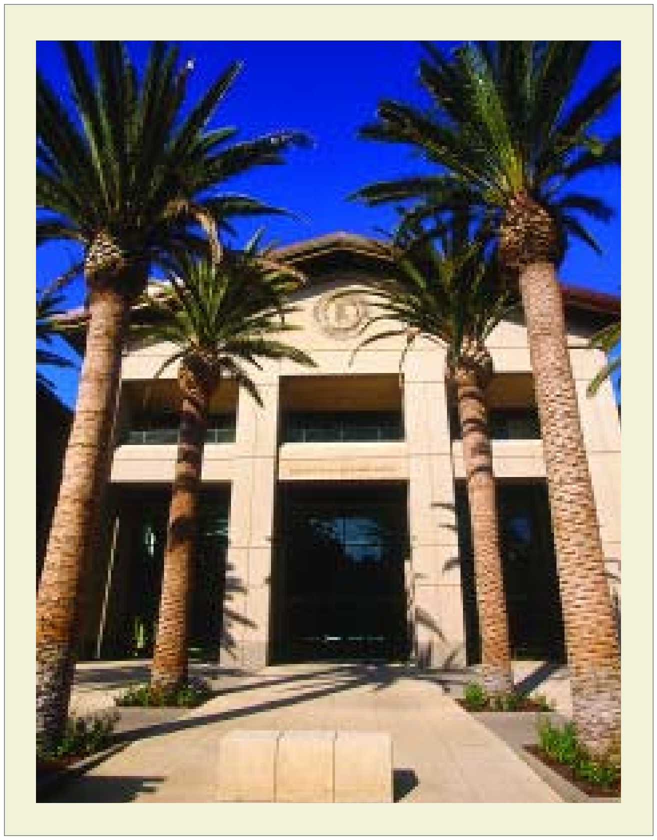
Building a
University
That Lasts



2001 Annual Report

# STANFORD UNIVERSITY

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**On the cover:** The Frances C. Arrillaga Alumni Center opened fall 2001. The 116,000-square-foot center on Galvez Street features a two-story "great hall" and other areas for visiting alumni. Funded through the generosity of the Arrillaga family and several other alumni donors, it honors the memory of alumna Frances Arrillaga, who worked tirelessly on behalf of Stanford until her death in 1995. (Photograph by Linda A. Cicero)

## STANFORD FACTS:

Enrollment (2001): **14,173**

Undergraduate Students: **6,637**

Graduate Students: **7,536**

Degrees Awarded (2000–2001):

Bachelor's: **1,676**

Master's: **2,086**

Doctoral: **850**

The Stanford Professoriate: **1,701**

Nobel Laureates: **17**

Pulitzer Prize Winners: **4**

MacArthur Fellows: **23**

National Medal of Science Recipients: **21**

National Medal of Technology Recipients: **3**

American Academy of Arts and Sciences Members: **219**

National Academy of Sciences Members: **124**

National Academy of Engineering Members: **82**

American Philosophical Society Members: **41**

National Academy of Education Members: **24**

Wolf Foundation Prize Winners: **6**

Koret Foundation Prize Winners: **6**

Presidential Medal of Freedom Recipients: **2**

LELAND STANFORD JUNIOR UNIVERSITY

DIE LUFT DER FREIHEIT WEHT

ORGANIZED 1891

# Building a University That Lasts

John L. Hennessy

This first year of the millennium has been a time of extraordinary change and challenge—for Stanford University, for the nation, and for the world. California's energy crisis led to rolling blackouts; the global economy began a steady decline; and the dot-com juggernaut returned to earth. And on Tuesday, September 11, the world was shocked by unprecedented acts of terror against thousands of people going about their daily lives.

Some years offer more stability than others, but the future always holds the potential for uncertainty, whether natural or man-made. Certainly, this past year has been challenging. Challenges, however, also provide an opportunity for examining our goals and priorities and assessing how those challenges should affect our course. In the face of both long-term evolutionary changes and the more rapid revolutionary changes of the past year, the same question remains: How do we build a university that lasts and continues to excel?

Stanford has always been clear in its priorities and bold in its thinking. In October 2000, we launched a campaign to raise $1 billion for undergraduate education. This campaign, believed to be the largest ever devoted exclusively to undergraduate education at any college or university, is a clear statement of our priorities and the plan that we have been pursuing for nearly a decade. Given the revolutionary changes of this year, we might well ask ourselves: What does it mean to go forward with a campaign at this time, and can we achieve our goals?

The work that we are doing has never been more important. Stanford, from the time of its founding, has been about building futures. Just as our predecessors educated generations of leaders, researchers, doctors, and teachers, the students we are educating today will play an important role in building a better world for the generations to come. This campaign will ensure those generations are given every opportunity to do so.

From its earliest days, Stanford has countered adversity with perseverance. When Jane and Leland Stanford's only child died, they transformed their grief into something positive by founding a university in his name. Soon after the University opened its doors, Leland Stanford died. This event generated great economic uncertainty and strain for the new University. Jane Stanford demonstrated remarkable strength of will: Not only did she keep the doors open, she continued to envision a better and stronger future. In July 1904, in her last address to the Board of Trustees, she exhorted:

> "Let us not be afraid to outgrow old thoughts and ways, and dare to think on new lines as to the future of the work under our care. Let us not be poor copies of other universities. Let us be progressive."

Throughout its history, this University has met enormous challenges, including two major earthquakes, and thrived. Today, Stanford is a leader throughout the world in teaching and research. Among the more than 1,700 faculty members, there are 17 Nobel laureates, four Pulitzer Prize winners, and 21 recipients of the National Medal of Science. Their research initiatives have advanced the frontiers of knowledge in fields ranging from history to economics, from biomedical research to information technology. Our innovations in undergraduate education have generated both admirers and imitators. New initiatives, like the Stanford Graduate Fellowships and the Bio-X collaboration, have inspired others to create similar programs.

Resolute in our commitment to excellence, we recognize that such advances do not come from standing still. The Campaign for Undergraduate Education supports programs that offer the world's brightest students access to the best teachers and scholars, particularly through small classes and personal mentoring relationships. Given the challenges facing all of us, the innovations we have made—and continue to make—in our undergraduate curriculum have never been more important. Our commitment to provide an extraordinary education to our students, who will go on to become future leaders of our country and the world, is more critical than ever.

For more than a century, our mission has been constant: to educate "cultured and useful citizens" for the benefit of humankind. In his last letter to President Jordan, Leland Stanford wrote: "The imagination needs to be cultivated and developed to assure success in life. A man will never construct anything he cannot conceive."

If we are to educate the leaders of tomorrow, we must cultivate intellectual curiosity. The Campaign for Undergraduate Education is an investment in cultivating the imagination and creativity of the extraordinary undergraduates who come to Stanford.

We have already begun to see the dividends from our investments in programs like Freshman and Sophomore Seminars, Overseas Studies, and Undergraduate Research Programs. Our return on that investment comes from the students whose lives we change—students like Sulggi Lee. Ms. Lee, a member of the Class of 1998, majored in Human Biology and minored in Latin American Studies. Research during overseas study in Santiago, Chile, led to an Undergraduate Research Opportunities grant and her Honors Research Thesis on the respiratory effects of particulate air contamination. But more important, Ms. Lee noted:

> "I learned to see academics as a gift, … I learned to study just for the sake of learning and understanding. … Most of all, I learned a lot about myself and gained the kind of self-confidence that propels me forward to this day."

Jane and Leland Stanford transformed their grief into a living gift that nurtures students like Sulggi Lee more than a hundred years later. It is now our responsibility to pass this gift on to future generations. We cannot predict what discoveries will come from our investments, nor what roles our students will play after they graduate. Nonetheless, just as Jane and Leland Stanford would be incredibly proud of the return on their investment, I am confident that we can and will be proud of the results from our investments in Stanford and from our steadfast commitment to building a university that will endure the test of time.

John Hennessy

**JOHN L. HENNESSY**
President

# SUPPORTING STANFORD'S HIGHEST PRIORITIES

When President John Hennessy was inaugurated in October of 2000, he announced the five-year, $1 billion Campaign for Undergraduate Education, known as CUE. CUE, believed to be the largest fundraising campaign devoted to undergraduate education ever undertaken by a college or university, is a bold statement about Stanford's commitment to undergraduates.

Most capital campaigns include buildings, but CUE is focused on people, programs, and ideas—the very essence of Stanford. CUE is designed to ensure that Stanford continues to provide its exceptional undergraduate students with unrivaled access to faculty and with an important role in its research mission.

**CUE'S OBJECTIVES ARE:**

- $300 million to create the Stanford Endowment for Undergraduate Education. Among the targeted programs is Stanford Introductory Studies, which includes Freshman and Sophomore Seminars and other small-group learning experiences.
- $300 million for endowed scholarships, including $250 million to ensure that Stanford can continue to admit students without regard for their ability to pay—a process called "need-blind" admission. Stanford is one of only a handful of private U.S. colleges and universities that provide this guarantee.
- $300 million to support the full range of opportunities available to undergraduates, including new and enhanced programs in the schools of Humanities and Sciences, Engineering, and Earth Sciences, as well as in the libraries, athletics, the Haas Center for Public Service, Overseas Studies, and Stanford in Washington.
- $100 million for The Stanford Fund for Undergraduate Education, which provides need-based scholarships and seed funding for ongoing curriculum and teaching innovations.

January 2001 >

**THE YEAR IN REVIEW**

A LOOK BACK AT SELECTED STANFORD EVENTS DURING THE CALENDAR YEAR 2001

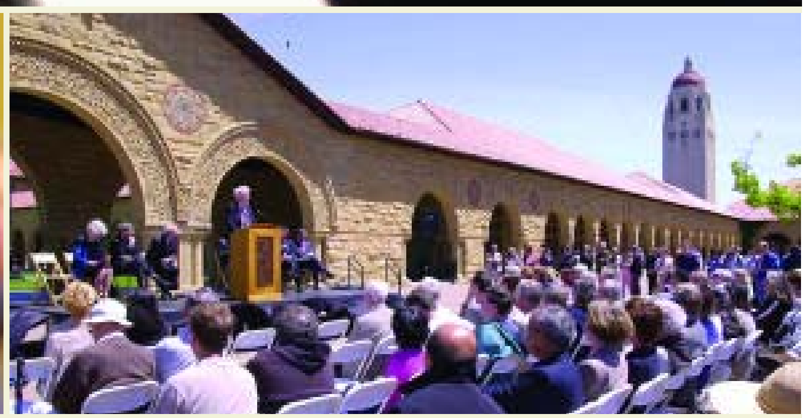
F.W. DEKLERK, FORMER PRESIDENT OF SOUTH AFRICA AND A NOBEL PRIZE WINNER, SPEAKS ABOUT SOUTH AFRICA'S PAST AND FUTURE TO A PACKED KRESGE AUDITORIUM AUDIENCE.

WILLIAM HEWLETT, AN ALUMNUS WHOSE VISION HELPED BUILD STANFORD INTO ONE OF THE WORLD'S PREEMINENT RESEARCH UNIVERSITIES, DIES JAN. 12.

MARY PRATT, PROFESSOR OF SPANISH AND PORTUGUESE, IS ELECTED SECOND VICE PRESIDENT OF THE MODERN LANGUAGE ASSOCIATION, A POSITION THAT WILL LEAD TO THE PRESIDENCY.

DEBRA ZUMWALT, A STANFORD ALUMNA AND PARTNER AT PILLSBURY WINTHROP LLP, IS NAMED GENERAL COUNSEL.

GENERAL MOTORS FUNDS A $3 MILLION RESEARCH LAB IN THE SCHOOL OF ENGINEERING FOR THREE YEARS TO STUDY "WORK SYSTEMS"—THE WAY PEOPLE USE MATERIALS AND INFORMATION TO CREATE PRODUCTS AND SERVICES.



Clockwise from the top:

Among the students featured on the Campaign for Undergraduate Education (CUE) Web pages is Jason Walker, Class of 2003. Says Walker, "When I was in high school, one of my teachers warned me that college professors wouldn't care whether or not I came to class, and they wouldn't care if I passed or failed. So, that is what I was expecting when I got here. But, it's not anything like that at Stanford." ✦ The William and Flora Hewlett Foundation's record-breaking $400 million gift, which supports the School of Humanities and Sciences and CUE, was announced during a noontime gathering in the Main Quadrangle. ✦ Walter Hewlett, chairman of the Hewlett Foundation, said the gift honors his late father's devotion to Stanford.

## HEWLETT GIFT MAKES HISTORY

The stunning news was delivered to the campus community at a hastily scheduled noontime gathering May 2 in the Main Quadrangle. Upon being introduced by President John Hennessy, Walter B. Hewlett, chairman of the William and Flora Hewlett Foundation, said simply: "The board of directors of the William and Flora Hewlett Foundation [has] unanimously approved a gift to Stanford University of $400 million."

The crowd of several hundred faculty and students—alerted to the event by an e-mail promising an "unprecedented historical announcement"—initially gasped in awe and then broke out in applause.

When Hewlett went on to say that $300 million of the gift was for the School of Humanities and Sciences (H&S) and $100 million for the Campaign for Undergraduate Education, the gasps and applause turned into sustained cheers. At that time, it was the largest single gift to an American college or university.

"This gift honors my father, who passed away in January, and honors his lifetime of philanthropy, his lifelong devotion to Stanford, and his passionate belief in the value of a liberal arts education," Walter Hewlett said, referring to his late father, the engineering pioneer William R. Hewlett, who established the foundation in 1966.

Although it is the largest of Stanford's seven schools, H&S has strained its resources in recent years to remain competitive with the schools of liberal arts at comparable institutions. The school offers 90 percent of the University's undergraduate instruction, awards nearly half of the doctoral degrees, and represents 41 percent of tenure-line faculty. The foundation's gift includes support for unrestricted endowment and matching funds for designated priorities, including professorships and graduate fellowships.

CUE builds on the renaissance in undergraduate programs at Stanford during the past decade. Most of these programs, including Stanford Introductory Studies, were funded through University seed money or expendable gifts. From 1994 to 2001, the University increased its budget for these initiatives from $4 million to $17 million. CUE seeks gifts to the endowment to make these enhancements permanent parts of the Stanford undergraduate program.

When Stanford announced the campaign, $429 million in gifts and pledges already had been committed. Six months later, CUE passed the halfway mark. At the end of the 2000–2001 fiscal year, CUE totaled $639 million. Among the gifts accelerating the campaign's progress was a $100 million gift—part of a larger $400 million gift—from the Hewlett Foundation (see accompanying story).

The campaign builds on the work of the Commission on Undergraduate Education, appointed in 1993 by President Gerhard Casper. The commission's report led to the creation of the programs that CUE is designed to support.

In the fall, Stanford began offering CUE-related events—called "Think Again"—in cities throughout the country to bring the current undergraduate experience to life for alumni, parents, and friends.

## MEET THE STUDENTS

The Campaign for Undergraduate Education Web pages (http://cue.stanford.edu) have provided alumni and others with opportunities to meet, read the online journals of, and exchange e-mail messages with the students their gifts benefit. Below are comments from two featured students.

KATE PEDATELLA, CLASS OF 2003

"It's such an amazing feeling to be taught by someone who wrote the textbook," Pedatella says of her Freshman Seminar, "Saints: The Rhetoric of Religious Perfection," taught by French Professor Brigitte Cazelles. "I'll never get over that! What made the class so rewarding was that Professor Cazelles always seemed to value our opinions so much. Obviously she's a world-renowned scholar in her field, but she sought our thoughts about what she'd written. She made us feel that, despite our age, we knew something or had the potential to know something."

TONY SUNG, CLASS OF 2004

"One of the best parts of Sophomore College was the opportunity to spend so much time with a respected faculty member in nontraditional settings. Professor [Richard] Zare would often share our meals, eating every lunch with us and twice inviting us to his home for dinner. His office door is open even on weekends, and conversations are not limited to science. I feel privileged to be at Stanford, where professors like Richard Zare are the rule rather than the exception and gifts of learning are freely passed on to later generations."

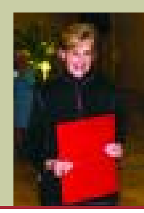
RANDALL LIVINGSTON, A STANFORD ALUMNUS AND EXECUTIVE VICE PRESIDENT, CHIEF FINANCIAL OFFICER, AND DIRECTOR OF OPEN TV, IS NAMED VICE PRESIDENT FOR BUSINESS AFFAIRS AND CHIEF FINANCIAL OFFICER.

LADORIS CORDELL, A STANFORD ALUMNA AND SANTA CLARA COUNTY JUDGE, IS NAMED VICE PROVOST AND SPECIAL COUNSELOR TO THE PRESIDENT FOR CAMPUS RELATIONS.

A STUDY OF LAKE TITICACA, CO-AUTHORED BY GEOLOGY PROFESSOR ROBERT DUNBAR IN THE JOURNAL *SCIENCE,* DEMONSTRATES HOW NATURE CAN PRODUCE SUDDEN, UNEXPECTED CLIMATE CHANGES THAT AFFECT THE ENTIRE PLANET.

February 2001 >

PRESIDENT HENNESSY AND EIGHT OTHER RESEARCH UNIVERSITY PRESIDENTS AGREE TO WORK TOWARD GENDER EQUALITY FOR WOMEN FACULTY IN SCIENCE AND ENGINEERING.



ALUMNA LINDA MEIER RECEIVES THE "DEGREE OF UNCOMMON WOMAN," THE UNIVERSITY'S HIGHEST HONOR, FOR EXTRAORDINARY SERVICE.

PSYCHOLOGY PROFESSOR JOHN GABRIELI AUTHORS A STUDY IN *NEUROREPORT* THAT SHOWS CHILDREN SUFFERING FROM DYSLEXIA HAVE A BIOLOGICAL DISRUPTION IN HOW THEIR BRAINS ARE WIRED FOR LANGUAGE AND READING.

# CONTINUING

## THE RENAISSANCE

Undergraduate education at Stanford has been virtually transformed since the Commission on Undergraduate Education concluded its comprehensive review in 1994. During the past several years, under the purview of the new office of the vice provost for undergraduate education, Stanford has intensified small-group learning experiences for freshmen and sophomores through such programs as:

- Freshman and Sophomore Seminars, limited to 16 students, which are taught by tenure-line professors, including those from Stanford's law, business, and medical schools;
- Sophomore Dialogues, which enroll no more than five students in an intensive course of directed reading;
- Sophomore College, which is a two-week residential academic program for returning sophomores held just prior to the start of the school year and featuring an intensive learning experience in a class with just 12 students;
- Freshman-Sophomore College, which brings together 180 freshmen and sophomores in one living area for a two-year program combining courses offered in the residence with special programs led by faculty and advising staff; and
- Introduction to the Humanities, which builds a foundation during the freshman year for the study of human thought, values, and culture.

In addition, resources have been committed to enhancing writing education through the creation of a new writing center and expansion of the writing requirement to include rhetoric and oral communication.

With many of these initiatives successfully underway, Stanford's attention has turned to the experience of juniors and seniors. Research opportunities have been augmented and major fields of studies strengthened.

In January, Vice Provost for Undergraduate Education John Bravman announced new faculty grants for independent study and research designed to enhance research opportunities for undergraduates. The grants fall under a new organization called Undergraduate Research Programs that places all such programs—including the highly successful Undergraduate Research Opportunities

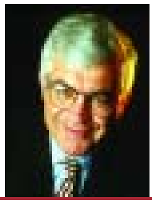
JOHN CIOFFI, ALICE GAST, AND AMOS NUR ARE ELECTED TO THE NATIONAL ACADEMY OF ENGINEERING, ONE OF THE HIGHEST PROFESSIONAL DISTINCTIONS ACCORDED ENGINEERS.

March 2001 >

THE BOARD OF TRUSTEES SETS RATES FOR UNDERGRADUATE TUITION, ROOM, AND BOARD FOR 2001–2002 REFLECTING A 5.4 PERCENT INCREASE OF PREVIOUS RATES. THE BOARD ALSO IMPROVES THE UNIVERSITY'S FINANCIAL AID PROGRAM FOR THE FOURTH YEAR IN A ROW.

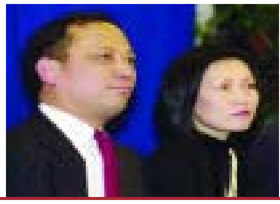
BIOCOMPUTATION, WHICH USES POWERFUL COMPUTERS TO SOLVE COMPLEX PROBLEMS IN THE BIOSCIENCES, TAKES A GIANT LEAP FORWARD WITH THE INSTALLATION AT THE GATES BUILDING OF AN SGI ORIGIN 3800 SUPERCOMPUTER.

THE REV. SCOTTY McLENNAN IS INSTALLED AS THE NEW DEAN FOR RELIGIOUS LIFE.

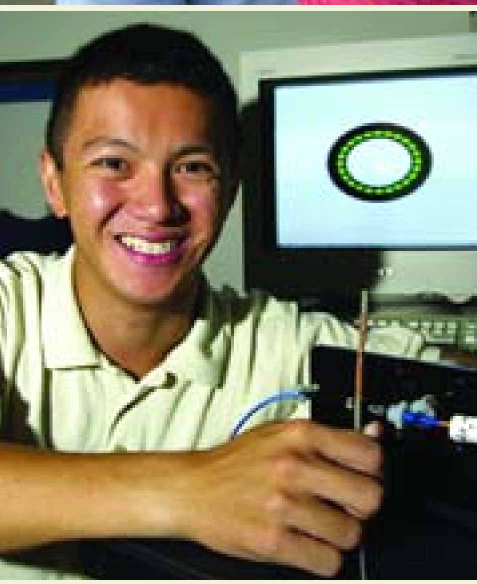


ECONOMICS PROFESSOR JOHN B. TAYLOR IS NOMINATED BY PRESIDENT GEORGE W. BUSH TO BE UNDERSECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS.

GEOLOGIST MARK ZOBACK THEORIZES IN THE JOURNAL *GEOLOGY* THAT THE CONTINUING REBOUNDING OF PAST GLACIERS CONTRIBUTES TO EARTHQUAKES TODAY.



PEHONG CHEN, FOUNDER AND CEO OF BROADVISION, AND HIS WIFE, ADELE, DONATE $15 MILLION TO ESTABLISH A NEW INSTITUTE FOR THE STUDY OF PARTICLE ASTROPHYSICS AND COSMOLOGY.



Clockwise from the top:

Jo Boaler, associate professor of education, is among the faculty members whose research group welcomes undergraduates, including Hermione Giffard, Sean Whalen, and Lisa Yiu. ✦ Jamie Hui and Terence Chia were among the students pursuing research during the Summer Research College. Hui is sequencing genes that may be involved in basal cell carcinoma, while Chia studied a fluorescence catheter that detects plaque in arteries or cancer cells in intestines. Chia calls the Summer Research College a "very horizon-broadening experience. During the day, you go to the lab and do research. You come back and talk to people who have diverse interests and are very passionate about them."

## THE POWER OF UNDERGRADUATE RESEARCH

One of the first new faculty grants for Stanford undergraduate research, announced recently by Vice Provost John Bravman, was awarded to Jo Boaler, associate professor of education (see photo above top). She worked with three undergraduates to evaluate the effectiveness of mathematics teaching at three area high schools.

"They were fantastic," says Boaler of her undergraduate assistants. As a member of a graduate faculty, Boaler doesn't interact as much as she would like with undergraduates. Her research project, which also includes doctoral research assistants, follows about 1,000 students over four years of high school, examining qualitative and quantitative data as the students go through different mathematics programs.

"I was really impressed with the undergraduates' insights," she says. "I didn't necessarily expect them to be as good as they were."

The admiration was mutual, according to sophomores Sean Whalen and Hermione Giffard.

"It was the first research project I'd ever been on, so it was interesting to be in a situation where you don't know the outcome of your experiment," says Whalen. "In most situations in school, for example, all the problems presented are ones that have definite solutions that someone has already calculated. Working with Professor Boaler was very different."

He adds, "I really liked working in a small group. I liked how much responsibility they gave us. I wasn't expecting to be so integral to the group, but they really got us involved in directing the path of the study."

Says Giffard, "The best thing that I've gotten from this project is an enticing view into issues affecting teaching and learning—how best to do each and how the two affect one another. It broadened my worldview and changed many of my preconceptions."

### SUMMER RESEARCH COLLEGE EXPANDS

Now in its second year, Stanford's Summer Research College (SRC) gives undergraduates pursuing research an opportunity to build a community among students with similar interests.

Linking the many department-based research programs for undergraduates, the SRC makes summer research feasible through housing subsidies. The eight- to 10-week program follows the models of Honors College and Sophomore College, both of which have combined residential and academic life.

In addition to performing their research duties, students meet each week to give short presentations about their work, exposing each other to subjects as diverse as infant language processing, beliefs about illness in Ghana, and proteins that protect the heart.

"The goal is to allow students to experience research over a concentrated period of time," says Susan Brubaker-Cole, director of undergraduate research programs in the Office of the Vice Provost for Undergraduate Education. "They learn what kinds of questions researchers ask and what counts as legitimate evidence." A few co-author papers with faculty members.

Psychology Professor Russell Fernald mentored four students through the SRC. He lauds the energy undergraduates bring to the lab. "They have a willingness to work hard, to ask questions, and they don't have preconceptions. And, they see how slow it is to find new knowledge—it gives them another perspective."

John Bravman

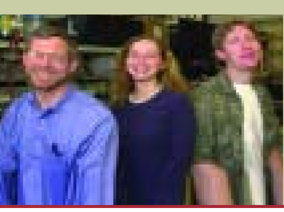
program—under one umbrella.During the 2000-01 academic year, the office gave $1.47 million for programs involving 795 students.

"This ties students more into the central mission of scholarship of the University in a way that many faculty and students find extremely rewarding," Bravman says. "The non-classroom component of a Stanford education can be as important as anything done in a classroom."

**AMONG THE INITIATIVE'S NEW PROGRAMS ARE:**

- grants that allow undergraduates to work individually with faculty mentors, providing a bridge between introductory course work and more advanced independent study during the junior and senior years;
- expansion of a similar program that makes funding available for department-based undergraduate research offerings; and
- Summer Research College, which expanded from 70 students in its pilot year last year to 165 students in 2001. The college allows students who have secured summer research positions to live together in a dorm with a significant portion of their room and board costs subsidized. Social activities provide a scholarly community for the students.

In addition, to strengthen the major, the Faculty Senate approved guidelines for comprehensive reviews of all undergraduate degree-granting programs every six to eight years.



ASSOCIATE PROFESSOR OF CHEMISTRY CHRISTOPHER CHIDSEY REPORTS IN *SCIENCE* THAT HE AND HIS STUDENTS HAVE SYNTHESIZED A MATERIAL THAT WILL BE IMPORTANT IN FUTURE APPLICATIONS OF NANOTECHNOLOGY.

THE UNIVERSITY MAKES OFFERS OF ADMISSION TO 2,406 FOR THE 1,600-STUDENT CLASS OF 2005—A CLASS THAT WILL BE AMONG STANFORD'S MOST DIVERSE.

HOWARD WOLF IS APPOINTED PRESIDENT OF THE STANFORD ALUMNI ASSOCIATION.

April 2001 >

JUNIOR DONALD MATSUDA IS AMONG 80 STUDENTS NATIONWIDE AWARDED TRUMAN SCHOLARSHIPS.

SHARON LONG IS APPOINTED THE VERNON R. & LYSBETH WARREN ANDERSON DEAN OF THE SCHOOL OF HUMANITIES AND SCIENCES.

May 2001 >

THE HEWLETT FOUNDATION PLEDGES STANFORD $400 MILLION IN UNRESTRICTED ENDOWMENT FUNDS. AT THAT TIME, IT IS THE LARGEST PLEDGE TO A UNIVERSITY.

# RELENTLESSLY PURSUING NEW KNOWLEDGE

As one of the nation's leading research universities, Stanford has been at the forefront of discovery and innovation, participating, for instance, in the creation and application of the information technology and biotechnology revolutions.

Stanford scholars and researchers have been credited with creating the process for recombinant DNA cloning, performing the first heart transplant in North America, producing the discoveries that have led to magnetic resonance imaging, and inventing new laser technology, music synthesizers, and the global positioning system.

Following are some of the ongoing efforts through which Stanford researchers and their graduate and undergraduate students are contributing to scholarship and society today.

**Enhancing biomedical research** Biomedical research is being strengthened with the construction of the James H. Clark Center for Biomedical Engineering and Sciences. The Clark Center is at the core of an initiative—known as Bio-X—that brings together the biosciences, physical sciences, medicine, and engineering to focus on interdisciplinary biomedical research.

**Unlocking the human genome** Stanford teams involved in the International Human Genome Sequencing Consortium joined colleagues this year to announce the analysis of the human genome sequence—the 3 billion DNA letters that comprise the complete set of human genes. The teams were headed by geneticists Richard Myers and Ronald Davis.

**Creating engineering marvels** The School of Engineering has a widespread reputation for innovation. Among its most recent contributions are a microphone array necklace that increases speech discernment for the hearing impaired, an innovative camera that uses a single chip and pixel-level processing to render enhanced images, and a low-cost magnetic resonance imaging scanner that provides better contrast in soft tissue compared to other imaging techniques. Stanford faculty are also among the most widely

PHYSICIST CHARLES PRESCOTT AND BIOLOGIST CHRISTOPHER FIELD ARE ELECTED TO THE NATIONAL ACADEMY OF SCIENCES.

W.S. DI PIERO, PROFESSOR OF ENGLISH, ROELAND NUSSE, PROFESSOR OF DEVELOPMENTAL BIOLOGY, AND W.E. MOERNER, PROFESSOR OF CHEMISTRY, ARE ELECTED FELLOWS OF THE AMERICAN ACADEMY OF ARTS AND SCIENCES.

THE RENOVATED THOMAS WELTON STANFORD ART GALLERY REOPENS WITH THE 2001 MASTER OF FINE ARTS EXHIBITION.

FOR THE FIRST TIME IN THE NATION, HUMAN CELLS COAXED IN THE LABORATORY TO BECOME NEURONS ARE IMPLANTED INTO THE BRAIN OF A STROKE-IMPAIRED MAN UNDER A TRIAL DIRECTED BY NEUROSURGEON GARY STEINBERG.

PROFESSORS DAVID M. KENNEDY, JAMES SHEEHAN, AND JAMES MARCH ARE NAMED TO THE AMERICAN PHILOSOPHICAL SOCIETY.

NOVELIST DOROTHY ALLISON SPEAKS AS PART OF THE 2001 TANNER LECTURES IN HUMAN VALUES.

THE CAMPUS SAYS GOOD-BYE IN WHITE PLAZA TO JAMES MONTOYA, OUTGOING VICE PROVOST FOR STUDENT AFFAIRS.

## CHYBA AWARDED MACARTHUR FELLOWSHIP

Christopher Chyba, a prominent astrobiologist, former White House security adviser and co-director of the Stanford Center for International Security and Cooperation (CISAC), was one of 23 people awarded a 2001 fellowship from the John D. and Catherine T. MacArthur Foundation.

Chyba, an associate professor (research) of geological and environmental sciences, becomes the 23rd Stanford winner of the so-called "genius award." In granting the fellowship, the foundation cited Chyba's "passion for understanding life on Earth and for protecting human civilization from self-destruction," as well as his recent work focusing on "the relationship between preparing for biological terrorism and improving public health."

The unrestricted fellowships are given to talented individuals who have demonstrated extraordinary originality. Each recipient receives a $500,000 "no-strings-attached" stipend.

During the Clinton administration, Chyba served as director for environmental affairs for the National Security Council and as energy liaison for the White House Office of Science and Technology. In February 2000, he became co-director of CISAC—part of Stanford's Institute for International Studies—which brings together scholars, policymakers, and other experts to focus on international security questions.


Christopher Chyba

recognized pioneers in nanotechnology, particularly in such areas as microscopy, microsensors, and nanomaterials.

**Understanding the importance of sleep** Stanford faculty such as William Dement have long been at the forefront of the study of sleep. Emmanuel Mignot, director of the Center for Narcolepsy, recently identified the gene that causes narcolepsy. Other researchers are now working to make sense of a link between apnea, a common sleep disorder, and Alzheimer's disease.

**Rethinking American history** Stanford's American historians are among the most recognized, including Pulitzer Prize winners David Kennedy and Jack Rakove. Kennedy's *Freedom from Fear* is a comprehensive history of the Great Depression, the New Deal, and World War II. Rakove's *Original Meanings: Politics and Ideas in the Making of the Constitution* challenges 'originalism' as a method of interpreting the framers' intentions.

**Probing the universe** Stanford researchers are among scientists worldwide seeking a better understanding of the fundamental particles of matter and the nature of the universe. The international BaBar Collaboration at the Stanford Linear Accelerator Center released initial results on the behavior of subatomic particles known as B mesons. Their experiments provide clues about why our universe contains more matter than antimatter. At the Hansen Experimental Physics Laboratory, physicists involved in Gravity Probe B are preparing to launch into space an experiment testing Einstein's theory of relativity in 2002.

**Pushing the humanities envelope** Scholarship in the humanities is expanding because of the Stanford Humanities Laboratory (SHL). SHL provides seed money to collaborative,

June 2001 >

HOPKINS MARINE STATION OPENS THE STATE-OF-THE-ART MAZIA MICROSCOPY CENTER.

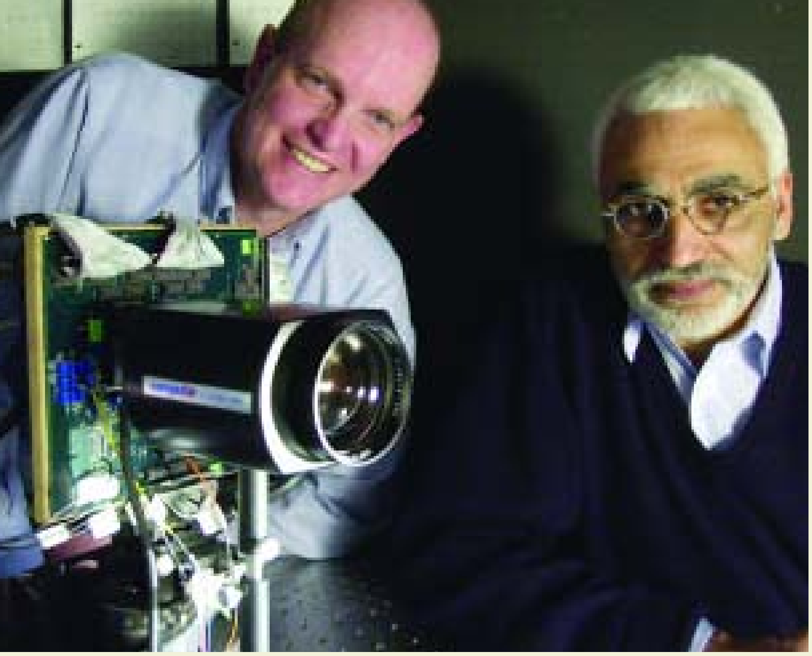
THE UNIVERSITY CELEBRATES THE 20TH ANNIVERSARY OF THE NATION'S FIRST PROGRAM IN FEMINIST STUDIES.

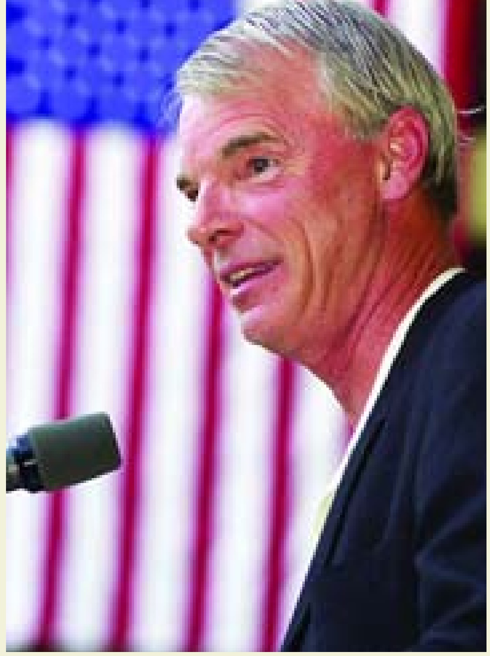
ATHLETICS DIRECTOR TED LELAND ACCEPTS STANFORD'S SEVENTH SEARS DIRECTORS CUP AS THE NATION'S TOP DIVISION I COLLEGE SPORTS PROGRAM.

STANFORD ALUMNA CARLY FIORINA, CEO OF HEWLETT-PACKARD, ADDRESSES 29,000 PEOPLE AT THE 110TH COMMENCEMENT CEREMONIES.

ECONOMICS PROFESSOR ANNE KRUEGER IS APPOINTED FIRST DEPUTY MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND.

ALONG WITH THE PRESIDENTS OF 27 OTHER INSTITUTIONS, PRESIDENT HENNESSY ENDORSES PRINCIPLES AIMED AT ENSURING FINANCIAL AID IS DISTRIBUTED FAIRLY TO STUDENTS BASED ON THEIR LEVEL OF NEED.





Clockwise from the upper left-hand corner:

Psychology professor Brian Wandell and Electrical Engineering faculty member Abbas El-Gamal and their students have developed a camera-on-a-chip that captures images at 10,000 frames per second, processes one billion pixels per second, and sets a record for continuous imaging. ✦ A. Michael Spence, the Philip H. Knight Professor Emeritus and former dean of the Graduate School of Business, shared the 2001 Nobel Memorial Prize in Economic Sciences for his work in information economics (see story below). ✦ The work of biologist Barbara Block of the Hopkins Marine Station is influencing international marine conservation efforts.

## A NOBEL PRIZE FOR SPENCE AND STIGLITZ

A. Michael Spence (photo top right), the Philip H. Knight Professor Emeritus and the former dean of the Graduate School of Business, and Joseph Stiglitz, a professor emeritus of economics now at Columbia, were awarded the 2001 Nobel Memorial Prize in Economic Sciences. They shared the $1 million prize with George Akerlof of the University of California at Berkeley. Stanford is now home to 17 living Nobel laureates.

The Royal Swedish Academy of Sciences awarded the prize for the trio's work in information economics. In the 1970s, the laureates laid the groundwork for a theory about markets with so-called "asymmetric" information. Their work explained how agents with differing amounts of information affect many kinds of markets. In its announcement, the Royal Swedish Academy of Sciences said that the winners' contributions "form the core of modern information economics."

Their work has led to real-world applications in areas ranging from agricultural markets to modern financial markets, according to the academy.

Biomedical research is being strengthened with the construction of the James H. Clark Center for Biomedical Engineering and Sciences.

interdisciplinary projects whose results are considered non-traditional. For instance, dpResearch: A Digital Performance Journal, is exploring and expanding the notion of performance. The project will result in a Website that is a cross between an online journal and exhibition space.

**Studying disease at a cellular level** Molecular and genetic medicine are among the specialties of Stanford researchers who search for the root causes of disease. Among them is biochemist Patrick Brown, a researcher at the Howard Hughes Medical Institute, whose work with DNA microarrays was singled out by the National Cancer Institute as representing the best hope for cancer diagnosis and treatment.

**Conserving the ocean's resources** Stanford's Hopkins Marine Station is the oldest marine laboratory on the American Pacific Coast. Among the researchers seeking a better understanding of the marine world is biologist Barbara Block, who works with the Tuna Research and Conservation Center, a joint project of Hopkins and the Monterey Bay Aquarium. Her research could affect international efforts to conserve the bluefin tuna, whose numbers have sharply declined.

**Leading in digital-age law** Scholars at the School of Law have made a major effort to be the leaders in technology-related law research and teaching through the Law, Science & Technology Program and the new Center for Internet and Society. Among them is Lawrence Lessig, whose book, *Code and Other Laws of Cyberspace,* stirred debate through its exploration of how the architecture of computer networks affects basic liberties. Another scholar, John Barton, is heading an international commission investigating how intellectual property rules affect developing nations.

**Focusing on writing** Stanford has long been recognized for its writing programs, partly because of the Creative Writing Program founded by Wallace Stegner more than 50 years ago. Two new gifts to the endowment support a visiting prose writer and visiting poet every year.

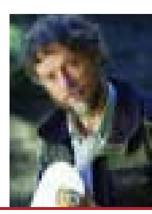
**Highlighting environmental research** Stanford has launched the Environmental Initiative to bring together the work of some 56 faculty working in 15 areas related to the environment. Stanford is particularly strong in environmental law, population studies, geochemistry, climate change, agricultural sustainability, energy policy, biodiversity, and world health.

**Exploring the worlds of music** For all their stylistic differences, the composition faculty in the Department of Music share international recognition. Last year's performances of Stanford composers covered cities around the globe. Melissa Hui's soundtrack for the Oscar-nominated National Film Board of Canada documentary *Sunrise Over Tiananmen Square* was heard worldwide at film festivals.

CONSTRUCTION WORKERS AT BUILDING 160—THE WALLENBERG GLOBAL LEARNING CENTER—DISCOVER A FORGOTTEN TIME CAPSULE BURIED BY JANE STANFORD MORE THAN A CENTURY AGO.

July 2001 >

*NATURE MEDICINE* FEATURES A STUDY BY RESEARCHERS LED BY JOHN COOKE, ASSOCIATE PROFESSOR OF CARDIOVASCULAR MEDICINE, THAT SHOWS NICOTINE PROMOTES THE GROWTH OF NEW BLOOD VESSELS.



ANTHROPOLOGIST JOHN RICK AND HIS STUDENTS UNEARTH 3,000-YEAR-OLD STROMBUS SHELLS AT THE ANCIENT PERUVIAN CENTER CHAVIN DE HUANTAR.

August 2001 >

SCIENTISTS FROM STANFORD AND SEVEN EUROPEAN AND CANADIAN INSTITUTIONS ANNOUNCE IN *SCIENCE* THE DECODING OF THE GENOME OF A MICROBE PROVIDING AN ESSENTIAL SOURCE OF NITROGEN.

GENE AWAKUNI, VICE PRESIDENT FOR STUDENT SERVICES AT COLUMBIA UNIVERSITY, IS NAMED VICE PROVOST FOR STUDENT AFFAIRS.

TO PROTEST PRESIDENT GEORGE W. BUSH'S POLICY ON STEM-CELL RESEARCH, ENTREPRENEUR JIM CLARK SUSPENDS PAYMENT OF $60 MILLION OF HIS $150 MILLION PLEDGE FOR STANFORD'S NEW PROGRAM, BIO-X.

# INVESTING

## IN COMMUNITY

In March 2001 President John Hennessy invited faculty, staff, and students to "Taking Stock: Five Successes—and Five Continuing Challenges," a presentation before the Academic Council.

Among the successes the president cited was the negotiation with Santa Clara County of a new General Use Permit and Community Plan overseeing land use on campus for the next decade.

The General Use Permit allows Stanford to add 2 million additional square feet of academic facilities and up to 3,000 new housing units on campus, while preserving more than 2,000 acres of the campus foothills for 25 years. The agreement involved a complex set of understandings in areas as diverse as open space, traffic, financial support for schools, and land for community services.

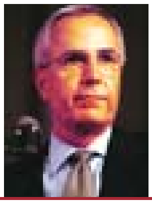
In the aftermath of the General Use Permit approval, the president identified one of Stanford's challenges as bolstering relationships with neighbors in the surrounding communities.

"This will require us to do a better job of listening and responding to the community concerns about our plans as we communicate the challenges and opportunities that Stanford faces," he said.

Among the steps he announced to improve community relations was the creation of a group to review the public access policy for the conservation area in the Stanford foothills. Also, local residents have been invited to celebrate Community Day at Stanford in spring 2002, a new event underscoring the University's many assets and contributions to the quality of life within the region.

Such moves will augment many existing programs and contributions to local communities. For instance, 128 acres of Stanford's lands are used by five public schools. About 40 percent of the students in the Palo Alto school district at any one time attend school in one of the four Palo Alto schools on Stanford lands. In addition, Stanford gave $10 million to the Palo Alto

September 2001 >



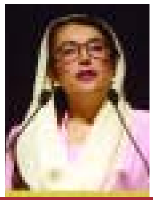
THE CAMPUS JOINS THE NATION IN MOURNING THE TRAGIC TERRORIST EVENTS OF SEPT. 11. MOST CAMPUS EVENTS ARE CANCELED OR RESCHEDULED.

GROUND IS BROKEN FOR THE NEW CENTER FOR CANCER TREATMENT, WHICH IS SCHEDULED TO BE COMPLETED IN THE SUMMER OF 2003.

COIT "CHIP" BLACKER, DEPUTY DIRECTOR OF THE INSTITUTE FOR INTERNATIONAL STUDIES, IS AWARDED THE LAURANCE AND NAOMI CARPENTER HOAGLAND PRIZE FOR UNDERGRADUATE TEACHING.

THE TAUBE FAMILY FOUNDATION COMMITS $2.5 MILLION TO ENDOW THE TAUBE CENTER FOR JEWISH STUDIES. THE CENTER WILL GIVE THE PROGRAM IN JEWISH STUDIES MORE OPPORTUNITY TO EXPAND ITS CURRICULUM, ORGANIZE CONFERENCES, AND FUND RESEARCH.

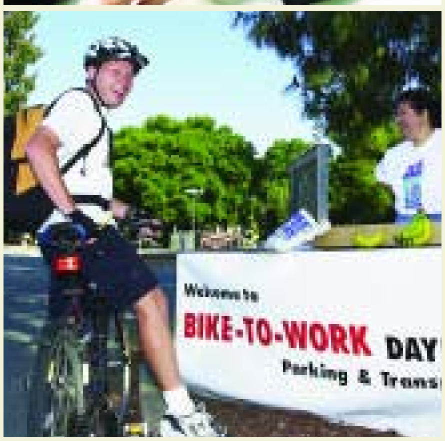
October 2001 >



AN ENVIRONMENTAL INITIATIVE IS ANNOUNCED TO UNDERSCORE THE UNIVERSITY'S LEADERSHIP IN ENVIRONMENTAL RESEARCH AND EDUCATION.

REUNION DRAWS A RECORD-BREAKING 6,700 PARTICIPANTS.

FORMER PAKISTANI LEADER BENAZIR BHUTTO BACKS U.S. MILITARY EFFORTS IN AFGHANISTAN BEFORE A CAPACITY CROWD IN MEMORIAL AUDITORIUM.




Clockwise from the upper left:

Nadinne Cruz, director of the Haas Center for Public Service, estimates there are at least 319 community-related groups across the University. ✦ The East Palo Alto Tennis and Tutoring Program, housed at the Taube Family Tennis Stadium, involves some 150 volunteers and 13 staff who provide one-on-one tutoring and tennis lessons to about 100 K-12 students. ✦ In recognition of area traffic challenges and the requirements of the new General Use Permit and Community Plan, Stanford will be increasing efforts such as "Bike-to-Work Day" to decrease single-occupant automobile trips to campus.

## FOCUSING ON TRANSPORTATION

Transportation and traffic are issues of intense concern among those living and working on the Peninsula. Stanford is expanding its already widely recognized transportation programs to contribute to regional solutions.

Stanford's Marguerite bus system, for instance, is believed to be the largest free, privately run, open-to-the-public transit system anywhere. The Marguerite runs throughout campus, to Caltrain stations serving Stanford, and to major commercial areas on campus and in Palo Alto and Menlo Park.

The University's Transportation Demand Management (TDM) programs—the most extensive in Santa Clara County—also include a vanpool and carpool incentive program, a Guaranteed Ride Home Program, a Clean Air Cash Rewards Program, and a Bicycle Support Program (see photo above). Among the organizations recognizing the University's TDM programs have been the American Lung Association, the Peninsula Corridor Joint Powers Board, and the Peninsula Conservation Center Foundation.

The new General Use Permit negotiated with Santa Clara County requires that future development create no net new commute trips for Stanford. As a result, Stanford will continue to focus new construction in the core campus and near transit corridors to reduce traffic congestion. Students, faculty, and staff are encouraged to walk or bike, on-campus housing is being increased, and investments are being made in additional alternative transportation programs.

## APPLYING EDUCATIONAL THEORY

The Ravenswood City School District had been without a public high school for 25 years. But, thanks to collaboration among Stanford's School of Education, a Bay Area nonprofit organization, and the district, a new school opened in September. The collaboration is just one among many projects through which Stanford reaches out to area school districts.

Stanford Professor of Education Linda Darling-Hammond, along with a half-dozen other faculty, helped design the charter school, the first in the area since Ravenswood High School closed in 1976.

Plans for creating a new community school took root last year, when Aspire Public Schools, a nonprofit organization dedicated to creating small schools, and Stanford School of Education professors began working with the Ravenswood City School District. They received funding from the state of California, the Bill and Melinda Gates Foundation, and Hewlett-Packard.

Stanford is providing curriculum development and support and school design assistance. The University also helped recruit staff and fundraise for the school. The School of Education plans to take advantage of the chance to give teachers in training practical experience—the Stanford Teacher Education Program will send student teachers to work with experienced teachers at the school.

schools to support construction of a new middle school and offered land to the city of Palo Alto for a new city community center.

Stanford's volunteer efforts in the surrounding communities may not be widely known, according to Nadinne Cruz, director of the Haas Center for Public Service, who gave a presentation this year to the Faculty Senate called "Stanford in the Community: The Untold Story." Cruz is documenting the many Stanford organizations with outreach to the area communities. Stanford has at least 319 such organized service efforts across 20 major programs and departments, Cruz reports.

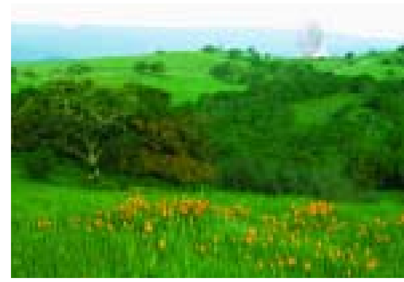
"I discovered so many deep and true tales that I have come to be a believer in the individuals I have met and the programs that have been evident all across Stanford. And I'm very proud of what those individuals do," she said.

"There are costs to not telling this story," she adds. Cruz suspects a lack of knowledge of the efforts of members of the University community can lead to misperceptions in the surrounding cities.

**AMONG THE UNIVERSITY'S MANY OUTREACH PROGRAMS ARE:**

- the East Palo Alto Law Project, in which volunteer law students work on special projects, counseling as many as 225 people annually;
- the Tom Ford Community Outreach Program, which supports Stanford athletes in participating in visits to hospitals and holiday food drives;

Among the steps the president announced to improve community relations was the appointment of a group to review the public access policy for the conservation area in the Stanford foothills.



- the Ravenswood Reads program, which provides more than 150 student tutors;
- the East Palo Alto Tennis and Tutoring Program, in which 150 volunteers and 13 staff provide one-on-one tutoring and tennis lessons to about 100 K-12 students;
- the Arbor Free Clinic, in which medical students, undergraduates, and physicians provide free medical care to some 1,000 uninsured and underinsured patients; and
- Barrio Assistance, the oldest community service program on campus, through which El Centro Chicano students tutor and mentor Latino grade school students in East Palo Alto and East Menlo Park.

In addition, many University academic departments work collaboratively with community groups. For instance, in 2001, the Stanford Division of Child and Adolescent Psychiatry, with the Division of General Pediatrics and the Children's Health Council, received a grant aimed at building self-esteem and reducing high-risk behaviors among East Palo Alto middle school students.

November 2001 >

ASTROBIOLOGIST CHRISTOPHER CHYBA, CO-DIRECTOR OF THE CENTER FOR INTERNATIONAL SECURITY AND COOPERATION, IS AWARDED A 2001 FELLOWSHIP BY THE JOHN D. AND CATHERINE T. MACARTHUR FOUNDATION.

EMERITI A. MICHAEL SPENCE AND JOSEPH STIGLITZ SHARE THE NOBEL PRIZE IN ECONOMICS, WHILE TWO OF THE THREE WINNERS OF THE NOBEL PRIZE IN PHYSICS EARNED DEGREES AT STANFORD.

THE AMERICAN ASSOCIATION FOR THE ADVANCEMENT OF SCIENCE ANNOUNCES ITS NEW FELLOWS, INCLUDING STANFORD'S ROBERT SIEMANN, CAROL BOGGS, ERIC KOOL, DAVID MCKAY, JAMES SPUDICH, LUCY TOMPKINS, AND PAUL WENDER.

A $100 MILLION GRANT FROM THE DAVID AND LUCILE PACKARD FOUNDATION LAUNCHES THE $500 MILLION CAMPAIGN BY THE LUCILE PACKARD FOUNDATION FOR CHILDREN'S HEALTH ON BEHALF OF LUCILE PACKARD CHILDREN'S HOSPITAL AND PEDIATRIC RESEARCH AND TRAINING AT THE SCHOOL OF MEDICINE.

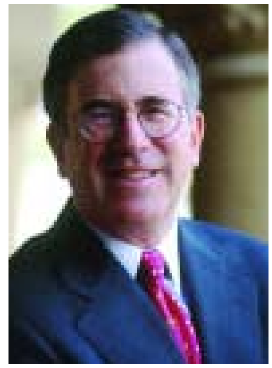
THE "THINK AGAIN" TOUR, CELEBRATING THE CAMPAIGN FOR UNDERGRADUATE EDUCATION, KICKS OFF IN PORTLAND, ORE.

December 2001 >

A STANFORD LINEAR ACCELERATOR CENTER SYMPOSIUM MARKS THE 10TH ANNIVERSARY OF PAUL KUNZ'S CREATION OF THE FIRST U.S. WEBSITE.

Message from the Chair of the Board of Trustees

# Putting Stanford in Perspective



Isaac Stein

The 1990s were a time of unparalleled growth in the U.S. economy. Until last year, Stanford, like many universities, saw its endowment earnings soar. Some people may have wondered why Stanford did not use more of those extraordinary gains to meet operating expenses. And why would we launch the $1 billion Campaign for Undergraduate Education (CUE) if the University could simply spend more of its endowment to cover new undergraduate programs?

A year like fiscal 2000–2001 answers that question. Just as the U.S. and international economies declined, so too did the value of Stanford's endowment, which decreased by approximately seven percent, or more than $600 million. Clearly the University cannot count on soaring returns every year, nor can our programs fluctuate whenever the markets do. Stanford is committed to its students and faculty in perpetuity, and the University's financial plan must be similarly long-term.

At times like this, the prudence of Stanford's endowment "payout" policy becomes clear. Like most universities, Stanford spends only about five percent of its endowment each year, even if its actual income is higher. This payout is calculated taking into account several years of past performance in order to smooth the impact of market fluctuations. It is also calculated to ensure that the endowment grows with inflation, so that the amount of payout we can count on increases gradually over the years.

Because Stanford drew on the endowment carefully in the past, the University was able to meet its obligations last year despite the economic decline. We are also confident that, over the long term, Stanford's endowment performance will continue to compare very favorably with that of other universities and with the markets in general. Stanford's endowment is an excellent investment.

But even with superb professional management, Stanford's current endowment goes only so far. And that, to return to the previous question, is the reason for the Campaign for Undergraduate Education.

In fiscal year 2001, payout from the endowment supported just 18.1 percent of the University's operating expenses, far less than some of our peer institutions. This payout is needed to preserve the new undergraduate programs, as well as the scope and quality of the entire Stanford enterprise. But it still left a tremendous financial challenge to maintain these programs, a challenge that Stanford must face each year.

This is why we need efforts such as CUE, which seeks further investment in Stanford's endowment, as well as an increase in the "living endowment" of annual giving. In undergraduate education, in graduate studies, and in law, business, and medicine, Stanford must not only preserve existing programs but also innovate continually. The flow of Stanford's intellectual endowment must never depend on the financial markets.

A university is an unusual organization, both conservative and progressive. Stanford represents both the value of stability and the spirit of innovation. If we continue to invest in this rare combination, whatever the future holds, our most important "investments" will grow.

**ISAAC STEIN**
Chair, Stanford University Board of Trustees

# STANFORD UNIVERSITY

## 2001 Financial Review

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# Discussion of Financial Results

During the 2000–2001 fiscal year (FY01), Stanford benefited from the strong financial resources built over the past several years and the continued generous support of its alumni and friends. These factors enabled Stanford to successfully pursue its teaching and research missions despite a significantly weakened investment environment, a volatile health care market, and the continuing high costs of living in the Bay Area.

*Highlights of the year included:*

Initial success of the five-year, $1 billion Campaign for Undergraduate Education (CUE) > This campaign is one of the largest ever devoted to undergraduate education at any university and will allow Stanford to continue implementing innovations in undergraduate education. When it was announced in October 2000, the campaign had already generated $429 million in gifts and pledges. At the end of the fiscal year, the campaign total was up to $639 million.

Receipt of the largest pledge in University history and one of the largest ever to any college or university > On May 2, the William and Flora Hewlett Foundation announced a $400 million pledge to Stanford, benefiting the School of Humanities and Sciences and the Campaign for Undergraduate Education. In addition to being the largest pledge in Stanford history, at the time of the announcement, it was the largest pledge ever made to any college or university. The gift honors the late William Hewlett, a Stanford alumnus whose vision helped position the University as a world leader in innovation. Of the total $400 million Hewlett Foundation pledge, $300 million is earmarked to increase the endowment of the School of Humanities and Sciences and to create endowed professorships and student fellowships in the school. The remaining $100 million of the pledge is to the Campaign for Undergraduate Education. Half of the Humanities and Sciences pledge and the total CUE pledge are to match gifts from other donors.

One of the most successful overall development programs among universities nationwide > Total cash gifts in FY01 were $469 million from 66,420 donors. Nearly 40 percent of undergraduate alumni gave gifts to the University. This was the second most successful year in Stanford's fundraising history.

Improved financial performance of Stanford Hospital and Clinics (SHC) and Lucile Packard Children's Hospital (LPCH) > A strategic plan is in place that continues to move the Hospitals on the path to financial stability, despite the ongoing challenges of reductions in federal reimbursements for academic medical centers. (See further discussion in the inset beginning on page 20.)

Continued capital improvement > Construction commenced on the James H. Clark Center for Biomedical Engineering and Sciences. The construction was unaffected by Mr. Clark's decision to protest President George W. Bush's stem-cell policies by suspending $60 million of his $150 million pledge. Work also continues on the new Wallenberg Global Learning Center, and ground was broken for the Center for Cancer Treatment and Prevention/Ambulatory Care Pavilion.

Following is a review of the FY01 financial activities of the University, excluding the results of the Hospitals and Clinics (the Hospitals), which are discussed separately on page 21. The financial activities of the Hospitals are consolidated with the University and reported in a separate column of the financial statements. The UCSF Stanford Health Care joint venture is reported on the equity method and is also presented in the "Hospitals" column.

## Statement of Activities

The Statement of Activities details operating revenues and expenses and other non-operating changes during the year and reports a total decline in the University's net assets of $571 million in FY01 compared to the $3.3 billion increase in the 1999–2000 fiscal year (FY00). The decrease in net assets is directly attributable to the decline in public and private equity market valuations. Total investment losses of $497 million were recognized in FY01, as compared to the total investment return of $2.8 billion in FY00. See the "Report from the Stanford Management Company" on page 25 for further discussion of investment performance. Additionally, gifts and pledges recorded in the financial statements—although still at high levels—were down from $848 million in FY00 to $460 million in FY01.

### 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 FY00, total University revenues increased 1.4% to more than $2.0 billion, and total expenses increased 11.1% to approximately $2.0 billion. Operations resulted in an excess of revenues over expenses of $59 million in FY01, compared to $227 million in FY00.

**HOSPITALS**

Since April 1, 2000, after the operating activities of UCSF Stanford Health Care were terminated, the financial results and financial position of Stanford Hospital and Clinics (SHC) and Lucile Salter Packard Children's Hospital (LPCH) have been consolidated in the University's financial statements under the "Hospitals" column. The University's investment in UCSF Stanford Health Care and its share of the joint venture's results are recorded on the equity method and are also included in the "Hospitals" column.

SHC and LPCH recorded a $13 million operating loss for FY01, including a realized gain on investments of $25 million. This is an improvement compared to a loss of $48 million for the five months ended August 31, 2000, following the termination of UCSF Stanford Health Care (see page 21). Operational improvements, including cost reductions, program closures, and increased volume in key areas, accounted for the reduction in losses. SHC and LPCH, like other academic medical centers around the nation, continue to be negatively affected by the reductions in federal reimbursement. Labor costs continue to increase due to shortages in skilled positions.

Both management teams continue to implement operational improvements on their path toward achieving financial stability and break-even operating results. SHC and LPCH continue to strive to provide excellent health care services in addition to furthering their missions in education and innovative research.

Effective September 1, 2001, the University became the sole corporate member of LPCH, replacing SHC. This enables both institutions to focus on institution-specific objectives, while remaining committed to working together on common issues. Several services are shared between the two facilities, including

*Highlights of the University's operating activities are summarized below:*

- Student income increased 7.1% to $300 million in FY01. Contributing to this increase were the undergraduate tuition rate increase of 6% and the room and board rate increase of 1.9%. Additionally, room and board fees were affected by an increase in off-campus housing stock and new on-campus residences such as the Escondido Village housing for graduate students, which opened in September 2000. Offsetting tuition and room and board revenues is need-based and merit-based aid for undergraduate and graduate students, which increased during FY01 by 2.9% to a total of $92 million.

- In total, sponsored research support increased by $53 million, or 7.9%, to $727 million in FY01. The University's direct cost reimbursement was up $21 million due largely to higher levels of research activity in the School of Medicine. SLAC's direct cost reimbursements were up $26 million due to two major projects (GLAST and Spear-3), upgrades to the B Factory, construction on the Research Administration Building, and general operating expenses to support the increased activity level. Indirect cost recovery was up 5.4% due to increased research volume. The indirect cost rate for FY01 was comparable to the prior year's rate.

- Expendable gifts in support of operations increased $12 million from FY00 to $125 million. These gifts are immediately expendable for the purpose set forth by the donor.

- Endowment income and gains distributed for operations covered 18.1% of total operating expenses for FY01, up from 17.9% for FY00. To protect the value of the endowment, the University has a policy governing distributions that was established by the Board of Trustees. Despite the 7.2% decline in the endowment in FY01, amounts distributed for operations were up 12.4% in FY01 at $354 million, compared to $315 million in FY00. The increase in the payout

laboratory, general services, information technology, patient financial services, payroll, and accounts payable. SHC and LPCH continue to be co-obligated on outstanding bonds and certificates.

On November 15, 2001, the Lucile Packard Foundation for Children's Health announced the five-year Campaign for Lucile Packard Children's Hospital. This campaign will benefit LPCH and the University School of Medicine by supporting efforts to improve children's health. To date, this initiative has received an inaugural grant of $100 million from the David and Lucile Packard Foundation, a promise of $200 million in matching funds also from the David and Lucile Packard Foundation, and additional pledges of $105 million.

**UCSF Stanford Health Care** > As of August 31, 2000, the University's investment in UCSF Stanford Health Care was $20 million. The joint venture continued to wind down its operations, transferring $17 million in net assets to Stanford Hospital and Clinics during FY01. As of August 31, 2001, the University's investment in UCSF Stanford Health Care has been reduced to $5 million. Final dissolution of the joint venture depends upon, among other things, a decision by the Internal Revenue Service and the Department of Labor regarding the distribution of the plan assets and obligations of the defined benefit plan. Net ongoing operating costs continue to be borne by the University and the University of California.

for FY01 was due to the growth in the market value of the endowment over the past several years and continued strong donor support. The market downturn contributed to the decline in other investment income, including the Expendable Funds Pool (EFP). The payout to operations from the EFP was approximately $55 million in FY01 as compared to $91 million in FY00. In FY00, other investment income included $78 million in realized and unrealized gains on an expendable investment fund that was transferred to endowment in FY01.

- Special program fees and other income increased $11 million, or 5.1%, to $232 million in FY01. This classification includes the external revenues generated by auxiliary enterprises and service centers and special programs, including technology licensing, Executive Education programs, and corporate affiliates programs. The increase in special program fees and other income is attributable primarily to activities of Highwire Press, a division of the libraries that provides enhanced online access to published scientific journals, to rental revenues from Stanford West Apartments, which started leasing apartments primarily to faculty and staff in October 2000, and to increased conference and catering services.

- Total expenses increased $196 million, or 11.1%, to $2.0 billion in FY01. The 10% increase in salaries and benefits was due in part to a budgeted 6% salary increase for faculty and staff. This was part of an initiative implemented during FY01 to make Stanford's salary program more competitive in Silicon Valley, where the University must compete for staff employees. Salary expense increased also because the University filled positions that had remained open in FY00 due to the tight labor market and strong competition for talented candidates. As a result of the recession in Silicon Valley, the University was better able to fill open positions with qualified candidates. Other operating expenses increased 20.5% due to higher costs related to utilities, interest, student stipends, and other one-time expenses. Such one-time expenses include, among other things, costs written off in connection with a canceled construction project and capitalized costs written off in connection with certain debt that was refinanced during the year. In addition, operating expenses for FY01 increased as a result of launching the Campaign for Undergraduate Education, implementing Web-integrated classes, increasing travel study and other alumni relations expenses, and increasing sponsored research activities. Partially offsetting the other operating expense increases was a decrease in depreciation expense, which was considerably higher in FY00 due to a one-time charge of approximately $40 million for the adoption of a revised set of useful lives and a change in method of computing depreciation for buildings.

*Other Changes in Unrestricted Net Assets* In total, unrestricted net assets of the University decreased by $787 million, including the excess of revenues over expenses of $59 million resulting from operations. The majority of other changes in unrestricted net assets were decreases in the value of investments of $869 million.

The University's endowment investment strategy and results are summarized in the Report from the Stanford Management Company on page 25. Stanford's investment strategy utilizes dividends, interest, rental income, and previously reinvested 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, and the excess is reinvested in the endowment. For example, in FY00, the endowment's total return of $2.5 billion more than covered the $315 million of income and gains distributed to operations. In FY01, the University utilized endowment income of $216 million and withdrew previously reinvested gains of $138 million to meet the $354 million payout to operations.

### Temporarily Restricted Net Assets

Temporarily restricted net assets increased by $19 million, or 4.0%, to $497 million in FY01. The University received $142 million of new gifts and pledges. During the year, $96 million of temporarily restricted net assets were released from their restrictions and utilized to fund operations and capital expenditures.

### Permanently Restricted Net Assets

Permanently restricted net assets increased by $197 million, or 7.7%, to $2.7 billion during FY01. The increase was due primarily to the receipt of $187 million in new gifts and pledges for the endowment.

## Financial Position

The University's Statement of Financial Position remains strong despite the impact of negative investment returns and increased debt. In FY01, total University assets declined $362 million to $13.6 billion, while total University liabilities increased $209 million to $2.5 billion.

- Total investments, primarily consisting of endowment assets and the EFP, decreased by $663 million, or 6.3%, to $9.9 billion. As discussed in the Report from the Stanford Management Company on pages 25 through 29, the endowment was affected by the global economic move toward recession and the related negative impact on equity values.

- Net pledges receivable increased approximately $38 million to $519 million for FY01. The gross increase in pledges was approximately $400 million, primarily attributable to the Hewlett Foundation pledge. However, only $150 million was recorded in FY01 because the remainder ($250 million) of the pledge is conditional upon matching gifts and may only be recorded when the conditions are satisfied.

- Plant facilities, net of accumulated depreciation, grew 8.5% to $2.1 billion. New additions to plant facilities in FY01 totaled $317 million, bringing total plant facilities before accumulated depreciation to $3.3 billion. This increase reflects the significant construction activity associated with the University's renewal of its physical infrastructure and efforts to meet faculty, student, and staff housing needs. Major projects completed during FY01 include the first phase of the Stanford West apartment project, which is primarily for faculty and staff housing, the Escondido Village apartments for graduate student housing, and the Frances C. Arrillaga Alumni Center.

- Notes and bonds payable were $1.2 billion at August 31, 2001, an increase of 7.2% from FY00. The continuing favorable interest rate environment has allowed the University to issue new debt to support the capital plan and to refinance existing debt at favorable interest rates. The University's debt ratios are within the guidelines of the internal debt policy approved by the Board of Trustees. The debt policy monitors the amount and type of debt Stanford may incur. It is intended to preserve the University's long-term debt capacity, financial flexibility, and access to capital markets at competitive rates.

- The endowment represents approximately 74% of the University's net assets. Net assets of the endowment decreased $636 million in FY01, or 7.2%, to $8.2 billion. The endowment recognized investment losses of $518 million, distributed $354 million to operations, and received new gifts of $158 million and transfers of $84 million of expendable funds.

## Conclusion

As a result of its strong financial base and the generosity of its many friends and alumni, the University was able to meet the challenges of the year despite negative investment returns. With the continued support of the faculty, staff, students, trustees, alumni, and other friends, our strong financial base will ensure that the University's resources will be available to future generations of students. Stanford remains committed to ensuring its excellence in teaching and research.

**RANDALL S. LIVINGSTON**
Vice President for Business Affairs
and Chief Financial Officer

**M. SUZANNE CALANDRA**
Controller

# Report from the Stanford Management Company

The test of any long-term strategic plan is its performance in the face of a difficult environment. Fiscal year 2000–2001 provided Stanford Management Company (SMC) the opportunity to test our diversified allocation policy. Following a decade of tremendous gains in the U.S. economy and capital markets, growth slowed significantly and the global economy moved toward recession, causing a substantial decline in broad public market stock indices. This environment presented a challenge to endowments. After a decade of outstanding returns, 16 of the largest 20 university endowments showed negative returns for the period ended June 30, 2001. Stanford ranked eighth among this group of 20, reporting a –2.1% return. A difficult market environment in July and August caused further deterioration in Stanford's results, and the return for the fiscal year ended August 31, 2001, was –7.2%. Although Stanford's 2001 returns are disappointing when compared to recent historical results, our diversified portfolio substantially outperformed broad market indices such as the S&P 500, which declined approximately 25% for the year ended August 31, 2001.

Given the perpetual nature of the University, Stanford's strategic investment horizon must be long-term. Our objective is to develop and execute an investment strategy that generates optimal total return (income plus price appreciation) relative to the risk taken. To meet this goal, 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 in excess of $10 billion of endowment and trust assets, working capital, temporarily invested expendable funds, and commercial real estate investments including the Stanford Research Park.

SMC's primary endowment management responsibilities involve establishing asset allocation policy and implementing that policy through manager selection. Performance is measured relative to real return objectives, as well as market benchmarks.

**Endowment Asset Allocation >** Most of Stanford's $8.2 billion of endowment assets are invested in a diversified portfolio, referred to as the Merged Endowment Pool (MEP). Results discussed in this report reflect the performance of this $7.8 billion portfolio. During fiscal year 2000–01, asset allocation targets shifted significantly from the prior year. Fifteen percent of MEP assets were moved from domestic and international public stocks to alternatives in private equity, absolute return, and real estate. SMC also redefined the category of Alternative Investments into its component sectors—Private Equity, Absolute Return, and Natural Resources—to illustrate their relative weights and different risk/return characteristics.

The asset classes of the Merged Endowment Pool and their target allocations as of August 31, 2001 follow:

| Asset Class | Strategic Allocation |
|---|---|
| Domestic Stocks | 15% |
| International Stocks | 17% |
| Private Equity | 17% |
| Absolute Return | 12% |
| Natural Resources | 7% |
| Real Estate | 20% |
| Domestic Fixed Income | 12% |
| | **100%** |

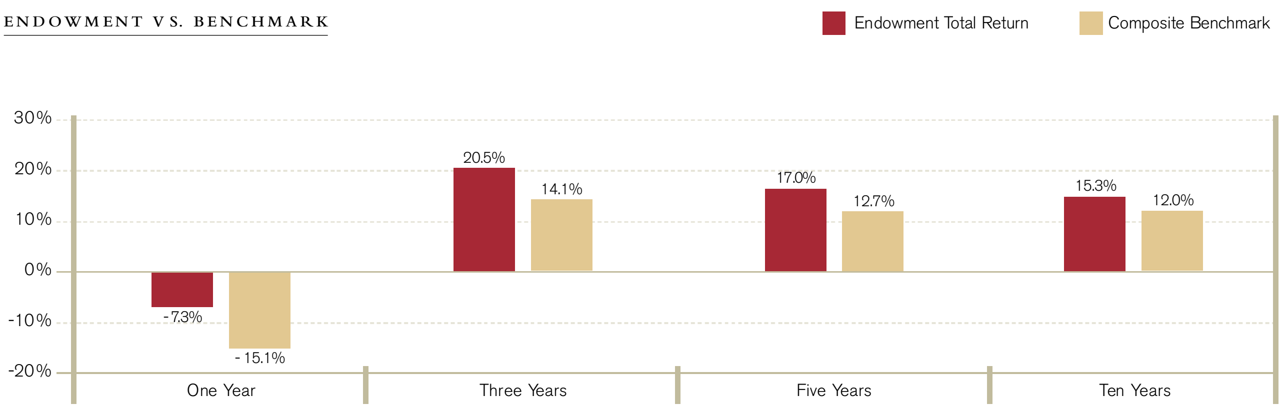
Endowment Performance Compared to Inflation > The table below illustrates annualized returns for various periods ending August 31, 2001 and shows the performance of Stanford's multi-asset strategy in a long-term context. Stanford's objective is to return a minimum of 6.25% over the rate of inflation. If this real return target is achieved over time, the value of the endowment will be maintained net of annual payouts to support endowed activities. Over the past three-, five-, and 10-year periods, Stanford's annualized real return has substantially exceeded the 6.25% target.

| | One Year | Three Years | Five Years | Ten Years |
|---|---|---|---|---|
| Nominal Endowment Return | - 7.3% | 20.5% | 17.0% | 15.3% |
| GDP Deflator (1) | 2.3% | 2.0% | 1.9% | 2.0% |
| Real Endowment Return | - 9.6% | 18.5% | 15.1% | 13.3% |

(1) The Gross Domestic Price (GDP) deflator, a measure of inflation, is through the quarter ended June 30, 2001.

**Endowment Performance Compared to Benchmarks >** SMC evaluates the performance of investment managers by comparing their returns to benchmarks that are appropriate for each individual asset class. For example, the benchmark for the Domestic Stocks asset class is the Russell 3000 Index. SMC evaluates overall portfolio performance by comparison to a composite benchmark, which represents a blending of the benchmark returns for each asset class weighted by the strategic allocations above. Actual performance, net of management fees, is compared to the composite benchmark for periods ended August 31, 2001:

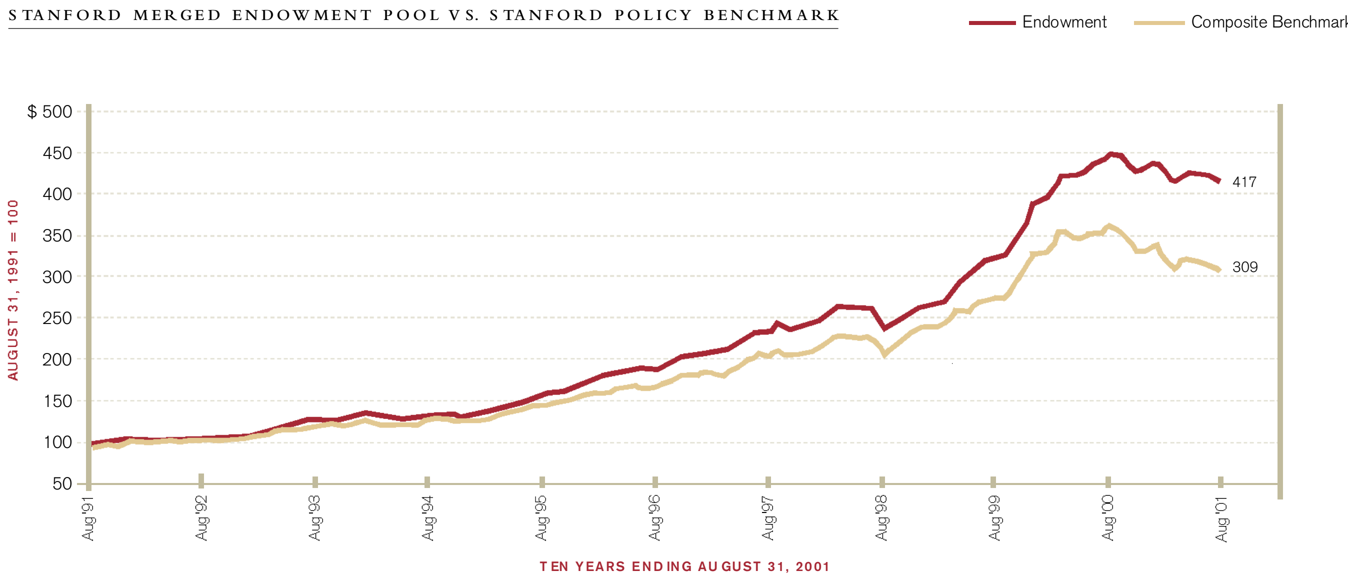
ENDOWMENT VS. BENCHMARK




SMC's effectiveness in implementing the multi-asset class approach, through superior manager selection, has resulted in a consistent and long-term performance advantage over the composite benchmark.

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

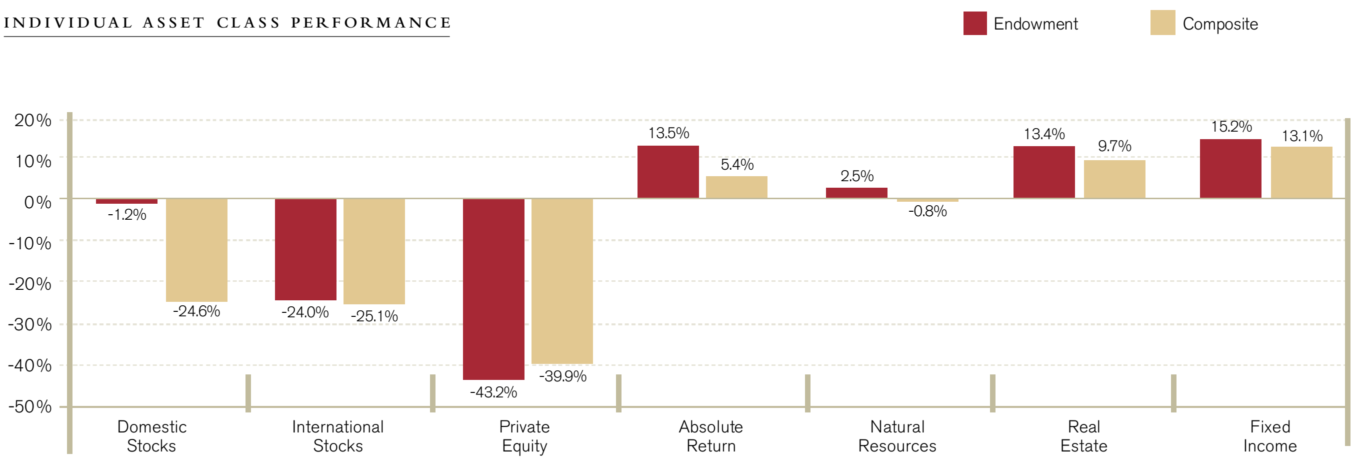
STANFORD MERGED ENDOWMENT POOL VS. STANFORD POLICY BENCHMARK




The performance advantage during this 10-year period relative to benchmark returns has added in excess of $1 billion to the value of the endowment.

**Individual Asset Class Performance >** The performance of the individual asset classes for the year ended August 31, 2001 gives more insight into the difficult environment and illustrates the benefits of diversification. The graph below shows individual class returns relative to each benchmark:

INDIVIDUAL ASSET CLASS PERFORMANCE




One year ended August 31, 2001

Stanford's Domestic Stock portfolio has been deliberately over-weighted in value stocks to offset the growth stock-oriented characteristics of venture capital partnerships held in Private Equity. This value orientation in Domestic Stocks resulted in a year of strong performance relative to benchmark as value stocks significantly outperformed the broader market. International equity, while slightly outperforming the benchmark, suffered a market correction similar to that of the broad domestic stock market in an environment of global economic uncertainty.

Private Equity represented the most challenging asset sector for SMC, when measured on a one-year return basis. Negative returns in this asset sector are due substantially to reversal of unrealized gains reported in prior periods. Despite this recent reversal, Private Equity has been a very successful asset class when evaluated long term, with investment gains that have added more than $2 billion to the value of the endowment over the last five years.

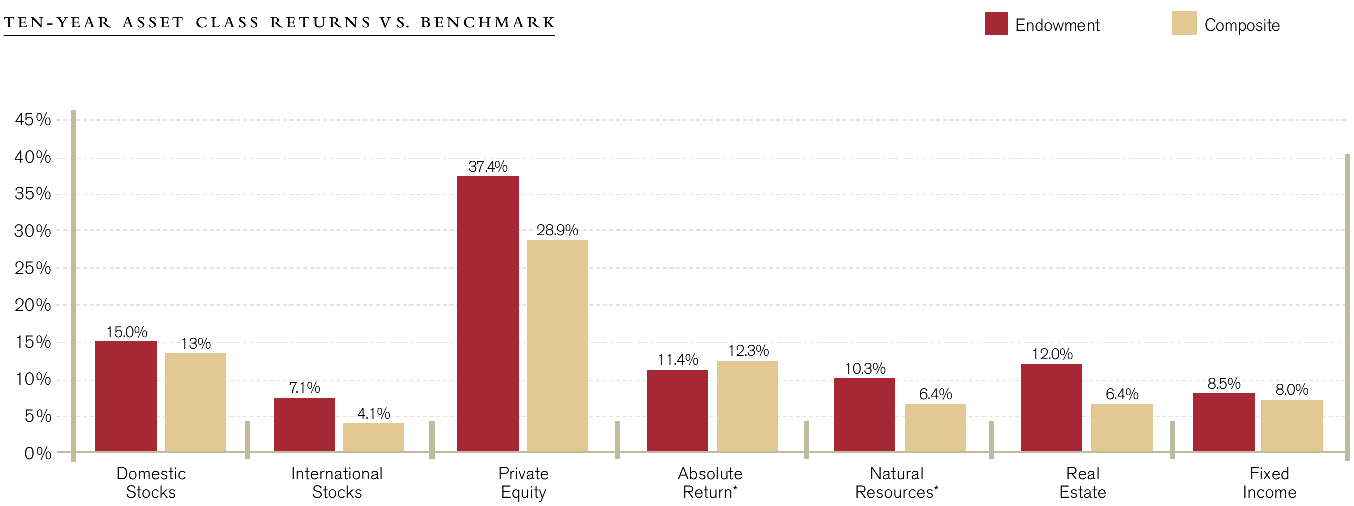
The Absolute Return portfolio is constructed to provide returns that are substantially uncorrelated to the broader equity markets. Absolute Return results for the last 12 months demonstrated successful execution of this strategy. The portfolio provided robust returns in several hedge fund categories including distressed debt, fixed income relative value, and multi-strategy arbitrage funds.

Stanford's endowment has a substantially larger commitment to Real Estate than peer institutions. The strategy of over-weighting real estate investments is based on SMC's extensive experience in real estate development and management of University lands. SMC's core competency in these areas provides a significant advantage when evaluating real estate investments. The Real Estate portfolio performed well in fiscal 2001, contributing returns through asset appreciation and high current cash yield.

Fixed Income was the highest returning asset class over the last 12 months as a result of open market actions by the Federal Reserve designed to reduce interest rates and investors' flight to U.S. Government securities during a time of global uncertainty. Fixed Income demonstrated a negative correlation to the equity markets, illustrating the advantage of a broadly diversified portfolio of assets.

Over a 10-year period, the total endowment return of 15.3% outperformed the benchmark's 12.0% as a result of individual asset class returns as outlined:

### TEN-YEAR ASSET CLASS RETURNS VS. BENCHMARK




* Natural Resources and Absolute Return are for an eight-year period.

During the last few years, investment returns have been impacted by extreme volatility in global financial markets, substantial variability in U.S. economic growth, and ongoing change to U.S. Federal Reserve policy. SMC expects this challenging investment environment to continue. We are confident that our long-term investment strategy and manager selection process will preserve endowment capital and provide excellent returns during this uncertain period.

Michael G. McCaffery

**MICHAEL G. McCAFFERY**
CEO, Stanford Management Company

# Decade in Review

Years ended August 31

| (in thousands of dollars) | 2001 | 1996 | 1991 |
|---|---|---|---|
| **FINANCIAL:** | | | |
| PRINCIPAL SOURCES OF REVENUES: | | | |
| Student tuition and fees (B) | $ 391,372 | $ 308,828 | $ 221,001 |
| Sponsored research support | 727,483 | 577,723 | 450,027 |
| Patient care (A) | 1,004,928 | – | – |
| Expendable gifts in support of operations | 125,284 | 93,169 | 76,650 |
| Endowment income in support of operations | 354,441 | 161,340 | 99,310 |
| PRINCIPAL PURPOSES OF EXPENDITURES: | | | |
| Instruction and departmental research | 667,991 | 408,104 | 309,988 |
| Organized research (direct costs) | 623,113 | 434,369 | 378,833 |
| Health care services (A) | 934,680 | – | – |
| Libraries | 107,001 | 62,001 | 52,740 |
| Student financial aid (B) | 91,671 | 65,113 | 57,157 |
| Administration, development, and general | 210,907 | 142,587 | 114,335 |
| FINANCIAL POSITION HIGHLIGHTS: | | | |
| Investments at fair value | 10,140,812 | 5,016,616 | 2,827,914 |
| Plant facilities, net of accumulated depreciation | 2,353,731 | 1,139,193 | 843,268 |
| Equity investment in related health care entities (A) | 5,443 | 319,471 | 240,353 |
| Notes and bonds payable | 1,445,491 | 729,481 | 458,175 |
| Total net assets | 11,533,849 | 5,797,708 | 3,735,339 |

| | 2001 | 1996 | 1991 |
|---|---|---|---|
| **STUDENTS:** | | | |
| ENROLLMENT: (C) | | | |
| Undergraduate | 6,637 | 6,550 | 6,527 |
| Graduate | 7,536 | 7,261 | 7,022 |
| DEGREES CONFERRED: | | | |
| Bachelor's degrees | 1,676 | 1,744 | 1,633 |
| Advanced degrees | 2,936 | 2,900 | 2,455 |
| **FACULTY:** | | | |
| Members of the Academic Council | 1,384 | 1,291 | 1,361 |
| ANNUAL UNDERGRADUATE TUITION RATE | $ 24,441 | $ 19,695 | $ 14,280 |

(A) Beginning in fiscal year 2000, health care activities have been reported on a consolidated basis. Prior to that, they were reported on an equity basis.

(B) Financial aid is reported as a reduction of student income in the statement of activities.

(C) Enrollment for fall quarter immediately following fiscal year end.

# Consolidated Statements of Financial Position

At August 31, 2001 and 2000
(in thousands of dollars)

| | 2001 University | 2001 Hospitals | 2001 Consolidated | 2000 Consolidated |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and cash equivalents | $ 701,453 | $ 115,890 | $ 817,343 | $ 533,666 |
| Accounts receivable, net | 158,725 | 175,146 | 333,871 | 565,738 |
| Receivables (payables) from SHC and LPCH, net | 14,499 | (14,499) | – | – |
| Inventories, prepaid expenses, and other assets | 45,424 | 35,536 | 80,960 | 74,926 |
| Pledges receivable, net | 519,379 | 7,905 | 527,284 | 481,497 |
| Student loans receivable, net | 74,185 | – | 74,185 | 74,693 |
| Faculty and staff mortgages and other loans receivable, net | 211,358 | – | 211,358 | 173,147 |
| Investments at fair value, including securities pledged or on loan of $389,936 and $184,424 for 2001 and 2000, respectively | 9,871,498 | 269,314 | 10,140,812 | 10,784,236 |
| Investment in UCSF Stanford Health Care | – | 5,443 | 5,443 | 20,063 |
| Plant facilities, net of accumulated depreciation | 2,053,188 | 300,543 | 2,353,731 | 2,203,846 |
| Collections of works of art | – | – | – | – |
| Total assets | $ 13,649,709 | $ 895,278 | $ 14,544,987 | $ 14,911,812 |
| **LIABILITIES AND NET ASSETS** | | | | |
| LIABILITIES: | | | | |
| Accounts payable and accrued expenses | $ 451,713 | $ 281,125 | $ 732,838 | $ 750,803 |
| Liabilities under security agreements | 511,507 | – | 511,507 | 358,441 |
| Income beneficiary share of living trust investments | 271,046 | – | 271,046 | 258,100 |
| Notes and bonds payable | 1,217,656 | 227,835 | 1,445,491 | 1,370,377 |
| U.S. Government refundable loan funds | 50,256 | – | 50,256 | 49,311 |
| Total liabilities | 2,502,178 | 508,960 | 3,011,138 | 2,787,032 |
| NET ASSETS: | | | | |
| Unrestricted: | | | | |
| Designated for operations | 1,000,173 | 218,335 | 1,218,508 | 1,335,931 |
| Investment in plant facilities | 1,152,108 | 64,458 | 1,216,566 | 1,146,307 |
| Endowment gains and funds functioning as endowment | 5,750,040 | – | 5,750,040 | 6,511,772 |
| Investment in UCSF Stanford Health Care | – | 5,443 | 5,443 | 20,063 |
| Unrestricted | 7,902,321 | 288,236 | 8,190,557 | 9,014,073 |
| Temporarily restricted | 497,215 | 28,681 | 525,896 | 503,824 |
| Permanently restricted | 2,747,995 | 69,401 | 2,817,396 | 2,606,883 |
| Total net assets | 11,147,531 | 386,318 | 11,533,849 | 12,124,780 |
| Total liabilities and net assets | $ 13,649,709 | $ 895,278 | $ 14,544,987 | $ 14,911,812 |

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

# Consolidated Statements of Activities

Years ended August 31, 2001 and 2000
(in thousands of dollars)

| | 2001 University | 2001 Hospitals | 2001 Consolidated | 2000 Consolidated |
|---|---|---|---|---|
| UNRESTRICTED NET ASSETS ACTIVITY | | | | |
| REVENUES: | | | | |
| Student income: | | | | |
| Undergraduate programs | $ 161,164 | $ – | $ 161,164 | $ 154,153 |
| Graduate programs | 157,241 | – | 157,241 | 149,013 |
| Room and board | 72,967 | – | 72,967 | 65,890 |
| Student financial aid | (91,671) | – | (91,671) | (89,117) |
| Total student income | 299,701 | – | 299,701 | 279,939 |
| Sponsored research support (primarily federal): | | | | |
| Direct costs—University | 400,344 | – | 400,344 | 379,070 |
| Direct costs—Stanford Linear Accelerator Center | 205,480 | – | 205,480 | 179,892 |
| Indirect costs | 121,659 | – | 121,659 | 115,446 |
| Total sponsored research support | 727,483 | – | 727,483 | 674,408 |
| Health care services: | | | | |
| Patient care, net | – | 1,004,928 | 1,004,928 | 361,891 |
| Physicians' services and support—SHC and LPCH, net | 158,100 | (158,100) | – | – |
| Physicians' services and support—UCSF Stanford Health Care and other facilities, net | 5,215 | – | 5,215 | 102,178 |
| Total health care services | 163,315 | 846,828 | 1,010,143 | 464,069 |
| Expendable gifts in support of operations | 125,284 | – | 125,284 | 113,187 |
| Investment income distributed for operations: | | | | |
| Endowment | 354,441 | – | 354,441 | 315,002 |
| Expendable funds pool and other investment income | 65,390 | 25,023 | 90,413 | 199,215 |
| Total investment income distributed for operations | 419,831 | 25,023 | 444,854 | 514,217 |
| Special program fees and other income | 231,979 | 36,188 | 268,167 | 236,001 |
| Net assets released from restrictions | 50,974 | 13,288 | 64,262 | 57,491 |
| Total revenues | 2,018,567 | 921,327 | 2,939,894 | 2,339,312 |
| EXPENSES: | | | | |
| Salaries and benefits | 981,389 | 487,236 | 1,468,625 | 1,082,964 |
| Depreciation | 143,836 | 48,658 | 192,494 | 194,278 |
| Stanford Linear Accelerator Center | 205,480 | – | 205,480 | 179,892 |
| Other operating expenses | 628,516 | 398,786 | 1,027,302 | 703,343 |
| Total expenses | 1,959,221 | 934,680 | 2,893,901 | 2,160,477 |
| Excess (deficit) of revenues over expenses | $ 59,346 | $ (13,353) | $ 45,993 | $ 178,835 |

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

# Consolidated Statements of Activities (CONTINUED)

Years ended August 31, 2001 and 2000
(in thousands of dollars)

| | 2001 University | 2001 Hospitals | 2001 Consolidated | 2000 Consolidated |
|---|---|---|---|---|
| **UNRESTRICTED NET ASSETS ACTIVITY (continued)** | | | | |
| Excess (deficit) of revenues over expenses | $ 59,346 | $ (13,353) | $ 45,993 | $ 178,835 |
| Other changes in unrestricted net assets: | | | | |
| Expendable gifts invested in the endowment | 5,884 | – | 5,884 | 17,742 |
| Increase (decrease) in reinvested endowment gains | (868,919) | – | (868,919) | 1,966,599 |
| Change in equity investment in UCSF Stanford Health Care | – | (14,620) | (14,620) | (51,994) |
| Capital and other gifts released from restrictions | 44,607 | 5,837 | 50,444 | 88,931 |
| Reclassification of SHC and LPCH net assets | – | – | – | (52,838) |
| Income (withdrawn from) invested in the endowment | (19,407) | – | (19,407) | 155,744 |
| Other investment gains (losses) | (16,118) | (25,783) | (41,901) | 566 |
| Other | 7,318 | 11,692 | 19,010 | (9,347) |
| Net change in unrestricted net assets | (787,289) | (36,227) | (823,516) | 2,294,238 |
| **TEMPORARILY RESTRICTED NET ASSETS ACTIVITY** | | | | |
| Gifts and pledges, net | 141,813 | 25,503 | 167,316 | 332,651 |
| Investment income (loss) | (18,516) | (589) | (19,105) | 24,926 |
| Living trust investment income (loss) and actuarial adjustment | (5,744) | – | (5,744) | 13,757 |
| Net assets released to operations | (50,974) | (13,288) | (64,262) | (57,491) |
| Capital and other gifts released to unrestricted net assets | (44,607) | (5,837) | (50,444) | (88,931) |
| Reclassification of SHC and LPCH net assets | – | – | – | 16,186 |
| Other | (2,916) | (2,773) | (5,689) | (26,286) |
| Net change in temporarily restricted net assets | 19,056 | 3,016 | 22,072 | 214,812 |
| **PERMANENTLY RESTRICTED NET ASSETS ACTIVITY** | | | | |
| Gifts and pledges, net | 187,169 | 13,655 | 200,824 | 406,836 |
| Investment income (loss) | (33,772) | (2,117) | (35,889) | 189,829 |
| Living trust investment income and actuarial adjustment | 18,599 | – | 18,599 | 10,845 |
| Reclassification of SHC and LPCH net assets | – | – | – | 36,652 |
| Other | 25,300 | 1,679 | 26,979 | 33,904 |
| Net change in permanently restricted net assets | 197,296 | 13,217 | 210,513 | 678,066 |
| Net change in total net assets | (570,937) | (19,994) | (590,931) | 3,187,116 |
| Total net assets, beginning of year | 11,718,468 | 406,312 | 12,124,780 | 8,937,664 |
| Total net assets, end of year | $ 11,147,531 | $ 386,318 | $ 11,533,849 | $ 12,124,780 |

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

# Consolidated Statements of Cash Flows

Years ended August 31, 2001 and 2000
(in thousands of dollars)

| | 2001 University | 2001 Hospitals | 2001 Consolidated | 2000 Consolidated |
|---|---|---|---|---|
| **CASH FLOW FROM OPERATING ACTIVITIES** | | | | |
| Change in net assets | $ (570,937) | $ (19,994) | $ (590,931) | $ 3,187,116 |
| Adjustments to reconcile change in net assets to net cash provided by (used for) operating activities: | | | | |
| Depreciation, amortization, and loss on disposal of fixed assets | 156,589 | 48,658 | 205,247 | 197,383 |
| Net realized and unrealized (gains) losses on investments and security agreements | 774,839 | 10,746 | 785,585 | (2,589,434) |
| Net realized and unrealized losses on derivatives | 4,200 | 5,115 | 9,315 | – |
| Actuarial change on living trust obligations | (733) | – | (733) | (12,947) |
| Equity in UCSF Stanford Health Care | – | (2,124) | (2,124) | 51,994 |
| Permanently restricted investment income | (2,339) | (260) | (2,599) | (4,344) |
| Gifts restricted for long-term investments | (192,814) | (28,757) | (221,571) | (356,413) |
| Net (increase) decrease in accounts receivable, pledges receivable, and receivables from SHC and LPCH | 1,802 | (13,874) | (12,072) | (431,472) |
| Increase in U.S. Government refundable loan funds | 945 | – | 945 | 894 |
| (Increase) decrease in inventories, prepaid expenses, and other assets | (8,556) | 1,406 | (7,150) | 3,337 |
| Increase (decrease) in accounts payable and accrued expenses | (42,358) | 13,785 | (28,573) | 326,263 |
| **Net cash provided by operating activities** | **120,638** | **14,701** | **135,339** | **372,377** |
| **CASH FLOW FROM INVESTING ACTIVITIES** | | | | |
| Purchases of land, building, and equipment | (316,341) | (37,238) | (353,579) | (361,765) |
| Student, faculty, and other loans: | | | | |
| New loans made | (81,131) | – | (81,131) | (76,739) |
| Principal collected | 43,428 | – | 43,428 | 30,527 |
| Purchases of investments | (3,681,299) | (161,293) | (3,842,592) | (4,944,294) |
| Sales and maturities of investments | 3,621,677 | 131,028 | 3,752,705 | 4,599,967 |
| Liabilities under security agreements | 214,145 | – | 214,145 | (35,222) |
| Cash transferred from UCSF Stanford Health Care | – | 41,130 | 41,130 | 60,127 |
| **Net cash used for investing activities** | **(199,521)** | **(26,373)** | **(225,894)** | **(727,399)** |
| **CASH FLOW FROM FINANCING ACTIVITIES** | | | | |
| Gifts and reinvested income of endowment, capital projects, and other restricted purposes | 206,056 | 28,757 | 234,813 | 377,317 |
| Increase in investment income for restricted purposes | 2,339 | 260 | 2,599 | 4,344 |
| Proceeds from borrowing | 307,224 | – | 307,224 | 95,596 |
| Repayment of notes and bonds payable | (166,703) | (3,701) | (170,404) | (77,501) |
| **Net cash provided by financing activities** | **348,916** | **25,316** | **374,232** | **399,756** |
| **Increase in cash and cash equivalents** | **270,033** | **13,644** | **283,677** | **44,734** |
| Cash and cash equivalents, beginning of year | 431,420 | 102,246 | 533,666 | 488,932 |
| **Cash and cash equivalents, end of year** | **$ 701,453** | **$ 115,890** | **$ 817,343** | **$ 533,666** |
| SUPPLEMENTAL DATA: | | | | |
| Gifts of equipment | $ 437 | $ 1,116 | $ 1,553 | $ 127 |
| Interest paid during the year | 65,163 | 13,851 | 79,014 | 74,203 |
| Reduction in debt related to real estate partnerships | 60,412 | – | 60,412 | – |

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

## 1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation > The consolidated financial statements include the accounts of Stanford University (the University), Stanford Hospital and Clinics (SHC) and Lucile Salter Packard Children's Hospital at Stanford (LPCH), and other majority-owned entities. All significant inter-entity transactions and balances have been eliminated upon consolidation.

*University* The University is a private, not-for-profit educational institution, founded in 1885 by Senator Leland and Mrs. Jane Stanford in memory of their son, Leland Stanford, Jr. It is organized into seven schools with approximately 1,700 faculty and more than 14,000 graduate and undergraduate students. The University category presented in the financial statements comprises all the accounts of the University, including the Stanford Alumni Association (SAA), the Hoover Institution and other institutes and research centers, and Stanford Linear Accelerator Center (SLAC).

The University manages and operates 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.

*Hospitals* The Hospitals category presented in the financial statements includes SHC, LPCH, and the University's investment in UCSF Stanford Health Care, a nonprofit corporation controlled jointly by the University and the Regents of the University of California (UC), which operated the clinical facilities of Stanford Health Services (SHS), LPCH, and the University of California, San Francisco Medical Center (UCSF) from November 1, 1997, through March 31, 2000.

The University's investment in UCSF Stanford Health Care is reported in these financial statements using the equity method of accounting. Effective March 31, 2000, the operating activities of UCSF Stanford Health Care were terminated. On April 1, 2000, UCSF Stanford Health Care transferred the operations of its clinical facilities to SHC, LPCH, and UC. The health care activities of SHC and LPCH, including revenues, expenses, assets, and liabilities, are consolidated in these financial statements. Accordingly, for fiscal year 2000, seven months of health care activities are presented under the equity method and five months are presented on a consolidated basis. For fiscal year 2001, all health care activities are presented on a consolidated basis. The organization, financial information, and agreements among the University and the aforementioned health care entities are discussed in Note 2.

Basis of Accounting > The financial statements are prepared in accordance with generally accepted accounting principles. These principles require management to make estimates 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 those estimates.

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—in accordance with generally accepted accounting principles.

*Unrestricted Net Assets* Unrestricted net assets are expendable resources used to support either the University's core activities of teaching and research or the Hospitals' patient care, teaching, and research missions. These net assets may be designated by the University or the Hospitals 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 or the Hospitals' core activities, that are received and expended, or deemed expended due to the nature of their restriction, 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 include funds designated for operations, plant facilities, endowment gains and funds functioning as endowment, and the University's investment in UCSF Stanford Health Care. Unrestricted net assets were $8,190,557,000 and $9,014,073,000 at August 31, 2001 and 2000, respectively.

*Temporarily Restricted Net Assets* Temporarily restricted net assets include investments and pledges that are subject to donor-imposed restrictions that expire upon the passage of time, upon the pledge payment, or upon specific actions undertaken by the University or the Hospitals, at which time they are released and reclassified to unrestricted support. Temporarily restricted net assets consist of the following balances at August 31, 2001 and 2000, in thousands of dollars:

| | 2001 | | | 2000 |
|---|---|---|---|---|
| | UNIVERSITY | HOSPITALS | CONSOLIDATED | CONSOLIDATED |
| TEMPORARILY RESTRICTED NET ASSETS | | | | |
| Support for capital projects | $ 206,148 | $ – | $ 206,148 | $ 198,794 |
| Term endowments | 56,469 | – | 56,469 | 66,259 |
| Funds subject to living trust agreements | 51,014 | – | 51,014 | 61,643 |
| Other gifts and income for instruction, research, and University support | 183,584 | – | 183,584 | 151,463 |
| SHC and LPCH indigent care, plant, and other funds | – | 28,681 | 28,681 | 25,665 |
| Temporarily restricted net assets | $ 497,215 | $ 28,681 | $ 525,896 | $ 503,824 |

*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, 2001 and 2000, in thousands of dollars:

| | 2001 UNIVERSITY | 2001 HOSPITALS | 2001 CONSOLIDATED | 2000 CONSOLIDATED |
|---|---|---|---|---|
| PERMANENTLY RESTRICTED NET ASSETS | | | | |
| Endowment funds | $ 2,481,019 | $ 69,401 | $ 2,550,420 | $ 2,378,452 |
| Funds subject to living trust agreements | 209,432 | – | 209,432 | 174,787 |
| Student loans | 57,544 | – | 57,544 | 53,644 |
| Permanently restricted net assets | $ 2,747,995 | $ 69,401 | $ 2,817,396 | $ 2,606,883 |

Management considers all revenues and expenses to be related to operations except reinvested endowment gains, changes in equity of UCSF Stanford Health Care, capital gifts, expendable gifts invested in the endowment, and certain other non-operating changes.

Cash and Cash Equivalents > Cash and cash equivalents including U.S. Treasury bills, bankers' acceptances, commercial paper, certificates of deposit, money market funds, and other short-term investments with remaining maturities of 90 days or less at the time of purchase, are carried at cost, which approximates market. Cash and cash equivalent amounts held in the endowment, as well as certain cash restricted in its use by the Hospitals, 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 loans receivable is considered impractical due to donor-restricted and federally sponsored student loans with mandated interest rates and repayment terms subject to significant restrictions as to their transfer and disposition.

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. Securities transactions are reported on a trade-date basis.

Derivatives > Derivative financial instruments are recorded at fair value with the resulting gain or loss recognized in the consolidated statement of activities. See Note 5.

Plant Facilities > Plant facilities are recorded at cost or fair value at date of donation. Interest for construction financing is capitalized as a cost of construction. Depreciation is computed using the straight-line method over the estimated useful lives of the plant assets.

As described in Note 7, beginning in fiscal year 2000, the University adopted a revised set of useful lives for its equipment and buildings to reflect current information and to conform with those used for federal cost reimbursement accounting purposes. The useful lives used in calculating depreciation for fiscal years 2001 and 2000 are as follows:

| | UNIVERSITY | HOSPITALS |
|---|---|---|
| Buildings | 20–40 years | 10–40 years |
| Land and building improvements | 10–40 years | 5–40 years |
| Equipment and books | 3–10 years | 3–20 years |

The method of computing depreciation on academic buildings was also changed in fiscal year 2000. Academic buildings placed in service before September 1, 1999, are depreciated based upon the estimated useful life of the building. Academic buildings placed in service after September 1, 1999, are depreciated based on individual component lives.

Collections of Works of Art > 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.

Self-insurance > The University self-insures for unemployment, disability, property losses, and general and professional liability losses. The Hospitals self-insure for workers' compensation and medical malpractice losses. Reinsurance is purchased to cover liabilities above specific per-claim exposures. Estimates of retained exposures are accrued.

Student Financial Aid > Financial assistance in the form of scholarship and fellowship grants that cover a portion of tuition, living, and other costs is reflected as a reduction in student income.

Health Care Services > The Hospitals derive a majority of patient care revenue from contractual agreements with Medicare, Medi-Cal, and certain other contracted rate payors. Payments under these agreements and programs are based on a percentage of charges, per diem, per discharge, per service, a fee schedule, a cost reimbursement, or capitation methodology.

Unsponsored Community Benefit Expense > SHC's and LPCH's commitment to community service is evidenced by services provided to persons who cannot afford to pay and benefits provided to the broader community. The amount of charity care services, which are not recorded as revenue (quantified at customary charges), was $4,821,000 for fiscal year 2001, and $2,172,000 for the five months ended August 31, 2000. The total quantifiable community benefits provided by SHC and LPCH for the year ended August 31, 2001, and the five months ended August 31, 2000, were $70,139,000 and $22,018,000, respectively.

Tax Status > The University, SHC, and LPCH are exempt from federal income tax to the extent provided by Section 501(c)(3) of the Internal Revenue Code.

Separate Hospital Financial Statements > The Hospitals prepare separate, stand-alone consolidated financial statements in conformity with generally accepted accounting principles. For purposes of presentation of the Hospitals' balance sheets, statements of operations, statements of changes in net assets, and statements of cash flows in these consolidated financial statements, conforming reclassifications have been made to the Hospitals' revenue and expenses and inter-entity receivables and payables consistent with categories in the consolidated financial statements.

Reclassifications > During the year ended August 31, 2001, the University changed the method of presenting the statement of cash flows from the direct to the indirect method to conform with prevailing industry practice. The statement of cash flows for the year ended August 31, 2000, has been reclassified to conform to the current year's presentation. In addition, certain other fiscal year 2000 amounts presented for comparative purposes have been reclassified to conform to the fiscal year 2001 presentation.

## 2. Related Health Care Entities

Organization and Background > The University is the sole member of SHC, which was the sole member of LPCH through August 31, 2001. Effective September 1, 2001, the University became the sole member of LPCH. Effective November 1, 1997, UC and the University transferred substantially all the assets and liabilities related to the clinical operations of UCSF and SHS (now known as SHC) to UCSF Stanford Health Care, a California nonprofit public benefit corporation. UCSF Stanford Health Care was organized by the University and UC to operate the clinical facilities of SHS, LPCH, and UCSF in support of the schools of medicine of the University and UCSF. The University and UC terminated the operating activities of UCSF Stanford Health Care effective March 31, 2000. On April 1, 2000, the operations of the hospitals and professional services of the members of the medical faculties of the University and the UCSF School of Medicine were transferred back to SHC, LPCH, and UCSF.

On April 1, 2000, net assets were transferred to SHC, LPCH, and UCSF at their historical cost basis of $674,991,000. UCSF Stanford Health Care's then-remaining net assets of $40,200,000 were retained to satisfy known liabilities and pay for ongoing costs. During fiscal year 2001, UCSF Stanford Health Care transferred cash to SHC, LPCH, and UCSF in satisfaction of related party balances and to return a portion of the net assets retained on behalf of each member. In addition, during fiscal year 2001, UCSF Stanford Health Care made certain payments on behalf of SHC, LPCH, and UCSF. The University's share of UCSF Stanford Health Care's remaining net assets was $5,443,000 and $20,063,000 at August 31, 2001 and 2000, respectively.

Final dissolution of UCSF Stanford Health Care depends upon, among other things, a decision by the Internal Revenue Service and the Department of Labor regarding the distribution of the plan assets and obligations of the defined benefit plan (see Note 15). Net ongoing operating costs of UCSF Stanford Health Care subsequent to March 31, 2000, continue to be borne by the University and UC.

**University's Investment in Hospitals** > The following table summarizes the changes in the University's investment in UCSF Stanford Health Care and the net assets of SHC and LPCH during the years ended August 31, 2001 and 2000, in thousands of dollars:

| | UCSF STANFORD HEALTH CARE | SHC AND LPCH |
|---|---|---|
| **Investment at August 31, 1999** | $ 451,613 | $ 33,331 |
| Deficit resulting from operations (seven months for UCSF Stanford Health Care, five months for SHC and LPCH) | (63,878) | (48,048) |
| Deficit resulting from winding-down activities | (37) | – |
| Other changes in net assets | 11,921 | 21,410 |
| Transfer of UCSF Stanford Health Care net assets | (379,556) | 379,556 |
| **Investment at August 31, 2000** | 20,063 | 386,249 |
| Deficit resulting from operations | – | (13,353) |
| Income resulting from winding-down activities | 6,440 | – |
| Other changes in net assets | (4,316) | (8,765) |
| Transfer of UCSF Stanford Health Care net assets | (16,744) | 16,744 |
| **Investment at August 31, 2001** | $ 5,443 | $ 380,875 |

UCSF Stanford Health Care's net assets were $12,336,000 and $40,126,000 at August 31, 2001 and 2000, respectively.

**Related-Party Transactions** > The University has entered into various operating agreements with SHC and LPCH for professional services of faculty members of the Stanford University School of Medicine, telecommunications services, and other services and facility charges. Revenues and expenses related to these agreements are eliminated in consolidation. Additionally, certain investments of SHC and LPCH with a fair market value of $64,804,000 (including $17,547,000 of cash and cash equivalents) and $169,089,000 at August 31, 2001 and 2000, respectively, were managed by the University. SHC and LPCH assets with a market value of $117,718,000 on August 31, 2001 are invested in an external liquid fund managed by the University.

For the seven months ended March 31, 2000, the University recorded net revenues from UCSF Stanford Health Care of $98,193,000 for professional medical services and other facility charges and services. SHC and LPCH had receivables from UCSF Stanford Health Care of $33,167,000 as of August 31, 2000.

## 3. Accounts Receivable

Accounts receivable at August 31, 2001 and 2000, in thousands of dollars, are as follows:

| | 2001 | 2000 |
|---|---|---|
| UNIVERSITY: | | |
| U.S. Government | $ 51,229 | $ 62,103 |
| Due from brokers | 47,466 | 221,232 |
| Accrued interest on investments | 18,779 | 19,855 |
| Non-government sponsors | 14,398 | 14,523 |
| Student | 3,246 | 3,148 |
| Other | 25,607 | 27,867 |
| | 160,725 | 348,728 |
| Less allowances for losses | 2,000 | 2,118 |
| | 158,725 | 346,610 |
| HOSPITALS: | | |
| Hospitals' patient receivables | 394,729 | 377,812 |
| UCSF Stanford Health Care | – | 33,167 |
| Other | 11,917 | 17,025 |
| | 406,646 | 428,004 |
| Less allowances for losses | 231,500 | 208,876 |
| | 175,146 | 219,128 |
| Consolidated accounts receivable | $ 333,871 | $ 565,738 |

## 4. Faculty and Staff Mortgages

In a program to attract and retain excellent faculty and senior staff, the University provides home mortgage financing assistance. Notes amounting to $208,259,000 and $170,897,000 at August 31, 2001 and 2000, respectively, from University faculty and staff are included in "Faculty and staff mortgages and other loans receivable, net" in the consolidated statements of financial position and are collateralized by deeds of trust on properties concentrated in the region surrounding the University.

## 5. Investments

Investments held by the University and the Hospitals at August 31, 2001 and 2000, are reported as follows, in thousands of dollars:

| | 2001 UNIVERSITY | 2001 HOSPITALS | 2001 CONSOLIDATED | 2000 CONSOLIDATED |
|---|---|---|---|---|
| Cash and short-term investments | $ 529,384 | $ 209,191 | $ 738,575 | $ 767,646 |
| Bonds and mutual funds | 1,287,146 | 6,105 | 1,293,251 | 1,011,512 |
| Corporate stocks and mutual funds | 4,499,482 | 6,761 | 4,506,243 | 4,834,474 |
| Assets held by other trustees | 96,528 | – | 96,528 | 114,455 |
| Real estate and improvements, including Stanford Shopping Center and Research Park | 949,493 | – | 949,493 | 968,643 |
| Limited partnership investments | 2,494,535 | – | 2,494,535 | 3,022,130 |
| Other | 62,187 | – | 62,187 | 65,376 |
| | 9,918,755 | 222,057 | 10,140,812 | 10,784,236 |
| SHC's and LPCH's investment in University's Merged Endowment Pool | (47,257) | 47,257 | – | – |
| Investments at fair value | $ 9,871,498 | $ 269,314 | $10,140,812 | $10,784,236 |

The University reports endowment cash and short-term investments as investments. Assets held by other trustees are reported net of income beneficiary share in the amounts of $38,948,000 and $40,729,000 at August 31, 2001 and 2000, respectively.

Total investment return (loss) reflected in the statement of activities for the years ended August 31, 2001 and 2000, in thousands of dollars, is as follows:

| | 2001 UNIVERSITY | 2001 HOSPITALS | 2001 CONSOLIDATED | 2000 CONSOLIDATED |
|---|---|---|---|---|
| Investment income | $ 277,795 | $ 7,280 | $ 285,075 | $ 287,049 |
| Net realized and unrealized gains (losses) | (774,839) | (10,746) | (785,585) | 2,589,434 |
| Total investment return (loss) | $ (497,044) | $ (3,466) | $ (500,510) | $ 2,876,483 |

For the year ended August 31, 2001, recognized investment losses and utilized prior years' gains amounted to $945,364,000. For the year ended August 31, 2000, total investment return of $2,362,266,000 was reinvested.

As indicated in the following table, as of August 31, 2001 and 2000, 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:

| | 2001 | 2000 |
|---|---|---|
| UNIVERSITY: | | |
| Expendable Funds Pool | $ 1,099,178 | $ 919,665 |
| Merged Endowment Pool | 7,811,508 | 8,575,607 |
| Merged Pool C | 125,424 | 165,928 |
| Living trusts | 539,623 | 494,530 |
| Other investments | 960,012 | 1,358,270 |
| | 10,535,745 | 11,514,000 |
| Less funds cross-invested in endowment pools (including SHC's and LPCH's investment of $47,257 and $159,811 in 2001 and 2000, respectively, in the University's Merged Endowment Pool) | 664,247 | 979,559 |
| | 9,871,498 | 10,534,441 |
| HOSPITALS: | | |
| SHC's and LPCH's investments | 269,314 | 249,795 |
| Investments at fair value | $10,140,812 | $10,784,236 |

The EFP is a pool of funds that is intended to provide adequate liquidity as well as an opportunity for the University to earn long-term growth on a portion of the pool. Approximately half of the EFP is invested in short-term or highly liquid securities, and the balance is cross-invested in the Merged Endowment Pool. The University Board of Trustees (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 range of pre-set interest rates 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, 2001 and 2000, the results of the EFP, in thousands of dollars, were as follows:

| | 2001 UNIVERSITY | 2000 UNIVERSITY |
|---|---|---|
| Total investment return of the EFP | $ 35,529 | $ 246,514 |
| Less income made available to fundholders | 54,936 | 90,770 |
| Income (withdrawn from) or invested in the endowment | $ (19,407) | $ 155,744 |

The University's endowment is invested with the objective of maximizing long-term total return. The University's policy governing the amounts paid annually from the endowment 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 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.

To meet the Board-authorized payout rate, income, gains, and previously reinvested endowment income were distributed for operations in fiscal years 2001 and 2000, as follows, in thousands of dollars:

| | 2001 UNIVERSITY | 2000 UNIVERSITY |
|---|---|---|
| Endowment income | $ 215,989 | $ 215,727 |
| Realized gains and previously reinvested income | 138,452 | 99,275 |
| **Approved payout** | **$ 354,441** | **$ 315,002** |

The University utilizes derivatives and other strategies to manage market risks, including interest rate and foreign currency risks, and to achieve efficient exposure to certain asset classes. The University enters into foreign currency forward contracts primarily for the purpose of minimizing the risk to the University of adverse changes in the relationship between currencies. The University uses interest rate swaps to manage the interest rate exposure of its commercial paper. See Note 8. The University generally enters into options and futures contracts for the purpose of reducing the risk level of its investments or serving as a temporary surrogate for investment in stocks and bonds.

At August 31, 2001, the University's derivative positions included foreign currency forward contracts, interest rate swaps, and options and futures contracts. The fair value of these derivatives was $14,507,000. It is not practicable to separate the gain or loss component of investment transactions associated with derivatives.

Foreign currency forward contracts, interest rate swaps, stock lending, and repurchase agreements necessarily involve counterparty credit risk. The University seeks to control this risk by entering into transactions with high quality counterparties and through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring. With respect to securities lending and repurchase agreements, it is the University's policy to require receipt of collateral on each contract equal to a minimum of 100% of the security loaned.

## 6. Pledges Receivable

Unconditional promises are included in the financial statements as pledges receivable and are classified as either temporarily restricted or permanently restricted, depending upon donor requirements. Conditional promises, which depend on the occurrence of a specified future and uncertain event, such as matching gifts from other donors, are recognized when the conditions are substantially met. Pledges are recorded at the present value of the discounted future cash flows, net of allowances. At August 31, 2001 and 2000, pledges receivable are as follows, in thousands of dollars:

| | 2001 University | 2001 Hospitals | 2001 Consolidated | 2000 Consolidated |
|---|---|---|---|---|
| One year or less | $ 71,473 | $ 3,636 | $ 75,109 | $ 28,736 |
| Between one year and five years | 431,673 | 22,669 | 454,342 | 498,578 |
| More than five years | 506,610 | – | 506,610 | 90,126 |
| | 1,009,756 | 26,305 | 1,036,061 | 617,440 |
| Less conditional pledges | 251,630 | 18,400 | 270,030 | 1,448 |
| Less discount/allowance | 238,747 | – | 238,747 | 134,495 |
| Pledges receivable | $ 519,379 | $ 7,905 | $ 527,284 | $ 481,497 |

## 7. Plant Facilities

Plant facilities at August 31, 2001 and 2000, in thousands of dollars, are as follows:

| | 2001 University | 2001 Hospitals | 2001 Consolidated | 2000 Consolidated |
|---|---|---|---|---|
| Land and improvements | $ 142,496 | $ 5,886 | $ 148,382 | $ 140,108 |
| Buildings | 1,968,783 | 420,909 | 2,389,692 | 2,136,033 |
| Equipment and books | 960,235 | 283,549 | 1,243,784 | 1,142,014 |
| Construction in progress | 256,457 | 32,001 | 288,458 | 342,500 |
| Plant facilities | 3,327,971 | 742,345 | 4,070,316 | 3,760,655 |
| Less accumulated depreciation | 1,274,783 | 441,802 | 1,716,585 | 1,556,809 |
| Plant facilities, net of accumulated depreciation | $ 2,053,188 | $ 300,543 | $ 2,353,731 | $ 2,203,846 |

In fiscal year 2000, the University revised the useful lives to reflect current useful life information and to comply with the new federal cost recovery regulations. The effect of this change in estimate was an increase in the depreciation charge for the year ended August 31, 2000 of approximately $40,000,000.

Fully depreciated assets, mainly equipment and books, that are still in use by the University amounted to approximately $567,000,000 and $539,000,000 at August 31, 2001 and 2000, respectively. During the year ended August 31, 2001, the University retired approximately $40,536,000 in fixed assets and their related accumulated depreciation.

## 8. University Notes and Bonds Payable

Notes and bonds payable at August 31, 2001 and 2000, in thousands of dollars, are as follows:

| | 2001 | 2000 |
|---|---|---|
| TAX-EXEMPT | | |
| CALIFORNIA EDUCATIONAL FACILITIES AUTHORITY (CEFA): | | |
| Revenue Bonds, due serially to 2032, with interest from 4.0% to 6.0% | $ 637,250 | $ 558,235 |
| Revenue Bonds, Series L with variable interest rates | 99,543 | 83,819 |
| Department of Education Bonds of 1959 to 1984 due serially to 2024, with interest from 3.0% to 3.5% | 3,222 | 3,913 |
| TAXABLE | | |
| 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 fixed interest from 5.85% to 7.65% | 142,100 | 87,100 |
| Commercial Paper, with variable interest rates | 155,000 | 160,500 |
| Other, with various interest rates | 29,726 | 93,166 |
| University notes and bonds payable before premiums (discounts) | 1,216,841 | 1,136,733 |
| Net unamortized premiums (discounts) | 815 | (1,027) |
| University notes and bonds payable | $ 1,217,656 | $ 1,135,706 |

At August 31, 2001 and 2000, the fair value of these debt instruments approximated their recorded value.

The University incurred interest expense of approximately $71,352,000 and $62,958,000 for fiscal years 2001 and 2000, respectively, of which approximately $7,029,000 and $9,885,000, respectively, have been capitalized as a cost of construction.

Scheduled principal payments on notes and bonds, in thousands of dollars, are approximately:

| YEAR | PRINCIPAL |
|---|---|
| 2002 Commercial Paper | $ 155,000 |
| 2002 Other | 18,535 |
| 2003 | 2,509 |
| 2004 | 1,057 |
| 2005 | 15,309 |
| 2006 | 965 |
| Thereafter | 1,023,466 |
| Total | $ 1,216,841 |

The University has a commercial paper credit facility that provides for borrowings up to $200,000,000. The outstanding balance at August 31, 2001, was $155,000,000. The weighted average days to maturity is 82.35, and the weighted average effective interest rate is 3.7%. The University uses interest rate swaps to manage the interest rate exposure of its commercial paper program. See Note 5.

The CEFA Revenue Bonds have certain restrictive covenants, including maintenance of certain financial ratios. In October 2001, the University issued $15,490,000 in CEFA L-9 Refunding Revenue Bonds at an initial interest rate of 1.85%. During fiscal year 2001, the University legally defeased approximately $124,000,000 of CEFA J Revenue Bonds.

## 9. Hospitals' Notes and Bonds Payable

Bonds and certificates at August 31, 2001 and 2000, in thousands of dollars, are as follows:

| | 2001 | 2000 |
|---|---|---|
| Fixed Rate Revenue Bonds 1998 Series B, payable in annual amounts through 2013, with an average interest rate of 5% | $ 188,935 | $ 191,475 |
| 1993 Variable Rate Certificates of Participation, payable in annual amounts through 2023, with an average interest rate of 3% in 2001 | 38,900 | 43,196 |
| Hospitals' notes and bonds payable | $ 227,835 | $ 234,671 |

The bonds and certificates are unsecured joint obligations of SHC and LPCH (the Obligated Group). Payments of principal and interest on the bonds and certificates are insured by municipal bond guaranty policies. The Master Trust Indenture of the Obligated Group includes, among other things, limitations on additional indebtedness, liens on property, restrictions on disposition or transfer of assets, and compliance with certain financial ratios. SHC and LPCH may redeem the bonds and certificates, in whole or in part, prior to the stated maturities. Redemption of the bonds requires a premium of up to 2%. Redemption of the certificates is without premium.

Holders of the certificates have the option to tender the certificates as of designated purchase dates. In order to ensure the availability of funds to purchase any certificates tendered that the remarketing agent is unable to remarket, LPCH has obtained bank credit agreements that expire beginning in September 2003, unless extended by mutual agreement. LPCH has the option to convert the certificates to a fixed rate.

Estimated principal payments on bonds and certificates, in thousands of dollars, are summarized below:

| YEAR | PRINCIPAL |
|---|---|
| 2002 | $ 3,570 |
| 2003 | 3,800 |
| 2004 | 4,045 |
| 2005 | 4,190 |
| 2006 | 4,445 |
| Thereafter | 207,785 |
| Total | $ 227,835 |

The fair value of these debt instruments is estimated based on the quoted market prices for the same or similar issues and on the current rates offered to SHC and LPCH for debt of the same remaining maturities. The estimated fair value of the debt instruments as of August 31, 2001 and 2000 approximated the recorded value.

At August 31, 2001, the Obligated Group had swap agreements expiring through 2023 to pay a fixed interest rate of 6.22%. The fair value of the interest rate swap is the estimated amount that the Hospitals would currently pay to terminate the swap agreement at the reporting date, taking into account current interest rates and current creditworthiness of the swap counterparties. The estimated fair value (loss) of the interest rate swap was $(8,250,000) as of August 31, 2001. The swap adjustment is net of the previously recorded fair value of the swap resulting from the purchase accounting adjustment related to the combination of SHS and LPCH in January 1997. The effect of the interest rate swap utilized to offset variable-rate funding was to increase interest expense by $1,280,000 for 2001.

The University is not an obligor or guarantor with respect to any obligations of the Obligated Group.

## 10. Liabilities Under Security Agreements

At August 31, 2001 and 2000, the University held $372,962,000 and $190,432,000, 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. In addition, at August 31, 2001, the University sold a security subject to an obligation to repurchase it at a future date in the amount of $28,469,000. The borrowing has been accounted for as a financing transaction and bears interest at a rate of 3.9%. The estimated market value of securities on loan and pledged under repurchase agreements at August 31, 2001 and 2000, were $389,936,000 and $184,424,000, respectively.

The University sells securities "short" in order to enhance investment returns and manage market exposure. At August 31, 2001 and 2000, the fair market value of such securities is $110,076,000 and $168,009,000, respectively.

## 11. University 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. Depending on the nature of the donor's stipulation, these resources are recorded as 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.

Changes in the University's endowment, excluding pledges for the years ended August 31, 2001 and 2000, in thousands of dollars, are as follows:

| | 2001 | 2000 |
|---|---|---|
| Endowment, beginning of year | $ 8,885,905 | $ 6,226,695 |
| INVESTMENT RETURNS: | | |
| Earned endowment income (including $3,957 and $3,203 reinvested in endowment, as required by donor, in 2001 and 2000, respectively) | 219,946 | 218,930 |
| Change in net realized and unrealized appreciation of investments during the year | (737,553) | 2,274,184 |
| Total investment returns | (517,607) | 2,493,114 |
| Unrestricted income and gains distributed for operations | (354,441) | (315,002) |
| Endowment returns reinvested (withdrawn) | (872,048) | 2,178,112 |
| OTHER CHANGES IN ENDOWMENT: | | |
| Gifts (net of $47,420 and $172,684 in pledges in 2001 and 2000, respectively) | 158,159 | 242,315 |
| Investment of funds in endowment | 102,911 | 80,420 |
| EFP income invested in (withdrawn from) endowment | (19,407) | 155,744 |
| Actuarial adjustment on living trusts | 733 | 12,404 |
| Other changes | (6,702) | (9,785) |
| Net increase (decrease) in endowment | (636,354) | 2,659,210 |
| Endowment, end of year | $ 8,249,551 | $ 8,885,905 |

## 12. University 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, 2001 and 2000, per the statement of activities reconciled to the cash basis (as reported by OOD), in thousands of dollars:

| | 2001 | 2000 |
|---|---|---|
| Expendable gifts in support of operations | $ 125,284 | $ 113,187 |
| Expendable gifts invested in the endowment | 5,884 | 17,742 |
| Temporarily restricted general gifts | 99,120 | 148,750 |
| Buildings and improvements | 42,693 | 178,197 |
| Permanently restricted endowment gifts | 187,085 | 390,605 |
| Permanently restricted student loans | 84 | 11 |
| **Total University gifts per statement of activities** | **460,150** | **848,492** |
| ADJUSTMENTS TO GIFT TOTAL AS REPORTED BY OOD: | | |
| Pledges | (215,382) | (532,434) |
| Non-government grants, recorded as sponsored research support | 48,865 | 37,706 |
| Payments made on pledges | 177,502 | 228,038 |
| Actuarial gains on maturity of living trusts within five years of date of gift | 292 | 265 |
| Other | (2,461) | (1,593) |
| **Total University gifts as reported by OOD** | **$ 468,966** | **$ 580,474** |

## 13. Functional Expenses

Expenses for each of the years ended August 31, 2001 and 2000, were categorized as follows, in thousands of dollars:

| | 2001 | 2000 |
|---|---|---|
| UNIVERSITY: | | |
| Instruction and departmental research | $ 667,991 | $ 610,270 |
| Organized research (direct costs) | 623,113 | 580,566 |
| Libraries | 107,001 | 92,586 |
| Student services | 56,306 | 49,129 |
| Administration and general | 128,446 | 116,547 |
| Development | 82,461 | 66,780 |
| SLAC construction | 12,433 | 7,332 |
| Auxiliary activities | 281,470 | 239,777 |
| | 1,959,221 | 1,762,987 |
| HOSPITALS: | | |
| Health care services | 934,680 | 397,490 |
| **Total consolidated expenses** | **$ 2,893,901** | **$ 2,160,477** |

Depreciation, interest, and plant operations and maintenance expenses are allocated to program and supporting activities, except for SLAC construction. Auxiliary activities include housing and dining services, intercollegiate athletics, SAA, other activities, and certain patient care provided by the School of Medicine.

## 14. University 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 (other post-retirement benefits).

Pension Plans > The University's policy is to fund pension costs in accordance with the Employee Retirement Income Security Act's minimum funding requirements. Total net pension expense for the years ended August 31, 2001 and 2000, was approximately $43,594,000 and $40,613,000, respectively.

Retirement benefits for certain nonexempt employees are provided through a noncontributory defined benefit pension plan. The University recognized a credit to net pension expense related to the defined benefit pension plan of $11,016,000 and $8,805,000 for the years ended August 31, 2001 and 2000, respectively. Effective January 1, 2001, benefits for each year of service prior to 1992 are based on 1992 earnings. The amendment applies to those who were both eligible employees and participants in the plan on January 1, 2001.

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 $54,496,000 and $49,404,000 for the years ended August 31, 2001 and 2000, respectively.

Other Post-Retirement Benefit Plans > The University's employees may become eligible for other post-retirement benefits upon retirement. Retiree health plans are paid for in part by retiree 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 post-retirement benefits over the periods that employees render service. The University recognizes the prior service obligation over 20 years.

Effective January 1, 1999, the University capped its health care benefits plan subsidy for post-65 benefits for non-Medicare+ Choice programs. The University's subsidy for post-65 benefits for non-Medicare+ Choice programs was increased effective January 1, 2001. Effective January 1, 2002, the University will remove the cap and provide a subsidy equal to the lowest cost plan for non-Medicare+ Choice programs.

The change in pension and other post-retirement plan assets and the related change in benefit obligation, in thousands of dollars as of and for the years ended August 31, 2001 and 2000, were as follows:

| | PENSION | | OTHER POST-RETIREMENT | |
|---|---|---|---|---|
| | 2001 | 2000 | 2001 | 2000 |
| **CHANGE IN PLAN ASSETS** | | | | |
| Fair value of plan assets at beginning of year | $ 284,642 | $ 253,611 | $ 28,103 | $ 25,266 |
| Actual return on plan assets | (13,022) | 45,543 | (2,516) | 3,698 |
| Employer contributions | – | – | 6,843 | 3,555 |
| Plan participants' contributions | – | – | 2,575 | 1,588 |
| Benefits paid | (15,695) | (14,512) | (9,418) | (6,004) |
| Fair value of plan assets at end of year | $ 255,925 | $ 284,642 | $ 25,587 | $ 28,103 |
| **CHANGE IN BENEFIT OBLIGATION** | | | | |
| Benefit obligation at beginning of year | $ 194,559 | $ 196,226 | $ 103,566 | $ 75,965 |
| Service cost | 4,699 | 4,286 | 3,678 | 2,777 |
| Interest cost | 14,961 | 13,760 | 7,551 | 5,352 |
| Plan participants' contributions | – | – | 2,575 | 1,588 |
| Amendments | 10,724 | – | 34,756 | 2, 274 |
| Actuarial (gain) loss | 8,390 | (5,201) | 14,778 | 21,614 |
| Benefits paid | (15,695) | (14,512) | (9,418) | (6,004) |
| Benefit obligation at end of year | $ 217,638 | $ 194,559 | $ 157,486 | $ 103,566 |

The accrued benefit asset (cost), in thousands of dollars, was determined as follows at August 31, 2001 and 2000:

| | PENSION | | OTHER POST-RETIREMENT | |
|---|---|---|---|---|
| | 2001 | 2000 | 2001 | 2000 |
| Plan assets minus benefit obligation | $ 38,287 | $ 90,083 | $ (131,899) | $ (75,463) |
| Unrecognized transition (asset) liability | (905) | (1,806) | 31,080 | 33,391 |
| Unrecognized prior service cost | 10,980 | 1,493 | 36,818 | 2,274 |
| Unrecognized net actuarial (gain) loss | (44,027) | (96,451) | 31,387 | 11,715 |
| Accrued benefit asset (cost) recorded in the statement of financial position | $ 4,335 | $ (6,681) | $ (32,614) | $ (28,083) |

The discount rate, expected rate of return on plan assets, and the projected covered payroll growth rates used in determining the previous accrued benefit costs were as follows for the years ended August 31, 2001 and 2000:

| | PENSION | | OTHER POST-RETIREMENT | |
|---|---|---|---|---|
| | 2001 | 2000 | 2001 | 2000 |
| Discount rate | 7.00% | 7.50% | 7.00% | 7.50% |
| Expected return on plan assets | 8.75% | 8.75% | 8.75% | 8.75% |
| Covered payroll growth rate | 5.00% | 5.00% | N/A | N/A |

The assumed health care cost trend rate used to measure the accumulated post-retirement benefit obligation at August 31, 2001, was 10% for calendar year 2002. The rate was assumed to decrease by 1% for each of the next four calendar years, and to decrease to 5.5% for the following year and remain level thereafter.

The assumed health care cost trend rate used to measure the accumulated post-retirement benefit obligation at August 31, 2000, was 10% for calendar year 2001. The rate was assumed to decrease by 1% for each of the next four calendar years, with a 6% annual rate for calendar year 2006, and to remain at that level thereafter.

Net benefit (income) expense related to the plans for the years ended August 31, 2001 and 2000, in thousands of dollars, included the following components:

| | PENSION | | OTHER POST-RETIREMENT | |
|---|---|---|---|---|
| | 2001 | 2000 | 2001 | 2000 |
| Service cost | $ 4,699 | $ 4,286 | $ 3,678 | $ 2,777 |
| Interest cost | 14,961 | 13,760 | 7,551 | 5,352 |
| Expected return on plan assets | (24,353) | (21,628) | (2,459) | (2,211) |
| Amortization of transition (asset) liability | (901) | (901) | 2,568 | 2,568 |
| Amortization of prior service cost | 1,237 | 187 | 212 | – |
| Recognized net actuarial (gain) loss | (6,659) | (4,509) | 81 | (52) |
| Net periodic benefit (income) expense | $ (11,016) | $ (8,805) | $ 11,631 | $ 8,434 |

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 1% in each future year would increase the accumulated post-retirement benefit obligation by $25,607,000 and the aggregate service and interest cost by $1,800,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post-retirement benefit obligation by $20,639,000 and the aggregate service and interest cost by $1,411,000.

## 15. Hospitals' Pension Plans and Other Post-Retirement Benefits

SHC and LPCH provide retirement benefits through defined benefit and defined contribution retirement plans covering substantially all employees.

Defined Benefit Plans > Certain employees of SHC and LPCH are covered by a noncontributory, defined benefit pension plan (SHC Staff Pension Plan). Benefits of certain prior employees of LPCH are covered by a frozen defined benefit plan. Benefit obligations of the LPCH plan at August 31, 2001, were $4,675,000, offset by $4,644,000 of plan assets, and at August 31, 2000 were $4,200,000, offset by an equal amount of plan assets. Benefits are based on years of service and the employee's compensation. Contributions to the plans are based on actuarially determined amounts sufficient to meet the benefits to be paid to plan participants.

Benefits accumulated through March 31, 2000 (other than benefits under the frozen LPCH plan), are included in the benefit obligation recorded on the books of UCSF Stanford Health Care. Management of SHC, UCSF Stanford Health Care, and UC are in discussion with the IRS and Department of Labor in order to transfer those obligations and related plan assets to SHC and UC. At this time, eligible employees will be paid benefits for services provided before April 1, 2000 from UCSF Stanford Health Care, and benefits for services provided after April 1, 2000 will be paid by the SHC Staff Pension Plan. Since SHC ultimately expects UCSF Stanford Health Care to transfer certain of these obligations and all of the plan assets to SHC Staff Pension Plan, SHC and LPCH have recorded the net periodic benefit gain allocated to SHC and LPCH since March 31, 2000. SHC and LPCH also recorded service costs incurred since March 31, 2000, and other pension costs related to benefits accumulated since March 31, 2000. As a result, a net prepaid pension benefit of $1,871,000 was recorded by SHC and LPCH.

Defined Contribution Plan > Employer contributions to the defined contribution retirement plan are based on a percentage of participant annual compensation. Employer contributions to this plan totaling $19,900,000 and $6,700,000 are included in the employee benefits expense for fiscal year 2001 and the five months ended August 31, 2000, respectively.

Post-Retirement Medical Benefit Plan > SHC and LPCH currently provide health insurance coverage for employees upon retirement at age 55 with years of service as defined by certain criteria, or, for specific employees, at age 65 with at least five years of service. The health insurance coverage is the same as that provided for active employees. The obligation for these benefits has been recorded in the accompanying consolidated statement of financial position.

The plan assets and benefit obligation presented below include the portion of the UCSF Stanford Health Care pension plan related to SHC and LPCH employees, the frozen LPCH plan, and the SHC Staff Pension Plan. The net periodic pension cost and post-retirement medical benefit cost include the following components, in thousands of dollars, as of and for the year ended August 31, 2001, and as of and for the five months ended August 31, 2000:

| | PENSION BENEFITS | | POST-RETIREMENT MEDICAL BENEFITS | |
|---|---|---|---|---|
| | 2001 | 2000 | 2001 | 2000 |
| **CHANGE IN PLAN ASSETS** | | | | |
| Fair value of plan assets at beginning of year | $ 129,165 | $ 129,222 | $ – | $ – |
| Actual return on plan assets | (10,952) | 1,545 | – | – |
| Employer contributions | 527 | 208 | 2,727 | 898 |
| Benefits paid | (5,872) | (1,810) | (2,727) | (898) |
| Fair value of plan assets at end of year | $ 112,868 | $ 129,165 | $ – | $ – |
| **CHANGE IN BENEFIT OBLIGATION** | | | | |
| Benefit obligation at beginning of year | $ 99,815 | $ 97,966 | $ 49,812 | $ 47,782 |
| Service cost | 1,764 | 681 | 1,958 | 751 |
| Interest cost | 7,669 | 3,331 | 3,777 | 1,528 |
| Actuarial (gain) loss | 10,531 | (353) | 12,019 | 649 |
| Benefits paid | (5,872) | (1,810) | (2,727) | (898) |
| Benefit obligation at end of year | $ 113,907 | $ 99,815 | $ 64,839 | $ 49,812 |

The accrued benefit asset (cost), in thousands of dollars, was determined as follows at August 31, 2001 and 2000:

| | PENSION BENEFITS | | POST-RETIREMENT MEDICAL BENEFITS | |
|---|---|---|---|---|
| | 2001 | 2000 | 2001 | 2000 |
| Plan assets minus benefit obligation | $ (1,039) | $ 29,350 | $ (64,839) | $ (49,812) |
| Unrecognized prior service cost | – | – | 3,317 | 2,730 |
| Unrecognized (gain) loss | (11,436) | (43,599) | 7,628 | (4,721) |
| Accrued benefit cost recorded in the statement of financial position | (12,475) | (14,249) | (53,894) | (51,803) |
| Less: Accrued benefit cost at UCSF Stanford Health Care | 14,998 | 14,998 | – | – |
| Accrued benefit asset (cost) recorded by SHC and LPCH | $ 2,523 | $ 749 | $ (53,894) | $ (51,803) |

Net benefit (income) expense related to the plans for the years ended August 31, 2001 and 2000, in thousands of dollars, included the following components:

| | PENSION BENEFITS | | POST-RETIREMENT MEDICAL BENEFITS | |
|---|---|---|---|---|
| | 2001 | 2000 | 2001 | 2000 |
| Service cost | $ 1,764 | $ 681 | $ 1,958 | $ 751 |
| Interest cost | 7,669 | 3,331 | 3,777 | 1,528 |
| Expected return on plan assets | (9,422) | (4,016) | – | – |
| Amortization of prior service cost | – | – | (587) | (436) |
| Recognized net actuarial (gain) | (1,237) | (607) | (330) | (403) |
| Net periodic benefit (income) expense | $ (1,226) | $ (611) | $ 4,818 | $ 1,440 |

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 were as follows for the years ended August 31, 2001 and 2000:

| | PENSION | | OTHER POST-RETIREMENT | |
|---|---|---|---|---|
| | 2001 | 2000 | 2001 | 2000 |
| Discount rate | 7.25% | 7.75% | 7.25% | 7.75% |
| Expected return on plan assets | 8.00% | 8.00% | N/A | N/A |
| Rate of compensation increase | 5.50% | 3.5–5.5% | N/A | N/A |

The assumed health care cost trend rate used to measure the accumulated post-retirement benefit obligation at August 31, 2001 was 12% for the year ended August 31, 2002. The rate was assumed to decrease by 1.5% for the next five years and to remain at 4.75% thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the medical benefit plan. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated post-retirement benefit obligation by $3,608,000 and the aggregate service and interest cost by $56,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post-retirement benefit obligation by $3,256,000 and the aggregate service and interest cost by $301,000.

## 16. Commitments and Contingencies

Management is of the opinion that none of the following commitments and contingencies will have a material adverse effect on the University's consolidated financial position.

Sponsored Projects > The University conducts substantial research for the federal government pursuant to contracts and grants from federal agencies and departments. The University records reimbursements of direct and indirect costs (facilities and administrative costs) from grants, contracts, and SLAC as operating revenues. The Office of Naval Research is the University's cognizant federal agency for determining indirect cost rates charged to federally sponsored agreements. It is supported by the Defense Contract Audit Agency, 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.

Hospitals > Cost reports filed under the Medicare program for services based upon cost reimbursement are subject to audit. The estimated amounts due to or from the program are reviewed and adjusted annually based upon the status of such audits and subsequent appeals.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of regulations by health care providers. These violations could result in the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. SHC and LPCH are subject to similar regulatory reviews, and while such reviews may result in repayments and/or civil remedies that could have a material effect on SHC's and LPCH's financial results of operations in a given period, management believes that such repayments and/or civil remedies would not have a material effect on the hospitals' financial position.

HIPAA > The Health Insurance Portability and Accountability Act (HIPAA) was enacted August 21, 1996, to assure health insurance portability, reduce healthcare fraud and abuse, guarantee security and privacy of health information and enforce standards for health information. Organizations are required to be in compliance with certain HIPAA provisions beginning October 2002. Provisions not yet finalized are required to be implemented two years after the effective date of the regulation. Organizations are subject to significant fines and penalties if found not to be compliant with the provisions outlined in the regulations. Management is in the process of evaluating the impact of this legislation on its operations including future financial commitments that will be required to comply with the legislation.

Litigation > The University and the Hospitals are defendants in a number of other 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 consolidated financial position.

Contractual Commitments > At August 31, 2001, the University had contractual obligations of approximately $86,292,000 in connection with major construction projects. Remaining expenditures on construction in progress are estimated to be $531,506,000, which will be financed with certain unexpended plant funds, gifts, and debt.

At August 31, 2001, the remaining commitment on contracts for the construction and remodeling of hospital facilities was approximately $38,000,000.

# Management Responsibility for Financial Statements

The consolidated financial statements on the preceding pages have been prepared in conformity with generally accepted accounting principles. The management of Stanford University is responsible for the integrity and objectivity of these consolidated 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 consolidated 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 consolidated 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 are neither 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 ensure 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.

**RANDALL S. LIVINGSTON**
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, based on our audits and the report of other auditors, the accompanying consolidated statements of financial position and the related consolidated statements of activities and cash flows, which appear on pages 31 through 58, present fairly, in all material respects, the financial position of Stanford University at August 31, 2001 and 2000, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University's management; our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Stanford Hospital and Clinics, an entity controlled by the University, which statements reflect total assets of $910 million and $924 million as of August 31, 2001 and 2000, respectively, and total unrestricted revenues of $1,059 million and $399 million for the years then ended. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Stanford Hospital and Clinics, is based solely on the report of the other auditors. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, 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 and the report of other auditors provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

San Francisco, California
November 21, 2001

## LELAND STANFORD JUNIOR UNIVERSITY:

John L. Hennessy President

John W. Etchemendy Provost

Randall S. Livingston Vice President for Business Affairs and Chief Financial Officer

John B. Ford Vice President for Development

Debra L. Zumwalt General Counsel

Howard Wolf President, Stanford Alumni Association

## UNIVERSITY CABINET:

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The Stanford University Annual Report is prepared by the Office of the Controller and the Office of University Communications.

DESIGN Brian Dittmar Graphic Design, San Francisco

PHOTOGRAPHY Linda A. Cicero, Stanford News Service; Jason Walker photograph on page 4 by Joel Simon; Linda Meier photograph on page 5 by Steve Castillo; foothill photographs are courtesy of the Stanford News Service.

Published February 2002

STANFORD UNIVERSITY

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651 Serra Street
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