STANFORD UNIVERSITY 2003 ANNUAL REPORT

Changing to Remain a Progressive Force

STANFORD
UNIVERSITY

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STANFORD FACTS

ENROLLMENT (October 2003): **14,454**
- Undergraduate Students: **6,654**
- Graduate Students: **7,800**

DEGREES AWARDED (2002-2003):
- Bachelor's: **1,788**
- Master's: **1,960**
- Doctoral: **895**

THE STANFORD PROFESSORIATE
(October 2003): **1,749**

NOBEL LAUREATES: **17**

PULITZER PRIZE WINNERS: **4**

MACARTHUR FELLOWS: **23**

NATIONAL MEDAL OF SCIENCE WINNERS: **21**

NATIONAL MEDAL
OF TECHNOLOGY WINNERS: **4**

AMERICAN ACADEMY OF
ARTS AND SCIENCES MEMBERS: **223**

NATIONAL ACADEMY OF
SCIENCES MEMBERS: **133**

NATIONAL ACADEMY OF
ENGINEERING MEMBERS: **82**

AMERICAN PHILOSOPHICAL
SOCIETY MEMBERS: **43**

NATIONAL ACADEMY OF
EDUCATION MEMBERS: **25**

WOLF FOUNDATION PRIZE WINNERS: **6**

KORET FOUNDATION PRIZE WINNERS: **6**

PRESIDENTIAL MEDAL OF
FREEDOM RECIPIENTS: **3**

On the cover: The James H. Clark Center is Stanford's most outwardly demonstrative sign of its commitment to pursuing multidisciplinary research and education. The center houses Bio-X, a multidisciplinary bioscience research effort designed to spur discoveries in the life sciences by breaking down conventional walls among disciplines.

CHANGING TO REMAIN A PROGRESSIVE FORCE

A MESSAGE FROM THE PRESIDENT

THE CREATION AND COMMUNICATION OF KNOWLEDGE IS AT THE HEART OF EVERY RESEARCH UNIVERSITY, AND A GREAT RESEARCH UNIVERSITY, LIKE STANFORD, ASPIRES TO CREATE KNOWLEDGE THAT WILL BENEFIT OUR SOCIETY.

When this University was founded in 1891, Jane and Leland Stanford envisioned that it would be a "University of high degree" and produce students who would become cultured and useful citizens. It was an admirable goal, but equally important was their realization that leadership in any endeavor necessitates breaking new ground. It requires us to reexamine how we approach our mission and to reorganize to pursue the newest frontiers.

This vision of a forward-looking and self-renewing university was certainly in Jane Stanford's mind in 1904 when she said,

> "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."

From those early days, this University has demonstrated an adventurous and pioneering spirit, and a commitment to excellence among its faculty and its students. The result: Imagination and creativity have flourished as we pursue our mission of discovery.

Although we have accomplished much at Stanford over the past century, we must always ask ourselves how we can continue to achieve excellence and what, if any, changes we might need to make to remain the progressive force that Jane Stanford exhorted us to be. I would like to examine this question and discuss Stanford's role as a leading teaching and research university in the 21st century, how it may change, and how we can best meet the needs of society.

Much of what we do at Stanford is invest in the future, and a strong undergraduate curriculum is the cornerstone for a great university. A decade ago, Stanford University's leaders recognized

the need to reconsider how it prepared students to be useful and productive citizens. We found that students often lacked strong personal interactions with faculty in their first two years of undergraduate study—the critical time before they chose a major. We also realized that too few of our undergraduates were taking advantage of the opportunity to engage in research, particularly at an institution like Stanford, where the opportunities abound.

So one important focus of our undergraduate initiatives is to enable students to take advantage of Stanford's preeminence as a research institution by working closely with our distinguished faculty. Since the landmark report of the Commission on Undergraduate Education in 1994, we have been engaged in a process of creating new opportunities for students. Support for undergraduate initiatives has extended to programs throughout the University, including Stanford Introductory Studies, Sophomore College, Undergraduate Research Programs, Jewish Studies, Islamic Studies, Overseas Studies, the University Libraries, and improved athletic and recreation facilities.

A five-year, $1 billion Campaign for Undergraduate Education was launched three years ago to support these new undergraduate programs. "Achieving Excellence in Undergraduate Education" in this annual report details the progress of the campaign. As noted in that section, we have made significant strides this past year and are more than 90 percent of the way to our goal—a remarkable accomplishment in this difficult economy. It is deeply gratifying to receive such a vote of confidence from alumni and friends, but we realize that this is not a time to become complacent. We have not yet reached our $1 billion goal, and the last mile is often the toughest.

The extended economic downturn of the past few years may have lingering effects, so we have worked hard to manage our finances carefully. To maximize the impact of our limited resources will require both creativity and discipline. The University planning process we have been engaged in for the past few years must be guided both by a bold determination and by a realistic understanding that we cannot do everything and must make some choices. Making those choices wisely is our challenge.

At the same time, we recognize that this is an extraordinary time in history. Our knowledge in many fields is advancing at an unprecedented pace, and we have opportunities to address some of the most fundamental and difficult questions facing society. Because the academic enterprise is one of the few in which long-term, basic research is given priority, research universities play a critical role in the creation of new knowledge. Furthermore, universities have an almost unique role in generating the discontinuous innovations that mark paradigm shifts and breakthroughs. Such discoveries and inventions come most easily in the unconstrained and open research environments within universities.

Stanford is uniquely positioned to lead in the exploration of research areas that are critical to our society and the world. Assembling a multidisciplinary team of scholars to tackle a critical problem is enabled by our diverse and distinguished faculty and by the geographic proximity of our schools and medical center. To attack these large, complex problems that require collaboration, however, we need to change how we conduct research. Although universities inherently house scholars from many disciplines, their traditional organizing principle has been around departments. Certainly such organizations will continue to have a role, but to support and encourage scholarship that crosses boundaries and leads to groundbreaking discoveries, we must develop new practices and structures that facilitate broad collaborations.

Our strategies for addressing this challenge are outlined in "Multidisciplinary Approaches Key to Future Innovation." Just as advances in the biological sciences are driving discoveries in engineering, medicine, and the other sciences, Stanford's Bio-X program is a model for how we can cultivate creativity across disciplines. But as this section notes, Bio-X is only one initiative among several being implemented. Other collaborations are examining the political and economic challenges of developing countries and exploring problems of sustainable development and use of natural resources. Our faculty are developing new curricula that will provide the foundation for future development in these cross-disciplinary areas.

I often talk about the Stanford spirit, and I think one characteristic that clearly defines Stanford and its people is our commitment to groundbreaking innovations that contribute to society. In little more than a century, Stanford University has become one of the world's leading teaching and research institutions, and I am confident that our second century holds a future as exciting and far-reaching as our first.

The work under our care today and in the coming years is to ensure that we continue to be pioneers at the frontier of knowledge—by investing in new initiatives, breaking barriers, and thinking on new lines. We recognize that there will be challenges ahead. But the opportunities to advance our knowledge and to bring these advances to bear on some of the world's most daunting problems are simply too important to miss. I have no doubt that Stanford will embrace these opportunities.

John Hennessy

John L. Hennessy

ACHIEVING EXCELLENCE IN UNDERGRADUATE EDUCATION

CAMPAIGN FOR UNDERGRADUATE EDUCATION ON TARGET

THE FOCUS OF MUCH OF STANFORD UNIVERSITY'S ATTENTION OVER THE PAST 10 YEARS HAS BEEN ON ACHIEVING EXCELLENCE IN UNDERGRADUATE PROGRAMS. THE FOUNDATION FOR INNOVATIONS IN THIS AREA HAS BEEN THE FIVE-YEAR, $1 BILLION CAMPAIGN FOR UNDERGRADUATE EDUCATION, OR CUE. GIVEN THE CHALLENGING ECONOMIC ENVIRONMENT, CUE HAS ACHIEVED REMARKABLE SUCCESS—INCLUDING THE ENDOWMENT OF 42 PROFESSORSHIPS—THANKS TO THE GENEROSITY OF STANFORD UNIVERSITY ALUMNI AND FRIENDS.

Daniel Gandarilla, Class of 2003, benefited from CUE as a William R. and Gretchen B. Kimball Scholar. A political science and psychology major, he volunteered at the East Palo Alto Stanford Academy and now plans a high school teaching career.

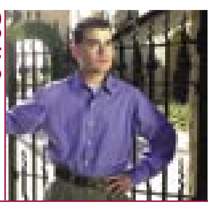
At the end of the fiscal year—August 2003—CUE had raised $889 million in pledges and gifts. At its three-year anniversary at the end of October, that total had risen to $902 million, or 90 percent of its goal. Specifically:

- The Stanford Endowment for Undergraduate Education has raised $266 million, including $22 million in expendable gifts, toward its $300 million goal. This endowment supports programs designed to give students small-group learning experiences with the University's most esteemed faculty through, for instance, Stanford Introductory Studies, Undergraduate Research Programs, and Sophomore College.
- $248 million has been raised toward a $300 million goal for endowed scholarships, both athletic and need-based. CUE has resulted in 170 new need-based scholarship funds and 72 athletic scholarship funds.
- The Stanford Fund has raised $61 million toward its $100 million goal. The Stanford Fund, the University's largest annual giving program, is an ongoing source of expendable, discretionary funds exclusively for undergraduate education.
- Other programs supporting undergraduate education across the University have attracted $261 million in gifts toward a $300 million goal, including the Overseas Studies Program, the University Libraries, and the Haas Center for Public Service.
- In addition, $66 million has been raised in funds not yet designated for specific purposes.

Matching funds have been important to CUE's success. CUE gifts have earned a total of $117 million of the more than $230 million in CUE matching funds committed by a small group of lead donors. The largest single pledge for matching funds came through a historic $400 million commitment from the William and Flora Hewlett Foundation in 2001. The foundation directed $100 million to CUE. The remaining $300 million is being used to match endowment gifts within the School of Humanities and Sciences, some of which support CUE as well.

A LOOK BACK AT SELECTED STANFORD EVENTS DURING THE CALENDAR YEAR 2003:

01/03



SENIOR PSYCHOLOGY MAJOR MICHAEL OSOFSKY IS ONE OF 11 STUDENTS NATIONWIDE AWARDED A GEORGE J. MITCHELL SCHOLARSHIP FOR STUDY IN IRELAND AND NORTHERN IRELAND.

PHYSICIST FRED KAVLI AND THE KAVLI FOUNDATION PLEDGE $7.5 MILLION TO ESTABLISH THE KAVLI INSTITUTE FOR PARTICLE ASTROPHYSICS AND COSMOLOGY.

02/03

MEDICAL SCHOOL DEAN PHILIP PIZZO IS APPOINTED TO CHAIR THE INSTITUTE OF MEDICINE'S HEALTH SCIENCES POLICY BOARD.

THE MEDICAL CENTER CELEBRATES THE 35TH ANNIVERSARY OF NORMAN SHUMWAY'S FIRST HEART TRANSPLANT IN THE UNITED STATES IN 1968.

STANFORD UNIVERSITY LIBRARIES ACQUIRES A UNIQUE COLLECTION OF HEBRAICA THAT WILL MAKE IT A FOCUS OF SCHOLARS RESEARCHING THE RELIGIOUS LIFE AND HISTORY OF EUROPEAN JEWRY.

Matching funds available through the Bass University Fellows in Undergraduate Education Program, which was created by alumnus Robert Bass and his wife, Anne, to support outstanding undergraduate teaching, have also been crucial to the University and CUE. At the end of October, 24 new University Fellows, many of them Stanford's leading faculty members, had been appointed. University Fellows can hail from any of the University's seven schools, including the graduate schools of business, law, education, and medicine.

CUE has been key in expanding and enhancing undergraduate research opportunities, which have become cornerstones of the Stanford undergraduate experience. In 2002-03, Stanford's budget of $3.3 million for Undergraduate Research Programs supported approximately 1,500 students. In 2003, Stanford's Summer Research College helped 250 undergraduates in 38 academic fields spend an extra eight to 10 weeks on campus working directly with faculty members. Stanford's undergraduate program encourages students to partner with faculty members in fulfilling the University's mission of discovering new knowledge. When research becomes an extension of teaching, the result is a learning experience that reaches far beyond the University to vastly expand students' educational horizons.

Although Stanford has experienced considerable success thanks to CUE and the generosity of donors, significant fundraising challenges remain. For instance, Stanford's peer institutions are able to funnel more endowment income into defraying operating expenses. Stanford's endowment ranked among the largest in private universities at $8.6 billion at the close of the fiscal year, and endowment income covered 17 percent of fiscal year expenses. In comparison, peer institutions cover up to 32 percent of operating budget using endowment income. Furthermore, although Stanford's endowment is one of the largest in the country in absolute terms, on a per-student basis, the University did not rank among the top 10 in 2001-02. Stanford has always achieved more with fewer resources because it is deliberate in making choices and efficient in execution.

Davie Yoon, Class of 2004 and a cognitive neuroscience major, benefits from CUE as an Honors College participant and a recipient of an Undergraduate Research Opportunities grant. She plans to pursue an academic career.

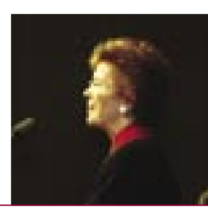
Walker Hanlon, Class of 2004 and an economics major, benefits from CUE as a Stanford in Government Fellow studying at the World Bank Thailand.

In addition, Stanford has long prided itself on maintaining a need-blind admission policy. However, peer institutions fund up to 70 or 80 percent of undergraduate aid from endowed or restricted funds. Stanford, with a smaller endowment for financial aid, gets about 55 percent of its undergraduate aid

THE BOARD OF TRUSTEES SETS RATES FOR TUITION, ROOM, AND BOARD FOR THE 2003-04 ACADEMIC YEAR THAT REPRESENT A 4.8 PERCENT INCREASE.

THE STANFORD LINEAR ACCELERATOR CENTER, LEADING AN INTERNATIONAL RELAY TEAM, SETS A DATA-TRANSFER RECORD BY INTERNET2—6.7 GIGABYTES ACROSS 7,000 MILES IN LESS THAN A MINUTE.

ENGINEERING PROFESSOR EMERITUS BRADFORD PARKINSON SHARES THE NATIONAL ACADEMY OF ENGINEERING'S 2003 CHARLES STARK DRAPER PRIZE FOR PIONEERING WORK IN GLOBAL POSITIONING SYSTEM TECHNOLOGY.



FORMER IRISH PRESIDENT MARY ROBINSON ARGUES FOR GLOBAL HUMAN RIGHTS DURING THE ANNUAL TANNER LECTURES.

STANFORD PARTNERS WITH MIT AND OTHER INSTITUTIONS OF SCIENCE AND TECHNOLOGY TO SUBMIT AN AMICUS BRIEF ARGUING THE IMPORTANCE OF DIVERSITY IN THE U.S. SUPREME COURT CASES ON UNIVERSITY OF MICHIGAN AFFIRMATIVE ACTION POLICIES.

COMPUTER SCIENTIST HECTOR GARCIA-MOLINA IS ELECTED TO THE NATIONAL ACADEMY OF ENGINEERING.

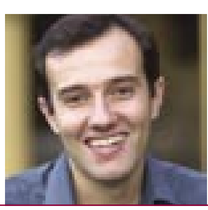
from endowed or restricted funds. As a result, the University must identify more than $20 million in new funds every year for financial aid. Realizing the importance of a larger endowment for that purpose, Stanford prioritized its goal to raise $300 million for financial aid as part of CUE. Even this amount, however, will likely leave a relatively smaller endowment for financial aid than most of Stanford's close peers.

Stanford remains confident in facing this and other challenges, primarily because of the loyalty and generosity of alumni and friends. Specifically:

- Gifts were up nearly 7 percent during fiscal year 2003 over the previous year, and included an all-time high for The Stanford Fund.
- The $486 million in donations during 2003 was the second-best result in the University's history and second among universities nationwide.

Starting in the coming year, Stanford will build on the success of CUE's 2001-02 "Think Again" national tour. A new "Stanford Day" has been inaugurated to bring students and faculty to some 28 venues, ranging from Honolulu to London, over the next four years. Stanford faculty will present intensive versions of their undergraduate courses. Several events will feature student presentations about seminars and research projects. Faculty will also introduce some of the groundbreaking research at the heart of the University's multidisciplinary initiatives.

THE CAMPAIGN FOR UNDERGRADUATE EDUCATION AT STANFORD



03/03

THE ALFRED P. SLOAN FOUNDATION CHOOSES SIX SCIENTISTS TO RECEIVE SLOAN RESEARCH FELLOWSHIPS FOR 2003: THOMAS CLANDININ, RONALD FEDKIW, IAN FISHER, DAVID GOLDHABER-GORDON, DMITRI PETROV (ABOVE), AND VLADAN VULETIC.

STANFORD DAILY EDITOR VAUHINI VARA IS THE FIRST DANIEL PEARL INTERN, HONORING THE SLAIN *WALL STREET JOURNAL* REPORTER AND STANFORD ALUMNUS.

NASA APPOINTS PHYSICIST DOUG OSHEROFF TO THE TEAM INVESTIGATING THE LOSS OF THE SPACE SHUTTLE COLUMBIA.

$9 MILLION BOLSTERS ISLAMIC STUDIES

A new program and professorship in Islamic Studies have been established to help increase knowledge of Islam and the Muslim world.

"Despite its growing importance in the world, Islam is poorly and inadequately understood in our country," President John Hennessy said in announcing the initiative. "To serve our educational mission in the 21st century, we must expand our program in Islamic Studies."

Sohaib Abbasi, a former Oracle Corp. executive and native of Pakistan, and his wife, Sara, have endowed the program in the School of Humanities and Sciences with a $2.5 million gift matched by the William and Flora Hewlett Foundation. The $5 million core endowment will be used to support public lectures, library acquisitions, visiting scholars, language instruction, and faculty and student research.

In addition, a new professorship, the Lysbeth Warren Anderson Professorship in Islamic Studies, has been created in the Department of Religious Studies. Endowed with a $2 million gift from alumna Lysbeth Warren and matched with funds from the Hewlett Foundation, the position will be filled with a distinguished scholar whose teaching and research are centered in Islamic religion, but relate to other areas of culture and society, forging interdisciplinary links to scholars throughout the University.

At top: Sohaib and Sara Abbasi; above: Lysbeth Warren

Stanford's program will have a global focus, says Sharon Long, dean of the School of Humanities and Sciences. The new program will provide students with a wide geopolitical lens and a multidisciplinary perspective that may include literature, religion, history, politics, economics, law, sociology, and anthropology.

Robert Gregg, professor of religious studies, is the program's inaugural director.

MULTIDISCIPLINARY APPROACHES KEY TO FUTURE INNOVATION

STANFORD LEADS THE WAY WITH ACADEMIC DEPTH AND BREADTH

A WILLINGNESS TO INNOVATE AND LEAD IN NEW ACADEMIC DIRECTIONS HAS BEEN FUNDAMENTAL TO STANFORD´S SUCCESS IN CREATING MULTIDISCIPLINARY APPROACHES TO SOME OF THE WORLD´S MOST PRESSING PROBLEMS.

Stanford's first president, David Starr Jordan, expressed the view that universities must be more than "a collection of colleges." He said, in 1902, "A true university is not … a college with an outer fringe of professional schools. It is not a cluster of professional schools. It is the association of scholars. It is the institution from which in every direction blazes the light of original research."

Jordan's comments seem prescient today. Yet, he could not have imagined that multidisciplinary research and education would become one of the most discussed trends in research universities. Stanford is recognized as a leader in those discussions. Among Stanford's strengths in fostering multidisciplinary approaches are the breadth and depth of departments, the central location of research centers and schools, and a willingness to minimize boundaries among disciplines.

President John Hennessy has made fostering multidisciplinary research and scholarship one of his top priorities. He has said that universities like Stanford make their most important contributions through new discoveries and discontinuous innovations—meaning fundamental breakthroughs in how a particular problem or challenge is approached. The preeminence of research universities in the future, he has said, will rest on their ability to create, sustain, and succeed in multidisciplinary initiatives that lead to such discoveries.

The James H. Clark Center

Stanford is tackling some of the world's most complex problems through collaboration among disciplines. For instance, molecular research often requires collaboration with physicists and chemists. Comparative international studies require legal, political, and economic analysis. Translational biomedical research depends on cooperation among engineers and medical clinicians. Environmental issues recognize no disciplinary boundaries. Among Stanford's multidisciplinary initiatives are:

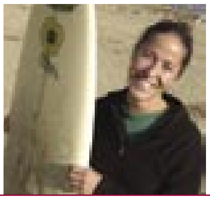
THE STANFORD PROGRAM FOR BIOENGINEERING, BIOMEDICINE, AND BIOSCIENCES (BIO-X). Bio-X brings together researchers from engineering, the physical and life sciences, and the clinical sciences. Bio-X represents Stanford's belief that the life sciences will play a major role in transforming society in the 21st century. Bio-X research themes include biophysics, chemical biology, biocomputation, regenerative medicine, genomics

HUNDREDS OF STUDENTS GATHER FOR A TEACH-IN ON THE MAIN QUAD ABOUT THE WAR IN IRAQ.

SCHOLARS GATHER FOR THE 10TH HUMANITIES CENTER BOOK CELEBRATION TO NOTE 53 NEW BOOKS, EIGHT MUSIC CDS, AND ONE MULTIMEDIA CD-ROM.

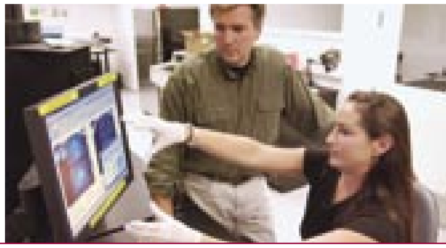
THE LUCILE PACKARD CHILDREN'S HOSPITAL AND SILICON VALLEY CHILDREN'S HOSPITAL FOUNDATION ANNOUNCE A PARTNERSHIP WITH SANTA CLARA VALLEY MEDICAL CENTER TO STUDY BUILDING A COMMUNITY CHILDREN'S HOSPITAL IN SAN JOSE.

ELECTRICAL ENGINEER ROBERT GRAY WINS THE PRESIDENTIAL AWARD FOR EXCELLENCE IN SCIENCE, MATHEMATICS, AND ENGINEERING MENTORING FOR "A SUCCESSFUL MODEL FOR ATTRACTING AND ACCOMMODATING WOMEN TO ENGINEERING."

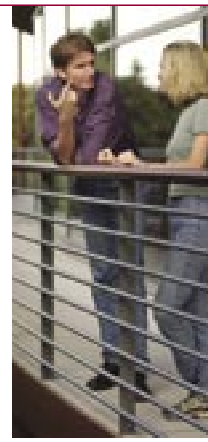


SARAH BILLINGTON AND ALEXANDRIA BOEHM (ABOVE) ARE NAMED CLARE BOOTHE LUCE ASSISTANT PROFESSORS IN THE DEPARTMENT OF CIVIL AND ENVIRONMENTAL ENGINEERING, SHARING A GRANT FROM THE CLARE BOOTHE LUCE PROGRAM OF THE HENRY LUCE FOUNDATION.

MEMORIAL CHURCH CELEBRATES ITS CENTENNIAL DURING THE SECOND COMMUNITY DAY WITH A SPECIAL CEREMONY.




The University's approach to multidisciplinary education and research is illustrated in the new James H. Clark Center. Among the researchers working there are, at top, from left to right, Chris Contag, assistant professor-research in pediatrics-neonatology, and postdoctoral student Caitlin O'Connell-Rodwell; Judith Frydman, assistant professor of biological sciences; at bottom, left to right, Alfred Spormann, associate professor of civil and environmental engineering, and graduate student Renee Saville; and Oussama Khatib, professor of computer science.




and proteomics, brain and behavior, imaging, and biodesign. Bio-X's Interdisciplinary Initiatives Program already has provided seed money to 40 projects, some of which have attracted further funding from, for instance, the National Institutes of Health.

THE DEPARTMENT OF BIOENGINEERING. The department, an outgrowth of the Bio-X initiative, is the first at Stanford to be established jointly in two schools—engineering and medicine. The department will focus on translating discoveries in the biosciences into clinical advances in human health.

THE CENTER FOR DEMOCRACY, DEVELOPMENT, AND RULE OF LAW. The Stanford Institute for International Studies, in partnership with the Law School and the Graduate School of Business, established this center to address the challenges of countries in transition. Scholars will improve understanding of the critical interaction of political, legal, and economic development throughout the world.

THE GLOBAL CLIMATE AND ENERGY PROJECT (GCEP). GCEP is exploring economically viable methods for the environmentally benign generation of energy—one of the most challenging problems facing both the developed and developing worlds. An international group of companies, representing a range of energy producers and users, anticipates investing up to $225 million in this research over the next 10 years.

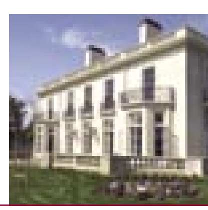
THE KAVLI INSTITUTE FOR PARTICLE ASTROPHYSICS AND COSMOLOGY. The institute bridges theoretical and experimental physics and focuses their combined strengths on the most challenging problems in particle astrophysics and cosmology. The institute brings together Stanford and Stanford Linear Accelerator Center scientists in cosmology, physics, and particle astrophysics to explore questions about the origin and evolution of the universe.

INITIATIVE FOR THE ENVIRONMENT. This new center will serve as an umbrella organization for environmental research and education. Its mission is to promote an environmentally sound and sustainable world by identifying and solving environmental challenges through the integration of science, technology, and policy making.

04/03

UNDERGRADUATE ADMISSION ACCEPTS 2,250 STUDENTS FOR THE CLASS OF 2007—AN ADMISSION RATE OF ONLY 12.6 PERCENT.

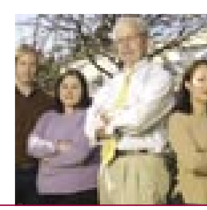
THE FRANCE-STANFORD CENTER FOR INTERDISCIPLINARY STUDIES RECEIVES A $1 MILLION ENDOWMENT FROM THE FRENCH MINISTRY OF FOREIGN AFFAIRS TO ESTABLISH A PROGRAM THAT ENCOURAGES ACADEMIC COOPERATION BETWEEN THE TWO COUNTRIES.



THE HISTORIC MEYER-BUCK HOUSE, LOCATED BETWEEN SAND HILL AND ALPINE ROADS, REOPENS AFTER A TWO-YEAR RENOVATION.

JOHN MCCARTHY, PROFESSOR EMERITUS OF COMPUTER SCIENCE AND A PIONEER IN ARTIFICIAL INTELLIGENCE, RECEIVES THE PRESTIGIOUS BENJAMIN FRANKLIN MEDAL IN COMPUTER AND COGNITIVE SCIENCE.

FORMER U.S. SURGEON GENERAL JOYCELYN ELDERS SPEAKS TO A FULL HOUSE AT KRESGE AUDITORIUM AS PART OF CONTINUING STUDIES' AURORA FORUM, WHICH BRINGS WRITERS, ARTISTS, SCHOLARS, AND INTELLECTUALS TO THE UNIVERSITY TO DISCUSS THE NATION'S IDEALS AND ASPIRATIONS.



THE STANFORD COMMUNITY LAW CLINIC OPENS AT A NEW LOCATION IN EAST PALO ALTO TO PROVIDE FREE LEGAL ADVICE TO PEOPLE IN EAST PALO ALTO, EAST MENLO PARK, REDWOOD CITY, AND SURROUNDING COMMUNITIES.

CLARK CENTER A MODEL FOR FOSTERING MULTIDISCIPLINARY WORK

The new James H. Clark Center is an innovative facility considered a model for fostering multidisciplinary research and education. The Clark Center provides a focal point for the Bio-X program, which aims to bridge the biological, medical, engineering, and physical disciplines.

The $138-million, 146,000-square-foot center, designed by the architectural firm led by Lord Norman Foster, is named for James Clark, the entrepreneur and former Stanford professor who founded Silicon Graphics, Netscape, Healtheon, and myCFO.

Bio-X is designed to spur discoveries in the life sciences by breaking down conventional walls among disciplines. Researchers in the Clark Center, who represent such areas as chemical biology, biocomputation, regenerative medicine, instrumentation, and genomics, required a unique building to support their work. What they got was three bridge-linked, glass-encased buildings—known as the East, West, and South wings—with curved facades that create a welcoming inner courtyard and contain remarkably flexible laboratories.

The Clark Center essentially reinvents lab space to accommodate within the same area the needs of different disciplines. For example, "wet" labs for chemistry require fume hoods, chemical storage cabinets, and safety stations, whereas "dry" labs for computer science need wiring for network connectivity. To that end, the services—gas, water, electricity, networking—come into rooms through the ceiling for quick and easy connections. Everything is on wheels. Researchers can simply roll lab benches to the desired spot, plug in, and start working. Even faculty offices—frosted-glass cubes—are movable. Mobility, coupled with open space, blurs the boundaries between labs.

"People in the building are affected greatly by what the building tells them about communication," says Matt Scott, Bio-X Leadership Council chair. "This is a building that draws them in. People walk into the courtyard and are immediately embraced by the building. The result of that is a sense of community center, a sense of belonging, a sense that people doing very different kinds of things are all welcome here."

Despite its innovative nature, the center is also designed to blend with Stanford's more traditional sandstone and tile buildings. The center's limestone face matches the hues of nearby contemporary buildings, while its trim matches the roof tiles of the Quad. The center of the courtyard features a circular stage for events. Beneath the stage—underground—is a round auditorium.

"The building is what I like to call a hinge," says David Neuman, outgoing University architect and associate vice provost for planning. "It hinges between the core academic traditional Stanford campus and the Medical Center, both in terms of its planning relationships as well as its architectural relationships."

More than 260 Stanford faculty in 60 departments are affiliated with Bio-X. Others have access to "hotel" spaces, where stays of six months to a year allow new project teams to form and new collaborations to begin.

Above, Bio-X Chair Matt Scott addressed hundreds of attendees during the October dedication of the James H. Clark Center.

ENHANCING DIVERSITY TO IMPROVE EDUCATION

INSTITUTIONS LIKE STANFORD SHOULD REFLECT SOCIETY

STANFORD IS COMMITTED TO ENHANCING THE DIVERSITY OF ITS FACULTY, STAFF, GRADUATE STUDENTS, AND UNDERGRADUATE STUDENT BODY. THIS COMMITMENT WAS FIRST ARTICULATED BY FOUNDER JANE STANFORD, WHO SAID IN 1902 THAT THE UNIVERSITY MUST "RESIST THE TENDENCY TO THE STRATIFICATION OF SOCIETY, BY KEEPING OPEN AN AVENUE WHEREBY THE DESERVING AND EXCEPTIONAL MAY RISE THROUGH THEIR OWN EFFORTS FROM THE LOWEST TO THE HIGHEST STATION IN LIFE. A SPIRIT OF EQUALITY MUST ACCORDINGLY BE MAINTAINED WITHIN THE UNIVERSITY."

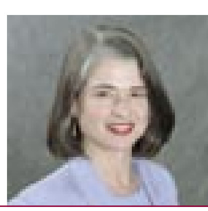
Provost John Etchemendy

In the late 1800s and early 1900s, when racially based exclusion was the norm in higher education, Stanford appears to have enrolled an African American student, as well as Japanese, Native American, Chinese, Chinese American, Filipino, and Korean students. Women have always been admitted to Stanford, although for a period of time in the University's early years, their numbers were limited. The University's history reflects turbulent times in the nation's efforts to come to terms with gender, racial, and ethnic struggles. For instance, in the 1960s, black students demonstrated for better recruitment of people of color; in the 1970s, a mascot considered racially insensitive was eliminated; and, in the 1980s and 1990s, ethnic studies disciplines were established.

Today, Stanford continues its efforts to reflect the diversity of California, the nation, and the world in order to better educate its students. Says Provost John Etchemendy, "It's imperative that an institution like Stanford reflect the multiracial, multiethnic society and pluralistic democracy that serves as a foundation to the university. Otherwise, we could not call ourselves a world-class university. It's Stanford's responsibility to educate the future leaders of our diverse society."

Among the groups working under Etchemendy's auspices is the Diversity Action Council, which includes members from across campus examining diversity efforts and making recommendations for improvement. The council, chaired by Haas Professor Al Camarillo, consists of four committees: postdoctoral and graduate student diversity, faculty diversity, undergraduate diversity, and staff diversity.

Also working under the auspices of the provost's office is the Provost's Advisory Committee on the Status of Women Faculty, chaired by law professor Deborah Rhode, which continues its studies in three areas: recruitment and retention practices; quality of life; and compensation and resources, including



05/03

MARTHA MARSH, CEO OF STANFORD HOSPITAL AND CLINICS, IS APPOINTED BY PRESIDENT BUSH TO SERVE ON THE NATIONAL INFRASTRUCTURE ADVISORY COUNCIL.

PSYCHOLOGY PROFESSOR LAURA CARSTENSEN IS NAMED A 2003 GUGGENHEIM FELLOW.

THE NATIONAL ACADEMY OF SCIENCES ELECTS SEVEN FACULTY MEMBERS: YAKOV ELIASHBERG, RICHARD KLEIN, WILLIAM NIX, HELEN QUINN, CLAUDE STEELE (ABOVE), BRIAN WANDELL, AND PAUL WENDER.

THE GRADUATE SCHOOL OF BUSINESS INAUGURATES THE *STANFORD SOCIAL INNOVATION REVIEW*, DEDICATED TO COVERING THE BEST IDEAS FOR NONPROFIT MANAGEMENT, PHILANTHROPY, AND CORPORATE CITIZENSHIP.

SOLOMON FEFERMAN, WHO HOLDS APPOINTMENTS IN PHILOSOPHY AND MATHEMATICS, IS AWARDED SWEDEN'S ROLF SCHOCK PRIZE IN LOGIC AND PHILOSOPHY FOR IMPORTANT CONTRIBUTIONS TO LOGIC.

THE AMERICAN ACADEMY OF ARTS AND SCIENCES ELECTS SEVEN FACULTY MEMBERS: THOMAS COVER (ABOVE), GRETCHEN DAILY, THOMAS GREY, IAIN JOHNSTONE, KENNETH JUDD, ELLEN MARKMAN, AND DOUGLAS MCADAM.

laboratory space, equipment, startup funds, research funds, and summer salaries. In an initial discussion before the Faculty Senate this year, committee members stressed the importance of casting the net widely in faculty searches so that applicant pools are both talented and diverse. The committee has undertaken the first-ever, campus-wide quality of life survey among faculty members.

Clockwise from top: Robin Mamlet, Charles Ogletree, Deborah Rhode

The University is committed to improving diversity among graduate students, in part because they represent the source of future faculty members. Among the factors affecting Stanford's ability to recruit a more diverse faculty is the low level of representation of women and minorities in the applicant pools for many fields. A "pipeline" study is being conducted among Stanford undergraduate and graduate students to identify factors that affect the decision whether to pursue careers as faculty members. To address the issue of increasing diversity in the Stanford graduate student population, Stanford faculty and staff enhanced the Graduate Diversity Admit Weekend. This year, more admitted candidates attended than previously, and the percentage of those attending the event who enrolled rose.

In the area of undergraduate student diversity, Stanford is considered a model among private universities. In February, Stanford joined MIT, IBM, DuPont, the National Academy of Sciences, the National Academy of Engineering, and the National Action Council for Minorities in Engineering in filing an amicus brief before the U.S. Supreme Court in *Grutter v. Bollinger* and *Gratz v. Bollinger*. The brief supported the principle of considering ethnicity in the admissions process as one factor in diversity broadly defined. The cases involved affirmative action policies at the University of Michigan.

In reaffirming Stanford's commitment to affirmative action in light of these court cases, President John Hennessy said, "Stanford has long recognized the importance of a diverse student body in creating the best learning environment for all our students. Although academic performance will always be the primary factor in our admissions process, the consideration of race and ethnicity as one factor among many helps achieve a diverse student body and fulfills our responsibility to prepare a generation of leaders that reflects the strengths and talents of all our nation's citizens."

06/03

MATHEMATICIAN LEON SIMON IS AMONG 42 NEW FELLOWS ELECTED TO THE ROYAL SOCIETY (UK).

PARKING AND TRANSPORTATION WINS A "CLEAN AIR HERO" AWARD FOR ITS ALTERNATIVE TRANSPORTATION PROGRAM FROM THE AMERICAN LUNG ASSOCIATION OF THE BAY AREA.

STANFORD ALUMNUS AND PERUVIAN PRESIDENT ALEJANDRO TOLEDO URGES GRADUATES AT THE 112TH COMMENCEMENT TO JOIN A WORLDWIDE FIGHT AGAINST POVERTY.

PRESIDENT HENNESSY ESTABLISHES A UNIVERSITYWIDE PANEL ON LABOR POLICIES TO ADDRESS CONCERNS RAISED BY STUDENTS.

THE SCHOOL OF MEDICINE COMMENCEMENT FEATURES JULIE GERBERDING, DIRECTOR OF THE CENTERS FOR DISEASE CONTROL AND PREVENTION.

ARTHUR BIENENSTOCK, PROFESSOR OF MATERIALS SCIENCE AND ENGINEERING AND OF APPLIED PHYSICS, IS APPOINTED DEAN OF RESEARCH AND GRADUATE POLICY.

The court eventually ruled in the Michigan law school case that race may be considered as a factor in admission as part of a narrowly tailored program designed to foster educational diversity. However, in a second ruling, the justices held that Michigan's undergraduate program failed the court's narrow tailoring requirement because it automatically awarded points to African American, Latino, and Native American students. Rather, the court said, race may be considered in furthering diversity in the context of an "individualized, holistic review of each applicant's file"—a process akin to Stanford's admission programs.

Robin Mamlet, dean of admission and financial aid, said the decisions reaffirm the way Stanford selects its student class because race is just one of "a whole host" of factors considered in reviewing applications. "Many aspects of diversity are considered, not just race," she said. "The primary criterion is who has the capacity and potential to contribute to Stanford and the world beyond our gates."

Also focused on issues of diversity at Stanford is the Task Force on Minority Alumni Relations, formed by the Board of Trustees and chaired by alumnus Charles Ogletree, a faculty member at Harvard University. That group has examined the attitudes and experiences of minority alumni across the country.

EXPANDED PROGRAMS FOCUS ON DIVERSITY

To support new and innovative approaches to increasing faculty and graduate student diversity, Stanford has obtained a three-year, $1.5 million grant from the James W. Irvine Foundation as part of the foundation's Campus Diversity Initiatives.

To assist schools and departments in their efforts to bring greater diversity to their faculties, Sally Dickson, former Stanford director of campus relations and vice president for institutional equity at Duke, was appointed associate vice provost for faculty development and associate dean of the School of Humanities and Sciences. She is establishing a faculty recruitment office to provide guidance and information both to faculty recruits and to the deans, department chairs, and faculty committees carrying out searches.

The Irvine Foundation grant also supports activities to enhance graduate diversity by coordinating programs across schools and departments that focus on the recruitment and retention of graduate students who bring such diversity. These efforts are led by Stanford alumna Claudia Schweikert, assistant dean for graduate diversity. The School of Humanities and Sciences appointed two new assistant deans for multicultural graduate student services and recruitment. Stephanie Fryberg and Joseph Brown both hold doctorates from Stanford.

At top: Sally Dickson. Above: Claudia Schweikert; below: Joseph Brown and Stephanie Fryberg

ECONOMIST MARK MCCLELLAN, HEAD OF THE FOOD AND DRUG ADMINISTRATION, RETURNS TO STANFORD TO DISCUSS HEALTH CARE COSTS WITH COLLEAGUES AT THE STANFORD INSTITUTE FOR ECONOMIC POLICY RESEARCH.

PHILANTHROPIC LEADERS FROM THROUGHOUT THE WORLD ATTEND THE GLOBAL PHILANTHROPY FORUM OF THE WORLD AFFAIRS COUNCIL AT THE ARRILLAGA ALUMNI CENTER.

STANFORD BLOOD CENTER IS THE FIRST IN THE BAY AREA TO OFFER ON-SITE SCREENING FOR THE WEST NILE VIRUS.

STANFORD UNIVERSITY RESEARCH HIGHLIGHTS

STANFORD SCHOLARS AND RESEARCHERS CONTINUED THEIR CONTRIBUTIONS TO THE CREATION OF NEW KNOWLEDGE DURING 2003.

In the BIOLOGICAL SCIENCES, geneticist **Marc Feldman** and colleagues at the Russian Academy of Sciences wrote in the *American Journal of Human Genetics* that human beings may have made their first journey out of Africa as recently as 70,000 years ago. Feldman also wrote in *Science* that populations from different parts of the world share more genetic similarities than was previously assumed.

At the GRADUATE SCHOOL OF BUSINESS, a National Science Foundation study by economist **Peter Henry** suggested that highly indebted countries should be targeted not for debt relief but for aid to assist governments in building social infrastructures that would make them more attractive for investment.

Seenu Srinivasan studied the dollar value the market puts on an improvement to a product and received the John Little Award from the Marketing Science Society for the best article published in *Marketing Science* or *Management Science*.

Defense against an airborne anthrax attack requires more aggressive action by the U.S. government than planned, according to a National Academy of Sciences study by **Lawrence Wein**, professor of operations, information, and technology.

In EARTH AND ENVIRONMENTAL SCIENCES, geophysicists **Kevin Arrigo** and **Gert L. van Dijken**, supported by NASA, monitored penguins and marine life endangered by an iceberg in Antarctica's Ross Sea.

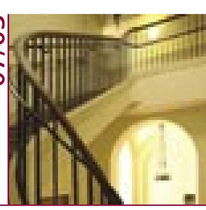
Steven Block

Global warming is affecting hundreds of plant and animal species, although dramatic effects may not be felt for decades, according to a study in *Nature* by Senior Fellow **Terry Root** of the Stanford Institute for International Studies and her colleagues.

Ecologist **Gretchen Daily** coauthored a study in *Nature* concluding that the size of the average household is shrinking—a worldwide trend that is fueling an international housing boom.

Stephen Palumbi of the Hopkins Marine Station wrote a report for the Pew Oceans Commission calling for a network of fully protected reserves where fishing and oil exploration are prohibited in all major marine habitats. Palumbi also coauthored a *Science* study showing scientists have vastly underestimated the number of humpbacks and other great whales that inhabited the North Atlantic Ocean before whaling.

07/03



STANFORD ATHLETICS WINS A NINTH CONSECUTIVE DIRECTORS' CUP, PRESENTED ANNUALLY TO THE BEST OVERALL COLLEGIATE ATHLETICS PROGRAM IN THE COUNTRY.

EXECUTIVES FROM THE NATIONAL FOOTBALL LEAGUE, THE NFL PLAYERS ASSOCIATION, AND PLAYERS THEMSELVES ATTEND THE NEW PROGRAM FOR NFL MANAGERS AT THE GRADUATE SCHOOL OF BUSINESS.

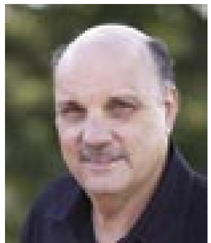
HISTORIC BRANNER HALL REOPENS AFTER A $20 MILLION RENOVATION.

AS PART OF ITS TEACHERS FOR A NEW ERA INITIATIVE, THE CARNEGIE CORPORATION OF NEW YORK AWARDS $5 MILLION TO STANFORD FOR THE SCHOOL OF EDUCATION'S TEACHER EDUCATION PROGRAM.

STANFORD PREPARES TO RETIRE ITS MAINFRAMES, THE DIGITAL WORKHORSES FOR DECADES, IN FAVOR OF DISTRIBUTED COMPUTER SYSTEMS.

WARD WATT, PROFESSOR OF BIOLOGICAL SCIENCES, IS ELECTED PRESIDENT OF THE CALIFORNIA ACADEMY OF SCIENCES.






Top: Marc Feldman, Mark Jacobson, Michael Kirst; bottom: Stephen Palumbi, Lawrence Wein, Gretchen Daily

In EDUCATION, **Michael Kirst** and his colleagues at the School of Education's Bridge Project found that more U.S. high school students plan to go to college than ever before, but many are being set up to fail because high school graduation requirements do not meet higher education standards.

A study by education scholars at Stanford and the University of California Policy Analysis for California Education (PACE) showed that charter schools rely on uncredentialed teachers, fail to acquire federal money intended to aid low-achieving or disabled children, and display the same financial disparities that beset public schools.

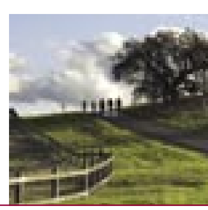
In a study published in *Educational Evaluation and Policy Analysis*, **Martin Carnoy** and **Susanna Loeb** found that state-imposed, high-stakes tests improve mathematics performance for minority students.

In SCIENCE AND ENGINEERING, Stanford researchers reported at the 12th Annual World Wide Web Conference that they developed techniques that may make it possible to calculate web page rankings as used in the Google search engine up to five times faster.

A laser microscope designed by physicist **Steven Block** and his colleagues provided clues to "motor molecules" that facilitate movement in living cells, as reported in the *Proceedings of the National Academy of Sciences.*

Computer scientist **Dan Boneh** and his Security Lab team built a secure file mechanism designed for remote storage systems that can be used with existing file systems without having to upgrade storage infrastructure.

Civil and environmental engineering faculty member **Mark Jacobson** and his students reported in *Geophysical Research (Atmospheres)* that 24 percent of U.S. wind monitoring sites experience winds fast enough to generate power as cheaply as coal or natural gas plants.



09/03


JONATHAN SAFRAN WINS THE FIRST BIENNIAL WILLIAM SAROYAN INTERNATIONAL PRIZE FOR WRITING FROM THE UNIVERSITY LIBRARIES AND THE WILLIAM SAROYAN FOUNDATION.

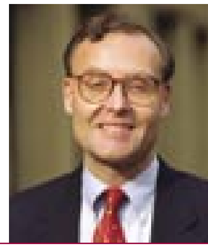
THE AMERICAN COLLEGE OF SURGEONS GIVES THE HOSPITAL'S TRAUMA PROGRAM A PERFECT RATING.

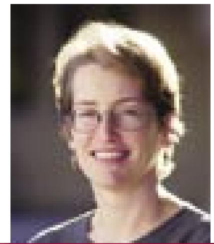
A COMMITTEE CHARGED WITH RECOMMENDING ACCESS POLICIES FOR THE DISH AREA REPORTS THAT MORE THAN AN ESTIMATED 300,000 VISITORS WILL RUN OR WALK ON THE TRAILS THIS YEAR.

PHYSICIST EDWARD TELLER OF THE HOOVER INSTITUTION, DEVELOPER OF THE HYDROGEN BOMB AND A PRESIDENTIAL MEDAL OF FREEDOM WINNER, DIES.

THE NATIONAL SCIENCE FOUNDATION GIVES RESEARCHERS, INCLUDING ELECTRICAL ENGINEER AND COMPUTER SCIENTIST NICK MCKEOWN, $7.5 MILLION OVER FIVE YEARS TO STUDY THE INTERNET'S INFRASTRUCTURE.

RESEARCHERS AT THE SCHOOL OF MEDICINE AND PACKARD CHILDREN'S HOSPITAL RECEIVE A $15 MILLION GRANT FROM THE NATIONAL INSTITUTE OF ALLERGY AND INFECTIOUS DISEASES TO STUDY THE FLU VIRUS AND METHODS OF GUARDING AGAINST ITS USE AS A BIOTERRORIST AGENT.





Chemist **Eric Kool** coauthored a *Science* study that reported the creation of an expanded molecule of DNA with a double helix wider than any found in nature.

Computer scientist **Daphne Koller** and her colleagues wrote in *Nature Genetics* that they developed a computational method that zeros in on the genes responsible for controlling the genetic machinery of a cell.

Martin Reinhard and **Alfred Spormann** of the civil and environmental engineering faculty developed membrane bioreactors that can remove inorganic contaminants in water and convert sewage organics into useful fuels.

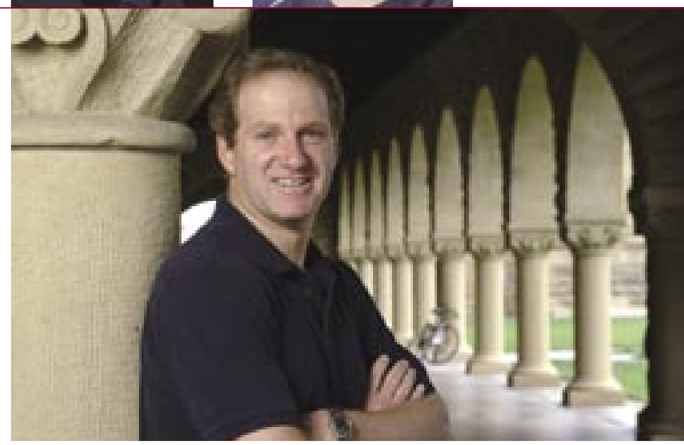
Physicist **Shoucheng Zhang** and colleagues at the University of Tokyo reported in *Science Express* that they diminished energy loss in computer chips by manipulating a neglected property of the electron—its "spin."

In the HUMANITIES AND SOCIAL SCIENCES, psychologist **John Gabrieli** wrote in *Proceedings of the National Academy of Sciences* that the brains of dyslexic children can be rewired through remediation to function more like those found in normal readers.

Communication professor **Theodore Glasser** oversaw "Grade the News," the first grading system for local news, funded by the Ford Foundation and the John S. and James L. Knight Foundation.

Political scientist **Judith Goldstein** is working with University librarians to digitize the massive archives of the General Agreement on Tariffs and Trade, predecessor to the World Trade Organization.

Historian **Katherine Jolluck** focused on the tragic story of Polish women and children deported to the Soviet Union after the Red Army annexed eastern Poland during World War II in *Exile and Identity.*



Top: John Gabrieli, Katherine Jolluck, Jennifer Trimble; bottom: Michael Klausner

Jennifer Trimble of the classics faculty was among archaeologists who unearthed evidence that the emperor Caligula was as much of a megalomaniac as lore suggests.

Barbara Voss, a cultural and social anthropologist, led an excavation of San Francisco's Presidio seeking clues to the Spanish colonial settlement at the fort.

At the LAW SCHOOL, **John Donohue** debunked previous research linking falling crime rates in certain areas to the enactment of laws allowing citizens to carry concealed weapons, suggesting that there is no statistical basis for thinking that right-to-carry laws reduce crime.

George Fisher traced the evolution of plea bargaining to its present pervasive role in *Plea Bargaining's Triumph: A History of Plea Bargaining in America.*

10/03

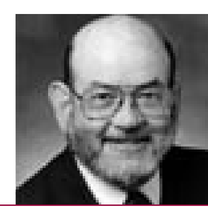
JAMES CLARK ATTENDS THE DEDICATION OF THE NEW MULTIDISCIPLINARY RESEARCH CENTER NAMED IN HIS HONOR.

ALUMNA SALLY RIDE AND THE HEWLETT-PACKARD CO. BRING THE SALLY RIDE SCIENCE FESTIVAL TO STANFORD TO NURTURE ASPIRATIONS IN SCIENCE, MATH, AND TECHNOLOGY AMONG MIDDLE-SCHOOL GIRLS.

THE UNIVERSITY DEDICATES THE HEWLETT AND PACKARD SCIENCE AND ENGINEERING QUADRANGLE IN MEMORY OF ALUMNI WILLIAM HEWLETT AND DAVID PACKARD.

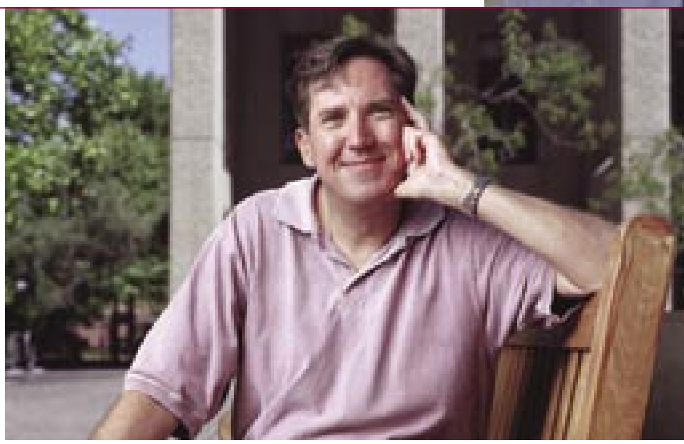
NEARLY 8,000 ALUMNI AND FAMILY MEMBERS—A NEW RECORD—RETURN FOR REUNION HOMECOMING WEEKEND.

THE BASS FELLOWS IN UNDERGRADUATE EDUCATION PROGRAM RECOGNIZES EIGHT PROFESSORS: ELIZABETH BERNHARDT, ROBERT DUNBAR, RUSS FERNALD, ANDREA LUNSFORD (ABOVE), JAMES SHEEHAN, ROBERT SIMONI, JONATHAN STEBBINS, AND TOM WASOW.



PRESIDENT BUSH NAMES JOHN BRAUMAN, THE J.G. JACKSON AND C.J. WOOD PROFESSOR OF CHEMISTRY, AS ONE OF EIGHT NATIONAL MEDAL OF SCIENCE WINNERS.



Top: George Fisher, Judith Goldstein, Barbara Voss; above: Barton Thompson, Jr.

In the inaugural issue of *Stanford Social Innovation Review,* **Michael Klausner** discussed the rate of foundation payouts and the time value of money, arguing that forcing foundations to distribute more cash grants each year may disadvantage future generations.

Lawrence Lessig partnered with U.S. Congresswoman Zoe Lofgren to reduce e-mail spam through proposed legislation, "Restrict and Eliminate Delivery of Unsolicited Commercial E-mail Spam Act."

Margaret Jane Radin, director of the Stanford Program in Law, Science & Technology and the Center for E-Commerce, published a casebook on the new area of e-commerce law, *Internet Commerce: The Emerging Legal Framework.*

The results of a Pew Charitable Trusts study by **Barton Thompson, Jr.**, and **Josh Eagle** of the Stanford Fisheries Policy Project argued for restructuring of U.S. fisheries.

In MEDICINE, Lucile Packard Children's Hospital neonatologist **Jeffrey Gould** debunked a long-standing belief that weekend births are more dangerous in a study published in the *Journal of the American Medical Association.*

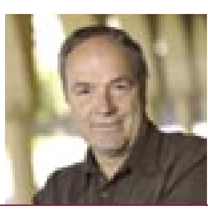
Mark Kay, professor of genetics and pediatrics, and his colleagues reported in *Nature Biotechnology* that they used a new gene therapy to inhibit hepatitis B virus replication in mice.

Researchers led by **Seung Kim**, assistant professor of developmental biology and of medicine, coaxed mouse embryonic stem cells into producing insulin and used the cells to treat an induced form of diabetes in mice, according to a study in the *Proceedings of the National Academy of Sciences.*

Researchers led by **Thomas Quertermous**, chief of cardiovascular medicine, reported in the *Journal of Clinical Investigation* that a recently discovered gene regulates "good" cholesterol, which could lead to new therapies for heart disease.

A study in the *New England Journal of Medicine* by Packard Children's Hospital pediatric nephrologist and molecular immunologist **Minnie Sarwal** described a test that may pinpoint children at high risk of rejecting newly transplanted kidneys.

Dale Umetsu, professor of pediatrics, and his colleagues reported in *Nature Medicine* the identification of immune cells required for development of asthma in mice.



FIVE STANFORD PROFESSORS ARE AMONG 348 NEWLY ELECTED FELLOWS OF THE AMERICAN ASSOCIATION FOR THE ADVANCEMENT OF SCIENCE, THE WORLD'S LARGEST FEDERATION OF SCIENTISTS: EVE CLARK, JAMES COLLMAN, RUSSELL FERNALD (ABOVE), HARRY GREENBERG, AND W. E. MOERNER.

11/03

SCIENTISTS FROM STANFORD AND THE U.S. GEOLOGICAL SURVEY CELEBRATE THE BEGINNING OF CONSTRUCTION OF THE LONG-AWAITED SAN ANDREAS FAULT OBSERVATORY AT DEPTH, WHICH WILL ALLOW MONITORING FROM INSIDE AN ACTIVE EARTHQUAKE ZONE.

RECENT GRADUATE TESS BRIDGEMAN AND SENIOR JARED COHEN ARE AMONG 32 AMERICANS NAMED RHODES SCHOLARS.

THE SMITHSONIAN INSTITUTION RECOGNIZES STANFORD'S PSYCHOLOGY DEPARTMENT FOR DECADES OF LEADERSHIP IN THE FIELD.

12/03

FIVE STUDENTS AND RECENT GRADUATES ARE NAMED MARSHALL SCHOLARS: SAMEER AHMED, MARDEN NICHOLS, NICK RODRIGUEZ, MICHAEL SULMEYER, AND TRACY WILLIAMS.

STANFORD AND THE WORLD

A MESSAGE FROM THE CHAIR OF THE BOARD OF TRUSTEES

TWO TRENDS STOOD OUT IN FISCAL 2003 AT STANFORD. ONE WAS A TREMENDOUS SHOW OF SUPPORT FROM UNIVERSITY DONORS. THE OTHER WAS THE CONTINUED PURSUIT OF AMBITIOUS PROGRAMS THAT REACH FAR BEYOND THE CAMPUS TO SERVE THE WORLD. I BELIEVE THAT THESE TRENDS WERE RELATED.

Giving to the University increased nearly 7 percent last year to $486 million, the second highest total in Stanford history. Despite lingering economic weakness, nearly 70,000 alumni, parents, friends, companies, and foundations contributed. Two multiyear development initiatives played a major role in these outstanding results.

The Campaign for Undergraduate Education (CUE), a five-year effort to raise $1 billion exclusively for undergraduate programs, is creating a strong base for programs like Freshman-Sophomore Seminars and Undergraduate Research Programs. By October 31, 2003, CUE had raised gifts and pledges totaling $902 million. This campaign continues through 2005. In addition, the $300 million Hewlett Challenge for the School of Humanities and Sciences, announced in May 2001, is enabling the school to establish new professorships and graduate fellowships, strengthen existing programs, and launch new initiatives like the Islamic Studies Program. Already, it has attracted $54.4 million, earning matching funds of $52.7 million.

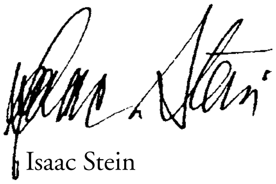
These gift totals are impressive, but the real inspiration comes from what they enable students and faculty to accomplish. Increasingly, these accomplishments extend beyond Palm Drive. Through new Universitywide, multidisciplinary initiatives, Stanford is working to find solutions to some of the world's most pressing issues.

For instance, last year saw dramatic growth in Stanford's Bio-X program. By gathering 700 students, faculty, and staff from departments all over campus in the new James H. Clark Center, Bio-X is addressing complex problems in human health with sophisticated combinations of science, medicine, and engineering. This multidisciplinary collaboration is a profound departure from science as usual and holds tremendous potential to heal injury and cure disease.

A comparable effort in environmental science, technology, and policy will accelerate in fiscal 2004. The Stanford Environmental Initiative is a consortium of faculty from all seven schools on campus. They are already creating innovative curricula and research to aid in a global transition to sustainability, helping to meet human needs while protecting Earth's life support systems.

These efforts reflect Stanford's commitment to organize its resources for the greatest good. Having achieved excellence in an unusually broad range of disciplines, our job is to bring all of the University's expertise to bear on real problems that defy academic borders. Stanford's mission must encompass the world.

Only when alumni and others share this vision can it be realized. Your support is critical to our efforts. I hope Stanford's results in fiscal 2003 and our plans for the future inspire you to take part.



Isaac Stein

2003 FINANCIAL REVIEW

STANFORD UNIVERSITY

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DISCUSSION OF FINANCIAL RESULTS

STANFORD'S CONSOLIDATED NET ASSETS INCREASED $1.2 BILLION IN THE 2002-2003 FISCAL YEAR (FY03) TO END THE YEAR AT $12.2 BILLION, THE LARGEST NET ASSET BALANCE RECORDED TO DATE. SEE FIGURE I. THE INCREASE WAS DUE, IN LARGE PART, TO POSITIVE INVESTMENT PERFORMANCE EXPERIENCED IN THE LAST HALF OF THE FISCAL YEAR, WHICH REPRESENTED A MARKED TURNAROUND FROM THE NEGATIVE INVESTMENT RETURNS OF THE PRIOR TWO AND A HALF YEARS.

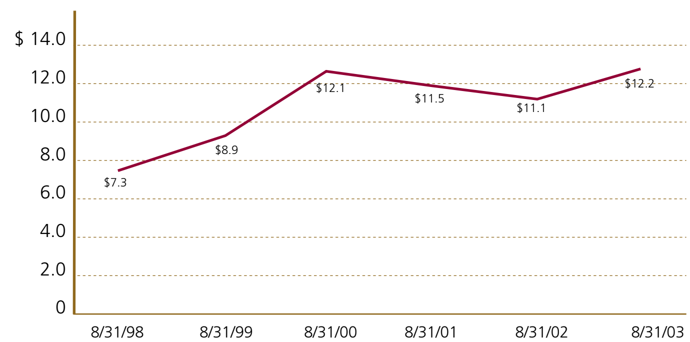
IN FY03, STANFORD'S CONSOLIDATED OPERATING REVENUES EXCEEDED EXPENSES BY $142 MILLION, COMPARED WITH $34 MILLION IN THE 2001-2002 FISCAL YEAR (FY02). THE UNIVERSITY, EXCLUDING THE HOSPITALS, REPORTED A SURPLUS IN FY03 OF $46 MILLION VERSUS A $17 MILLION DEFICIT IN FY02. THE HOSPITALS REPORTED A SURPLUS OF $96 MILLION IN FY03, COMPARED WITH $51 MILLION IN FY02.

UNIVERSITY

At the beginning of FY03, the University implemented a number of steps to moderate growth in expenditures, including a hiring freeze on nonessential staff recruitment and operating budget reductions. These efforts, combined with strong investment performance, higher levels of research activity, continued donor support, and increased health care revenues, led to favorable operating results after a disappointing FY02. Total revenues increased by 9%, while total expenses increased 6%.

FIGURE I

CONSOLIDATED NET ASSETS (IN BILLIONS)



Some of the highlights of FY03 included:

IMPROVED INVESTMENT PERFORMANCE. The University experienced dramatic fluctuations in its investment performance throughout FY03. Due to very strong performance in the second half of the fiscal year, the University recognized investment returns of $1.3 billion in FY03, compared to losses of $300 million in FY02. The FY03 investment returns included a $213 million unrealized gain in the estimated fair market value of the Stanford Shopping Center. The University entered into a 51-year lease of the shopping center with a large real estate investment trust. See the report from the Stanford Management Company on page 55 for an in-depth analysis of University investment strategies and performance.

GENEROUS SUPPORT FROM ALUMNI, PARENTS, AND FRIENDS. In FY03, gifts recorded by the University's Office of Development totaled $486 million, making it the second best fundraising year in University history. Significant gift activity included:

> An all time high of $16.3 million raised by the Stanford Fund.

> The Campaign for Undergraduate Education (CUE) continued to move toward its target of $1 billion. Since CUE's launch in October 2000, a total of $889 million in gifts and pledges had been received as of August 31, 2003.

> The $300 million Hewlett Challenge for the School of Humanities and Sciences reached $54.4 million. This amount will be matched by the William and Flora Hewlett Foundation.

CONTINUED CAPITAL IMPROVEMENT. Several large construction projects were completed in FY03, including:

> *The James H. Clark Center* – The 146,000 square foot center, which was dedicated in October 2003, represents the first interdisciplinary research facility at Stanford. It houses the Bio-X Program, an innovative program for Bioengineering, Biomedicine, and Biosciences.

> *The Lorry I. Lokey Laboratory Building* – A new 85,000 square foot research facility for chemistry and biology opened in August 2003.

> *Escondido Village* – Two new buildings in the Escondido student housing complex were opened in FY03 to provide 326 additional studio apartments for graduate students.

> *The SLAC User Lodging Facility* – The facility provides much needed temporary housing space with 112 guest rooms for academically related visits to the Stanford Linear Accelerator Center (SLAC) and the University.

> *Branner Hall* – The hall, originally built in 1923, reopened after major renovation of the dormitory, kitchen, and dining facilities. The facility houses 180 freshmen.

STATEMENT OF ACTIVITIES

The Statement of Activities details operating revenues and expenses and other nonoperating changes in net assets during the year. University total net assets increased $980 million in FY03 compared with a $576 million decrease in FY02. This significant increase in net assets is primarily attributable to the increased value of the University's investments. Additionally, gifts and pledges recorded in the University's financial statements increased to $378 million, up from $352 million in FY02.

UNRESTRICTED NET ASSETS – RESULTS OF OPERATIONS. Operating activities include all revenues and expenses that support current-year teaching and research efforts and other University priorities. In FY03, total University revenues increased 9% to just over $2.3 billion and total expenses increased 6% to just under $2.3 billion, resulting in a $46 million surplus from operations.

The components of the University's $2.3 billion in operating revenues are shown in Figure 2. A total of 37% of revenues were derived from sponsored research support, and an additional 29% came from the combination of investment income distributed for operations, gifts in support of operations, and net assets released from restrictions. Highlights of the University's operating activities are summarized below:

> Consistent with FY02, student income represented 14% of University operating revenues, increasing from $305 million in FY02 to $318 million in FY03. Contributing to this increase was the tuition rate increase of 5% for undergraduates and most graduate programs. In addition, room and board rates increased 4.5%, and the University continued to increase its student housing stock with additional graduate student housing in Escondido Village. Offsetting tuition and room and board revenues is financial aid, which increased by 9% to a total of $116 million in FY03. As tuition and room and board increase, the amount of financial aid needed per student continues to increase. In addition, the University has experienced an increase in the number of students needing financial assistance.

> Sponsored research support represented 37% of University operating revenues, increasing $59 million, or 7%, to $860 million in FY03. The University's direct cost reimbursement was up $57 million, due largely to higher levels of research activity in the School of Medicine. Research activity also increased across campus with larger increases in the school of Humanities and Sciences and in the Independent Labs. SLAC revenue decreased $8 million, or 4%, due to a decrease in funding for its high energy physics research activities and decreased construction expenditures. Indirect cost recovery was up 7% due to increased research volume and a change in the indirect cost rate to 58% in FY03, up from 57% in FY02.

> Total health care services revenue for the University increased 16% in FY03 to $211 million and represented 9% of University revenues. Health care services revenue consists primarily of payments made by the Hospitals to the University, including $179 million to the School of Medicine for faculty physicians' services, blood center, and other essential services. An additional $22

million includes other services provided by the School of Medicine and other University departments to the Hospitals, reduced by the value of certain services provided by the Hospitals to the School of Medicine and University. Faculty physicians also provided $10 million in revenue for services provided to external parties, including the Santa Clara Valley Medical Center and the Palo Alto Veterans Administration Hospital.

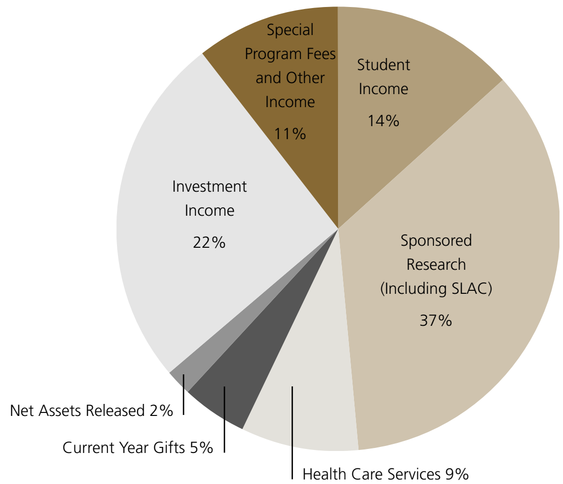
> Current year gifts in support of operations increased 8% or $9 million from FY02 to FY03. These gifts are immediately expendable for purposes described by the donor.

> Net assets released from restrictions, which consist of payments on prior year pledges and prior year pledges released from donor restrictions, were $54 million compared to $40 million in FY02.

> Total investment income included in operations represented 22% of University revenue.

FIGURE 2

UNIVERSITY OPERATING REVENUES FY03 ($2.3 BILLION)



Endowment income distributed for operations was $391 million in FY03, equal to 5.1% of the total endowment value at the beginning of the year, and up from $378 million, or 4.6% of the endowment, in FY02. For those funds invested in the Merged Endowment Pool (MEP), the University applies a "smoothing formula" in determining the endowment distribution to ease the impact of volatile investment markets. The University's endowment increased 13% to $8.6 billion at August 31, 2003 due primarily to improved investment performance. The endowment, which represents approximately 75% of the University's net assets, is a significant source of revenue for the University, with payout covering 17% of expenses in FY03.

The market upturn also contributed to an increase in other investment income to $117 million in FY03 from $69 million in FY02. This category includes the payout to operations from the Expendable Funds Pool (EFP), faculty and staff mortgage loan program income, and investment income covering the costs of managing investment programs. The EFP is the principal investment vehicle for the University's expendable funds, and a substantial portion of it is cross-invested in the MEP. The EFP payout policy seeks to achieve a minimum payout to operations, while also providing that amounts in excess of the guidelines be reinvested in the endowment. The EFP payout was approximately $80 million in FY03, compared to $37 million in FY02. Effective September 1, 2003, the EFP payout policy has been revised to reduce the volatility of the payout to operations.

> Special program fees and other income totaled $247 million in FY03, compared to $239 million in FY02. This revenue category consists of the external revenues generated by auxiliary enterprises and service centers, and special programs, including the executive education programs, corporate affiliates programs, and technology licensing. Included are the operations of residential housing and dining (other than room and board revenues from students), catering services, revenues from the Stanford West Apartments, and revenues from intercollegiate athletic activities.

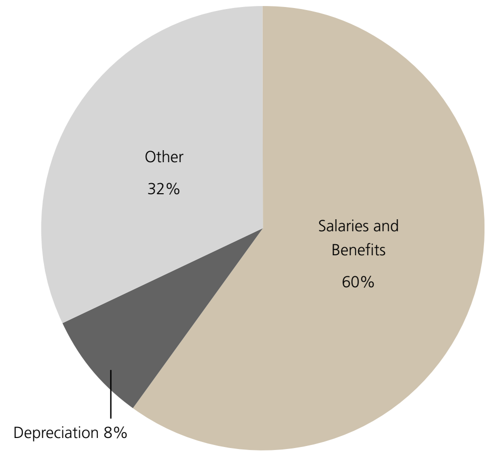
> Total expenses increased $129 million, or 6%, to just under $2.3 billion in FY03. As depicted in Figure 3, salaries and benefits comprise approximately 60% of the University's total expenses, depreciation expense was 8%, and other operating expenses represented approximately 32%.

> Salaries and benefits increased 10% in FY03, despite the hiring freeze on nonessential staff that was in effect for the majority of the year. Salary increases were granted at the beginning of FY03 and additional staff was hired to support the growth in sponsored research and clinical services. Health care benefit costs for employees and retirees increased 17% in FY03 from FY02. Despite continued efforts to design affordable health care plans for Stanford employees and retirees, health care costs have continued to escalate. The University continues to explore options for containing medical costs, while still providing its employees with competitive benefits.

> Depreciation expense increased 3%, primarily as a result of the completion of major projects that were placed in service during FY03 and FY02.

> Other operating expenses were flat compared to FY02. In response to management's request to cut spending, University staff reduced nonessential spending. This allowed other operating expenses to remain flat despite increased utilities and maintenance costs associated with the opening of several new buildings and increased grant and contract spending.

FIGURE 3
UNIVERSITY OPERATING EXPENSES FY03 ($2.3 BILLION)



UNRESTRICTED NET ASSETS—OTHER CHANGES. In total, unrestricted net assets of the University increased by $908 million, including the operating surplus of $46 million. The majority of the increase in unrestricted net assets was due to increases in the value of investments of approximately $761 million. This is net of the $391 million of endowment income distributed for operations. In years with strong investment performance, the University's investment returns exceed the amount of the predetermined payout, and the excess is reinvested. In years of poor investment returns, such as FY02, the payout is funded by a withdrawal from the endowment. In FY03, total investment return of the EFP was $122 million, of which $37 million was reinvested in the endowment. In contrast, total investment return of the EFP was $10 million in FY02, requiring a withdrawal of $36 million from the endowment to meet the Board-approved payout.

TEMPORARILY RESTRICTED NET ASSETS. Temporarily restricted net assets decreased by $79 million to $382 million in FY03. Included in this category are pledges that will become expendable upon payment, gifts pending designation by the donor, and gifts for capital construction and certain other purposes. The University received $95 million of new temporarily restricted gifts and pledges in FY03. During the year, $54 million of temporarily restricted net assets were released from their restrictions and utilized to fund operating activities. In addition, $128 million of capital and other gifts for use by the University and Hospitals were released to unrestricted net assets.

PERMANENTLY RESTRICTED NET ASSETS. Permanently restricted net assets increased by $150 million to $3 billion during FY03. The principal value of these funds must be invested in perpetuity to generate endowment income to be used only for the purpose designated by the donor. The increase this year was due primarily to the receipt of $157 million in new gifts and pledges to the endowment. This was partially offset by the transfer of $49 million to unrestricted net assets because donor restrictions were clarified to allow the use of previously reinvested gains in accordance with the University's endowment payout policy.

FINANCIAL POSITION

The University's Statement of Financial Position reflects the positive investment returns and continued improvements to the University's physical infrastructure. In FY03, total University assets increased $1.9 billion to $14.7 billion, and total University liabilities increased $899 million to $3.1 billion.

Highlights of the Statement of Financial Position are as follows:

> Net pledges receivable decreased approximately $46 million to $417 million in FY03. Cash payments on prior year pledges exceeded new pledges recorded in FY03 by more than $40 million. Valuation allowances were recorded for pledges that may not be collectible or where the pledge terms may be extended.

> Total investments, consisting primarily of endowment assets and expendable funds, increased by $1.6 billion, or 18%, to $10.8 billion.

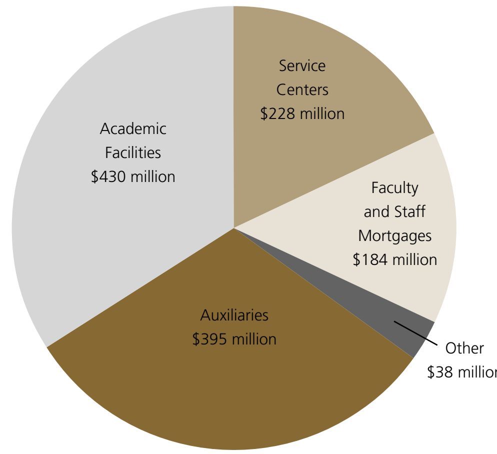
> Plant facilities, net of accumulated depreciation, grew 6% to $2.4 billion. New additions to plant facilities in FY03 totaled $256

million, bringing gross plant facilities before accumulated depreciation to $3.9 billion. As previously discussed, several new academic, support, and housing facilities were completed in FY03.

> Deferred rental income, consisting of prepaid rents on properties leased by the University, was $369 million at August 31, 2003. A total of $332 million related to the Stanford Shopping Center lease. These amounts will be recognized as revenue ratably over the terms of the associated leases.

FIGURE 4

USES OF DEBT FY03 ($1.275 MILLION)



> Notes and bonds payable were approximately $1.3 billion at August 31, 2003, an increase of $29 million from FY02. As of August 31, 2003, $430 million in debt has been allocated to academic facilities, such as the new Lokey Laboratory; $395 million to auxiliaries, primarily residential housing and dining facilities; $228 million to service centers, primarily for utility infrastructure projects, information technology, and communications purposes; $184 million for faculty and staff mortgage loans; and the remaining $38 million for other miscellaneous projects. See Figure 4. In March 2003, the University initiated a $150 million tax-exempt commercial paper program through the California Educational Facilities Authority, allowing the University to finance capital expenditures with short-term debt. The University's debt ratios are within the guidelines of the debt policy approved by the Board of Trustees. The debt policy governs the amount and type of debt Stanford may incur and preserves the University's long-term debt capacity, financial flexibility, and access to capital markets at competitive rates.

HOSPITALS

The financial results and financial position of the Stanford Hospital and Clinics (SHC) and the Lucile Packard Children's Hospital (LPCH) are combined in the consolidated financial statements under the "Hospitals" column, together with the results of the UCSF-Stanford Health Care joint venture which was effectively dissolved in FY03. The University is the sole corporate member of each of the Hospitals.

During FY03, SHC and LPCH continued to improve their operations and progressed toward their goals of long-term financial stability. The Hospitals had a combined operating surplus of $96 million for FY03, up 88% from $51 million in FY02. At August 31, 2003, the Hospitals' net assets were $685 million versus $501 million at August 31, 2002, an increase of $184 million or 37%. As discussed below, both SHC and LPCH have increased volume in key areas and have implemented operational improvements such as enhanced revenue cycle performance, cost reductions, and program development. They continue to implement operational improvements to enhance the quality of care and financial performance. They provide excellent health care services in addition to furthering their missions in education and innovative research. The following summarizes the individual financial results of SHC and LPCH:

STANFORD HOSPITAL AND CLINICS. SHC experienced substantial financial improvement during FY03, reporting an excess of revenues over expenses from operations of $36 million, up from $12 million in FY02. The operating margin was 3% in FY03, compared to 1% in FY02. SHC's net assets at the end of FY03 were $247 million. Net patient revenues grew 7% to $918 million in FY03 compared to $860 million in FY02. This increase is due to renegotiation of capitated contracts and growth in both inpatient and outpatient revenues. Inpatient and outpatient revenue now represent 56% and 44%, respectively, of net patient revenues.

Among the initiatives that contributed to SHC's financial improvement in FY03 were the following:

> Enhanced revenue cycle management, which resulted in 11% fewer days of revenue in accounts receivable (45 days in FY03 from 51 days in FY02). Days cash on hand increased to 157 days in FY03 from 95 days in FY02.

> Financial management and collection efforts, which reduced the provision for bad debts by $27 million, or 34% in FY03. Provision for bad debts as a percentage of net patient revenue was 6% in FY03 as compared to 9% in FY02.

> Improved purchasing policy to control supply costs was implemented during FY03 and FY02.

> Improved asset controls and management. During FY02, asset impairments were identified and written off. As a result of the write offs, depreciation expense decreased $10 million, or 27%, in FY03.

> SHC also improved its cash position and liquidity by 71% in FY03. Cash, cash equivalents, and investments, less restricted assets, were $396 million at August 31, 2003 versus $231 million at August 31, 2002.

Supported by improved financial performance, in FY03 SHC issued a total of $250 million in tax-exempt bonds to support its capital plan. A total of $150 million of such bonds were issued as credit-enhanced variable rate debt, swapped to fixed rate through the use of interest rate swap agreements. In addition, $100 million of such bonds were issued as fixed rate debt. SHC will utilize a portion of the bond proceeds to complete construction of its new cancer center, which is expected to open in early 2004.

LUCILE PACKARD CHILDREN'S HOSPITAL. LPCH also experienced improved financial performance in FY03, reporting an excess of revenues over expenses from operations of $60 million in FY03, compared to $39 million in FY02. The operating margin was 15% in FY03, up from 12% in FY02. LPCH's total net assets at the end of FY03 were $438 million compared to $316 million in FY02.

Significant accomplishments during FY03 included:

> Inpatient days increased to 73,187 in FY03 from 70,271 in FY02.

> Net patient service revenue increased 28% to $356 million from $279 million in FY02. Most notably, heart, medical subspecialties, and the Johnson Center grew at a combined 38%.

> LPCH returned to eligibility for Disproportionate Share Hospital Funding (DSH) in FY03, receiving $5.1 million. LPCH received no DSH funding in FY02.

> Provision for bad debts as a percentage of net patient service revenue was 5% in FY03 as compared to 7% in FY02.

> Improved purchasing policy to control supply costs was implemented during FY03 and FY02. Supplies cost as a percentage of net patient service revenue was 6% in FY03 versus 8% in FY02.

> Enhanced revenue cycle performance has improved net days of revenue in accounts receivable to 58 days in FY03 from 61 days in FY02.

> Days cash on hand increased to 194 days in FY03 from 144 days in FY02.

LPCH withdrew from the SHC obligated group in March 2003, allowing for the issuance of bonds under its own credit. In July 2003, LPCH issued $115 million of credit enhanced variable rate bonds. LPCH will utilize the proceeds from these tax-exempt bonds to fund facilities improvements.

CHALLENGES FACING STANFORD

Despite the improvement in operating results in FY03, the University and Hospitals face a number of financial challenges in FY04 and beyond:

> Sponsored research funding for American universities is projected to flatten over the next several years, following several years of double-digit increases, as the federal deficit tempers support for further growth.

> Health care costs for employees and retirees are projected to continue rising at double-digit rates for the next several years, driving significant increases in the University's and Hospitals' expense base.

> Universities are being pressured by Congress to limit tuition increases, at the same time that demands for financial aid continue to rise rapidly.

> The financial markets continue to be highly volatile, with no assurance that the positive investment returns experienced in FY03 will continue.

> The University and Hospitals will need to absorb depreciation, debt service, utilities, and maintenance costs associated with the opening of major new facilities in FY03 and early FY04.

> The Hospitals face particular financial challenges, operating in an increasingly competitive market, constrained by Medicare, Medi-Cal, and private reimbursement regimens, and in a very tight market for health care workers.

As we move into the next fiscal year, we will continue to address these challenges while working to protect and increase Stanford's resources. Our commitment to excellence in teaching, research, and health care remains strong. With the continued support of the faculty, staff, students, trustees, alumni, and other friends, we will support leading edge research and continue to offer an outstanding education to future generations of students.

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

M. SUZANNE CALANDRA
Controller
Stanford University

ROY T. SANTARELLA
Chief Financial Officer
Stanford Hospital and Clinics

KEITH S. GRUNDY
Chief Financial Officer
Lucile Salter Packard Children's Hospital

SELECTED FINANCIAL DATA

Fiscal Year Ended August 31

	2003	2002	2001	2000	1999
FINANCIAL:					
(In millions of dollars)					
PRINCIPAL SOURCES OF OPERATING REVENUES:					
Student tuition and fees, net of student financial aid (A)	$ 318	$ 305	$ 300	$ 280	$ 268
Sponsored research support	860	802	727	674	634
Patient care (B)	1,267	1,177	1,005	362	–
Current year gifts in support of operations	113	104	111	113	97
Endowment income in support of operations	391	378	354	315	262
PRINCIPAL PURPOSES OF EXPENDITURES:					
Instruction and departmental research	744	681	655	610	558
Organized research (direct costs)	738	707	628	581	520
Health care services (B)	1,067	1,019	935	397	–
Libraries	101	101	105	93	75
Administration, development and general	248	238	217	183	185
FINANCIAL POSITION HIGHLIGHTS:					
Pledges receivable, net	475	513	527	481	177
Investments at fair value	11,494	9,520	10,141	10,784	7,807
Plant facilities, net of accumulated depreciation	2,723	2,527	2,365	2,204	1,718
Equity investment in related health care entities (B)	–	7	5	20	452
Notes and bonds payable:					
University	1,275	1,246	1,218	1,135	1,126
Hospital	591	224	228	235	–
University endowment, end of year	8,614	7,613	8,250	8,886	6,227
Total Net Assets	**12,237**	**11,073**	**11,534**	**12,125**	**8,938**

	2003	2002	2001	2000	1999
STUDENTS:					
ENROLLMENT: (C)					
Undergraduate	6,654	6,731	6,637	6,548	6,594
Graduate	7,800	7,608	7,536	7,700	7,625
DEGREES CONFERRED:					
Bachelor degrees	1,788	1,692	1,676	1,737	1,687
Advanced degrees	2,855	2,777	2,936	2,904	2,909
FACULTY:					
MEMBERS OF THE ACADEMIC COUNCIL	1,396	1,377	1,384	1,368	1,364
ANNUAL UNDERGRADUATE TUITION RATE (IN DOLLARS)	$ 27,204	$ 25,917	$ 24,441	$ 23,058	$ 22,110

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

(B) 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.

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

At August 31, 2003 and 2002 (In thousands of dollars)

	2003 UNIVERSITY	2003 HOSPITALS	2003 CONSOLIDATED	2002 CONSOLIDATED
ASSETS				
Cash and cash equivalents	$ 521,268	$ 392,298	$ 913,566	$ 522,195
Accounts receivable, net	151,469	178,312	329,781	345,296
Receivables (payables) from SHC and LPCH, net	23,597	(23,597)	–	–
Inventories, prepaid expenses, and other assets	30,156	51,016	81,172	65,994
Pledges receivable, net	417,341	57,140	474,481	513,134
Student loans receivable, net	63,245	–	63,245	68,072
Faculty and staff mortgages and other loans receivable, net	248,912	–	248,912	257,956
Investments at fair value, including securities pledged or on loan of $303,251 and $30,200 for 2003 and 2002, respectively	10,841,586	652,627	11,494,213	9,519,716
Investment in UCSF-Stanford Health Care	–	–	–	6,547
Plant facilities, net of accumulated depreciation	2,370,007	353,016	2,723,023	2,527,454
Collections of works of art	–	–	–	–
TOTAL ASSETS	**$14,667,581**	**$ 1,660,812**	**$16,328,393**	**$13,826,364**
LIABILITIES AND NET ASSETS				
LIABILITIES:				
Accounts payable and accrued expenses	$ 438,320	$ 384,053	$ 822,373	$ 713,155
Pending trades	378,307	–	378,307	211,336
Liabilities under security agreements	343,741	–	343,741	28,845
Deferred rental income	369,008	–	369,008	9,029
Income beneficiary share of living trust investments	258,261	–	258,261	267,514
Notes and bonds payable	1,275,196	591,300	1,866,496	1,470,546
U.S. government refundable loan funds	53,597	–	53,597	52,705
TOTAL LIABILITIES	**3,116,430**	**975,353**	**4,091,783**	**2,753,130**
NET ASSETS:				
Unrestricted	8,186,542	484,036	8,670,578	7,620,235
Temporarily restricted	382,417	76,286	458,703	530,057
Permanently restricted	2,982,192	125,137	3,107,329	2,922,942
TOTAL NET ASSETS	**11,551,151**	**685,459**	**12,236,610**	**11,073,234**
TOTAL LIABILITIES AND NET ASSETS	**$14,667,581**	**$ 1,660,812**	**$16,328,393**	**$13,826,364**

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

CONSOLIDATED STATEMENTS OF ACTIVITIES

For the years ended August 31, 2003 and 2002 (In thousands of dollars)

	2003 UNIVERSITY	2003 HOSPITALS	2003 CONSOLIDATED	2002 CONSOLIDATED
UNRESTRICTED NET ASSETS ACTIVITY				
REVENUES:				
Student income:				
Undergraduate programs	$ 185,277	$ –	$ 185,277	$ 175,508
Graduate programs	166,580	–	166,580	157,752
Room and board	82,062	–	82,062	78,273
Student financial aid	(116,102)	–	(116,102)	(106,693)
TOTAL STUDENT INCOME	**317,817**	**–**	**317,817**	**304,840**
Sponsored research support (primarily federal):				
Direct costs – University	496,702	–	496,702	439,837
Direct costs – Stanford Linear Accelerator Center	219,687	–	219,687	227,809
Indirect costs	143,921	–	143,921	133,956
TOTAL SPONSORED RESEARCH SUPPORT	**860,310**	**–**	**860,310**	**801,602**
Health care services:				
Patient care, net	–	1,266,976	1,266,976	1,177,419
Physicians' services and support - SHC and LPCH, net	201,146	(201,146)	–	–
Physicians' services and support - other facilities, net	10,091	–	10,091	3,883
TOTAL HEALTH CARE SERVICES	**211,237**	**1,065,830**	**1,277,067**	**1,181,302**
CURRENT YEAR GIFTS IN SUPPORT OF OPERATIONS	**112,885**	**–**	**112,885**	**104,310**
Net assets released from restrictions:				
Payments received on prior year pledges	27,419	–	27,419	37,190
Prior year gifts released from donor restrictions	26,760	18,240	45,000	14,466
TOTAL NET ASSETS RELEASED FROM RESTRICTIONS	**54,179**	**18,240**	**72,419**	**51,656**
Investment income distributed for operations:				
Endowment	391,416	–	391,416	377,765
Expendable funds pool and other investment income	116,732	6,152	122,884	76,209
TOTAL INVESTMENT INCOME DISTRIBUTED FOR OPERATIONS	**508,148**	**6,152**	**514,300**	**453,974**
SPECIAL PROGRAM FEES AND OTHER INCOME	**246,779**	**73,038**	**319,817**	**291,655**
TOTAL REVENUES	**2,311,355**	**1,163,260**	**3,474,615**	**3,189,339**
EXPENSES:				
Salaries and benefits	1,360,364	589,719	1,950,083	1,765,968
Depreciation	181,265	37,758	219,023	226,008
Other operating expenses	724,101	439,619	1,163,720	1,163,549
TOTAL EXPENSES	**2,265,730**	**1,067,096**	**3,332,826**	**3,155,525**
EXCESS OF REVENUES OVER EXPENSES	**$ 45,625**	**$ 96,164**	**$ 141,789**	**$ 33,814**

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

CONSOLIDATED STATEMENTS OF ACTIVITIES

For the years ended August 31, 2003 and 2002 (In thousands of dollars)

	2003 UNIVERSITY	2003 HOSPITALS	2003 CONSOLIDATED	2002 CONSOLIDATED
UNRESTRICTED NET ASSETS ACTIVITY (CONTINUED)				
EXCESS OF REVENUES OVER EXPENSES	**$ 45,625**	**$ 96,164**	**$ 141,789**	**$ 33,814**
OTHER CHANGES IN UNRESTRICTED NET ASSETS:				
Expendable gifts invested in the endowment	12,965	–	12,965	6,127
Increase (decrease) in reinvested endowment gains	761,120	11,845	772,965	(695,131)
Change in equity investment in UCSF-Stanford Health Care	–	(6,547)	(6,547)	1,104
Capital and other gifts released from restrictions	87,156	8,635	95,791	80,141
Capital gifts released from University	–	41,000	41,000	–
Increase in additional pension liability	(33,994)	(23,857)	(57,851)	–
Net assets released from permanent restrictions	49,134	–	49,134	2,826
Other	(13,883)	14,981	1,098	797
NET CHANGE IN UNRESTRICTED NET ASSETS	**908,123**	**142,221**	**1,050,344**	**(570,322)**
TEMPORARILY RESTRICTED NET ASSETS ACTIVITY				
Gifts and pledges, net	95,184	27,068	122,252	141,288
Investment income	9,024	6,996	16,020	2,077
Living trust investment income (loss) and actuarial adjustment	2,204	–	2,204	(5,543)
Net assets released to operations	(54,179)	(18,240)	(72,419)	(51,656)
Capital and other gifts released to unrestricted net assets	(87,156)	(8,635)	(95,791)	(80,141)
Capital gifts released to Hospitals unrestricted net assets	(41,000)	–	(41,000)	–
Other	(2,620)	–	(2,620)	(1,864)
NET CHANGE IN TEMPORARILY RESTRICTED NET ASSETS	**(78,543)**	**7,189**	**(71,354)**	**4,161**
PERMANENTLY RESTRICTED NET ASSETS ACTIVITY				
Gifts and pledges, net	157,272	34,557	191,829	173,762
Investment gain (loss)	26,435	–	26,435	(37,918)
Living trust investment income (loss) and actuarial adjustment	1,630	–	1,630	(23,297)
Net assets released from restriction	(49,134)	–	(49,134)	(2,826)
Other	13,626	–	13,626	(4,175)
NET CHANGE IN PERMANENTLY RESTRICTED NET ASSETS	**149,829**	**34,557**	**184,386**	**105,546**
NET CHANGE IN TOTAL NET ASSETS	**979,409**	**183,967**	**1,163,376**	**(460,615)**
Total net assets, beginning of year	10,571,742	501,492	11,073,234	11,533,849
TOTAL NET ASSETS, END OF YEAR	**$11,551,151**	**$ 685,459**	**$12,236,610**	**$11,073,234**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended August 31, 2003 and 2002 (In thousands of dollars)

	2003 UNIVERSITY	2003 HOSPITALS	2003 CONSOLIDATED	2002 CONSOLIDATED
CASH FLOW FROM OPERATING ACTIVITIES				
Change in net assets	$ 979,409	$ 183,967	$ 1,163,376	$ (460,615)
Adjustments to reconcile change in net assets to net cash provided by operating activities:				
Depreciation, amortization, and loss on disposal of fixed assets	194,508	37,758	232,266	233,574
Net realized and unrealized (gains) losses on investments and security agreements	(1,063,363)	(10,815)	(1,074,178)	594,177
Net realized and unrealized (gains) losses on derivatives	(1,558)	(5,574)	(7,132)	5,643
Actuarial change on living trust obligations	(20,346)	–	(20,346)	(27,607)
Change in equity in UCSF-Stanford Health Care	–	6,547	6,547	(1,104)
Permanently restricted investment income	(825)	(7,035)	(7,860)	(5,810)
Gifts restricted for long-term investments	(246,275)	(61,625)	(307,900)	(242,096)
Net (increase) decrease in accounts receivable, pledges receivable, and receivables from SHC and LPCH	(41,800)	13,781	(28,019)	(24,973)
Increase in U.S. government refundable loan funds	892	–	892	2,449
Decrease (increase) in inventories, prepaid expenses, and other assets	4,583	(22,805)	(18,222)	3,784
Increase in accounts payable and accrued expenses	41,849	53,598	95,447	30,907
Increase (decrease) in deferred rental income	359,979	–	359,979	(21)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**207,053**	**187,797**	**394,850**	**108,308**
CASH FLOW FROM INVESTING ACTIVITIES				
Land, building, and equipment purchases	(328,047)	(85,986)	(414,033)	(395,923)
Student, faculty, and other loans:				
New loans made	(56,268)	–	(56,268)	(82,155)
Principal collected	70,138	–	70,138	41,670
Purchases of investments	(6,139,586)	(405,063)	(6,544,649)	(4,337,471)
Sales and maturities of investments	5,783,925	60,468	5,844,393	4,503,877
Distribution of assets from UCSF-Stanford Health Care, net of pension liabilities	–	(8,257)	(8,257)	–
Cash transferred from UCSF-Stanford Health Care	–	28,189	28,189	–
NET CASH USED FOR INVESTING ACTIVITIES	**(669,838)**	**(410,649)**	**(1,080,487)**	**(270,002)**
CASH FLOW FROM FINANCING ACTIVITIES				
Gifts and reinvested income of endowment, capital projects, and other restricted purposes	305,014	61,625	366,639	310,248
Increase in investment income for restricted purposes	825	7,035	7,860	5,810
Proceeds from borrowing	74,989	373,879	448,868	73,390
Repayment of notes and bonds payable	(46,075)	(3,800)	(49,875)	(48,334)
Increase (decrease) in liabilities under security agreements	314,896	–	314,896	(492,024)
Other financing	(11,380)	–	(11,380)	17,456
NET CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES	**638,269**	**438,739**	**1,077,008**	**(133,454)**
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**175,484**	**215,887**	**391,371**	**(295,148)**
Cash and cash equivalents, beginning of year	345,784	176,411	522,195	817,343
CASH AND CASH EQUIVALENTS, END OF YEAR	**$ 521,268**	**$ 392,298**	**$ 913,566**	**$ 522,195**
SUPPLEMENTAL DATA:				
Gifts of equipment	$ 300	$ –	$ 300	$ 1,033
Interest paid during the year	$ 61,699	$ 10,048	$ 71,747	$ 74,383

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

NOTES TO THE 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), Lucile Salter Packard Children's Hospital at Stanford (LPCH), and other majority-owned or controlled entities. All significant inter-entity transactions and balances have been eliminated upon consolidation. Certain prior year amounts have been reclassified to conform to the current year's presentation.

> *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. A Board of Trustees (the Board) governs the University, which is organized into seven schools with approximately 1,740 faculty and more than 14,400 graduate and undergraduate students. The "University" category presented in the financial statements comprises all the accounts of the University, including 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. SLAC is a federally funded research and development center, owned by the DOE and, accordingly, the assets and liabilities are not included in the University's statement of financial position, other than employee related accrued compensation.

> *Hospitals* – The Hospitals category presented in the financial statements includes SHC, LPCH, and the University's share of UCSF-Stanford Health Care (USHC). USHC is a California nonprofit, public-benefit corporation controlled jointly by the University and The Regents of the University of California (UC). During fiscal year 2003, USHC was engaged in the process of winding down its accounts in anticipation of voluntary dissolution. The health care activities of SHC and LPCH (the Hospitals), including revenues, expenses, assets, and liabilities, are consolidated in these financial statements (see Note 2).

BASIS OF ACCOUNTING The financial statements are prepared in accordance with generally accepted accounting principles. These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from 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.

> *Unrestricted Net Assets:* Unrestricted net assets are expendable resources used to support 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 donors' restrictions, 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.

Management considers all revenues and expenses to be related to operations except reinvested endowment gains, capital, and other gifts released from restrictions, expendable gifts invested in the endowment, minimum pension liability, and certain other nonoperating changes, which are reported in other changes in unrestricted net assets.

> *Temporarily Restricted Net Assets:* Temporarily restricted net assets include gifts and pledges that are subject to donor-imposed restrictions that expire in accordance with donor restrictions, which may include the passage of time, payment of pledges, 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 are comprised of approximately 25% capital projects and 75% other institutional support.

> *Permanently Restricted Net Assets:* Permanently restricted net assets consist principally of endowment, annuities, and life income funds, which are subject to donor-imposed restrictions requiring that the principal be invested in perpetuity.

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. Securities transactions are reported on a trade-date basis. The values of fixed income and publicly traded equity securities are based on quoted market prices and exchange rates, if applicable.

Assets held by other trustees, limited partnerships, real estate and improvements, and other investments are recorded based on estimated fair values. Methods for determining estimated fair values include discounted cash flows and estimates provided by trustees and general partners. The estimated fair value of certain of these investments is based on valuations provided by the external investment managers as of June 30, adjusted for cash receipts, cash disbursements, and securities distributions through August 31. The University believes the carrying amounts of these financial instruments are a reasonable estimate of fair value. Because the limited partnership investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed. Such differences could be material.

Donated assets are recorded at fair value at the date of donation. Estimates of fair value involve assumptions and estimation methods that are uncertain and, therefore, the estimates could differ from actual results.

Undeveloped land is reported at cost.

DERIVATIVES Derivative financial instruments are recorded at fair value with the resulting gain or loss recognized in the consolidated statement of activities (see Note 6).

PLANT FACILITIES Plant facilities are recorded at cost or, for donated assets, at fair value at the 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 assets.

The useful lives used in calculating depreciation for years ended August 31, 2003 and 2002 are as follows:

	UNIVERSITY	HOSPITALS
Buildings	20-40 years	7-40 years
Land and building improvements	10-40 years	10-40 years
Equipment and books	3-10 years	3-20 years

Under the original endowment from Senator Leland and Mrs. Jane Stanford, a significant portion of University land may not be sold.

COLLECTIONS OF WORKS OF ART Art objects and collections, which are preserved and protected, 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 up to specified limits for unemployment, disability, workers' compensation, property losses, certain health care plans, and general and professional liability losses. The Hospitals self-insure up to specified limits for workers' compensation and medical malpractice losses. Third party insurance is purchased to cover liabilities above specific per-claim exposures. Estimates of retained exposures are accrued.

STUDENT INCOME 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 commercial payors. Payments under these agreements and programs are based on a percentage of charges, per diem, per discharge, per service, a fee schedule, or cost reimbursement or negotiated charges.

CHARITY CARE The Hospitals provide care to patients who meet certain criteria under their charity-care policies without charge or at amounts less than their established rates. Amounts determined to qualify as charity care are not reported as net patient-service revenue. The Hospitals also provide services to other indigent patients under Medi-Cal and other publicly sponsored programs, which reimburse at amounts less than the cost of the services provided to the recipients. The difference between the cost of services provided to these indigent persons and the expected reimbursement is included in the estimated cost of charity care. The amount of charity-care services, quantified at established rates, was $14,429,000 and $10,291,000 for the years ended August 31, 2003 and 2002, respectively. Estimated cost in excess of reimbursements for Medi-Cal and county services by the Hospitals for the years ended August 31, 2003 and 2002 was $69,025,000 and $63,869,000, respectively (unaudited).

TAX STATUS The University and the Hospitals are exempt from federal and state income taxes to the extent provided by Section 501(c)(3) of the Internal Revenue Code and equivalent state provisions.

SEPARATE HOSPITAL FINANCIAL STATEMENTS Each of the Hospitals prepares separate, stand-alone financial statements. For purposes of presentation of the Hospitals' balance sheets, statements of operations and changes in net assets, and statements of cash flows in these consolidated financial statements, conforming reclassifications have been made to the Hospitals' revenues and expenses and inter-entity receivables and payables consistent with categories in the consolidated financial statements.

2. HEALTH CARE ENTITIES

HOSPITALS The Hospitals are California nonprofit, public-benefit corporations. The University is the sole member of the Hospitals. The Hospitals support the mission of medical education and clinical research of the University's School of Medicine (SoM). They operate two licensed acute care and specialty hospitals on the Stanford campus and numerous physician clinics on the campus, in community settings, and in association with regional hospitals in the San Francisco Bay Area. The Hospitals own 100% of a captive insurance company.

The University has entered into various operating agreements with the Hospitals for professional services of faculty members of the SoM, telecommunications services, and other services and facilities charges. Revenues and expenses related to these agreements are eliminated in consolidation. The Hospitals' investments, with a combined market value of $256,210,000 and $218,612,000 at August 31, 2003 and 2002, respectively, are managed by the University.

UNIVERSITY'S INVESTMENT IN UCSF-STANFORD HEALTH CARE During 2003, the University and UC made significant progress towards voluntary dissolution of USHC. Effective July 31, 2003, all of USHC's liabilities had either been discharged or assumed by SHC or UC, and USHC made a final distribution of its residual net assets. The University's investment in USHC was zero at August 31, 2003. At August 31, 2002, the investment was $6,547,000.

Final voluntary dissolution of USHC is anticipated to occur on or before December 31, 2003, and depends upon, among other things, statutory filings and regulatory approvals.

3. ACCOUNTS RECEIVABLE

Accounts receivable at August 31, 2003 and 2002, in thousands of dollars, are as follows:

	2003	2002
UNIVERSITY:		
U.S. Government	$ 63,431	$ 43,208
Nongovernment sponsors	12,496	16,126
Due from brokers	29,304	63,846
Accrued interest on investments	16,346	17,836
Student	2,995	2,297
Other	29,425	19,292
	153,997	162,605
Less allowances for losses	2,528	2,257
University accounts receivable, net	151,469	160,348
HOSPITALS:		
Gross patient receivables	550,785	523,651
Other	6,894	11,266
	557,679	534,917
Less contractual and bad debt allowances	379,367	349,969
Hospitals accounts receivable, net	178,312	184,948
CONSOLIDATED ACCOUNTS RECEIVABLE, NET	**$ 329,781**	**$ 345,296**

4. PLEDGES RECEIVABLE

Unconditional promises are included in the financial statements as pledges receivable and are classified as 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. Total combined conditional pledges for the University and Hospitals for August 31, 2003 and 2002 were approximately $301,276,000 and $384,000,000, respectively. Pledges are recorded at the present value of the discounted future cash flows, net of allowances. At August 31, 2003 and 2002, pledges receivable are as follows, in thousands of dollars:

	2003 UNIVERSITY	2003 HOSPITALS	2003 CONSOLIDATED	2002 CONSOLIDATED
One year or less	$ 87,126	$ 39,201	$ 126,327	$ 82,477
Between one year and five years	319,746	19,610	339,356	423,183
More than five years	239,046	6,113	245,159	233,743
	645,918	64,924	710,842	739,403
Less discount/allowance	228,577	7,784	236,361	226,269
PLEDGES RECEIVABLE, NET	**$ 417,341**	**$ 57,140**	**$ 474,481**	**$ 513,134**

5. 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 $248,423,000 and $256,143,000 at August 31, 2003 and 2002, 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.

6. INVESTMENTS

Investments held by the University and the Hospitals at August 31, 2003 and 2002 are reported as follows, in thousands of dollars:

	2003 UNIVERSITY	2003 HOSPITALS	2003 CONSOLIDATED	2002 CONSOLIDATED
Cash and short-term investments	$ 874,508	$ 473,611	$ 1,348,119	$ 670,239
Bonds and mutual funds	1,495,228	30,044	1,525,272	1,553,142
Public equities and mutual funds	4,140,054	18,760	4,158,814	3,605,574
Assets held by other trustees (net of income beneficiary share of $59,357 and $40,625 at August 31, 2003 and 2002, respectively)	68,395	–	68,395	82,106
Real estate and improvements, including Stanford Shopping Center and Research Park	1,287,184	–	1,287,184	1,020,012
Limited partnership investments	3,061,357	–	3,061,357	2,537,800
Other	45,072	–	45,072	50,843
	10,971,798	522,415	11,494,213	9,519,716
Hospitals' investment in the University's Merged Endowment Pool	(130,212)	130,212	–	–
INVESTMENTS AT FAIR VALUE	**$10,841,586**	**$ 652,627**	**$11,494,213**	**$ 9,519,716**

The University reports endowment cash and short-term investments as investments. Hospital investments totaling $305,218,000 and $16,068,000 at August 31, 2003 and 2002, respectively, are restricted as to use.

Total investment return (loss) reflected in the statement of activities for the years ended August 31, 2003 and 2002, in thousands of dollars, is as follows:

	2003 UNIVERSITY	2003 HOSPITALS	2003 CONSOLIDATED	2002 CONSOLIDATED
Investment income	$ 255,632	$ 14,178	$ 269,810	$ 299,667
Net realized and unrealized gains (losses)	1,063,363	10,815	1,074,178	(594,177)
TOTAL INVESTMENT RETURN (LOSS)	**$ 1,318,995**	**$ 24,993**	**$ 1,343,988**	**$ (294,510)**

For the year ended August 31, 2003, total investment return of $819,253,000 was reinvested by the University and Hospitals. Recognized investment losses and prior year gains were $759,812,000 for the year ended 2002. These amounts are reported in other changes in unrestricted net assets and changes in temporarily and permanently restricted net assets.

As indicated in the following table, as of August 31, 2003 and 2002, in thousands of dollars, the University's investments are held in various pools or in specific instruments to comply with donor requirements:

	2003	2002
UNIVERSITY:		
Expendable Funds Pool	$ 1,151,888	$ 1,041,658
Merged Endowment Pool	9,250,907	7,305,562
Living trusts	524,492	508,281
Other investments	878,081	1,064,653
	11,805,368	9,920,154
Less funds cross-invested in endowment pools (including the Hospitals' investment of $130,212 and $82,107 in 2003 and 2002, respectively, in the University's Merged Endowment Pool)	963,782	699,106
	10,841,586	9,221,048
HOSPITALS:		
Investments	652,627	298,668
INVESTMENTS AT FAIR VALUE	**$11,494,213**	**$ 9,519,716**

The Expendable Funds Pool (EFP) is the principal investment vehicle for the University's expendable funds. A substantial portion of the EFP is cross-invested in the Merged Endowment Pool (MEP).

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 in, or withdrawn from, funds functioning as endowment. For the years ended August 31, 2003 and 2002, the results of the EFP, in thousands of dollars, are as follows:

	2003	2002
Total investment return of the EFP	$ 121,592	$ 9,769
Less distribution to fund holders and operations	84,722	46,119
AMOUNTS INVESTED IN (WITHDRAWN FROM) THE ENDOWMENT	**$ 36,870**	**$ (36,350)**

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, a portion of realized capital gains, and funds functioning as endowment, as needed.

To meet the Board-authorized payout rate, income, gains, and previously reinvested endowment income were distributed for operations in fiscal years 2003 and 2002, as follows, in thousands of dollars:

	2003	2002
Endowment income	$ 192,807	$ 220,973
Realized gains and previously reinvested income	198,609	156,792
APPROVED PAYOUT	**$ 391,416**	**$ 377,765**

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. Foreign currency forward contracts are used primarily for the purpose of minimizing the risk to the University of adverse changes in the relationship between currencies. Interest rate swaps are used to manage the interest rate exposure of the University's commercial paper (see Note 8). Options and futures contracts are used 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, 2003, the University's derivative positions included foreign currency forward contracts, interest rate swaps, and options and futures contracts. The fair value (loss) of these derivatives was $31,054,000 and $(12,569,000) at August 31, 2003 and 2002, respectively.

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 102% of the security loaned.

During fiscal year 2003, the University entered into an agreement to lease the Stanford Shopping Center for a period of 51 years. The University is entitled to receive certain minimum and participation rents. The lessee prepaid $332,000,000 of the lease commitment at signing. The cash received has been recorded as deferred rental income and will be recognized ratably over the term of the lease.

Future minimum rental income due from Stanford Shopping Center, Research Park, and other properties under noncancelable leases in effect with tenants at August 31, 2003, is as follows, in thousands of dollars:

YEAR	RENTAL INCOME
2004	$ 46,710
2005	44,789
2006	43,264
2007	38,464
2008	35,846
Thereafter	774,294
TOTAL	**$ 983,367**

7. PLANT FACILITIES

Plant facilities at August 31, 2003 and 2002, in thousands of dollars, are as follows:

	2003 UNIVERSITY	2003 HOSPITALS	2003 CONSOLIDATED	2002 CONSOLIDATED
Land and improvements	$ 233,698	$ 6,089	$ 239,787	$ 205,333
Buildings	2,370,981	466,080	2,837,061	2,588,057
Equipment and books	1,150,228	169,144	1,319,372	1,383,564
Construction in progress	158,902	139,341	298,243	284,100
Plant facilities	3,913,809	780,654	4,694,463	4,461,054
Less accumulated depreciation	1,543,802	427,638	1,971,440	1,933,600
PLANT FACILITIES, NET OF ACCUMULATED DEPRECIATION	**$ 2,370,007**	**$ 353,016**	**$ 2,723,023**	**$ 2,527,454**

8. UNIVERSITY NOTES AND BONDS PAYABLE

Notes and bonds payable at August 31, 2003 and 2002, in thousands of dollars, are as follows:

	2003	2002
TAX-EXEMPT:		
California Educational Facilities Authority (CEFA):		
Revenue Bonds, Series M, N, O, P, Q, and R due serially to 2032, with interest from 4.0% to 5.35%	$ 621,760	$ 621,760
Commercial Paper, with variable interest rates	72,600	–
Revenue Bonds, Series L with variable interest rates	115,033	115,033
Department of Education Bonds of 1963 to 1984 due serially to 2024, with interest from 3.0% to 3.5%	–	2,554
TAXABLE:		
Stanford University Bonds due 2024, with fixed interest of 6.875%	150,000	150,000
Medium Term Notes ($150,000 authorized) due to 2026, with fixed interest from 5.85% to 7.65%	150,000	150,000
Stanford University Bonds PARS 2002A due 2032, with variable interest rates	50,000	50,000
Commercial Paper, with variable interest rates	87,400	128,500
Other, with various interest rates	28,017	27,834
University notes and bonds payable	1,274,810	1,245,681
Premiums	386	600
TOTAL	**$ 1,275,196**	**$ 1,246,281**

At August 31, 2003 and 2002, the fair value of these debt instruments approximated their recorded value.

The University incurred interest expense of approximately $56,846,000 and $57,125,000 for fiscal years 2003 and 2002, respectively, which is net of approximately $4,853,000 and $4,370,000, respectively, in interest capitalized as a cost of construction.

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

YEAR	PRINCIPAL
2004 Commercial Paper	$ 160,000
2004 Other	3,319
2005	14,994
2006	662
2007	715
2008	771
Thereafter	1,094,349
TOTAL	**$ 1,274,810**

The University has a taxable commercial paper credit facility that provides for borrowings up to $200,000,000 outstanding at any time. The outstanding balance at August 31, 2003, was $87,400,000. The weighted average days to maturity were 95.6, and the weighted average effective interest rate was 1.08%, as of August 31, 2003. The University uses interest rate swaps to manage the interest rate exposure of its commercial paper program (see Note 6).

The University's School of Law has an $8,000,000 line of credit with the Student Loan Corporation (SLC). There was $2,560,000 outstanding at August 31, 2003.

In March 2003, the University established a 30 year, $150,000,000 tax-exempt commercial paper facility through CEFA. The outstanding balance at August 31, 2003 was $72,600,000. The weighted average days to maturity were 84.4, and the weighted average effective interest rate was 0.87%.

9. HOSPITALS NOTES AND BONDS PAYABLE

Bonds and certificates of participation at August 31, 2003 and 2002, in thousands of dollars, are as follows:

	2003	2002
SHC:		
California Health Facilities Financing Authority (CHFFA):		
Fixed Rate Revenue Bonds 1998 Series B, payable in annual amounts through 2013, with an average interest rate of 5%	$ 183,465	$ 186,265
2003 Fixed Rate Bonds, payable in varying annual amounts from November 2006 through 2023, with interest rates ranging from 2% to 5%	100,000	–
2003 Variable Rate Bonds, maturing in November 2036, with variable interest rates	150,000	–
LPCH:		
1993 Variable Rate Certificates of Participation (Certificates), payable in annual amounts through 2023, with variable interest rates	37,000	38,000
California Health Facilities Financing Authority (CHFFA):		
2003 Auction Rate Revenue Bonds Series 2003A and 2003B, payable in annual amounts starting in 2027 through 2033, with variable interest rates	60,000	–
2003 Fixed Rate Revenue Bonds Series 2003C, payable in annual amounts starting in 2013 through 2027, with an effective interest rate of 4.88%	55,000	–
Hospitals notes and bonds payable	585,465	224,265
Premium (discount)	5,835	(3,044)
TOTAL	**$ 591,300**	**$ 221,221**

The estimated fair value of the debt instruments as of August 31, 2003 and 2002 approximated the recorded value.

Payments of principal and interest on the Hospitals' bonds are collateralized by a pledge against the revenues of the respective hospital. Certain of the bonds and certificates of participation are insured by municipal bond guaranty policies.

LPCH and SHC are each subject to separate Master Trust Indentures which include, among other things, limitations on the incurrence of additional indebtedness, liens on property, restrictions on disposition or transfer of assets, and compliance with certain financial ratios. The Hospitals may redeem the bonds and certificates, in whole or in part, prior to the stated maturities.

In July 2003, the California Health Facilities Financing Authority (CHFFA) issued, on behalf of SHC, revenue bonds in the aggregate principal amount of $250,000,000. The 2003 bonds are comprised of $100,000,000 of Series A Fixed Rate Revenue Bonds and $150,000,000 of Variable Rate Revenue Bonds that were issued as Series B, Series C, and Series D.

In July 2003, CHFFA issued, on behalf of LPCH, revenue bonds in the aggregate principal amount of $115,000,000. The 2003 bonds are comprised of $60,000,000 of Series A and Series B auction rate revenue bonds and $55,000,000 of Series C fixed rate revenue bonds.

Holders of the Certificates have the option to tender the certificates weekly. In order to ensure the availability of funds to purchase any certificates tendered that the remarketing agent is unable to remarket, LPCH has obtained a standby bond purchase agreement that expires in September 2004 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
2004	$ 4,045
2005	4,190
2006	4,445
2007	8,300
2008	9,200
Thereafter	555,285
TOTAL	**$ 585,465**

At August 31, 2003, SHC had swap agreements expiring through November 15, 2036 to pay an interest rate of approximately 3.365% based on an amount equal to the outstanding balance of the 2003 Variable Rate Bonds. At August 31, 2003, LPCH had swap agreements expiring through 2023 to pay a fixed interest rate of 6.22% on an amount equal to the outstanding balance of the 1993 Certificates.

The University is not an obligor or guarantor with respect to any obligations of SHC or LPCH.

10. LIABILITIES UNDER SECURITY AGREEMENTS

At August 31, 2003 and 2002, the University held $311,790,000 and $251,000, respectively, of short-term U.S. government obligations and cash as collateral deposits for certain securities loaned temporarily to brokers. The University also entered into certain forward sale and purchase agreements totaling $31,951,000 at August 31, 2003. These amounts are included as assets and liabilities in the University's financial statements. In addition, at August 31, 2002, the University sold a security subject to obligations to repurchase it at a future date in the amount of $28,594,000. These borrowings have been accounted for as financing transactions and bear interest at a rate of 1.97%. At August 31, 2003, there were no securities sold that were subject to repurchase. The estimated market value of securities on loan and pledged under repurchase agreements at August 31, 2003 and 2002, was $303,251,000 and $30,200,000, respectively.

11. UNIVERSITY ENDOWMENT

The University manages a substantial portion of its financial resources within its endowment. These assets include pure endowment funds, term endowments funds, 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 6. The University classifies the original endowment gift and any donor-imposed restricted gains as permanently restricted net assets and reports all remaining reinvested gains as unrestricted net assets. The University recognizes the limitation on expending such gains that are specified in CUMIFA.

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 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 in the statement of financial position based on 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 (loss) and actuarial adjustment in the statement of activities. 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, 2003 and 2002, in thousands of dollars, are as follows:

	2003	2002
ENDOWMENT, BEGINNING OF YEAR	**$ 7,612,769**	**$ 8,249,551**
INVESTMENT RETURNS (LOSSES):		
Earned endowment income	194,484	222,792
Unrealized and realized gains (losses)	962,252	(577,326)
Total investment returns (losses)	1,156,736	(354,534)
Amounts distributed for operations	(391,416)	(377,765)
Gifts	189,943	130,612
Funds invested in (withdrawn from) endowment	4,139	(12,454)
EFP returns (shortfall) invested in (withdrawn from) endowment	36,870	(36,350)
Actuarial adjustment to living trusts	20,346	26,697
Other	(15,582)	(12,988)
Net increase (decrease) in endowment	1,001,036	(636,782)
ENDOWMENT, END OF YEAR	**$ 8,613,805**	**$ 7,612,769**

12. UNIVERSITY GIFTS AND PLEDGES

The University's Office of Development (OOD) reports total gifts based on contributions received in cash or property during the fiscal year. Gifts and pledges reported for financial statement purposes are recorded on the accrual basis. The following summarizes gifts and pledges received for the years ended August 31, 2003 and 2002, per the statement of activities reconciled to the cash basis (as reported by OOD), in thousands of dollars:

	2003	2002
Current year gifts in support of operations	$ 112,885	$ 104,310
Expendable gifts invested in the endowment	12,965	6,127
Temporarily restricted – general	66,466	54,814
Temporarily restricted – capital	28,718	44,724
Permanently restricted – endowment	157,226	141,725
Permanently restricted – student loans	46	16
TOTAL PER STATEMENT OF ACTIVITIES	**378,306**	**351,716**
ADJUSTMENTS TO GIFT TOTAL AS REPORTED BY OOD:		
Pledges	(150,269)	(158,491)
Payments made on pledges	196,654	214,144
Nongovernment grants, recorded as sponsored research support	61,465	48,741
Other	(81)	(1,341)
TOTAL AS REPORTED BY OOD	**$ 486,075**	**$ 454,769**

Gifts restricted to particular purposes are used for those purposes subject to the University's restricted fund policy adopted by the Board in 1995. Under the policy, 6% of the expenditure from restricted funds, with exceptions for some categories of funds, is allocated for space and infrastructure charges. The policy also provides that no interest is credited to gifts that are fully expendable.

13. FUNCTIONAL EXPENSES

Expenses for each of the years ended August 31, 2003 and 2002, are categorized on a functional basis as follows, in thousands of dollars:

	2003	2002
UNIVERSITY:		
Organized research (direct costs)	$ 737,741	$ 707,343
Instruction and departmental research	744,004	681,068
Auxiliary activities	362,596	333,296
Administration and general	202,952	190,142
Libraries	101,068	101,153
Development	45,245	47,304
Student services	59,175	58,897
SLAC construction	12,949	17,593
	2,265,730	2,136,796
HOSPITALS:		
Health care services	1,067,096	1,018,729
TOTAL CONSOLIDATED EXPENSES	**$ 3,332,826**	**$ 3,155,525**

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 SoM faculty.

14. UNIVERSITY RETIREMENT PLANS

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

RETIREMENT PLANS Retirement benefits for certain nonexempt employees are provided through a noncontributory defined benefit pension plan. Effective January 1, 2001, for those who were both eligible employees and participants in the plan on that date, benefits for each year of service prior to 1992 are based on 1992 earnings. New plan participants are limited. The University's policy is to fund pension costs in accordance with the Employee Retirement Income Security Act minimum funding requirements.

A minimum liability adjustment is required when the actuarial present value of accumulated benefits exceeds plan assets and accrued pension liabilities. The University's minimum liability adjustment of $33,994,000 is reported in other changes in unrestricted net assets. By definition, the adjustment is not an expense but rather represents an unrealized net periodic pension cost.

The University offers a defined contribution 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 $68,724,000 and $60,296,000 for the years ended August 31, 2003 and 2002, 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 health care payors or health maintenance organizations, 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 current cost of post-retirement benefits over the periods that employees render service and the prior service obligation over 20 years.

Effective September 1, 2003, the University instituted a cap on University contributions for pre-Medicare plans at $3,800 for retirees and $3,200 for spouses, and for post-Medicare plans at $2,500 for retirees and $2,000 for spouses.

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, 2003 and 2002, are as follows:

	PENSION		OTHER POST-RETIREMENT	
	2003	2002	2003	2002
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	$ 232,599	$ 255,925	$ 27,790	$ 25,587
Actual return on plan assets	7,189	(8,909)	2,559	(1,054)
Employer contributions	–	–	15,563	9,144
Plan participants' contributions	–	–	4,894	3,810
Benefits paid	(18,535)	(14,417)	(11,116)	(9,697)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	**$ 221,253**	**$ 232,599**	**$ 39,690**	**$ 27,790**
CHANGE IN BENEFIT OBLIGATION				
Benefit obligation at beginning of year	$ 238,136	$ 217,638	$ 292,512	$ 157,486
Effect of curtailment	(1,860)	–	–	–
Service cost	4,097	4,879	4,161	5,864
Interest cost	15,773	14,542	11,786	10,807
Plan participants' contributions	–	–	4,894	3,810
Amendments	–	–	(119,902)	–
Actuarial loss	29,766	15,494	23,962	124,242
Benefits paid	(18,535)	(14,417)	(11,116)	(9,697)
BENEFIT OBLIGATION AT END OF YEAR	**$ 267,377**	**$ 238,136**	**$ 206,297**	**$ 292,512**

The accrued benefit asset (liability), in thousands of dollars, was determined as follows at August 31, 2003 and 2002:

	PENSION		OTHER POST-RETIREMENT	
	2003	2002	2003	2002
Plan assets minus benefit obligation	$ (46,124)	$ (5,537)	$ (166,607)	$ (264,722)
Unrecognized transition (asset) liability	–	(4)	6,865	31,001
Unrecognized prior service cost	7,051	9,743	(52,910)	33,446
Unrecognized net actuarial loss	43,759	3,675	173,558	158,002
NET AMOUNT RECOGNIZED IN THE STATEMENT OF FINANCIAL POSITION	**$ 4,686**	**$ 7,877**	**$ (39,094)**	**$ (42,273)**

Amounts recognized in the statement of financial position, in thousands of dollars, are as follows at August 31, 2003 and 2002:

	PENSION	
	2003	2002
Accrued pension (liability) prepaid cost	$ (36,359)	$ 7,877
Intangible asset	7,051	–
Minimum pension liability	33,994	–
NET AMOUNT RECOGNIZED	**$ 4,686**	**$ 7,877**

The discount rate, expected rate of return on plan assets, and the projected covered payroll growth rates used in determining the above accrued benefit assets (liabilities) are as follows for the years ended August 31, 2003 and 2002:

	PENSION		OTHER POST-RETIREMENT	
	2003	2002	2003	2002
Discount rate	6.00%	7.00%	6.00%	7.00%
Expected return on plan assets	8.00%	8.75%	8.00%	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 was as follows:

	AUGUST 31, 2003			AUGUST 31, 2002		
	MEDICAL			MEDICAL		
	PRE-65	POST-65	DENTAL	PRE-65	POST-65	DENTAL
2003 to 2004	–	–	–	14.0%	16.0%	8.0%
2004 to 2005	14.0%	16.0%	8.0%	13.0%	15.0%	7.5%
2005 to 2006	13.0%	15.0%	7.5%	12.0%	13.0%	7.0%
2006 to 2007	12.0%	13.0%	7.0%	11.0%	12.0%	6.5%
2007 to 2008	11.0%	12.0%	6.5%	10.0%	11.0%	6.0%
2008 to 2009	10.0%	11.0%	6.0%	9.0%	10.0%	5.5%
2009 to 2010	9.0%	10.0%	5.5%	8.0%	9.0%	5.5%
2010 to 2011	8.0%	9.0%	5.0%	7.0%	8.0%	5.5%
2011 to 2012	7.0%	8.0%	5.0%	6.0%	7.0%	5.5%
2012 to 2013	6.0%	7.0%	5.0%	5.5%	6.0%	5.5%
2013 to 2014	5.5%	6.0%	5.0%	5.5%	5.5%	5.5%
2014 to 2015	5.0%	5.5%	5.0%	5.5%	5.5%	5.5%
2016 and later	5.0%	5.0%	5.0%	5.5%	5.5%	5.5%

Net benefit (income) expense related to the plans for the years ended August 31, 2003 and 2002, in thousands of dollars, include the following components:

	PENSION		OTHER POST-RETIREMENT	
	2003	2002	2003	2002
Service cost	$ 4,097	$ 4,879	$ 4,161	$ 5,864
Interest cost	15,773	14,542	11,786	10,807
Expected return on plan assets	(19,367)	(21,470)	(2,432)	(2,239)
Amortization of transition (asset) liability	(4)	(901)	–	2,568
Amortization of prior service cost	1,025	1,237	(5,291)	3,372
Recognized net actuarial (gain) loss	–	(1,829)	8,279	920
Plan settlement expenses	1,667	–	–	–
NET PERIODIC BENEFIT (INCOME) EXPENSE	**$ 3,191**	**$ (3,542)**	**$ 16,503**	**$ 21,292**

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 $4,646,000 and the aggregate service and interest cost by $357,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post-retirement benefit obligation by $4,086,000 and the aggregate service and interest cost by $310,000.

15. HOSPITALS RETIREMENT PLANS

The Hospitals provide retirement benefits through defined benefit and defined contribution retirement plans covering substantially all employees.

DEFINED BENEFIT PLANS Certain employees of the Hospitals 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. 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), have been included in the benefit obligation recorded on the books of UCSF-Stanford Health Care. The obligations and related plan assets were transferred to and assumed by SHC and UC on December 3, 2002. In anticipation of such transfer and assumption, the Hospitals recorded the net periodic benefit gain (loss) allocated to the Hospitals as well as service costs and other pension costs related to benefits accumulated since March 31, 2000. A net prepaid pension liability of $14,254,000 and benefit of $2,742,000 were recorded by the Hospitals in 2003 and 2002, respectively.

A minimum liability adjustment is required when the actuarial present value of accumulated benefits exceeds plan assets and accrued pension liabilities. The Hospitals minimum liability adjustment of $23,857,000 is reported in other changes in unrestricted net assets. By definition, the adjustment is not an expense but rather represents an unrealized net periodic pension cost.

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 $25,506,000 and $21,596,000 are included in the employee benefits expense at August 31, 2003 and 2002, respectively.

POST-RETIREMENT MEDICAL BENEFIT PLAN The Hospitals currently provide health insurance coverage for employees upon retirement as early as age 55, with years of service as defined by specific criteria. The health insurance coverage for retirees who are under age 65 is the same as that provided to active employees. A Medicare supplement option is provided for retirees over age 65. The obligation for these benefits has been recorded in the statement of financial position.

The plan assets and benefit obligation presented below include the portion of the USHC plan related to the Hospitals' employees, the frozen LPCH plan, and the SHC Staff Pension Plan (the Plans). The net periodic pension cost and post-retirement medical benefit cost include the following components, in thousands of dollars, as of and for the years ended August 31, 2003 and 2002:

	Pension Benefits		Post-Retirement Medical Benefits	
	2003	2002	2003	2002
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	$ 100,827	$ 112,868	$ –	$ –
Actual return on plan assets	6,789	(7,759)	–	–
Employer contributions	190	533	2,827	3,051
Benefits paid	(3,911)	(4,815)	(2,827)	(3,051)
Transfer of assets to UC Retirement Plan	(4,514)	–	–	–
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	**$ 99,381**	**$ 100,827**	**$ –**	**$ –**
CHANGE IN BENEFIT OBLIGATION				
Benefit obligation at beginning of year	$ 122,681	$ 113,907	$ 71,648	$ 64,839
Service cost	1,761	1,893	2,150	1,962
Interest cost	8,433	8,021	4,893	4,597
Actuarial loss	20,473	3,675	5,892	3,301
Benefits paid	(3,911)	(4,815)	(2,827)	(3,051)
BENEFIT OBLIGATION AT END OF YEAR	**$ 149,437**	**$ 122,681**	**$ 81,756**	**$ 71,648**

The accrued benefit asset (liability), in thousands of dollars, was determined as follows at August 31, 2003 and 2002:

	Pension Benefits		Post-Retirement Medical Benefits	
	2003	2002	2003	2002
Plan assets minus benefit obligation	$ (50,056)	$ (21,854)	$ (81,756)	$ (71,648)
Contributions	47	–	–	–
Estimated net benefit payments	–	–	594	–
Unrecognized prior service cost	–	–	2,051	2,684
Unrecognized loss	33,533	10,209	15,953	10,356
Accrued benefit cost recorded in the statement of financial position	(16,476)	(11,645)	(63,158)	(58,608)
Less: Accrued benefit cost at UCSF-Stanford Health Care	–	14,998	–	–
NET AMOUNT RECOGNIZED IN THE STATEMENT OF FINANCIAL POSITION	**$ (16,476)**	**$ 3,353**	**$ (63,158)**	**$ (58,608)**

Amounts recognized in the statement of financial position, in thousands of dollars, are as follows at August 31, 2003 and 2002:

	Pension Benefits 2003	Pension Benefits 2002
Accrued benefit liability	$ (42,064)	$ (15,282)
Minimum pension liability	25,588	3,637
Net amount recognized	(16,476)	(11,645)
Less accrued health benefit cost at UCSF-Stanford Health Care	–	14,998
NET AMOUNT RECOGNIZED	**$ (16,476)**	**$ 3,353**

The discount rate, expected rate of return on plan assets, and the projected covered payroll growth rates used in determining the above accrued benefit asset (liability) are as follows for the years ended August 31, 2003 and 2002:

	Pension Benefits		Other Post-Retirement	
	2003	2002	2003	2002
Discount rate	6.0%	7.0%	6.0%	7.0%
Expected return on plan assets	4.5% – 8.0%	8.0%	N/A	N/A
Covered payroll growth rate	5.5%	5.5%	N/A	N/A

Net benefit (income) expense related to the Plans for the years ended August 31, 2003 and 2002, in thousands of dollars, include the following components:

	Pension Benefits		Post-Retirement Medical Benefits	
	2003	2002	2003	2002
Service cost	$ 1,761	$ 1,893	$ 2,150	$ 1,962
Interest cost	8,433	8,021	4,893	4,597
Expected return on plan assets	(9,215)	(9,602)	–	–
Amortization of prior service cost	–	–	633	633
Recognized net actuarial (gain) loss	62	(576)	834	573
Other	(487)	–	(539)	–
NET PERIODIC BENEFIT (INCOME) EXPENSE	**$ 554**	**$ (264)**	**$ 7,971**	**$ 7,765**

The assumed health care cost trend rate used to measure the accumulated post-retirement benefit obligation at August 31, 2003 was 13% for the year ended August 31, 2004. The rate was assumed to decrease by 2% for the next two years, 1% for the subsequent four years, and to remain at 5% 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 $4,686,000 and the aggregate service and interest cost by $403,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post-retirement benefit obligation by $4,115,000 and the aggregate service and interest cost by $355,000.

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 and contracts, 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 by health care providers. These regulations could result in the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. The Hospitals 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 the Hospitals' results of operations in a given period, management believes that such repayments and/or civil remedies would not have a material adverse effect on the Hospitals' financial position.

Approximately 40% of SHC's and 60% of the LPCH's employees are covered under union contract arrangements, and are therefore subject to labor stoppages when contracts expire. There are currently no expired agreements.

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

CONTRACTUAL COMMITMENTS At August 31, 2003, the University had contractual obligations of approximately $42,624,000 in connection with major construction projects. Remaining expenditures on construction in progress are estimated to be $203,479,000, which will be financed with certain unexpended plant funds, gifts, and debt.

At August 31, 2003, the remaining commitment on contracts for the construction and remodeling of hospital facilities was approximately $146,000,000.

The University has made commitments to make investments in certain investment partnerships pursuant to provisions of the various partnership agreements. As of August 31, 2003, the aggregated amount of such unfunded commitments was $1,513,180,000.

GUARANTEES AND INDEMNIFICATIONS The University (including the Hospitals) indemnifies, in the normal course of business, its officers and directors for certain events or occurrences while they are, or were, serving at the University's request in such capacity. While the maximum potential amount of future payments under these arrangements is unlimited, the University carries insurance that limits its exposure. Management believes that the estimated fair value of these indemnifications is minimal. The University also enters into mutual indemnification agreements in the normal course of its business, the impact of which is not expected to be material. As a result, the University has not recorded any liabilities related to guarantees and indemnities as of August 31, 2003.

REPORT OF INDEPENDENT AUDITORS

To the Board of Trustees
Stanford University

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of activities and cash flows, which appear on pages 27 through 52, present fairly, in all material respects, the financial position of Stanford University (the "University") at August 31, 2003 and 2002, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with 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 provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

San Francisco, California
November 14, 2003

MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS

The University is the sole member of Stanford Hospitals and Clinics and Lucile Packard Children's Hospital; however each of the Hospitals has its own separate management with responsibility for its own financial reporting.

Management of the University and the Hospitals are responsible for the integrity and objectivity of their respective portions of these financial statements. The University oversees the process of consolidating the Hospitals' information into the consolidated financial statements. Management of each entity represents that with respect to their financial information the consolidated financial statements on the preceding pages have been prepared in conformity with generally accepted accounting principles.

In accumulating and controlling financial data, management of the University and the Hospitals maintain separate systems of internal accounting controls. Management of the respective entities believes that effective internal controls are maintained and communication of accounting and business policies, by selection and training of qualified personnel and by programs of internal audits, give reasonable assurance, at reasonable cost, that assets are protected and that transactions and events are recorded properly.

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

The Board of Trustees for the University and the separate Boards of Directors for the Hospitals, through their respective Audit Committees, comprised of trustees and directors not employed by the University or the Hospitals, are responsible for engaging the independent auditors and meeting with management, internal auditors, and the independent auditors to independently assess whether each is carrying out its responsibility and to discuss auditing, internal control, and financial reporting matters. Both the internal auditors and the independent auditors have full and free access to the respective Audit Committees. Both meet with the respective Audit Committees at least annually, with and without each other, and without the presence of management representatives.

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

M. SUZANNE CALANDRA
Controller
Stanford University

ROY T. SANTARELLA
Chief Financial Officer
Stanford Hospital and Clinics

KEITH S. GRUNDY
Chief Financial Officer
Lucile Salter Packard Children's Hospital

REPORT FROM THE STANFORD MANAGEMENT COMPANY

STANFORD UNIVERSITY 2003

THE STANFORD MANAGEMENT COMPANY (SMC) WAS ESTABLISHED IN 1991 TO MANAGE STANFORD´S FINANCIAL AND REAL ESTATE 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 INVESTMENT AND REAL ESTATE PROFESSIONALS, THE UNIVERSITY PRESIDENT, CHIEF FINANCIAL OFFICER, CHAIRMAN OF THE BOARD OF TRUSTEES, AND THE CEO OF SMC. THE BOARD APPROVES SMC ASSET ALLOCATION TARGETS, OVERSEES THE HIRING OF EXTERNAL ASSET MANAGERS, AND EVALUATES THE PERFORMANCE OF SMC INVESTMENTS AND PROFESSIONALS. SMC OVERSEES APPROXIMATELY $10.0 BILLION OF ENDOWMENT AND TRUST ASSETS, EXPENDABLE FUNDS, AND COMMERCIAL REAL ESTATE INVESTMENTS.

The majority of the University's endowment assets are invested through the Merged Endowment Pool (MEP), which is a diversified portfolio of actively managed financial and real estate assets valued at $8.2 billion as of June 30, 2003. MEP performance measurements are calculated on the 12 months ended June 30, 2003 to be comparable to the results of other endowments and foundations. The following discussion of endowment performance relates solely to investments in the MEP. The MEP generated an 8.8% investment return for the 12 months ended June 30, 2003. The MEP's well-diversified mix of assets protected the portfolio in an extremely volatile period for world financial markets. During the same 12-month period, the S&P 500 stock index cycled through six movements of plus or minus 20%. The 8.8% one-year return placed Stanford in the top 5% of university and college endowments reporting to the survey conducted by the consulting firm of Cambridge Associates. Over the past 10 years, the MEP achieved an annualized rate of return of 14.0%, growing from $2.4 billion to $8.2 billion. This investment performance places Stanford in the top 2% of all reporting university and college endowments during this period, according to Cambridge.

SMC, with assistance from its board, actively manages the endowment, while remaining committed to a consistent long-term investment strategy. The MEP portfolio is constructed on a foundation of modern portfolio theory and strategic asset allocation and is continuously tested through the rigors of state-of-the-art risk management techniques. The portfolio is designed to optimize long-term returns, create consistent annual payout to the University's operating budget, and preserve purchasing power for future generations of Stanford faculty and students.

The environment during the past year was one of continued volatility in virtually all asset classes. This short-term volatility serves as a cautionary note when reviewing short-term performance and highlights the importance of the long-term focus that underpins the management of a perpetual endowment. SMC endeavors to invest thoughtfully without being whipsawed by this volatility, turning our long-term investment focus into a competitive advantage. Although the returns for the last year were 8.8%, the quarterly volatility behind this performance was substantial. The MEP's three-year annualized performance of 1.3% since June 30, 2000 should be regarded as a more meaningful review of recent endowment results. Over this three-year period, the financial markets have created challenges for all investors. SMC has responded to this environment by remaining committed to our managers, who have demonstrated consistent strategies and excellent returns over a long period of time. In addition, SMC has invested substantially in increased risk management by hiring additional professionals and implementing new information technology systems. The investment decision process at SMC involves an ongoing review of all portfolio assumptions, a detailed analysis of interim returns, and an in-depth dialogue with the board.

STANFORD MEP ASSET ALLOCATION Given the perpetual nature of the University, SMC's investment horizon is very long-term. Our objective is to generate optimal total return relative to an appropriate level of risk for Stanford. SMC reevaluates portfolio asset allocation each June, reviewing with the SMC board expected risk, return, and correlation among asset classes in the process of confirming current strategic asset allocation targets or setting new targets. The process takes into consideration an analysis of the historical characteristics of asset classes, as well as a review of current market trends.

Recently, SMC entered into a long-term ground lease with a public REIT, whereby the University transferred 75% of its economic interest in the Stanford Shopping Center (SSC). After half a century of spectacular success in developing and managing the growth of the SSC, the University felt that it was prudent to investigate alternative economic and management arrangements for what had become one of the top five regional malls in the country. During the last decade, the regional shopping center industry has undergone significant consolidation, unlocking economies of scale in operating centers that Stanford, as a single-asset owner/operator, was unable to achieve. Our national search resulted in the University signing a 51-year ground lease partnership with the largest – and we believe highest quality – mall operator in the country. As a result of this and other property transactions consummated during the year, the MEP's exposure to real estate declined.

The corporate accounting scandals of late 2001 and early 2002 created significant turmoil in the financial markets. In particular, many corporate debt instruments were downgraded, and the pricing of these securities suffered. A number of corporations ultimately were forced to file Chapter 11 bankruptcy due to the combination of the operating stresses of a recession and acutely tight lending practices that followed these accounting problems. This "credit crunch" exacerbated the already weakening prices of many corporate credit instruments. Over the course of late 2001 and early 2002, SMC came to the conclusion that this credit crunch represented a contrarian buying opportunity. We engaged investment managers to overweight our exposure to corporate credit instruments, such as performing high-yield bonds, and negotiated purchases of nonperforming corporate bank loans. The markets for corporate credit investments have steadily improved since the summer of 2003, easing—and ultimately resolving—this credit crunch. As a result, we recently moved to reduce this overweight to corporate credit investments.

The asset allocation targets for the MEP as of June 30, 2003 are listed below:

LONG-TERM POLICY TARGETS

ASSET CLASS	STRATEGIC ALLOCATION
Public Equity	40%
Real Estate	16%
Private Equity	10%
Natural Resources	7%
Absolute Return	15%
Fixed Income	12%

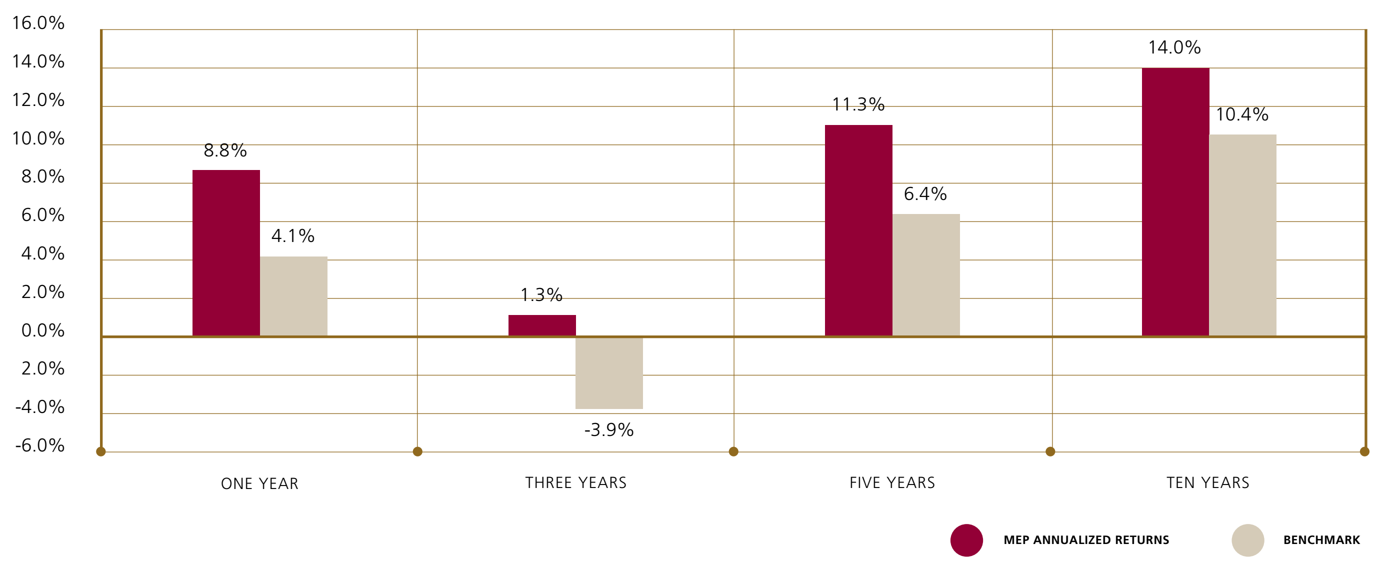
STANFORD MEP PERFORMANCE COMPARED TO INFLATION The table below outlines annualized returns for various periods ending June 30, 2003 and illustrates the performance of the MEP in a long-term context. Stanford's objective is to return a minimum of 6.25% over the rate of inflation. If this real return target is achieved over time, the value of the endowment will be maintained net of annual payouts to support endowed activities. Over the past one-, five-, and 10-year periods, Stanford's annualized real return has substantially exceeded the 6.25% target.

MEP PERFORMANCE COMPARED TO INFLATION

	ONE YEAR	THREE YEAR	FIVE YEAR	TEN YEAR
Nominal Endowment Return	8.8%	1.3%	11.3%	14.0%
GDP Deflator	1.5%	1.6%	1.7%	1.8%
Real Endowment Return	7.2%	-0.4%	9.6%	12.2%

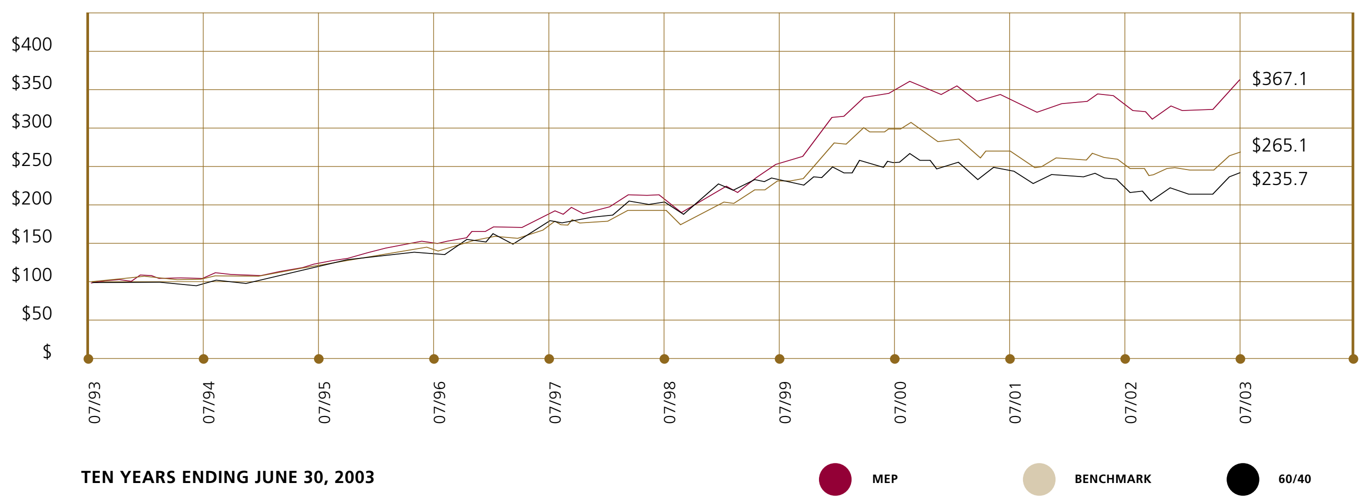
STANFORD MEP PERFORMANCE COMPARED TO BENCHMARKS SMC evaluates the performance of investment managers by comparing their returns to benchmarks that are appropriate for each individual asset class. SMC may alter an asset class benchmark to allow for a change in investment style, a shift in mix within an asset category, or to account for the impact of leverage. The SMC board reviews asset class benchmarks on an annual basis to ensure comparability. SMC evaluates overall MEP 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. In the table below, actual performance, net of management fees, is compared to the composite benchmark for periods ended June 30, 2003.

STANFORD MEP VS. STANFORD COMPOSITE BENCHMARK



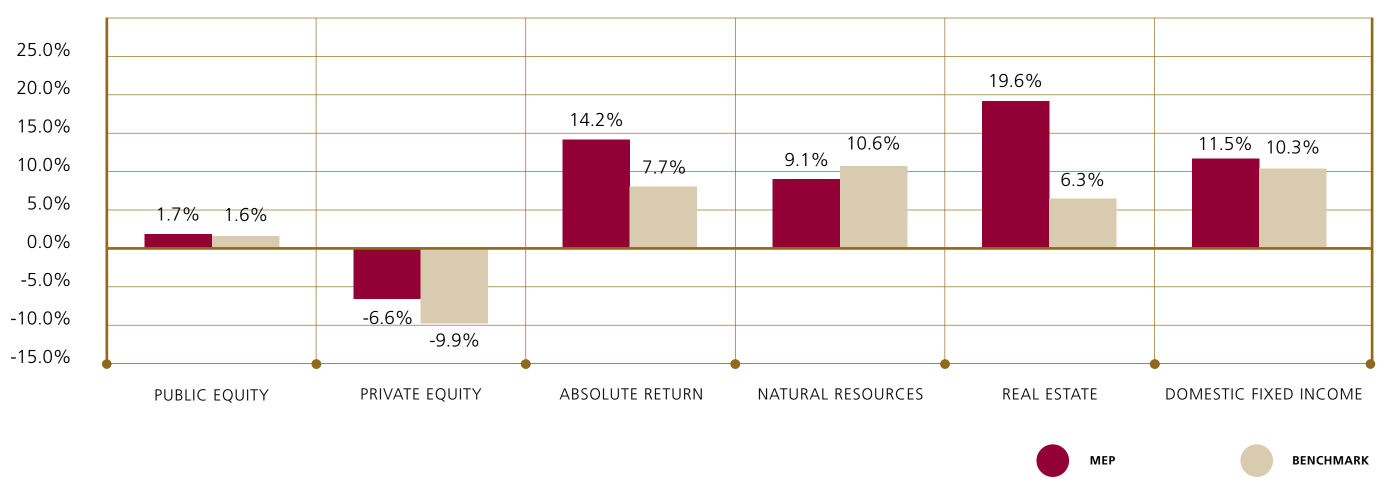
SMC's effectiveness in implementing its investment strategies through superior manager selection has resulted in a consistent and long-term performance advantage over the composite benchmark. The cumulative return chart below compares the growth of $100 in Stanford's endowment with that of the composite benchmark over the past 10 years. The MEP performance advantage (relative to benchmark returns) attributable to superior active manager selection has added in excess of $2 billion to the value of the endowment over this 10-year period. The chart also compares the growth of this $100 against a passive "60/40 portfolio" (a portfolio consisting of 60% stocks and 40% bonds), which represents a more traditional passive asset allocation. As one can observe from the chart, this passive 60/40 portfolio tracked the return of the MEP quite closely from 1993 through 1999. Beginning in the early 1990s, SMC shifted the MEP's asset allocation away from a dominant dependence on public stocks toward a much more diversified set of financial and real estate assets in a strategic move to mitigate risk in the portfolio. During the late 1990s this was, at times, an unpopular investment strategy as the stock market was rising in excess of 20% per year. The benefits of this diversification strategy did not become readily apparent until the last three years. During the period from June of 2000 through June of 2003, the U.S. stock market was down more than 28% while the MEP's investment performance was up 4% cumulatively. The recent returns to this multi-asset class diversification are also apparent relative to the benchmark 60/40 portfolio as seen in the chart below.

STANFORD MEP VS. STANFORD COMPOSITE BENCHMARK VS. PASSIVE 60% EQUITY / 40% BOND COMPOSITE



INDIVIDUAL ASSET CLASS PERFORMANCE The performance of individual asset classes for the 12 months ended June 30, 2003, relative to each asset class benchmark is illustrated in the graph below:

STANFORD MEP ONE-YEAR ASSET CLASS RETURNS VS. BENCHMARK



Relative performance of MEP asset classes versus benchmark was strong for the one-year period with an overall portfolio alpha (return over benchmark) of 4.7%. Total return in almost every asset class also improved from the year-ago period. However, we have not seen, and do not expect to see, a return of the broad-based bull market of 1982-2000. The last three years provide a stark contrast to the previous bull market period when substantially all financial assets exhibited double-digit annual returns. The bull-market was a period of protracted interest rate declines, valuation expansion, and seemingly unsustainable economic overexpansion. The 20-year secular decline in interest rates appears to have continued through June of 2003, but SMC is not optimistic that this trend can continue. The view at SMC is that the tailwinds of the bull market have become the headwinds of today's challenging investment environment. Over the past three years, the markets have experienced an overall compression in financial and real estate asset returns that has caused investors to reexamine their investment strategies. For example, many institutions have reacted to today's environment by allocating substantial additional assets to alternative asset categories that are often limited in their investment opportunity and capacity to absorb additional capital. As a result of these trends, SMC has reviewed our assumptions for relative risk-adjusted returns among asset classes and the impact of manager fees on net returns in alternative asset classes.

Stanford's Public Equity portfolio had been deliberately overweighted in value stocks for the last 10 years. This value-tilt had been effective in offsetting the heavy growth stock concentration in the venture capital portfolio and provided substantial cushion during the decline in global equity markets in 2001 and 2002. However, during the past year, SMC moved to unwind the value-tilt in the Public Equity portfolio. The venture capital portfolio no longer constitutes as significant a percentage of endowment assets, thus reducing its impact on the value/growth bias within the portfolio. Public Equity portfolio performance was roughly at benchmark while demonstrating the greatest volatility within the MEP throughout the year.

Private Equity, a combination of venture capital and leveraged buyout limited partnerships, continued to struggle in the aftermath of the excesses of the late 1990s. However, the rate of loss has slowed significantly in these partnerships, giving SMC some reason to believe that this market has neared its bottom. We are also beginning to see a return to positive alpha in the portfolio, renewing our expectation that the top private equity firms will once again deliver returns significantly greater than the private equity market as a whole. SMC remains cautious in the current venture capital environment due to the substantial "overhang" of capital raised by venture partnerships in 1999-2001, together with the latent demand for the asset class found in the unfulfilled asset allocations of many new limited partner entrants to this marketplace. Nonetheless, venture capital has been a very successful asset class for Stanford when evaluated over the long term. In the past nine years, venture capital investment gains have added more than $2 billion to the value of the endowment. SMC will continue to allocate capital to this asset sector by maintaining relationships with proven private equity funds and by selectively investing in new funds.

The Absolute Return portfolio is constructed to provide returns that are substantially uncorrelated to the equity markets. The portfolio includes quantitative and fundamental equity hedge fund strategies, distressed debt, fixed income relative value, and multi-strategy arbitrage funds. One-year results for the period ended June 30, 2003 demonstrate the successful execution of all of these strategies with a particular focus on distressed debt investing. The Absolute Return portfolio was deliberately overweighted to investment managers in the distressed debt sector for the past 18 months. Over the last 12 months, credit spreads have compressed, causing these debt instruments to appreciate in value. With the steady appreciation of securities in the distressed debt market, the MEP has become a net seller, reducing our exposure to corporate credit securities of all varieties. SMC remains committed to a well-diversified Absolute Return portfolio, but cautious about the current environment due to substantial increases in cash flows from institutional investors into many hedge fund investment strategies.

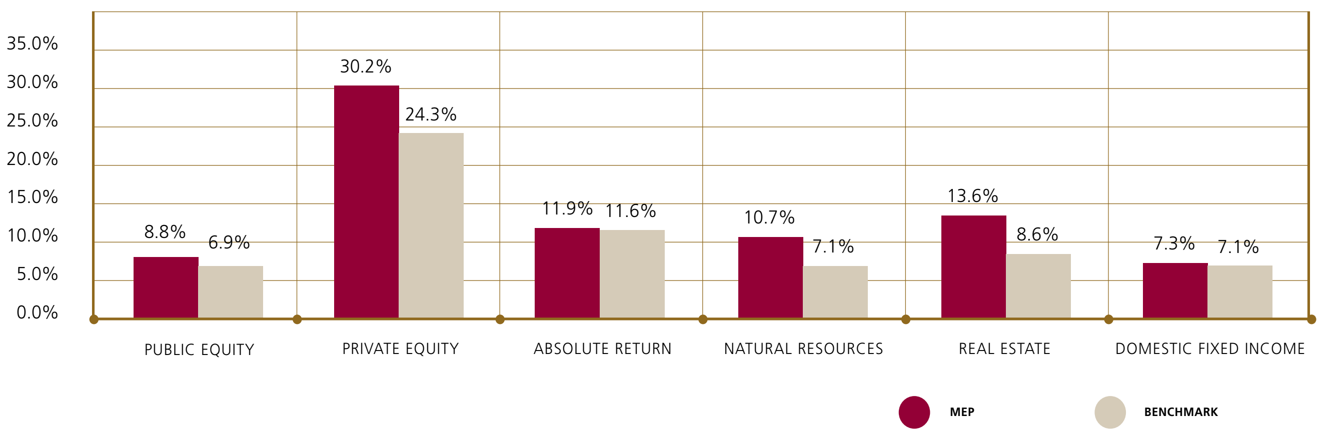
The Natural Resources portfolio is comprised of domestic and international investments in timber, direct oil and gas assets, and oil and gas private equity partnerships. The natural resources sector enjoyed generally strong performance over the last 12 months, buoyed by higher commodities prices. SMC continues to build a diverse portfolio of outstanding managers in the oil, gas, energy, and timber industries.

Stanford's endowment has a substantially larger commitment to Real Estate than our peer institutions. The strategy of overweighting 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 portfolio includes direct investments in commercial and residential real estate development, limited partnership positions in real estate opportunity funds, and publicly traded real estate investment trusts. SMC strives to invest in real estate assets outside of the San Francisco Bay Area and Santa Clara County to provide economic diversification and seismic risk mitigation. The Real Estate portfolio demonstrated strong returns relative to benchmark over the past year as a result of a number of successful asset dispositions across the MEP's global Real Estate portfolio.

Fixed Income experienced strong relative and absolute return during the year. On June 30, 2003, the yield on the 10-year Treasury bond stood at 3.51%, approaching its lowest level in almost 50 years. This provided a tailwind for all fixed income investment managers. The MEP's active managers in this space also created alpha through superior security selection.

The results of 10-year asset class returns, relative to benchmark, illustrate the value of SMC's ability to shift investment style/strategies and identify outstanding managers in each asset class as outlined below:

STANFORD MEP TEN-YEAR ANNUALIZED ASSET CLASS RETURNS VS. BENCHMARK



While we are pleased with the portfolio's 8.8% return for the 12 months ending June 30, 2003, we are more focused upon, and encouraged by, the MEP's three-year annualized return of 1.3%. This three-year period was characterized by repeated challenges to the global financial markets, including a significant recession, the terrorist attacks of September 11, the bursting of the dot-com and telecom bubbles, corporate malfeasance, and a war in the Middle East. Each of these unexpected crises represents another stress test to a portfolio built to withstand the unexpected. While we remain vigilant for the next crisis, as long-term investors we endeavor to turn short-term challenges into successful investment strategies. As an integral component of one of the world's great universities, the Stanford Management Company remains energetically committed to our mission: the pursuit of optimized risk-adjusted investment strategies that preserve the long-term purchasing power of the endowment for future generations.

MICHAEL G. MCCAFFERY
President and Chief Executive Officer
Stanford Management Company

MICHAEL L. ROSS
Chief Investment Officer
Stanford Management Company

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