418	47,219
Total liabilities	2,216,721	2,065,614
Net assets (Note 1):		
Unrestricted:		
Designated for operations	918,666	791,423
Investment in plant facilities	1,023,620	915,883
Endowment gains and funds functioning as endowment	4,325,936	3,094,917
Related health care entities	451,613	476,431
Unrestricted	6,719,835	5,278,654
Temporarily restricted	289,012	318,941
Permanently restricted	1,928,817	1,687,801
Total net assets	8,937,664	7,285,396
Total liabilities and net assets	**$ 11,154,385**	**$ 9,351,010**

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

CONSOLIDATED STATEMENT OF **ACTIVITIES**

YEARS ENDED AUGUST 31, 1999 AND 1998

(in thousands of dollars)

	1999	1998
UNRESTRICTED NET ASSETS ACTIVITY		
Revenues:		
Student income:		
Undergraduate programs	$ 147,429	$ 142,865
Graduate programs	141,904	134,778
Room and board	61,251	57,030
Student financial aid	(72,328)	(68,987)
Total student income	278,256	265,686
Sponsored research support (primarily federal):		
Direct costs - University	357,482	350,720
Direct costs - Stanford Linear Accelerator Center	170,660	187,160
Indirect costs	105,476	97,665
Total sponsored research support	633,618	635,545
Expendable gifts in support of operations	97,412	77,629
Investment income:		
Endowment income distributed for operations	143,835	139,875
Endowment gains distributed for operations	117,770	90,037
Other investment income	141,212	34,368
Total investment income	402,817	264,280
Other income:		
Special program fees	136,759	131,653
Auxiliary activities (excluding room and board)	146,354	116,208
Other	40,574	33,214
Total other income	323,687	281,075
Net assets released from restrictions	32,931	34,158
Total revenues	1,768,721	1,558,373
Expenses:		
Salaries and benefits	648,004	596,089
Depreciation	93,909	91,149
Stanford Linear Accelerator Center	170,660	187,160
Auxiliary activities (including room and board)	211,667	172,885
Institutional support	293,580	281,635
Other operating expenses	201,893	148,378
Total expenses	1,619,713	1,477,296
Excess of revenues and net assets released over expenses	**$ 149,008**	**$ 81,077**

CONSOLIDATED STATEMENT OF **ACTIVITIES** *(continued)*

YEARS ENDED AUGUST 31, 1999 AND 1998

(in thousands of dollars)

UNRESTRICTED NET ASSETS ACTIVITY (continued)	**1999**	**1998**
Excess of revenues and net assets released over expenses	**$ 149,008**	**$ 81,077**
Other changes in unrestricted net assets:		
Expendable gifts invested in the endowment	4,087	3,379
Reinvested (utilized) endowment gains	1,128,604	(93,647)
Change in equity of related health care entities	(24,818)	11,599
Stanford Alumni Association contribution	23,535	-
Capital and other gifts released from restrictions	118,681	115,142
Other investment income invested in (withdrawn from) the endowment	54,742	(3,458)
Other	(12,658)	9
Net change in unrestricted net assets	**1,441,181**	**114,101**
TEMPORARILY RESTRICTED NET ASSETS ACTIVITY		
Gifts and pledges	86,047	150,653
Temporarily restricted return (losses) from endowment investments	3,165	(3,203)
Living trust investment income and actuarial adjustment	29,132	1,799
Other investment income	5,580	9,488
Net assets released from restrictions	(32,931)	(34,158)
Capital and other gifts released from restrictions	(118,681)	(115,142)
Other	(2,241)	7,285
Net change in temporarily restricted net assets	**(29,929)**	**16,722**
PERMANENTLY RESTRICTED NET ASSETS ACTIVITY		
Gifts and pledges	99,611	87,409
Permanently restricted return from endowment investments	101,569	8,985
Living trust investment income and actuarial adjustment	31,482	8,010
Other investment income	2,599	1,960
Other	5,755	2,394
Net change in permanently restricted net assets	**241,016**	**108,758**
Net change in total net assets	**1,652,268**	**239,581**
Total net assets, beginning of year	7,285,396	7,045,815
Total net assets, end of year	**$ 8,937,664**	**$ 7,285,396**

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

CONSOLIDATED STATEMENT OF **CASH FLOWS**

YEARS ENDED AUGUST 31, 1999 AND 1998

(in thousands of dollars)

	1999	1998
Cash flow from operating activities:		
Tuition, fees, sales, and services of auxiliary enterprises	$ 627,599	$ 615,210
Investment income	341,384	210,030
Gifts, grants, and contracts	792,037	791,834
Cash paid to suppliers and employees	(1,495,281)	(1,437,171)
Interest paid	(50,164)	(53,393)
Net cash provided by operating activities	215,575	126,510
Cash flow from investing activities:		
Land, building, and equipment purchases	(344,671)	(304,517)
Student, faculty, and other loans:		
New loans made	(62,515)	(47,120)
Principal collected	33,778	15,258
Purchases of investments	(3,630,748)	(2,705,137)
Sales and maturities of investments	3,160,554	2,593,498
Advances under security agreements	63,721	91,620
Net cash used for investing activities	(779,881)	(356,398)
Cash flow from financing activities:		
Gifts for endowment, capital projects, and student loans	167,792	143,322
Income reinvested in endowment, capital projects, and student loans	(383)	5,150
Proceeds from borrowing	298,393	271,472
Repayment of debt	(138,486)	(47,014)
Net cash provided by financing activities	327,316	372,930
(Decrease) increase in cash and cash equivalents	(236,990)	143,042
Cash and cash equivalents, beginning of year	725,922	582,880
Cash and cash equivalents, end of year	**$ 488,932**	**$ 725,922**

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

NOTES TO THE **CONSOLIDATED FINANCIAL STATEMENTS**

1. SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation: Stanford University (the "University"), a private, not-for-profit educational institution, was founded in 1885 by Senator and Mrs. Leland Stanford in memory of their son, Leland Stanford, Junior. The University is organized into seven schools with approximately 1,600 faculty and more than 14,000 graduate and undergraduate students.

The consolidated financial statements include the accounts of the University, Stanford Health Services ("SHS"), Stanford Alumni Association ("SAA"), and other wholly owned entities. All significant inter-entity transactions and balances have been eliminated. The University's investment in UCSF Stanford Health Care is reported in the financial statements as a joint venture using the equity method of accounting. The University's 50% interest in the earnings or losses of UCSF Stanford Health Care is recorded as a change in unrestricted net assets and as an increase or decrease in the University's investment (see further discussion of the joint venture and of the decision subsequent to year end to terminate the affiliation in Note 2). In addition, the University manages and operates Stanford Linear Accelerator Center ("SLAC") for the Department of Energy ("DoE") under a management and operating contract; therefore, the revenues and expenditures of SLAC are included in the statement of activities. As SLAC is a federally funded research and development center, the assets and liabilities of SLAC are owned by the DoE and, accordingly, are not included in the statement of financial position. Hoover Institution is an integral part of the University and is included in the financial statements. Auxiliary activities include housing and dining services, intercollegiate athletics, SAA, and certain patient care provided by the School of Medicine. Effective September 1, 1998, the University became the sole member of the Stanford Alumni Association. The University has recorded the net assets of SAA at September 1, 1998, as a contribution for the year ended August 31, 1999.

Basis of Accounting: The financial statements are prepared in accordance with generally accepted accounting principles. These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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 the estimates and assumptions made.

For financial reporting purposes, net assets and revenues, expenses, gains and losses are classified into one of three categories — unrestricted, temporarily restricted, or permanently restricted. These categories, as described below, are the method by which the Financial Accounting Standards Board has chosen to standardize the financial statements of all private not-for-profit institutions.

Unrestricted Net Assets: Unrestricted net assets are expendable resources used to support the University's core activities of teaching and research. These net assets may be designated by the University for specific purposes under internal operating and administrative arrangements or be subject to contractual agreements with external parties. Donor-restricted contributions, which relate to the University's core activities, that are received and expended, or deemed expended due to the nature of their restriction, in accordance with the provisions of Statement of Financial Accounting Standards No. 117, "Financial Statements of Not-for-Profit Organizations," (SFAS No. 117), are classified as unrestricted. Donor-restricted resources intended for capital projects are released from their temporary restrictions and reclassified as unrestricted support when spent. All expenses are recorded as a reduction of unrestricted net assets.

Unrestricted net assets consist of the following balances at August 31, 1999 and 1998, in thousands of dollars:

	1999	1998
Designated for operations:		
University programs	$ 373,931	$ 350,661
Other gifts and income	454,669	366,265
Student loans and capital projects	90,066	74,497
	918,666	791,423
Investment in plant facilities	1,023,620	915,883
Endowment gains and funds functioning as endowment:		
Funds functioning as endowment	1,113,378	1,036,150
Gains on pure endowment	1,746,254	1,097,604
Gains on funds functioning as endowment	1,466,304	961,163
	4,325,936	3,094,917
Net assets of related health care entities	451,613	476,431
	$ 6,719,835	$ 5,278,654

Temporarily Restricted Net Assets: Temporarily restricted net assets are subject to donor-imposed restrictions that expire upon the passage of time or upon specific actions being undertaken by the University. These net assets are released and reclassified to unrestricted support when they are expended.

Temporarily restricted net assets consist of the following balances at August 31, 1999 and 1998, in thousands of dollars:

	1999	1998
Support for capital projects	$ 86,753	$ 148,619
Term endowments	35,616	31,858
Funds subject to living trust agreements	64,928	37,650
Other gifts and income for instruction, research, and University support	101,715	100,814
	$ 289,012	$ 318,941

Permanently Restricted Net Assets: Permanently restricted net assets are subject to donor-imposed restrictions requiring that the principal be invested in perpetuity.

Permanently restricted net assets consist of the following balances at August 31, 1999 and 1998, in thousands of dollars:

	1999	1998
Endowment funds	$ 1,721,798	$ 1,492,331
Funds subject to living trust agreements	156,556	148,172
Student loans	50,463	47,298
	$ 1,928,817	$ 1,687,801

The University's internal financial management practices differ from the reporting requirements set forth in SFAS No. 117, particularly with respect to the recognition of the release of the donor-imposed restrictions on gifts and related investment income and gains. In order to comply with the internal and external restrictions placed on the use of the University's resources, the accounts are maintained in accordance with the principles of fund accounting. Under these principles, resources are managed through various funds in accordance with their specified activities or objectives.

The University considers all revenues and expenses to be related to operations except endowment gains and losses, changes in equity of related health care entities, capital gifts, expendable gifts invested in the endowment, and certain other non-operating changes.

Cash and Cash Equivalents: Cash and cash equivalents include U.S. Treasury bills, bankers' acceptances, commercial paper, certificates of deposit, money market funds and other short-term investments, carried at cost, which approximates market value. For purposes of the statement of cash flows, the University considers all investments with remaining maturities of 90 days or less at the time of purchase to be cash equivalents except cash and cash equivalent amounts held in connection with endowments, which are classified as investments.

Student Loans Receivable: Student loans receivable are carried at cost, less an allowance for doubtful accounts. Determination of the fair value of student loan receivables, which include donor-restricted and federally sponsored student loans with mandated interest rates and repayment terms subject to significant restrictions as to their transfer and disposition, could not be made without incurring excessive costs.

Investments: Investments are generally recorded at fair value based upon quoted market prices, when available, or estimates of fair value. Donated assets are recorded at fair value at the date of donation. Those investments for which fair value is not readily determinable are carried at cost, fair value at date of donation, or at a nominal value. Developed real estate is generally valued based on discounted cash flows of existing leases. Non-developed land is reported at cost. The University records its securities transactions on a trade date basis.

Plant Facilities: Plant facilities (including land), dedicated to educational purposes, are stated at cost or fair value at date of donation. Interest for construction financing is capitalized as a cost of construction. Art objects and collections are not capitalized, as the University uses the proceeds from any sales of such items to acquire other art or collection pieces.

Depreciation is computed using the straight-line method over the estimated useful lives of the plant assets. The estimated useful lives are:

Buildings	40 years
Building improvements	15 years
Equipment and books	6 years

Depreciation related to auxiliary activities is recorded as an auxiliary expense.

The depreciable lives used by the University for financial reporting differ from those used for cost accounting under OMB Circular A-21. Recent changes in federal regulations will require conformity of the lives and methods used for cost accounting and financial reporting. In order to comply with these changes, the University may record additional depreciation expense in its financial statements beginning in FY 2000. The University has not fully determined the impact of such depreciation changes.

Provision for Employee Benefits and Compensated Absences: The University self-insures unemployment, disability, and workers' compensation benefits. Annual provisions for estimated claims are charged to operating expenses. The provision includes an accrual for compensated absences.

Student Financial Aid: Certain students receive assistance in the form of scholarship and fellowship grants which cover a portion of tuition, living, and other costs. In accordance with the American Institute of Certified Public Accountants' Audit and Accounting Guide for Not-for-Profit Organizations, student financial aid of $72,328,000 and $68,987,000 for the years ended August 31, 1999 and 1998, respectively, is reported as a reduction in student income.

The University utilized $62,262,000 and $59,842,000 of externally provided resources that were intended specifically to support student financial aid expenses in fiscal years 1999 and 1998, respectively.

Indirect Cost Recovery: The University records reimbursements of indirect costs from grants, contracts, and SLAC as operating revenues.

Tax Status: The University is exempt from federal income tax to the extent provided by Section 501(c)(3) of the Internal Revenue Code.

Reclassification: Fiscal year 1998 amounts presented for comparative purposes have been reclassified to conform with the fiscal year 1999 presentation.

2. RELATED HEALTH CARE ENTITIES:

UCSF Stanford Health Care, a private non-profit California public benefit corporation, was established by the University and the Regents of the University of California ("UC") to consolidate the facilities and operations of the hospitals, clinics, and faculty practices of UC San Francisco ("UCSF") and Stanford Health Services ("SHS"), including Lucile Salter Packard Children's Hospital at Stanford ("LSPCH"). See section entitled "Termination of Affiliation" for further discussion of the joint venture and of the decision subsequent to year end to terminate the affiliation.

On November 1, 1997, the University transferred or leased substantially all of the assets and liabilities of SHS and LSPCH to UCSF Stanford Health Care. SHS retained total assets of approximately $68,000,000, of which $38,000,000 was intended to be used for workers' compensation, medical malpractice, and other self-insured liabilities. General contingent liabilities, if any, which were not asserted or recorded at October 31, 1997, were retained by SHS and UCSF subject to an agreement (ten-year term) under which UCSF Stanford Health Care agreed to pay an amount not to exceed $40,000,000 to each university. The University would be obligated to make payments above that amount, if needed. Management believes that such payments would not have a material effect on the University's financial position.

The transaction has been accounted for as a joint venture, and substantially all assets and liabilities of SHS (including LSPCH) and UCSF were transferred to UCSF Stanford Health Care at their previously recorded amounts. The University reports its proportionate share of UCSF Stanford Health Care's change in net assets on an equity basis in the accompanying consolidated financial statements. SHS, a separate non-profit California public benefit corporation controlled by the University, was reported on an equity basis in the accompanying consolidated financial statements prior to November 1, 1997, and has been accounted for as a consolidated entity since that date.

The University has entered into operating agreements with UCSF Stanford Health Care for the professional services of faculty members of the Stanford University School of Medicine, for certain other University employees, and for other facility charges and services. Accordingly, net revenues from UCSF Stanford Health Care of approximately $155,000,000 for the year ended August 31, 1999, and $147,000,000 for the ten-month period ended August 31, 1998, were recorded. The University has receivables, net of payables, from UCSF Stanford Health Care of approximately $81,000,000 and $40,000,000 at August 31, 1999 and 1998. In addition, the University holds a note receivable of $4,700,000 at August 31, 1999 and 1998. Certain investments of UCSF Stanford Health Care with an approximate fair market value of $160,000,000 and $125,000,000 at August 31, 1999 and 1998, are managed by the University.

Summarized financial information for UCSF Stanford Health Care for the years ended and as of August 31, 1999 and 1998 (derived from audited financial information provided by UCSF Stanford Health Care), in thousands of dollars, follows:

	1999	1998
Total revenues	$ 1,704,703	$ 1,384,646
Excess (deficit) of revenues over expenses	$ (78,518)	$ 29,538
Other changes in net assets	23,921	(15,350)
Increase (decrease) in net assets	$ (54,597)	$ 14,188
	1999	**1998**
Total assets	$ 1,664,134	$ 1,611,919
Total liabilities	821,379	714,567
Total net assets	$ 842,755	$ 897,352

The following table summarizes the changes in the University's investment in related health care entities during the years ended August 31, 1999 and 1998, in thousands of dollars:

	1999	1998
Investment, beginning of year	$ 476,431	$ 495,187
Decrease in SHS net assets for the two months ended October 31, 1997		(12,512)
Net assets retained by SHS at November 1, 1997		(30,355)
University assets transferred to UCSF Stanford Health Care at November 1, 1997		9,342
University's interest in UCSF Stanford Health Care change in net assets during the year:		
50% of excess (deficit) of revenues over expenses	(39,259)	14,769
Other changes in net assets, attributable to Stanford's interest	14,441	
Investment, end of year	$ 451,613	$ 476,431

On November 1, 1997, the date of inception, SHS transferred $449,628,000, including advances of $1,017,000, in net assets to UCSF Stanford Health Care. The remaining net assets retained by SHS are consolidated with the University's accounts.

Termination of Affiliation: Subsequent to August 31, 1999, the University and UC agreed to terminate the affiliation of Stanford University Medical Center and UCSF Medical Center (together, the "Medical Centers"). On dates to be determined by the University and UC, the operations of UCSF Medical Center will be returned to the control of UC and the operations of Stanford University Medical Center (hospitals, clinics, and faculty practices of SHS and LSPCH) will be returned to the control of SHS. The University has proposed March 1, 2000, as the date when financial responsibility for Stanford University Medical Center will be transferred to SHS. At present, the University and UC expect UCSF Stanford Health Care will continue to provide certain services to the Medical Centers and therefore remain in operation for a limited period of time after the transfer of Stanford University Medical Center.

3. ACCOUNTS RECEIVABLE:

Accounts receivable at August 31, 1999 and 1998, in thousands of dollars, are as follows:

	1999	1998
U.S. Government	$ 40,283	$ 56,820
Accrued interest on investments	17,149	17,014
Student	3,317	2,838
Related health care entities	85,795	51,297
Other	38,323	25,139
	184,867	153,108
Less allowances for losses	2,164	2,585
	$ 182,703	$ 150,523

4. LOANS RECEIVABLE:

In a program to attract and retain excellent faculty and senior staff, the University provides home mortgage financing assistance. Notes amounting to $134,607,000 and $105,070,000 at August 31, 1999 and 1998, respectively, from University faculty and staff are collateralized by first and junior deeds of trust on properties concentrated in the region surrounding the University. The carrying value of such loans approximates fair value.

5. INVESTMENTS:

Investments held by the University at August 31, 1999 and 1998 are reported principally at fair value, as follows, in thousands of dollars:

	1999	1998
Endowment cash and short-term investments	$ 449,447	$ 329,372
Bonds and mutual funds	821,553	882,884
Corporate stocks and mutual funds	3,938,482	2,993,140
Assets held by other trustees	155,554	140,786
Real estate and improvements:		
Stanford Shopping Center	211,972	195,425
Other	629,147	424,761
Limited partnership investments	1,775,833	1,199,894
Other	47,814	56,007
	8,029,802	6,222,269
Funds managed for related health care entities	(159,914)	(125,083)
	$ 7,869,888	$ 6,097,186

Total investment return reflected in the statement of activities for the years ended August 31, 1999 and 1998, in thousands of dollars, is as follows:

	1999	1998
Investment income	$ 310,336	$ 214,520
Net realized and unrealized gains (losses)	1,449,354	(20,306)
Total return	$ 1,759,690	$ 194,214

For the year ended August 31, 1999, total investment return not used in current operations was $1,356,873,000. For the year ended August 31, 1998, previously recognized gains of $70,066,000 were utilized in current operations.

As indicated in the following table, as of August 31, 1999 and 1998, in thousands of dollars, the University's investments are invested in the expendable funds pool ("EFP"), the merged endowment pools, or in specific instruments to comply with donor requirements:

	1999	1998
Expendable Funds Pool	$ 754,062	$ 649,919
Merged Endowment Pool	5,952,681	4,412,816
Merged Pool C	142,166	108,762
Living trusts	495,939	439,659
Other investments	1,303,118	872,348
Less funds cross-invested in endowment pools (including cash equivalents)	(778,078)	(386,318)
	$ 7,869,888	$ 6,097,186

The EFP is a pool of short-term investments, bonds, and equities that is intended to provide adequate liquidity and prudent growth, as well as an opportunity for the University to earn long-term premiums on a portion of its working capital. The University's endowment is invested through several pools with varying objectives. The Merged Endowment Pool holdings are invested for total return, and a prudent portion of the realized gain may be expended. Merged Pool C is invested for capital appreciation rather than current yield. The distributions of certain endowments whose gift terms allow only yield to be expended are appropriately limited to current yield.

The Board has established a policy for the distribution of the investment returns of the EFP. The policy requires that an amount based upon a pre-set interest rate and the performance of the EFP be made available to support current operations. The difference between the actual return of this pool and the required distribution amount is deposited or withdrawn from funds functioning as endowment. For the years ended August 31, 1999 and 1998, the results of the EFP, in thousands of dollars, were as follows:

	1999	1998
Total investment return of the EFP	$ 124,516	$ 36,583
Income made available to current operations	69,774	40,041
Income invested in (withdrawn from) the endowment	$ 54,742	$ (3,458)

The University's policy governing the amounts paid annually from the endowment pools to support current operations is designed to protect the value of the endowment against the expected impact of inflation and to provide real growth of the endowment, while also funding a relatively constant portion of the University's current operating expenditures. The payout rate, set annually by the Board, is based upon an estimate of total investment returns and the expected impact of inflation on the endowment assets. The sources of the payout are earned income on the endowment assets (interest, dividends, rents, and royalties), previously reinvested income, and a portion of realized capital gains.

The Board approved a target payout rate of 5.25% for fiscal years 1999 and 1998. To meet the Board-authorized payout rate, endowment gains were distributed for operations, in thousands of dollars, as follows:

	1999	1998
Merged Endowment Pool	$ 113,358	$ 86,438
Merged Pool C	4,412	3,599
Total	$ 117,770	$ 90,037

Individual funds subscribe to or dispose of shares of the endowment pools on the basis of market value per share as of the most recent valuation date. Information on shares and data per share for the merged pools is as follows:

	1999	1998
Merged Endowment Pool:		
Total market value (in $000's)	$ 5,952,681	$ 4,412,816
Number of shares outstanding (in 000's)	59,999	56,864
Market value per share	$ 99.213	$ 77.603
Payout amount per share:		
Endowment income	$ 1.958	$ 2.052
Endowment gains	2.152	1.648
Total	$ 4.110	$ 3.700
Merged Pool C:		
Total market value (in $000's)	$ 142,166	$ 108,762
Number of shares outstanding (in 000's)	3,573	3,682
Market value per share	$ 39.789	$ 29.539
Payout amount per share:		
Endowment income	$ .302	$ .310
Endowment gains	1.198	.950
Total	$ 1.500	$ 1.260

The investments of the University include a variety of financial instruments with off-balance sheet risk involving contractual commitments for future settlements, including futures, forwards, options and swap contracts, which are exchange traded or are executed over-the-counter.

The University enters into foreign currency forward contracts primarily for the purpose of minimizing the risk to the University from adverse changes in the relationship between currencies. A forward currency contract is an obligation to purchase or sell a currency against another currency at a future date and price as agreed upon by the parties. Forward contracts are traded over-the-counter and not on organized commodities or securities exchanges. The University intends to cover the commitments to deliver currency under these contracts by acquiring a sufficient amount of the underlying currency. At August 31, 1999, the University had forward contracts to sell and buy foreign currency of $380,745,000 and $383,648,000, respectively. At August 31, 1998, the University had forward contracts to sell and buy foreign currency of $633,297,000 and $676,428,000, respectively. In connection with these contracts, net unrealized losses of $92,000 and $939,000 have been recorded by the University as of August 31, 1999 and 1998, respectively.

Forwards necessarily involve counterparty credit exposure. The University seeks to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring.

The University generally invests in options and futures contracts for the purposes of reducing the risk level of its investments or serving as a temporary surrogate for investment in stocks and bonds. An option is a contract which grants the right, but not the obligation, to execute a specific purchase or sales transaction at a stated exercise price. A futures contract is a standardized agreement between two parties to buy and sell an asset at a set price on a future date. Upon entering into futures contracts, the University is required to pledge to the broker an amount of cash or securities equal to the minimum initial margin requirements of the exchange on which the contracts are traded. At August 31, 1999 and 1998, the total margin pledged on options and futures contracts was $21,367,000 and $27,288,000, respectively. In connection with these contracts, net unrealized losses of $433,000 and $41,118,000 have been recorded by the University as of August 31, 1999 and 1998, respectively.

The University also sells securities "short" in order to enhance investment returns (see Note 9 regarding securities sold short).

6. PLEDGES RECEIVABLE:

Unconditional promises are included in the financial statements as pledges receivable and are classified as either temporarily restricted or permanently restricted revenue. Pledges are recorded at the present value of the discounted future cash flows, net of allowances. At August 31, 1999 and 1998, pledges were expected to be received in the following periods, in thousands of dollars:

	1999	1998
One year or less	$ 21,739	$ 19,320
Between one year and five years	171,998	173,914
More than five years	35,570	16,704
	229,307	209,938
Less discount/allowance	52,206	37,633
	$ 177,101	$ 172,305

7. PLANT FACILITIES:

Plant facilities at August 31, 1999 and 1998, in thousands of dollars, are as follows:

	1999	1998
Land and improvements	$ 112,156	$ 98,918
Buildings	1,525,470	1,328,883
Equipment and books	823,643	748,521
Construction in progress	266,545	246,250
	2,727,814	2,422,572
Less accumulated depreciation	1,009,384	924,243
Plant facilities	$ 1,718,430	$ 1,498,329

Fully depreciated assets, mainly equipment and books, that are still in use by the University amounted to $394,000,000 and $367,000,000 at August 31, 1999 and 1998, respectively. During the year ended August 31, 1999, the University retired $35,471,000 in fixed assets and their related accumulated depreciation.

The insurable value of the University's museum and special collection pieces, which are not capitalized, approximated $200,000,000 at August 31, 1999 and 1998.

8. NOTES AND BONDS PAYABLE:

Notes and bonds payable at August 31, 1999 and 1998, in thousands of dollars, are as follows:

	1999	1998
California Educational Facilities Authority (CEFA):		
Revenue Bonds, Series B,I,J,K,M,N,O, and P due serially to 2031,		
with interest from 2.690% to 5.816%	$ 576,634	$ 483,564
Revenue Bonds, Series L with variable interest rates	65,425	47,610
Department of Education Bonds of 1959 to 1984 due serially to 2024,		
with interest from 3.0% to 3.5%	4,583	5,307
Stanford University Bonds due 2024, with fixed interest of 6.875%	150,000	150,000
Medium Term Notes ($150,000 authorized):		
due to 2026, with interest from 5.85% to 7.65%	100,000	50,000
Commercial Paper, with variable interest rates	134,601	159,167
Other, with various interest rates	95,050	65,303
	$ 1,126,293	$ 960,951

At August 31, 1999 and 1998, the fair value of these debt instruments approximated the recorded value of the related debt obligations.

The University incurred interest expense of $55,791,000 and $51,480,000 for fiscal years 1999 and 1998, respectively, of which $4,530,000 and $2,736,000, respectively, has been capitalized as a cost of construction.

Scheduled principal and interest payments on notes and bonds, exclusive of commercial paper, for the fiscal years 2000 through 2004, in thousands of dollars, are approximately:

Year	Principal	Interest	Total
2000	$ 33,432	$ 57,012	$ 90,444
2001	$ 51,789	$ 52,624	$104,413
2002	$ 17,016	$ 51,344	$ 68,360
2003	$ 7,283	$ 50,667	$ 57,950
2004	$ 27,606	$ 48,790	$ 76,396

The collateral for the annual debt service on certain CEFA Revenue Bonds consists of a pledge of annual tuition revenue of approximately $525,000 and investments of approximately $2,046,000 (at market), which were on deposit with a trustee at August 31, 1999. The University is in compliance with its CEFA bond covenants.

On March 15, 1999, the University issued $50,000,000 in taxable Medium Term Notes with a coupon interest rate of 5.85% and priced to yield 5.87% to the maturity date of March 15, 2009. The net proceeds of these notes will be used for general corporate purposes, including the repayment of outstanding obligations and capital improvements programs. To date the University has issued $100,000,000 of debt under the $150,000,000 authorized Medium Term Note Program.

On March 15, 1999, the University issued $110,440,000 in CEFA Revenue Bonds Series P ("CEFA P") to finance certain costs of faculty and staff housing, the creation, expansion, and improvement of certain campus roadways, and for other capital and financing purposes. CEFA P was issued as follows: (i) $51,260,000 with a coupon interest rate of 5.25% and priced to yield 4.55% to the maturity date of December 13, 2013; (ii) $59,180,000 with a coupon interest rate of 5.00% and priced to yield 5.03% to the maturity date of December 1, 2023.

On October 6, 1998, the University issued $89,555,000 of CEFA Refunding Revenue Bonds, Series O, at an average interest rate of 5.125% as part of a plan to refund $89,110,000 of CEFA Series I bonds on a current basis.

The University issues variable rate demand notes to refinance current CEFA principal payments. In October 1997 and October 1998, the University issued $15,165,000 and $17,815,000 in CEFA L-5 and L-6 Refunding Revenue bonds at initial interest rates of 3.6% and 3.1%, respectively. In October 1999, the University issued $18,393,000 in CEFA L-7 Refunding Revenue bonds at an initial interest rate of 3.5%.

The University has a commercial paper credit facility which provides for borrowings up to $200,000,000. The outstanding balance at August 31, 1999 was $134,601,000. The weighted average days to maturity is 180, and the weighted average effective interest rate is 5.5%.

The University uses interest rate swaps to manage the interest rate exposure of its commercial paper program. An interest rate swap is an agreement between counterparties to exchange periodic interest payments based on specific interest rate differentials applied to a specified notional amount. A swap allows one party to effectively change the interest rate structure of a debt obligation or an investment through the exchange of payments with another party. Swaps enable participants to obtain financing at the least possible cost and simultaneously hedge unwanted risk. The contracts executed by the University are structured with the purpose of minimizing any mismatch between the commercial paper rate paid and the short-term rate received. Swaps necessarily involve counterparty credit exposure. The University seeks to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring. Additionally, the terms of swap agreements provide that collateral may be posted or appropriate guarantees obtained between the University and the counterparty in order to minimize credit exposure to or from the counterparty. At August 31, 1999, the University had swap agreements expiring through 2008 to pay fixed interest rates from 5.78% to 8.01% which had notional principal amounts totaling $63,000,000. At August 31, 1998, the University had swap agreements expiring through 2008 to pay fixed interest rates from 5.78% to 8.01% which had notional principal amounts totaling $76,000,000. The fair value of the interest rate swaps, which is not material, are not recorded in the University's financial statements.

9. LIABILITIES UNDER SECURITY AGREEMENTS:

At August 31, 1999 and 1998, the University held $165,371,000 and $269,278,000, respectively, of short-term U.S. Government obligations and cash as collateral deposits for certain securities loaned temporarily to brokers. These amounts are included as assets and liabilities in the University's financial statements. Securities on loan at August 31, 1999 and 1998 had estimated market values of $157,963,000 and $250,791,000, respectively.

At August 31, 1999 and 1998, the University sold securities subject to an obligation to repurchase them at a future date in the amount of $67,826,000 and $10,016,000, respectively. The borrowings have been accounted for as financing transactions and bear interest at rates between 3.875% and 4.76%, inclusive, for 1999 and 5.69% for 1998.

The University also sells securities "short" in order to enhance investment returns. Short sales are transactions in which the University sells a security it does not own, in anticipation of a decline in the market value of that security. To complete such a transaction, the University must borrow the security to deliver to the buyer upon the short sale; the University is then obligated to replace the security borrowed by purchasing it in the open market at some later date. The University will incur a loss if the market price of the security increases between the date of the short sale and the date on which the borrowed security is replaced, and will realize a gain if the security declines in value between those dates. At August 31, 1999 and 1998, the fair market value of such securities is $109,818,000 and $103,385,000, respectively.

10. ENDOWMENT:

The University manages a substantial portion of its financial resources within its endowment. These assets include pure endowment, term endowments, funds functioning as endowment, and funds subject to living trust agreements. These resources are recorded as either permanently restricted, temporarily restricted, or unrestricted net assets.

Pure endowment funds are subject to the restrictions of the gift instruments requiring that the principal be invested in perpetuity and the income and an appropriate portion of gains only be spent as provided for under the California Uniform Management of Institutional Funds Act ("CUMIFA"). In the absence of further donor restrictions, the amount of gains that are to be expended in a given year is determined through the endowment payout policy discussed in Note 5. The University classifies the original endowment gift and any donor-imposed restricted gains as permanently restricted assets. The Financial Accounting Standards Board ("FASB") has determined that the legal limitations imposed by CUMIFA on the amount of realized and unrealized gains on endowments that may be appropriated for current expenditure do not constitute restrictions for financial reporting purposes. Accordingly, the University reports the reinvested realized and unrealized gains as unrestricted net assets. Notwithstanding this FASB-mandated reporting, the University recognizes the limitations on expending such gains that are specified in CUMIFA.

Expendable endowment assets include term endowments and funds functioning as endowment. Term endowments are similar to other endowment funds except that upon the passage of a stated period of time or the occurrence of a particular event, all or part of the principal may be expended. These resources are classified as temporarily restricted net assets. Funds functioning as endowment are unrestricted University resources designated as endowment by the Board and are invested in the endowment for long-term appreciation and current income. However, these assets remain available and may be spent at the Board's discretion. Funds functioning as endowment are recorded as unrestricted net assets.

Funds subject to living trust agreements represent trusts with living income beneficiaries where the University has a residual interest. The investments of these funds are recorded at their fair market value. The discounted present value of any income beneficiary interest is reported as a liability on the statement of financial position in accordance with actuarial tables established by the Internal Revenue Service. Gifts subject to such agreements are recorded as revenue net of the income beneficiary share at the date of gift. Actuarial gains or losses are included in living trust investment income and actuarial adjustment. Resources that are expendable upon maturity are classified as temporarily restricted net assets; all others are classified as permanently restricted net assets.

At August 31, 1999 and 1998, the University's endowment, excluding pledges, is included in the following net asset categories, in thousands of dollars:

	1999	1998
Unrestricted net assets	$ 4,325,936	$ 3,094,917
Temporarily restricted net assets	100,544	69,508
Permanently restricted net assets	1,800,215	1,580,463
	$ 6,226,695	$ 4,744,888

Changes in the University's endowment, excluding pledges, for the years ended August 31, 1999 and 1998, in thousands of dollars, are as follows:

	1999	1998
Investment returns:		
Earned endowment income (including $676 and $1,999 reinvested in endowment, as required by donor, in 1999 and 1998, respectively)	$ 144,511	$ 141,874
Change in net realized and unrealized appreciation of investments during the year	1,388,248	12,789
Total investment returns	1,532,759	154,663
Unrestricted income and gains distributed for operations	(261,605)	(229,912)
Endowment returns reinvested or (withdrawn)	1,271,154	(75,249)
Other changes in endowment:		
Gifts (net of $18,136 and $5,630 in pledges in 1999 and 1998, respectively)	92,230	88,074
Transfer to funds functioning as endowment, net	104,471	54,585
Actuarial adjustment on living trusts	22,170	13,434
Other changes	(8,218)	(2,958)
Net change in endowment	1,481,807	77,886
Endowment and funds functioning as endowment, beginning of year	4,744,888	4,667,002
Endowment and funds functioning as endowment, end of year	$ 6,226,695	$ 4,744,888

Endowment returns reinvested or (withdrawn) are classified in the following net asset categories at August 31, 1999 and 1998, in thousands of dollars:

	1999	1998
Unrestricted	$ 1,128,604	$ (93,647)
Temporarily restricted	23,118	(2,600)
Permanently restricted	119,432	20,998
	$ 1,271,154	$ (75,249)

11. GIFTS:

The University's Office of Development ("OOD") reports total gifts based on contributions received in cash or property during the fiscal year. Gifts reported for financial statement purposes are recorded on the accrual basis. The following summarizes gifts and pledges received, for the years ended August 31, 1999 and 1998, per the statement of activities as well as on the cash basis (as announced by OOD), in thousands of dollars:

	1999	1998
Expendable gifts in support of operations	$ 97,412	$ 77,629
Expendable gifts invested in the endowment	4,087	3,379
Temporarily restricted general gifts	55,812	95,094
Buildings and improvements	30,235	55,559
Permanently restricted student loans	38	132
Permanently restricted endowment gifts	99,573	87,277
Total gifts per statement of activities	287,157	319,070
Adjustment to reported gift total as announced by OOD:		
Pledges	(102,387)	(109,700)
Non-government grants, recorded as sponsored research support	34,384	30,647
Payments made on pledges	97,591	79,385
Actuarial gains on early maturity of living trusts	4,164	
Gifts benefiting related health care entities	(1,254)	(55)
Total gifts as announced by OOD	$ 319,655	$ 319,347

The Office of Development includes in its annual gifts total actuarial gains on living trusts that mature within five years of the date of gift.

12. FUNCTIONAL EXPENSES:

Expenses for each of the years ended August 31, 1999 and 1998 were categorized as follows, in thousands of dollars:

	1999	1998
Instruction and departmental research	$ 541,169	$ 492,020
Organized research (direct costs)	538,117	541,318
Libraries	75,904	71,625
Student services	45,492	41,818
Administration	94,850	84,333
Development and general	98,739	60,376
SLAC construction	13,775	12,921
Auxiliary activities	211,667	172,885
	$ 1,619,713	$ 1,477,296

Depreciation, interest, and plant operations and maintenance expenses are allocated to program and supporting activities, except for SLAC construction.

13. PENSION PLANS AND OTHER POSTRETIREMENT BENEFITS:

The University provides retirement benefits, through both contributory and noncontributory pension plans, for substantially all of its employees. In addition to providing pension benefits, the University provides certain health care benefits for retired employees.

Pension Plans: The University's policy is to fund pension costs in accordance with the Employee Retirement Income Security Act minimum funding requirements. Total pension expense for the years ended August 31, 1999 and 1998 was approximately $45,994,000 and $39,590,000, respectively.

Retirement benefits for certain nonexempt employees are provided through a noncontributory defined benefit pension plan. Effective January 1, 1998, certain employees became eligible and have elected to participate in the defined contribution plan. The University recognized income related to the defined benefit pension plan of $581,000 and $2,962,000 for the years ended August 31, 1999 and 1998, respectively.

The University offers a defined contribution pension plan to eligible faculty and staff. University and participant contributions are invested in annuities and mutual funds. University contributions under this plan amounted to approximately $46,539,000 and $42,471,000 for the years ended August 31, 1999 and 1998, respectively.

Postretirement Benefits: Substantially all of the University's employees may become eligible for certain health care benefits if they reach a qualifying retirement age while working for the University. Retiree health plans are paid for in part by employee contributions, which are adjusted annually. Benefits are provided through various insurance companies whose charges are based either on the benefits paid during the year or annual premiums. Health benefits are provided to retirees and their covered dependents.

The University recognizes the cost of postretirement benefits other than pensions over the periods that employees render service. In accordance with SFAS 106, the University recognizes the prior service obligation over 20 years.

The University adopted Statement of Financial Accounting Standards No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" effective September 1, 1997. This statement standardizes and consolidates the disclosure requirements for pension plans and other postretirement benefits.

The change in plan assets and the change in benefit obligation, in thousands of dollars as of August 31, 1999 and 1998, were as follows:

	Pension		Other Postretirement	
	1999	1998	1999	1998
Change in Plan Assets				
Fair value of plan assets at beginning of year	$ 219,467	$ 218,031	$ 21,304	$ 18,811
Actual return on plan assets	50,466	14,363	4,641	1,533
Employer contributions	-	-	2,617	5,185
Plan participants' contributions	-	-	1,880	1,419
Benefits paid	(16,322)	(12,927)	(5,176)	(5,644)
Fair value of plan assets at end of year	$ 253,611	$ 219,467	$ 25,266	$ 21,304
Change In Benefit Obligation				
Benefit obligation at beginning of year	$ 205,634	$ 194,299	$ 56,530	$ 72,814
Service cost	4,901	4,671	1,807	2,624
Interest cost	14,046	13,789	3,825	5,322
Amendments	-	1,992	-	(21,970)
Actuarial (gain) loss	(12,033)	3,810	17,589	1,471
Benefits paid	(16,322)	(12,927)	(3,786)	(3,731)
Benefit obligation at end of year	$ 196,226	$ 205,634	$ 75,965	$ 56,530

Effective January 1, 1998, the University amended its medical benefit plan contributions for eligible retirees over the age of 65. The University contribution to such individuals' health insurance is capped at its 1998 level for all non-Medicare and Medicare+ Choice (formerly Medicare risk) plans.

The accrued benefit cost, in thousands of dollars, was determined as follows at August 31, 1999 and 1998:

	Pension		Other Postretirement	
	1999	**1998**	**1999**	**1998**
Plan assets minus benefit obligation	$ 57,385	$ 13,833	$ (50,699)	$ (35,226)
Unrecognized transition (asset) liability	(2,707)	(3,608)	35,959	38,527
Unrecognized prior service cost	1,680	1,867	-	-
Unrecognized net actuarial gain	(71,844)	(28,159)	(8,464)	(25,064)
Accrued benefit cost recorded in the statement of financial position	$ (15,486)	$ (16,067)	$ (23,204)	$ (21,763)

The discount rate, expected rate of return on plan assets, and the projected covered payroll growth rates used in determining the above accrued benefit costs for the years ended August 31, 1999 and 1998 were:

	Pension		Other Postretirement	
	1999	**1998**	**1999**	**1998**
Discount rate	7.25%	7.00%	7.25%	7.00%
Expected return on plan assets	8.75%	8.50%	8.75%	8.50%
Covered payroll growth rate	5.00%	5.00%	N/A	N/A

The assumed health care trend rate used to measure the accumulated postretirement benefit obligation was 6.0% at August 31, 1999. The rate was assumed to remain at 6.0% in subsequent years and then decrease to 5.5% for 2002-2003 and remain at that level thereafter.

Net benefit (income) expense related to the plans for the years ended August 31, 1999 and 1998, in thousands of dollars, included the following components:

	Pension		Other Postretirement	
	1999	**1998**	**1999**	**1998**
Service cost	$ 4,901	$ 4,671	$ 1,807	$ 2,624
Interest cost	14,046	13,789	3,825	5,322
Expected return on plan assets	(18,231)	(18,623)	(1,811)	(1,411)
Amortization of transition (asset) liability	(901)	(901)	2,568	3,801
Amortization of prior service cost	187	125	-	(294)
Recognized net actuarial gain	(583)	(2,023)	(1,162)	(831)
Net periodic benefit (income) expense	$ (581)	$ (2,962)	$ 5,227	$ 9,211

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. Increasing the health care cost trend rate by one percent in each future year would increase the accumulated postretirement benefit obligation by $8,737,000 and the aggregate service and interest cost by $676,000. Decreasing the health care cost trend rate by one percent in each future year would decrease the accumulated postretirement benefit obligation by $7,836,000 and the aggregate service and interest cost by $545,000.

14. CASH FLOW RECONCILIATION:

The change in University net assets is reconciled to net cash provided by operations for the years ended August 31, 1999 and 1998 as follows, in thousands of dollars:

	1999	1998
Change in net assets	$ 1,652,268	$ 239,581
Increase in accounts receivable	(32,180)	(20,972)
(Increase) decrease in inventories and prepaid expenses	(3,682)	2,465
Increase in pledges receivable	(4,796)	(30,308)
Realized and unrealized (gains) losses on investments	(1,449,354)	20,306
Decrease (increase) in net equity of related health care entities	24,818	(11,599)
Depreciation and loss on disposal of fixed assets	117,444	115,384
Increase in accounts payable and accrued expenses	3,419	4,115
Increase in income beneficiary share of living trust investments	20,811	6,358
Increase in U.S. Government refundable loan funds	1,199	2,921
Gifts, grants, and reinvested income of student loan, endowment, and plant net assets	(131,692)	(182,474)
Other	17,320	(19,267)
Net cash provided by operating activities	$ 215,575	$ 126,510

15. COMMITMENTS AND CONTINGENCIES:

Contingencies Associated with Sponsored Projects: The University conducts substantial research for the federal government pursuant to contracts and grants from federal agencies and departments. The Office of Naval Research (ONR) is the cognizant federal agency for determining indirect cost rates charged to federally sponsored agreements at Stanford. It is supported by the Defense Contract Audit Agency (DCAA), which has the responsibility for auditing direct and indirect charges under those agreements. Direct and indirect costs recovered by the University in support of sponsored research are subject to audit and adjustment.

General Contingencies: The University is a defendant in a number of legal actions. While the final outcome cannot be determined at this time, management is of the opinion that the liability, if any, resulting from these legal actions will not have a material adverse effect on the University's financial position.

Contractual Commitments: At August 31, 1999, the University had contractual obligations of approximately $68,970,000 in connection with major construction projects. Remaining expenditures on the construction projects are estimated to be $471,747,000, which will be financed with certain unexpended plant funds, gifts, and debt.

PATH Audit: The Office of the Inspector General of the United States Department of Health and Human Services has been engaged, since June 1996, in the Physicians at Teaching Hospitals ("PATH") initiative, which reviews the billing to Medicare for teaching physician services. In 1997, SHS volunteered to undergo a PATH audit. Management believes that settlement of a liability, if any, arising from the PATH audit will not have a material adverse effect on the University's financial position.

MANAGEMENT RESPONSIBILITY
FOR FINANCIAL STATEMENTS

The financial statements on the preceding pages have been prepared in conformity with generally accepted accounting principles applicable to colleges and universities. The management of Stanford University is responsible for the integrity and objectivity of these financial statements.

In accumulating and controlling its financial data, management maintains a highly developed system of internal accounting controls. Management believes that a high level of internal control is maintained by the establishment and communication of accounting and business policies, by the selection and training of qualified personnel, and by a program of internal audits to give it reasonable assurance at reasonable cost that the University's assets are protected and that transactions and events are recorded properly.

The accompanying financial statements, where indicated, have been audited by the University's independent accountants, PricewaterhouseCoopers LLP. Their report expresses an informed judgment as to whether management's financial statements considered in their entirety, present fairly, in conformity with generally accepted accounting principles, the University's financial position and changes in net assets and cash flows. The independent accountants' opinion is based on audit procedures described in their report, which include obtaining an understanding of University systems, procedures, and internal accounting controls, and performing tests and other auditing procedures to provide reasonable assurance that the financial statements neither are materially misleading nor contain material errors. While the independent accountants make extensive tests of University procedures and controls, it is neither practical nor necessary for them to scrutinize a large portion of the University's transactions.

The Board of Trustees, through its Audit Committee, composed of trustees not employed by the University, is responsible for engaging the independent accountants and meeting with management, internal auditors, and the independent accountants to assure that each is carrying out its responsibilities and to discuss auditing, internal control, and financial reporting matters. Both the internal auditors and the independent accountants have full and free access to the Audit Committee. Both meet with the Audit Committee at least annually, with and without each other, and with and without the presence of management representatives.

Mariann Byerwalter
Vice President for Business Affairs and Chief Financial Officer

M. Suzanne Calandra
Controller

REPORT OF **INDEPENDENT ACCOUNTANTS**

To The Board of Trustees
Stanford University
Stanford, California

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of activities and cash flows, which appear on pages 19 through 38 present fairly, in all material respects, the financial position of Stanford University at August 31, 1999 and 1998, and the changes in its net assets and its cash flows for the years then ended, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the University'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 generally accepted auditing standards, which 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 the opinion expressed above.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
San Francisco, California
December 6, 1999

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(February 2000)

The Annual Report is prepared by the Office of the Controller, the Office of Business Development, and the Office of University Communications.

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