STANFORD UNIVERSITY 2004 ANNUAL REPORT

Creating a Sustainable Future

STANFORD
UNIVERSITY

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STANFORD FACTS

ENROLLMENT (October 2004): **14,846**
- Undergraduate Students: **6,753**
- Graduate Students: **8,093**

DEGREES AWARDED (2003-2004):
- Bachelor's: **1,713**
- Master's: **2,040**
- Doctoral: **891**

THE STANFORD PROFESSORIATE
(October 2004): **1,783**

NOBEL LAUREATES: **16**

PULITZER PRIZE WINNERS: **4**

MACARTHUR FELLOWS: **22**

NATIONAL MEDAL OF SCIENCE WINNERS: **21**

NATIONAL MEDAL
OF TECHNOLOGY WINNERS: **3**

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

NATIONAL ACADEMY OF
SCIENCES MEMBERS: **132**

NATIONAL ACADEMY OF
ENGINEERING MEMBERS: **80**

AMERICAN PHILOSOPHICAL
SOCIETY MEMBERS: **42**

NATIONAL ACADEMY OF
EDUCATION MEMBERS: **23**

WOLF FOUNDATION PRIZE WINNERS: **6**

KORET FOUNDATION PRIZE WINNERS: **7**

PRESIDENTIAL MEDAL OF
FREEDOM RECIPIENTS: **3**

On the cover: The Stanford University Main Quadrangle and foothills from
Palm Drive. Photo by Linda A. Cicero, Stanford News Service.

CREATING A SUSTAINABLE FUTURE

A MESSAGE FROM THE PRESIDENT

A CENTURY AGO, IN AN ADDRESS TO THE BOARD OF TRUSTEES, JANE STANFORD DESCRIBED THE IMAGE THAT SUSTAINED HER AS SHE LOOKED TO THE FUTURE:

> *I could see a hundred years ahead when all the present trials were forgotten, and all of the present active parties gone, and nothing remaining but the institution. I could see beyond all this the children's children's children coming here from the East, the West, the North, and the South.*

The institution remains. Those children are today's students, and Stanford University is recognized as a global leader in research and teaching. But the 21st century presents its own significant challenges, and we must ask: How will Stanford help meet today's challenges?

Throughout the University's 113-year history, Stanford has prospered by being a pioneer. We have introduced significant changes to the landscape of higher education—from David Starr Jordan's development of the concept of undergraduate majors more than a century ago to Wallace Sterling's vision of the modern research university to, most recently, Gerhard Casper's renewed commitment to undergraduate education.

Stanford University has thrived on the challenge of finding new and better ways of doing things. Ten years ago, after the Commission on Undergraduate Education recommended a sweeping set of enhancements, we introduced significant changes to the curriculum and added new undergraduate opportunities. The renaissance that resulted encompassed all disciplines and introduced enhancements throughout the undergraduate years. Our innovations have included a new Freshman Humanities core, minors in 60 different departments and programs and increased opportunities for undergraduates to participate in honors studies and research. Faculty and students embraced these programs with enthusiasm; peer institutions admired and imitated them. The Stanford undergraduate experience has been transformed.

To support the enhancements and make them permanent, four years ago we launched a five-year, $1 billion Campaign for Undergraduate Education. "Providing the Finest Undergraduate Education Anywhere" in this annual report details the progress of the campaign. With the remarkable support and generosity of alumni and friends around the world, we have achieved great success. As gratifying as this vote of confidence might be, we must maintain our focus. Important goals remain in the undergraduate campaign.

As we enter the final year of our campaign and mark the 10th anniversary of the commission's landmark report, I believe that we stand on the threshold of another transformation. At the beginning of this new century, we have begun to redefine the University and its relationship to the broader world. The challenges surrounding us and around the world are enormous. Emerging infectious diseases have become a global threat. Chronic diseases have limited our ability to improve quality of life. Environmental challenges range from identifying renewable energy sources to sustaining the quality of our water and air to halting the rapid extinction of species. Threats of terrorism, the abuse of human rights and a growing divide between rich and poor have increased political and civil strife throughout the world.

As a research university, Stanford can play a critical role in addressing these problems. Our intellectual tradition—as pioneer and educator—puts us in a unique position to make a difference. Finding solutions will require teams of the best scholars from multiple disciplines to work together under a common vision, and if we are to prepare effective leaders for this complex and challenging world, we must ensure that our education also reflects the needs of the 21st century.

Recent initiatives in the biosciences, the environment and international studies are outlined in "Advancing Multidisciplinary Research and Education." Stanford University is committed to being a pioneer in these areas. Solutions to these problems will require advances in science and technology, but there are significant ethical, cultural and social challenges as well. Our ability to confront these issues and build a sustainable world for our children will require participation by the best minds in the social sciences and humanities as well as those in the sciences and engineering.

In contemplating our future, I have been inspired by the University's Founding Grant and the words of our first president, who faced seemingly insurmountable challenges in Stanford's early days. At the University's opening day, David Starr Jordan said:

> *Our university is hallowed by no traditions. It is hampered by none. Its finger-posts all point forward.*

In the intervening time, we have developed many wonderful traditions, but they do not hamper us. It is with the same sense of boldness and willingness to innovate that we look to the future and go forward.

John L. Hennessy

PROVIDING THE FINEST UNDERGRADUATE EDUCATION ANYWHERE

$1 BILLION CAMPAIGN FOR UNDERGRADUATE EDUCATION INVESTS IN THE UNIVERSITY'S MOST ENDURING COMMITMENT

A DECADE AGO, THE COMMISSION ON UNDERGRADUATE EDUCATION ISSUED A REPORT THAT LED TO SWEEPING ENHANCEMENTS IN UNDERGRADUATE EDUCATION AT STANFORD. THE CAMPAIGN FOR UNDERGRADUATE EDUCATION, OR CUE, WAS LAUNCHED BY PRESIDENT JOHN HENNESSY DURING HIS INAUGURATION AS PRESIDENT IN FALL OF 2000 TO MAKE THOSE ENHANCEMENTS PERMANENT.

At the end of the fiscal year in August, CUE had raised $972 million in gifts and pledges toward its $1 billion goal. At its four-year anniversary in October, CUE had raised $982 million. Specifically, as of the end of October:

- The Stanford Endowment for Undergraduate Education had raised $277 million, including $22 million in expendable gifts, toward its $300 million goal. This endowment supports programs that 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.
- $260 million had been raised toward a $300 million goal for endowed scholarships, both athletic and need-based. CUE has resulted in 229 new need-based scholarship funds and 88 athletic scholarship funds.
- The Stanford Fund had raised $81 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.

Vice Provost for Undergraduate Education John Bravman

- Other undergraduate programs across the University attracted $301 million in gifts against a $300 million goal, supporting offerings such as Overseas Studies, the Haas Center for Public Service and athletics.
- $63 million had been raised in funds not yet designated for specific purposes.

CUE is on track to surpass the $1 billion mark in early 2005. In the final year of CUE, the focus will be on achieving the $100 million, five-year campaign goal for The Stanford Fund, as well as completing several important endowment initiatives. The campaign continues through December 31, 2005.

A LOOK BACK AT SELECTED STANFORD EVENTS DURING THE CALENDAR YEAR 2004:

01/04

SIX LAW STUDENTS AND GRADUATES ARE AWARDED SKADDEN AND EQUAL JUSTICE WORKS FELLOWSHIPS TO WORK ON SUCH ISSUES AS IMMIGRANT AND MIGRANT FARM WORKER RIGHTS, AFFORDABLE HOUSING AND DISCRIMINATION AGAINST ARABS AND MUSLIMS.

THE STANFORD LINEAR ACCELERATOR CENTER DEDICATES SPEAR3, WHICH USES EXTREMELY BRIGHT X-RAY LIGHT TO AID RESEARCH IN MATERIALS SCIENCE, CHEMISTRY AND BIOLOGY.

02/04

GREGORY BOARDMAN, FORMER ASSOCIATE VICE PRESIDENT FOR STUDENT AFFAIRS AT TULANE, BEGINS HIS NEW JOB AS DEAN OF STUDENTS.

MODERN/MODERNITY, THE JOURNAL OF THE MODERNIST STUDIES ASSOCIATION EDITED BY JEFFREY SCHNAPP, PROFESSOR OF COMPARATIVE LITERATURE, WINS THE PHOENIX AWARD FOR SIGNIFICANT EDITORIAL ACHIEVEMENT.

THE NEW STANFORD CANCER CENTER, WHICH CONSOLIDATES CANCER CLINICS AND RESOURCES INTO A SINGLE STRUCTURE, OPENS.

More broadly, Stanford experienced the second-best fundraising year in its history in 2003–04. Stanford received $524.2 million in gifts—a 7.8 percent increase over last year. Gifts to the endowment were up 9.9 percent.

A DECADE OF ADVANCES

John Bravman, the Freeman-Thornton Vice Provost for Undergraduate Education, used the 10th anniversary of the commission report to brief the Faculty Senate in April about enhancements made possible by the commission's work and by CUE. "I think that today we can say that there is no university that delivers a finer undergraduate program," he said.

THE CAMPAIGN FOR UNDERGRADUATE EDUCATION AT STANFORD

Under Bravman's auspices, the Office of the Vice Provost for Undergraduate Education continues to pursue four objectives in undergraduate education:

- sustain a special focus on the first two years of education,
- promote and enable faculty-student engagement around mutual intellectual interests,
- advocate for "general education," and
- support faculty and departments by nurturing a culture of excellence in teaching and mentoring.

Many other innovative undergraduate initiatives are being pursued throughout the University's schools and departments.

More than a third of all of Stanford's faculty members are involved in special undergraduate programs, including:

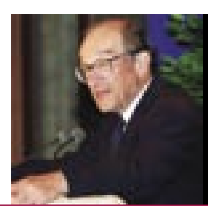
- Stanford Introductory Studies, which includes more than 200 freshman and sophomore seminars taught by some of the University's most esteemed faculty members; classes number 16 students or fewer.
  - Introduction to the Humanities, a yearlong freshman program that builds an intellectual foundation in the study of human thought, values, beliefs, creativity and culture.
- Sophomore College, an intensive two-week program held prior to the opening of school that encourages close student and faculty interaction. More than 20 courses were held in 2003, with 12 to 14 students per class.
- Program in Writing and Rhetoric, with classes of no more than 15 students, designed to help participants develop complex and well-researched academic arguments and oral presentations.
- Freshman-Sophomore College, now in its sixth year, which allows 180 students to integrate classroom and residence exploration of the liberal arts and sciences.
- Undergraduate Research Programs, which promote undergraduate involvement in research and, in 2004, allocated $3.3 million for programs involving 945 students.
- Honors College, which encourages undergraduates to pursue a research project in conjunction with faculty mentors. In 2004, 136 students from 29 majors participated in Honors College.

03/04

PATHOLOGY PROFESSOR EUGENE BUTCHER WINS THE $500,000 CRAFOORD PRIZE FROM THE ROYAL SWEDISH ACADEMY OF SCIENCES FOR HIS WORK IN IMMUNOLOGY AND ITS APPLICATION TO ARTHRITIS.

BRIAN CANTWELL (ABOVE) AND BOB STREET ARE AMONG 76 NEW MEMBERS OF THE NATIONAL ACADEMY OF ENGINEERING.

NEUROBIOLOGIST WILLIAM NEWSOME SHARES IN THE $1 MILLION DAN DAVID PRIZE FOR DEVELOPING A NEW LEVEL OF UNDERSTANDING OF HOW THE VISUAL SYSTEM WORKS.



FEDERAL RESERVE CHAIRMAN ALAN GREENSPAN DELIVERS THE KEYNOTE SPEECH ABOUT INTELLECTUAL PROPERTY AT AN ECONOMIC SUMMIT HOSTED BY THE STANFORD INSTITUTE FOR ECONOMIC POLICY RESEARCH.

PUBLIC EDUCATORS, INCLUDING THE HEADS OF LOS ANGELES AND NEW YORK CITY SCHOOLS, JOIN EDUCATION DEAN DEBORAH STIPEK AND THE STANFORD INSTITUTE FOR ECONOMIC POLICY RESEARCH TO DISCUSS THE PUBLIC EDUCATION CRISIS.

STANFORD AND CORNELL WILL OPERATE AN ENVIRONMENTAL RESEARCH CENTER IN COLLABORATION WITH THE GOVERNMENTS OF JORDAN AND ISRAEL ON A 150-ACRE SITE ALONG THOSE COUNTRIES' BORDER, THANKS TO A GRANT FROM THE BRIDGING THE RIFT FOUNDATION.

"THIS GIFT HONORS MY FATHER. IT HONORS HIS LIFETIME OF PHILANTHROPY, HIS LIFELONG DEVOTION TO STANFORD AND HIS PASSIONATE BELIEF IN THE VALUE OF A LIBERAL ARTS EDUCATION." — *Walter Hewlett*

SCHOOL OF HUMANITIES AND SCIENCES BREAKS $100 MILLION MARK IN HEWLETT CHALLENGE

The Hewlett Challenge, an initiative benefiting the School of Humanities and Sciences (H&S), surpassed $100 million in new gifts and pledges in July. With Hewlett Challenge matching funds of $98.9 million, H&S has increased its endowment by nearly $200 million.

Dean of the School of Humanities and Sciences Sharon Long (above); Trustee and alumnus Walter Hewlett (at right)

"This is a truly important milestone," said Sharon Long, the Vernon R. and Lysbeth Warren Anderson Dean of Humanities and Sciences and the William C. Steere Jr.–Pfizer Inc. Professor in Biological Sciences. "We could not be happier, or more grateful, to the Hewlett Foundation and to our many generous donors for making such a significant, long-term investment in Stanford and the School of Humanities and Sciences."

In 2001, the William and Flora Hewlett Foundation created the Hewlett Challenge with a gift of $300 million to H&S. (At the same time, the foundation gave $100 million to The Campaign for Undergraduate Education.) The gift to H&S aims to bolster the school's endowment for future generations of scholars and students and to ensure a strong liberal arts core at Stanford.

Currently, endowment income represents 20 percent of the school's funding. The $100,529,895 in new gifts and pledges will increase this percentage and is earmarked to support dozens of professorships, directorships, graduate fellowships and new or existing academic programs.

Areas benefiting from the Hewlett Challenge include the Institute for Research on Women and Gender and the Archeology Program. Among the new programs created with Hewlett Challenge matching funds are the Center for Interdisciplinary Studies in Science and Technology and the International, Comparative and Area Studies Division, which includes the new Sohaib and Sara Abbasi Program in Islamic Studies and the France-Stanford Center for Interdisciplinary Studies.

By 2009, H&S seeks to double the Hewlett gift, to $600 million, by building core endowment support for professorships, faculty scholars, graduate fellowships and strategically identified program areas. Further endowed support could help to create funds for innovation and faculty recruitment and to launch new efforts, such as an arts initiative and the Program for Post-Doctoral Fellows in Physical and Mathematical Sciences.

The progress in raising endowment support for H&S through the Hewlett Challenge brings the school closer to fulfilling another important aspect of the challenge: honoring the memory of William Hewlett, co-founder of the Hewlett-Packard Company.

"This gift honors my father," said Walter Hewlett, a Stanford alumnus, member of the University's board of trustees and chairman of the board of the Hewlett Foundation. "It honors his lifetime of philanthropy, his lifelong devotion to Stanford and his passionate belief in the value of a liberal arts education. By helping Stanford fulfill its promise—namely, increasing knowledge and helping young people—we honor his wishes."

ADVANCING MULTIDISCIPLINARY RESEARCH AND EDUCATION

COMPLEX 21ST-CENTURY PROBLEMS BEST ADDRESSED THROUGH COLLABORATIONS ACROSS THE DISCIPLINES

MULTIDISCIPLINARY INITIATIVES IN RESEARCH AND EDUCATION CONTINUE TO CHARACTERIZE STANFORD'S ACADEMIC AGENDA AND DISTINGUISH THE UNIVERSITY AS AN INNOVATOR IN RESEARCH AND TEACHING.

The 21st century represents a new era in scholarship, driven by a need to cross disciplinary boundaries to solve complex worldwide challenges. Urgent problems do not conform to academic categories; their scale defies one field of study. Multidisciplinary initiatives are critical to the University's future as a leader in higher education and in providing solutions to the world's most daunting problems.

President Hennessy has established three key areas of multidisciplinary focus:

- initiative in the biosciences, anchored by the innovative Stanford Program for Bioengineering, Biomedicine and Biosciences (Bio-X);
- initiative in the environment, anchored by the new Stanford Institute for the Environment; and
- initiative in international affairs, anchored by the Stanford Institute for International Studies.

INITIATIVE IN THE BIOSCIENCES

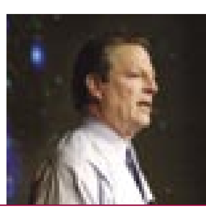
Bio-X, drawing from such fields as computer science, chemistry, physics, law, ethics, engineering and psychology, is the nexus for Stanford's work in interdisciplinary biosciences and bioengineering. About 270 faculty members in 57

Provost John Etchemendy

departments are affiliated with the program. The James H. Clark Center is the focus for Bio-X and also houses the new Department of Bioengineering—the first department to bridge two schools (Engineering and Medicine).

To facilitate research collaborations, the Bio-X Interdisciplinary Initiatives Program (IIP) was created. IIP has provided seed funding to 40 projects totaling more than $6 million. These grants have led to subsequent success in attracting external funding of about $39 million. For instance, the National Institutes of Health (NIH) awarded Stanford a five-year grant to extend a pilot course on cross-disciplinary training for diabetes research. That course, funded by IIP, educated graduate students in the biological

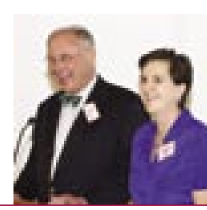
A $5 MILLION GRANT FROM THE ANNENBERG FOUNDATION HONORS HOOVER INSTITUTION DISTINGUISHED FELLOW GEORGE SHULTZ, SUPPORTS THE INSTITUTION AND CREATES A DISSERTATION FUND AT THE STANFORD INSTITUTE FOR ECONOMIC POLICY RESEARCH.



FORMER VICE PRESIDENT AL GORE TELLS GRADUATE SCHOOL OF BUSINESS STUDENTS IN KRESGE AUDITORIUM THAT THE INDUSTRIALIZED WORLD IS ON A COLLISION COURSE WITH NATURE.

THE ALFRED P. SLOAN FOUNDATION CHOOSES EIGHT STANFORD SCIENTISTS TO RECEIVE RESEARCH FELLOWSHIPS: SERAFIM BATZOGLOU, JUSTIN DU BOIS, ASHISH GOEL, KALANIT GRILL-SPECTOR, JONATHAN LEVIN, TIRIN MOORE, KANG SHEN AND ANTHONY WAGNER.

STANFORD GRADUATE STUDENTS AND POST-DOCTORAL FELLOWS LAUNCH A CAMPAIGN URGING SCIENTISTS TO SIGN A STATEMENT OF CONCERN ABOUT FEDERAL ENVIRONMENTAL RESEARCH POLICIES.



THE ANNUAL HUMANITIES CENTER BOOK CELEBRATION, HOSTED BY CENTER DIRECTOR JOHN BENDER AND ASSOCIATE DIRECTOR ELIZABETH WAHL, NOTES THE CREATION OF 88 BOOKS, EIGHT COMPACT DISCS AND THREE DIGITAL VIDEO DISCS BY FACULTY IN THE HUMANITIES IN 2003.

PHYSICIST ANDREI LINDE SHARES THE 2004 COSMOLOGY PRIZE OF THE PETER GRUBER FOUNDATION FOR HIS PROMINENT ROLE IN DEVELOPING AND REFINING THE THEORY OF COSMIC INFLATION.



From left: Stanford Institute for International Studies Director Coit Blacker, chair of Stanford's multidisciplinary bioscience Bio-X program Matthew Scott, alumna Nancy Munger and her husband, Charles Munger

sciences, bioinformatics and bioengineering about the disease so that they can apply their skills to clinical problems. Another IIP grant led to a $14.6 million NIH contract for the Stanford Proteomics Center. Gifts also have led to new graduate and postdoctoral fellowships in interdisciplinary biosciences.

INITIATIVE IN THE ENVIRONMENT

The Stanford Institute for the Environment (see accompanying story on page 8), created in 2004, has been established to focus the University's many environmental resources on the crucial issue of sustainability. The institute is creating a research and teaching program that integrates science, technology and policy. Science will provide the foundation for a deeper understanding of the environment, technology will help create innovative solutions to current problems, and development of new policies will lead to sustainable approaches to the environment.

INITIATIVE IN INTERNATIONAL AFFAIRS

Based in the Stanford Institute for International Studies, which is headed by Coit Blacker, the initiative in international affairs will include faculty from all seven schools. The initiative will pursue research, education and outreach on three global challenges: national and international security; governance at all levels; and human well-being through health, education, economic development and legal reform.

"Stanford has already become one of the great international universities, whether you measure by its faculty, its students, its reputation or its impact," said Provost John Etchemendy in announcing the initiative in April. "The international initiative was not launched to achieve that status, but in recognition of it. It is precisely because we are an international university that we have the obligation to help address the great issues facing the world today."

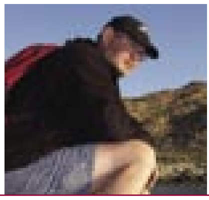
RETHINKING GRADUATE EDUCATION

In concert with these initiatives, a Commission on Graduate Education has been established to focus on the University's mission of educating graduate students. The commission will issue its report in June of 2005.

Explains Etchemendy, "Our vision for graduate education in the 21st century recognizes the growing need for graduate and professional students to have a much broader set of skills that cross disciplinary and school lines. Stanford is uniquely positioned to provide such an education, thanks to the breadth of strengths present on our campus."

Crossing disciplinary boundaries in graduate education also will be encouraged through proposed new graduate residential facilities. The University will use a $43.5 million gift from alumna Nancy Munger and her husband, lawyer and businessman Charles Munger, as the foundation for a mixed graduate community that will house 600 students, including law, business and other graduate students. The residences will offer an array of communal space to encourage cross-disciplinary thought, debate and collaboration.

04/04



RESEARCHERS LED BY WILLIAM GILLY OF THE HOPKINS MARINE STATION BEGIN RETRACING THE 1940 VOYAGE BY JOHN STEINBECK AND ED "DOC" RICKETTS OF THE SEA OF CORTEZ ABOARD THE *GUS D* FISHING BOAT TO STUDY ENVIRONMENTAL CHANGES.

STUDIES SHOW THAT STANFORD IS MEETING ITS REQUIREMENTS FOR CREATING NO NEW "NET COMMUTE TRIPS" UNDER THE TERMS OF THE GENERAL USE PERMIT PASSED IN 2000, THANKS TO AGGRESSIVE NEW ALTERNATIVE TRANSPORTATION PROGRAMS.

URBAN STUDIES MAJOR JOHNNY MADRID IS ONE OF 77 STUDENTS NATIONWIDE SELECTED FOR A TRUMAN SCHOLARSHIP TO SUPPORT GRADUATE STUDY AND LEADERSHIP TRAINING.

VICE PROVOST JOHN BRAVMAN CREATES POTTER COLLEGE FOR UNDERGRADUATES ENGAGED IN INDEPENDENT RESEARCH PROJECTS.

THE AMERICAN SOCIETY FOR MICROBIOLOGY DESIGNATES HOPKINS MARINE STATION AS A "MILESTONES IN MICROBIOLOGY" SITE WITH A PLAQUE HONORING THE WORK OF THE LATE MICROBIOLOGIST CORNELIS B. VAN NIEL.

FORTY-FIVE YEARS AFTER ITS CONCEPTION, THE STANFORD-BASED GRAVITY PROBE B EXPERIMENT TESTING EINSTEIN'S THEORY OF RELATIVITY IS LAUNCHED INTO SPACE.

THE STANFORD INSTITUTE FOR THE ENVIRONMENT TAKES SHAPE

Stanford Institute for the Environment Directors Barton Thompson and Jeff Koseff

In October, President John Hennessy announced the creation of the Stanford Institute for the Environment (SIE), a multidisciplinary initiative that will serve as the focus for the University's environmental research and education.

The institute's mission is sustainability—finding ways to provide for human needs, while protecting the Earth's limited resources. Learning to manage the use of water, fuels and land without disrupting the Earth's life-support systems is necessary to safeguard the health and well-being of people worldwide. What makes Stanford's efforts noteworthy is the centrality of multidisciplinary problem solving.

Stanford already has broad strengths in environmental scholarship—from biology and Earth sciences to environmental engineering to economic environmental policy and environmental law. Many pioneers of environmental science—Paul Ehrlich, Donald Kennedy, Perry McCarty, among others—teach and do research at Stanford. Much environmental research occurs in the School of Earth Sciences, the Jasper Ridge Biological Preserve and the Hopkins Marine Station.

In addition, programs that address environmental issues have been recently created, such as the Interdisciplinary Graduate Program in Environment and Resources, the Center for Environmental Science and Policy, the Global Climate and Energy Project and the Environmental and Natural Resources Law and Policy Program. Stanford alumni also have a tradition of environmental activism. A group led by Stanford alumnus Denis Hayes organized the first Earth Day.

The institute provides an infrastructure to support the growth and interplay of programs across the University. The absence of a traditional, centralized "school of environmental science" has generated creative research, as well as collaboration across disciplines. It is on that foundation that the institute is being built under the leadership of environmental engineering professor Jeff Koseff and environmental legal scholar Barton Thompson.

An Environmental Interdisciplinary Initiatives Program (EIIP), based on a similar funding program in Bio-X, awarded nine grants to promising interdisciplinary research efforts in 2004. For example, scientists recently have uncovered the risks to animals and humans of chemicals used to fight fires, repel stains and lubricate equipment. A group of Stanford researchers representing engineering and marine sciences is using an EIIP grant to develop new biodegradable, nontoxic chemicals in their place.

Training and educating the next generation of environmental leaders is another goal of the institute, and courses will be developed that blend environmental science, technology and policy. Another vital aspect of the institute's mission is to establish collaborations with public and private leaders and with the community at large. The institute also will encourage an ongoing dialogue with communities in the San Francisco Bay Area and throughout California.

"This is an enormous undertaking, but if we are to learn how to live on this planet in an environmentally sustainable way, if we are to leave something to be proud of for our children's children's children, we must begin," President Hennessy said. "I believe that the Stanford Institute for the Environment is uniquely positioned to lead the way and to make a difference in this worthwhile effort."

INVESTING IN COMMUNITY RELATIONS

AWARDS AND PROGRAMS REFLECT CONTINUING EFFORTS TO PARTNER WITH SURROUNDING COMMUNITIES

FOLLOWING THE APPROVAL OF A GENERAL USE PERMIT (GUP) BY THE COUNTY OF SANTA CLARA IN 2000, PRESIDENT JOHN HENNESSY IDENTIFIED ONE OF STANFORD'S CHALLENGES AS BOLSTERING RELATIONSHIPS WITH THE SURROUNDING COMMUNITIES. NEARLY FIVE YEARS AFTER THE GUP PROCESS, INVESTING IN COMMUNITY RELATIONS AND CREATING PARTNERSHIPS TO IMPROVE LIFE IN THE MID-PENINSULA CONTINUES TO BE A PRIORITY FOR STANFORD.

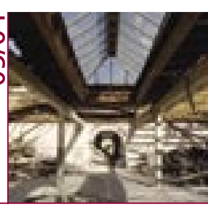
Director of Community Relations Jean McCown

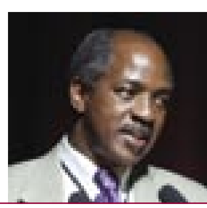
As part of those efforts, a new awards program was created—the Community Partnership Awards—to recognize members of the campus community who partner with local individuals or organizations. Gordon Earle, vice president for public affairs, presented the first three awards to:

- East Palo Alto Tennis and Tutoring (EPATT), which matches K–12 East Palo Alto students with more than 140 volunteer tutors, most of whom are Stanford students. Tennis and tutoring, combined with parent participation, helps EPATT build self-esteem and confidence.
- Partners in Caring (PIC), which matches 90 volunteers, including members of several campus groups, with homebound residents in communities from Los Altos to Redwood City to provide transportation to appointments, shopping assistance, meal preparation and light housekeeping—all at no cost. PIC is a project of Stanford Hospital and Avenidas Senior Center in Palo Alto.
- Stanford Community Law Clinic (SCLC), which is staffed by three attorneys, one paralegal and Stanford Law School students participating in community law courses. SCLC provides free legal assistance to East Palo Alto residents, serves 450 clients a year and refers 450 more to the Legal Aid Society of San Mateo. The clinic is a partnership among Stanford, Stanford Law School, the Legal Aid Society of San Mateo and local law firms.

In addition, thanks to alumna Miriam Aaron Roland, the Haas Center for Public Service for the first time this year recognized faculty members who have demonstrated exceptional commitment to community service. The Miriam Aaron Roland Volunteer Service Prize was given to:

05/04





STANFORD AND IBM JOIN FORCES TO RESEARCH HIGH-PERFORMANCE, LOW-POWER ELECTRONICS IN THE EMERGING FIELD OF NANOTECHNOLOGY CALLED "SPINTRONICS" THROUGH THE NEW SPINTRONIC SCIENCE AND APPLICATIONS CENTER.

STANLEY COHEN WINS THE $500,000 ALBANY MEDICAL CENTER PRIZE IN MEDICINE FOR HIS WORK IN MODERN GENETIC ENGINEERING.

THE NATIONAL ACADEMY OF SCIENCES ELECTS ROBERT ERNEST HALL (ABOVE), PROFESSOR OF ECONOMICS, AND ANDREW FIRE, PROFESSOR OF PATHOLOGY AND GENETICS, TO MEMBERSHIP.

THE 90-YEAR-OLD ENCINA GYM IS RAZED TO MAKE WAY FOR THE NEW 75,000-SQUARE-FOOT ARRILLAGA FAMILY RECREATION CENTER.

NEARLY 750 ALUMNI RETURN TO CAMPUS FOR THE FIRST-EVER CONFERENCE FOR MINORITY ALUMNI AND ISSUES OF DIVERSITY AT STANFORD, FEATURING ALUMNUS CHARLES OGLETREE.

THREE RESEARCHERS ARE AMONG 57 OF THE NATION'S MOST PROMISING YOUNG SCIENTISTS AND ENGINEERS HONORED WITH 2002 PRESIDENTIAL EARLY CAREER AWARDS: J. CHRISTIAN GERDES (ABOVE), HARI MANOHARAN AND DAVID GOLDHABER-GORDON.

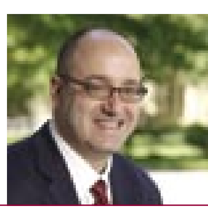
- Boyd Paulson Jr., the Charles H. Leavell Professor of Civil Engineering and a volunteer with Peninsula Habitat for Humanity and Mid-Peninsula Housing Coalition. He has provided pro bono consulting on low-income housing for nearly a decade. Through his courses, he has helped students create affordable housing in many communities.
- Milbrey McLaughlin, the David Jacks Professor of Higher Education and founder and director of the John W. Gardner Center for Youth and Their Communities. The center, founded in 2000, creates alliances among community leaders, schools and organizations to serve the needs of urban youth.

Clockwise from left: Miriam Aaron Roland Volunteer Service Prize winner Boyd Paulson, the East Palo Alto Tennis and Tutoring program, the Stanford Community Law Clinic, Ballet Folklórico at Community Day

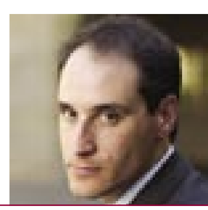
Stanford further invested in community relations through:

- the appointment of attorney Jean McCown, former Palo Alto mayor, as director of community relations. McCown served on the Palo Alto City Council, the Palo Alto Planning Commission and government transportation committees, including the Santa Clara County Congestion Management Agency and the Metropolitan Transportation Commission. She is past director of the Committee for Green Foothills, is on the board of directors of the Greenbelt Alliance, and is the 2004 winner of the prestigious Athena Award, given by the Palo Alto Chamber of Commerce.
- sponsorship of Stanford's third annual Community Day, which attracted about 10,000 visitors in April. More than 20 student groups and two dozen departments participated. During Community Day, Stanford invites its neighbors, especially the residents of Palo Alto, Menlo Park, East Palo Alto, Woodside, Mountain View, Los Altos, Los Altos Hills and Portola Valley, for a free family-oriented open house featuring music, arts, athletic events, science displays, a children's community carnival and health fair.
- the second annual Discovering Dickens: A Community Reading Project, featuring *A Tale of Two Cities*. More than 5,000 people—most from the surrounding communities—received 15 weekly installments free through the mail or downloaded from the Web of the serial novel, compiled from the University Libraries' Special Collections. The program, sponsored by Continuing Studies, gives the community a chance to experience Dickens as Victorian-era readers did.

FORMER 49ERS DEFENSIVE BACK RONNIE LOTT GIVES A $1 MILLION CHALLENGE GRANT TOWARD THE CREATION OF A MARTIN LUTHER KING JR. RESEARCH INSTITUTE, BASED ON THE KING PAPERS PROJECT HEADED BY CLAYBORNE CARSON (ABOVE).



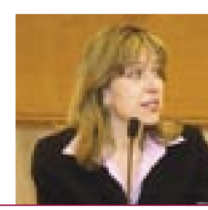
LARRY KRAMER, ASSOCIATE LAW DEAN AT NEW YORK UNIVERSITY, IS NAMED TO SUCCEED KATHLEEN SULLIVAN AS DEAN OF THE SCHOOL OF LAW.



PRESIDENT JOHN HENNESSY LEADS A DELEGATION TO CHINA TO OPEN STANFORD'S NEW CAMPUS AT PEKING UNIVERSITY, HEADED BY ALUMNUS JASON PATENT (ABOVE).

THE AMERICAN ACADEMY OF ARTS AND SCIENCES ELECTS SEVEN STANFORD SCHOLARS TO MEMBERSHIP: JONATHAN BENDOR, JOAN BRESNAN, JEREMY BULOW, ROBERT CONQUEST, ANDREW FIRE, AVNER GREIF AND MARK LEPPER.

ENTERTAINER BILL COSBY RAISES $1 MILLION FOR STANFORD TEACHER EDUCATION PROGRAM STUDENTS WHO WANT TO WORK IN UNDERSERVED SCHOOLS DURING A VISIT FEATURING A PERFORMANCE, CONFERENCE AND A DINNER HOSTED BY TOM BROKAW.



ELIZABETH SHERWOOD-RANDALL, SENIOR RESEARCH SCHOLAR AT THE CENTER FOR INTERNATIONAL SECURITY AND COOPERATION, IS NAMED A 2004 CARNEGIE SCHOLAR.

STANFORD UNIVERSITY RESEARCH HIGHLIGHTS

STANFORD SCHOLARS AND RESEARCHERS CONTINUED THEIR CONTRIBUTIONS TO THE CREATION OF NEW KNOWLEDGE DURING 2004—MANY THROUGH MULTIDISCIPLINARY INITIATIVES. FOLLOWING ARE EXAMPLES.

Dean of the School of Humanities and Sciences and Professor of Biological Sciences Sharon Long (right) with postdoctoral fellow Raka Mitra

UNRAVELING HUMAN BEHAVIOR

Psychologist **John Gabrieli** and his coauthors at the University of Oregon write in *Science* that a biological mechanism exists in the human brain to block unwanted memories.

PROBING THE BUILDING BLOCKS OF LIFE

Biochemist **Patrick Brown** and others report in *Public Library of Science Biology* that genes that help wounds heal may be responsible for promoting aggressive tumors.

Biochemist **James Spudich** and physics graduate student David Altman report in *Cell* how a molecular motor provides the rigidity needed by the tiny sensors in the inner ear to respond to sound, which has implications for understanding the maintenance of cells.

People with fragile X syndrome, the most common inherited developmental disability, have reduced blood levels of a protein vital for brain development, according to a study in the *Proceedings of the National Academy of Sciences* by **Allan Reiss**, professor and director of the Psychiatry Neuroimaging Laboratory and Behavioral Neurogenetics Research Center.

A team led by **Sharon Long**, professor of biological sciences and dean of the School of Humanities and Sciences, reports in *Proceedings of the National Academy of Sciences* about a technique called transcript-based cloning that streamlines isolating individual genes and determining their function.

Developmental biologist **David Kingsley** writes in *Nature* that the evolutionary loss of hind limbs or fins in some fish can be traced to alterations in a single gene.

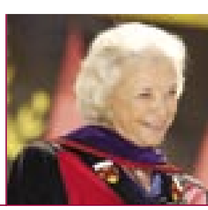
Developmental biologists **Harley McAdams** and **Lucy Shapiro** announce in *Science* that they have discovered a pair of genes that essentially acts as the engine of cell division.

ADVANCING BUSINESS AND MANAGEMENT

Michaela Draganska, assistant professor of marketing in the Graduate School of Business, produces a mathematical model that challenges conventional wisdom about maximizing

A STUDY COMPARING FEMALE AND MALE FACULTY BY A PROVOST'S ADVISORY COMMITTEE SHOWS NO SIGNIFICANT DIFFERENCES EITHER IN MEASURES OF OVERALL SATISFACTION OR IN NON-SALARY COMPENSATION AND SUPPORT IN MOST PARTS OF THE UNIVERSITY.

06/04



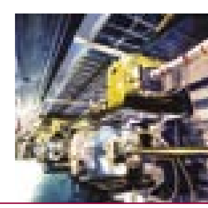
ALUMNA AND U.S. SUPREME COURT JUSTICE SANDRA DAY O'CONNOR ENCOURAGES GRADUATES TO PURSUE PUBLIC SERVICE AT THE 113TH COMMENCEMENT.

GROUND IS BROKEN FOR THE NEW FRED KAVLI BUILDING, WHICH WILL HOUSE THE KAVLI INSTITUTE FOR PARTICLE ASTROPHYSICS AND COSMOLOGY, AT THE STANFORD LINEAR ACCELERATOR CENTER.

STANFORD ANNOUNCES IT WILL RESUME MANAGEMENT OF THE RED BARN TO BETTER INTEGRATE THE HISTORIC EQUESTRIAN RIDING FACILITY INTO THE UNIVERSITY'S ACADEMIC PROGRAM.

07/04

ELIZABETH KWO AND CLARA SHIH ARE AMONG 15 SENIORS NATIONWIDE TO WIN THE INAUGURAL $20,000 MERAGE AMERICAN DREAM FELLOWSHIPS, GIVEN TO IMMIGRANT CITIZENS OR PERMANENT RESIDENTS.



THE PEP-II ACCELERATOR AT THE STANFORD LINEAR ACCELERATOR CENTER REACHES A NEW MILESTONE WHEN IT DELIVERS THREE TIMES AS MANY PARTICLE COLLISIONS PER SECOND AS IT WAS DESIGNED TO PRODUCE.

Clockwise from above: Assistant Professor of Civil and Environmental Engineering Alexandria Boehm, Professor of Geological and Environmental Sciences Donald Lowe, Professor of Biological Sciences Peter Vitousek, and Biological Sciences researcher Christopher Field and field technician Julia Silvis

consumer choice and that helps companies decide how long product lines should compete.

Economists **Jeremy Bulow** and **John Shoven** develop an economically rational method to value stock options and testify about the method before the Securities and Exchange Commission.

Hau Lee and **Seungjin Whang**, professors of operations, information and technology at the Graduate School of Business, suggest a cost-effective model for improving security and inspecting container ships in the face of terrorist threats.

Corporations that accept responsibility for a bad financial year rather than blame external forces may be rewarded by the stock market, according to research by **Larissa Tiedens**, associate professor of organizational behavior at the Graduate School of Business.

UNDERSTANDING THE EARTH AND ITS ENVIRONMENT

Replacing gasoline vehicles with diesel vehicles—equipped even with modern pollution controls—may increase smog over most of the United States, according to a study by **Mark Jacobson**, associate professor of civil and environmental engineering, in *Geophysical Research Letters*.

Periodic unexplained pollution that temporarily closes California beaches may be due to contaminated groundwater discharging into the surf zone, according to a report on the *Environmental Science & Technology* website by **Alexandria Boehm**, assistant professor of civil and environmental engineering, and **Adina Paytan**, assistant professor of geological and environmental sciences.

Rocks and the development of continents played a critical role in the evolution of Earth's early atmosphere, according to NASA-funded research by **Donald Lowe**, professor of geological and environmental sciences, and his student in *Geology*.

Volcanoes played a crucial role in early Hawaiian agriculture and in the conquest of the island chain by one chiefdom, according to a study in *Science* by **Peter Vitousek**, professor of biological sciences.

Global climate change could significantly alter life in California by the end of the century, according to a study in the *Proceedings of the National Academy of Sciences* by biological sciences researchers, including **Christopher Field** and **Stephen Schneider**.

For the first time, scientists, led by biologist **Elizabeth Hadly**, have found a relationship between global warming and the evolution of contemporary wildlife, according to a study in *Public Library of Science Biology* online.

08/04

FIFTEEN ATHLETES AND COACHES WITH STANFORD TIES COMBINE FOR 17 MEDALS AT THE 2004 OLYMPIC GAMES.

ALUMNA NANCY MUNGER AND HER HUSBAND, CHARLES, GIVE THE LARGEST GIFT EVER FOR HOUSING, DONATING $43.5 MILLION FOR A NEW GRADUATE RESIDENCE TO HOUSE LAW AND OTHER GRADUATE STUDENTS.

09/04

MILDRED CHO, ASSOCIATE DIRECTOR OF THE CENTER FOR BIOMEDICAL ETHICS, RECEIVES $3.8 MILLION FROM THE NATIONAL HUMAN GENOME RESEARCH INSTITUTE TO ESTABLISH THE NEW CENTER FOR INTEGRATION OF RESEARCH ON GENETICS AND ETHICS.

THE CAMPUS WELCOMES 1,650 FRESHMEN AND 78 TRANSFER STUDENTS FROM 47 COUNTRIES AND 49 STATES.

THREE STANFORD FACULTY MEMBERS WIN 2003 PRESIDENTIAL EARLY CAREER AWARDS FOR SCIENTISTS AND ENGINEERS, THE NATION'S HIGHEST HONOR FOR PROFESSIONALS AT THE OUTSET OF RESEARCH CAREERS: ERICA PLAMBECK (ABOVE), JUAN SANTIAGO AND RAVI VAKIL.

THE NEWLY ESTABLISHED DEPARTMENT OF BIOENGINEERING WELCOMES ITS FIRST 19 GRADUATE STUDENTS, LAUNCHING A PROGRAM TO COMBINE THE STUDY OF BIOMEDICAL SCIENCES AND ENGINEERING.



FOCUSING ON HOW CHILDREN LEARN

Susanna Loeb, assistant professor of education, reports in *Child Development* that poor preschool children enrolled in high-quality child care centers develop early reading skills faster than those placed in home-based care.

Education Professor **Sam Wineburg** argues in the *Journal of American History* that American students have always performed poorly on history tests designed to gauge factual knowledge, contextualizing findings of the National Assessment of Educational Progress.

CREATING SOLUTIONS THROUGH ENGINEERING

Researchers at Stanford and Cal create the first working integrated silicon circuit that incorporates carbon nanotubes in its design, a step in building advanced nanoelectronic products.

Computer scientist **David Dill** makes a case for a "voter-verifiable paper audit trail" at a symposium on voting at the annual meeting of the American Association for the Advancement of Science.

Shanhui Fan, assistant professor of electrical engineering, and his students write in *Physical Review Letters* about development of a blueprint for capturing light on a chip that boosts prospects for smaller, faster optical computers.

Harvey Fishman, director of the Stanford Ophthalmic Tissue Engineering Laboratory, leads a study that developed a prototype for an implantable chip that could serve as a prosthetic retina for people who suffer from age-related blindness and as a drug-delivery system to treat conditions such as Parkinson's disease.

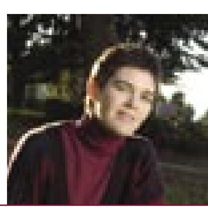
Clockwise from top left: Assistant Professor of Education Susanna Loeb, Education Professor Sam Wineburg, Hoover Institution Senior Fellow Larry Diamond and Computer Science Professor David Dill

RESEARCH IN THE HUMANITIES AND SOCIAL SCIENCES

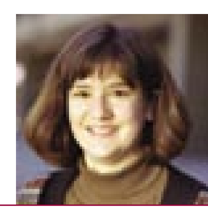
Hoover Institution Senior Fellow **Larry Diamond**, head of the democracy program at the Center on Democracy, Development and the Rule of Law at the Stanford Institute for International Studies, writes the lead article in *Foreign Affairs* about "What Went Wrong in Iraq."

In "Culture War? The Myth of a Polarized America," political scientist **Morris Fiorina** asserts that the American electorate is centrist and not polarized.

Archeologist **Jennifer Trimble**, assistant professor of classics and codirector of Stanford's Digital Forma Urbis Romae Project, is helping to build an online archive of what remains of a massive marble map of third-century Rome.



10/04

A $3 MILLION GIFT FROM ALUMNI BILL AND DONNALISA BARNUM WILL CONVERT THE FIRE-DAMAGED FORMER CAREER DEVELOPMENT CENTER INTO THE BARNUM FAMILY CENTER FOR SCHOOL AND COMMUNITY PARTNERSHIPS AT THE SCHOOL OF EDUCATION.

JULIE THERIOT, ASSISTANT PROFESSOR OF BIOCHEMISTRY AND OF MICROBIOLOGY AND IMMUNOLOGY, AND DAPHNE KOLLER (ABOVE), ASSOCIATE PROFESSOR OF COMPUTER SCIENCE, ARE NAMED MACARTHUR FELLOWS.

THE NATIONAL INSTITUTE OF GENERAL SCIENCES AWARDS $19.9 MILLION TO RUSS ALTMAN, ASSOCIATE PROFESSOR OF GENETICS, AND SCOTT DELP, CHAIR OF BIOENGINEERING, TO ESTABLISH THE NATIONAL CENTER FOR PHYSICS-BASED SIMULATION OF BIOLOGICAL STRUCTURES.

THE LIBRARY OF CONGRESS SELECTS STANFORD AND THE UNIVERSITY OF CALIFORNIA-SANTA BARBARA TO DEVELOP ONE OF EIGHT NATIONAL INITIATIVES FOR DIGITAL INFORMATION PRESERVATION.

ALUMNUS LORRY LOKEY WAS ON HAND FOR THE DEDICATION OF THE NEW LORRY I. LOKEY LABORATORY FOR CHEMISTRY AND BIOLOGICAL SCIENCES.

PHYSICISTS KATHRYN MOLER AND DAVID GOLDHABER-GORDON WILL CODIRECT THE CENTER FOR PROBING THE NANOSCALE, CREATED WITH A $7.5 MILLION, FIVE-YEAR NATIONAL SCIENCE FOUNDATION GRANT.

CONTRIBUTIONS TO THE LAW

Assistant Professor of Law **Jenny Martinez** argues before the U.S. Supreme Court on behalf of José Padilla in *Rumsfeld v. Padilla*, focusing on whether the U.S. president has the authority to seize and detain indefinitely a U.S. citizen on U.S. soil as an enemy combatant.

The U.S. Supreme Court agrees to hear four cases submitted by law students enrolled in the Supreme Court Litigation Clinic, taught by Professor **Pamela Karlan** and Lecturer **Thomas Goldstein**.

An article by Law Professor **Robert Daines** on IPO firms and an article coauthored by Law Professor **Ronald Gilson** on convertible preferred stock are among the "Top 10 Corporate and Securities Articles of 2003," according to *Corporate Practice Commentator*.

Law School faculty members Jenny Martinez and Pamela Karlan

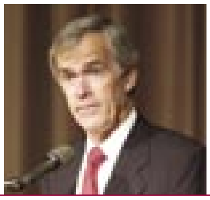
IMPROVING HUMAN HEALTH

Writing in the *Journal of the American Medical Association*, **Marcia Stefanick**, professor of medicine at the Stanford Prevention Research Center and chair of the steering committee for the Women's Health Initiative study, reports that unopposed estrogen therapy for women in their 60s and 70s is not beneficial.

Jonathan Pollack, assistant professor of pathology, leads a study published in the *New England Journal of Medicine* that uncovered 133 genes that point to the most dangerous strains of adult myeloid leukemia, which could help identify patients in need of aggressive therapy.

A report in *Stroke* by neuroscientist **Gary Steinberg** and biological scientist **Robert Sapolsky** shows that cooling the brain gives doctors more time to protect brain cells during a stroke. In *Proceedings of the National Academy of Sciences*, Steinberg also reports success using stem cells to populate the brain region damaged by stroke in rats, raising hope for people recovering after a stroke.

Psychological factors more accurately predict who will develop lower back pain than both disc injection and magnetic resonance imaging, according to a study in *Spine* by lead author **Eugene Carragee**, professor of orthopedic surgery.



THE NATIONAL SCIENCE FOUNDATION AWARDS $25 MILLION TO THE STANFORD CENTER FOR INNOVATIONS IN LEARNING, THE UNIVERSITY OF WASHINGTON AND SRI INTERNATIONAL TO ADVANCE THE SCIENTIFIC UNDERSTANDING AND PRACTICES OF LEARNING.

THE NEW GRADUATE COMMUNITY CENTER IS OPENED ON ESCONDIDO ROAD DURING A GALA CELEBRATION.

U.S. SENATOR JEFF BINGAMAN, A STANFORD ALUMNUS, SPEAKS AT THE SUSTAINABILITY DAYS CONFERENCE SPONSORED BY THE STANFORD INSTITUTE FOR THE ENVIRONMENT.

FORMER DEFENSE SECRETARY ROBERT MCNAMARA SPEAKS AT THE CENTER FOR INTERNATIONAL SECURITY AND COOPERATION.

THE STANFORD INSTITUTE FOR THE ENVIRONMENT RECEIVES A $3.5 MILLION GIFT FROM MELVIN AND JOAN LANE TO ESTABLISH A PROFESSORSHIP IN INTERDISCIPLINARY ENVIRONMENTAL STUDIES IN THE SCHOOL OF HUMANITIES AND SCIENCES.

EDWARD LAZEAR, PROFESSOR AT THE GRADUATE SCHOOL OF BUSINESS AND A HOOVER INSTITUTION SENIOR FELLOW, WINS THE 2004 PRIZE IN LABOR ECONOMICS GIVEN BY THE INSTITUTE FOR THE STUDY OF LABOR IN BONN.

Researchers led by **Ann Arvin**, chief of pediatric infectious diseases at Packard Children's Hospital, report in *Proceedings of the National Academy of Sciences* on a new model designed to reveal how the varicella-zoster virus that causes chicken pox hides in nerve cells.

Researchers at the School of Medicine, including **Richard Myers**, director of the Stanford Human Genome Center, helped finalize the sequencing of Chromosomes 5 and 19, with both reports published in *Nature*.

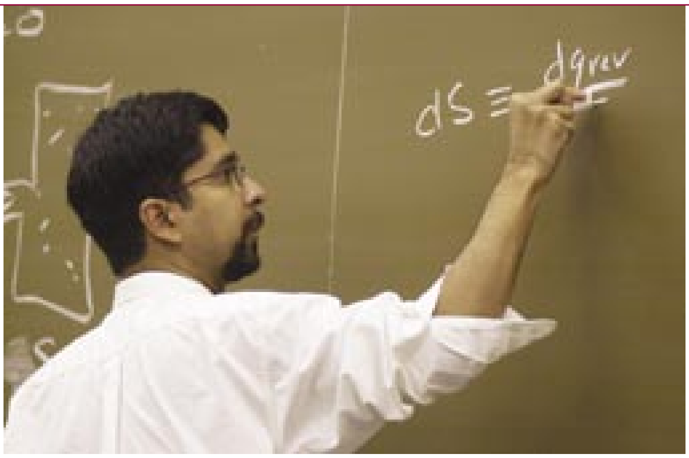
Thomas Stamey, professor of urology, leads a study published in the *Journal of Urology* that questions the validity of the most commonly used screening tool—the PSA test—for detecting prostate cancer.

Garry Nolan, associate professor of microbiology and immunology, reports in *Cell* on a technique for speeding up the identification of appropriate treatment for people with acute myelogenous leukemia.

Writing in *Archives of Internal Medicine*, **Randall Stafford**, assistant professor of medicine, and his team at the Stanford Prevention Research Center report that millions of people with osteoporosis are going undiagnosed.

DISCOVERIES IN THE SCIENCES

Writing in *Science*, a team led by scientists at the Stanford Synchrotron Radiation Laboratory and Stockholm University overturn 20 years of research in the physical chemistry of water by showing that water molecules clump more loosely than previously thought.



Vijay Pande, assistant professor of chemistry

Vijay Pande, assistant professor of chemistry, writes in *Proceedings of the National Academy of Sciences* that he and his colleagues have come up with a way to study protein folding—the process through which proteins in every cell assemble themselves into functional 3-D shapes.

Scientists at the Stanford Synchrotron Radiation Laboratory report in *Nature* that the ultimate speed of magnetic switching is at least 1,000 times slower than previously expected, which has implications for future hard-disk computer drive technologies.

Astrophysicists at the Kavli Institute led by **Roger Romani** report in the *Astrophysical Journal Letters* website that they have spotted a black hole whose distance suggests it was formed when the universe first began, providing a window to cosmological origins.

11/04

SOME 7,500 ALUMNI RETURN FOR REUNION HOMECOMING, ENJOYING AN ALL-ALUMNI PANEL CONSISTING OF U.S. SUPREME COURT JUSTICE STEPHEN BREYER, CALIFORNIA CHIEF JUSTICE RONALD GEORGE AND NINTH CIRCUIT COURT JUDGE PAMELA RYMER.

MEDICAL SCHOOL DEAN PHILIP PIZZO IS NAMED TO THE COMMITTEE THAT WILL OVERSEE DISTRIBUTION OF $3 BILLION IN STATE FUNDS FOR EMBRYONIC STEM CELL RESEARCH.

EIGHT NEW BASS UNIVERSITY FELLOWS IN UNDERGRADUATE EDUCATION ARE NAMED: PATRICIA BURCHAT, HESTER GELBER, JAMES GROSS, H. CRAIG HELLER, DAPHNE KOLLER, JOHN RICKFORD, CHANNING ROBERTSON AND JOHN SHOVEN.

12/04

HUMAN BIOLOGY MAJOR SARAH SCHULMAN IS NAMED ONE OF 32 RHODES SCHOLARS FROM THE UNITED STATES.

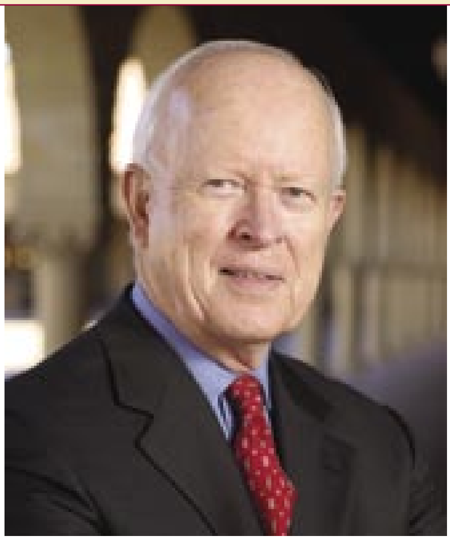
STUDENTS SHEENA CHESTNUT, ROSS PERLIN AND CLARA SHIH AND GRADUATES TARUN CHHABRA AND JOE SHAPIRO ARE NAMED 2005 MARSHALL SCHOLARS.

STANFORD AND GOOGLE ANNOUNCE PLANS TO DIGITIZE HUNDREDS OF THOUSANDS—PERHAPS MILLIONS—OF BOOKS FROM THE STANFORD LIBRARIES AND MAKE THEM AVAILABLE WORLDWIDE WITHOUT CHARGE.

PASSING THE TORCH

A MESSAGE FROM THE CHAIR OF THE BOARD OF TRUSTEES

AS THE NEWLY ELECTED CHAIR OF THE BOARD OF TRUSTEES, I SUCCEED AN EXCEPTIONAL LEADER. ISAAC STEIN´S TIRELESS WORK FOR THE UNIVERSITY SET A MARVELOUS EXAMPLE, AND, LIKE HIM, I AM DETERMINED TO HELP BUILD AN EVEN STRONGER STANFORD FOR FUTURE GENERATIONS.



This annual report covers a year in which Stanford successfully stewarded existing resources and gained new ones thanks to the extraordinary generosity of our alumni and friends. In 2003–2004, a recovering economy and expert investment management enabled the University's endowment to grow 15 percent to nearly $10 billion. And, representing the second highest result in our history, new gifts to Stanford totaled $524 million.

The Campaign for Undergraduate Education (CUE) was one effort that continued to receive strong support last year. In fact, by the time this report is published, CUE will likely have surpassed its $1 billion goal. While this is a tremendous achievement, important campaign objectives remain unmet. To ensure the future of all the undergraduate programs encompassed by the campaign, CUE will continue through its original completion date of Dec. 31, 2005.

The School of Humanities and Sciences (H&S) also reached a milestone last year—in its "Hewlett Challenge." Using a gift of $300 million from the William and Flora Hewlett Foundation to match gifts from other donors, the school attracted more than $100 million in new gifts and pledges. Through further new gifts, Stanford hopes to match all $300 million of the Hewlett gift, producing $600 million for H&S by 2009.

Such remarkable support strengthens Stanford's commitment to address the most pressing issues facing the world. As noted elsewhere in this report, solving problems in human health, the environment and international affairs increasingly requires that experts from different disciplines work together. Stanford, with its well-established track record of cross-disciplinary collaboration, is poised to achieve dramatic breakthroughs in these fields.

As part of this effort, Stanford is undertaking major enhancements in graduate education, a key element of the research enterprise. The University's comprehensive review of graduate programs will likely result in recommendations for programs to train graduate students across disciplines and departmental boundaries, thereby preparing them for leadership in a complex world. The extraordinary gift of $43.5 million from Nancy (Class of 1945) and Charles Munger for a new graduate residence is a critical step in this direction. The building will complement the academic program by encouraging cross-disciplinary thought in a residential setting.

We live in unpredictable times, but we face unprecedented opportunities for real and lasting change globally. Therein lies our responsibility as stewards of this University: to ensure that it continues to have a positive and meaningful impact in the world through unparalleled teaching and research. To all of you who uphold this important mission through your generosity and good work, I am pleased to extend Stanford's and my deepest gratitude.

Sincerely,

Burton J. McMurtry, M.S. '59, Ph.D. '62

2004 FINANCIAL REVIEW

STANFORD UNIVERSITY

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CONSOLIDATED STATEMENTS OF FINANCIAL POSITION, PAGE 27

CONSOLIDATED STATEMENTS OF ACTIVITIES, PAGE 28

CONSOLIDATED STATEMENTS OF CASH FLOWS, PAGE 30

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MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS, PAGE 54

REPORT FROM THE STANFORD MANAGEMENT COMPANY, PAGE 55

DISCUSSION OF FINANCIAL RESULTS

STANFORD´S CONSOLIDATED NET ASSETS INCREASED $1.7 BILLION IN THE 2003–2004 FISCAL YEAR (FY04) TO END THE YEAR AT $14 BILLION. SEE FIGURE I. THE INCREASE WAS DUE PRIMARILY TO CONTINUED POSITIVE INVESTMENT PERFORMANCE, TOGETHER WITH STRONG OPERATING RESULTS AT THE HOSPITALS AND SUBSTANTIAL NEW GIFTS.

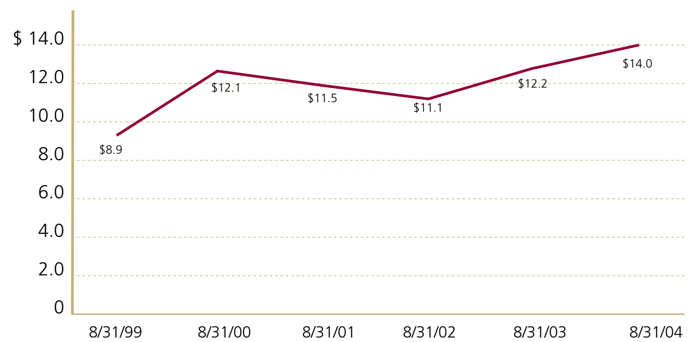
IN FY04, STANFORD´S CONSOLIDATED OPERATING REVENUES EXCEEDED EXPENSES BY $155 MILLION, COMPARED WITH $142 MILLION IN THE 2002–2003 FISCAL YEAR (FY03). THE UNIVERSITY, EXCLUDING THE HOSPITALS, REPORTED A SURPLUS FROM OPERATIONS IN FY04 OF $7 MILLION VERSUS $46 MILLION IN FY03. THE HOSPITALS REPORTED A SURPLUS OF $148 MILLION IN FY04, COMPARED WITH $96 MILLION IN FY03.

UNIVERSITY

The University achieved essentially breakeven results with a surplus from operations of $7 million, following a $46 million surplus in the previous year. Total revenues increased by 3%, while total expenses increased 4%. The decline in operating results was due almost entirely to a change in the University's policy for allocating expendable funds investment income to operations. The Expendable Funds Pool (EFP) and Endowment Income Funds Pool (EIFP) payout to operations was $42 million in FY04, compared to $82 million in FY03. Application of the new policy resulted in $122 million in EFP investment returns being transferred to endowment in FY04, compared to only $37 million in FY03.

FIGURE I

CONSOLIDATED NET ASSETS (IN BILLIONS)



Some of the highlights of FY04 included:

CONTINUED STRONG INVESTMENT PERFORMANCE. The University experienced its second consecutive year of solid investment performance in FY04. Total investment returns were $1.7 billion in FY04 and $1.3 billion in FY03. The FY04 investment returns included a $279 million unrealized gain in the estimated fair market value of Google stock owned by the University. See the report from the Stanford Management Company on page 55 for an in-depth analysis of University investment strategies and performance.

SIGNIFICANT DONOR SUPPORT. Continued strong support from alumni, parents and friends in FY04 resulted in the second highest year for gifts in the University's history. The University's Office of Development reported gifts, on a cash basis, of $524 million compared to $486 million in FY03. Significant gift activity included the following:

> A single gift of $43.5 million was received from alumna and parents Nancy and Charles Munger for the construction of graduate student housing.

> The Stanford Fund raised a record $18.2 million.

> With more than a year remaining, The Campaign for Undergraduate Education (CUE) moved even closer toward its target of $1 billion, raising $83 million in FY04. This brought the total to $972 million in gifts and pledges received as of August 31, 2004.

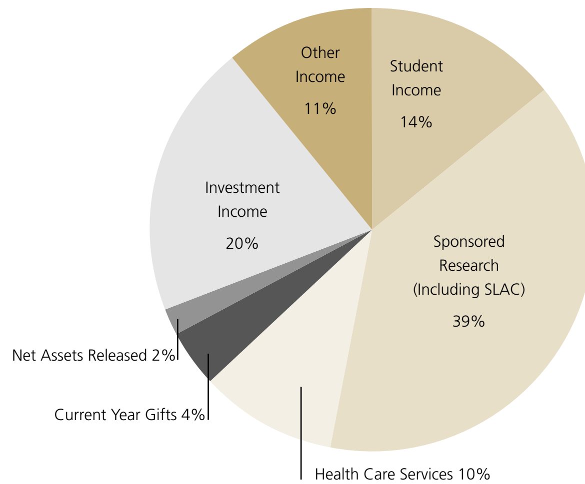
> The $300 million Hewlett Challenge for the School of Humanities and Sciences reached $100 million, to be matched by the William and Flora Hewlett Foundation.

STATEMENT OF ACTIVITIES

The Statement of Activities details operating revenues and expenses and other non-operating changes in net assets during the year. University total net assets increased $1.5 billion in FY04 compared with a $1.0 billion increase in FY03. This significant increase in net assets resulted almost entirely from the increase in the value of the University's investments and new gifts and pledges.

FIGURE 2

UNIVERSITY OPERATING REVENUES FY04 ($2.4 BILLION)



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 FY04, total University revenues increased 3%, expenses increased 4% and both were approximately $2.4 billion. The University had a $7 million operating surplus.

The components of the University's $2.4 billion in operating revenues are shown in Figure 2. A total of 39% of revenues was derived from sponsored research support, and an additional 26% came from the combination of investment income distributed for operations and gifts and pledges in support of operations. Highlights of the University's operating activities are summarized below:

> Consistent with prior years, student income represented 14% of University operating revenues, increasing from $318 million in FY03 to $332 million in FY04. As in FY03, the tuition rate increased by 5% for undergraduates and most graduate programs. Room and board rates increased 4.25%. Offsetting tuition and room and board revenues is financial aid, which increased by 10% to $128 million in FY04, reflecting continuing increases in the number of students needing financial assistance.

> Sponsored research support increased $63 million, or 7%, to $924 million in FY04, representing 39% of University operating revenue. Revenue from the Stanford Linear Accelerator Center (SLAC) increased $14 million, or 6%, due to increased funding for its Gamma-Ray Large Area Space Telescope (GLAST). GLAST is a high-energy gamma-ray observatory that is expected to be launched in 2007. It will be used to study high-energy sources of radiation such as black holes. Researchers from Stanford's Hansen Experimental Physics Lab are working in conjunction with SLAC on the GLAST project. That work, along with higher levels of research activity in the School of Medicine, contributed to the $29 million year over year increase in direct cost reimbursement. Indirect cost recovery was up 14% due to increased research volume and an increase in the indirect cost rate to 60% in FY04, up from 58% in FY03. The predetermined indirect cost rate will decrease to 57% in FY05 and 56% in FY06.

> Health care services revenue for the University increased 9% in FY04 to $230 million and represented 10% of University revenue. Health care services revenue consists primarily of payments made by the Hospitals to the University, including $200 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. The University also received $8 million in revenue for services provided by faculty physicians to external parties, including the Santa Clara Valley Medical Center and the Palo Alto Veterans Administration Hospital.

> Current year gifts in support of operations totaled $105 million in FY04, compared to $113 million in 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 $46 million compared to $54 million in FY03.

> Total investment income included in operations represented 20% of University revenue.

> > Endowment income distributed for operations was $400 million in FY04, equal to 4.6% of total endowment value at the beginning of the year, and up from $391 million, or 5.1% of the endowment, in FY03. The University's endowment increased 15% to $9.9 billion at August 31, 2004 due to strong investment performance, new gifts and transfers of expendable funds. The endowment, which represents approximately 76% of the University's net assets, is a significant source of revenue for the University. Consistent with prior years, payout from the endowment covered approximately 17% of expenses in FY04.

> > Other investment income, which includes the payout to operations from the EFP and EIFP, faculty and staff mortgage loan program income and investment income covering the costs of managing investment programs was $77 million in FY04. Other investment income decreased 34%, or $39 million, from FY03, primarily as a result of the University having revised the EFP payout policy, effective September 1, 2003, to reduce the volatility of the payout to operations. The EFP is the principal investment vehicle for the University's expendable funds, and a substantial portion of it is cross-invested in the Merged Endowment Pool (MEP). The EFP payout policy seeks to achieve a minimum payout to operations, while also providing that amounts in excess of the guidelines be invested in the endowment. The EFP and EIFP payout was approximately $42 million in FY04, compared to $82 million in FY03.

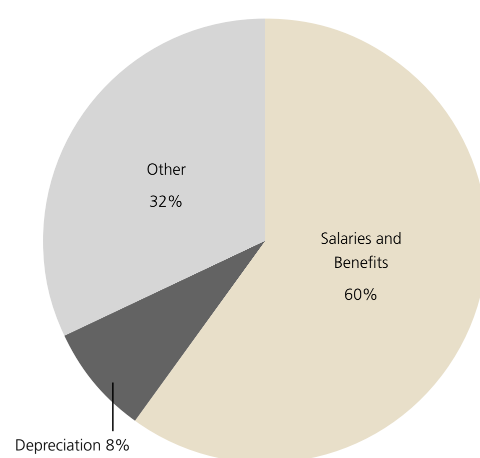
> Special program fees and other income were $259 million in FY04, compared to $247 million in FY03. This revenue category consists of the external revenues generated by auxiliary enterprises and service centers, executive education, corporate affiliates programs, technology licensing and other programs. Also 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 from intercollegiate athletic activities.

Total expenses increased $100 million, or 4%, to $2.4 billion in FY04. As depicted in Figure 3, salaries and benefits comprised approximately 60% of the University's total expenses, depreciation expense was 8% and other operating expenses represented approximately 32%.

> Salaries and benefits increased 5% in FY04, despite the salary freeze that was in place for FY04 and limitations imposed on hiring of non-essential staff. Staffing increased significantly in the School of Medicine and other areas with growing sponsored research support and in the Residential and Dining Enterprises auxiliary. Although base salaries were generally frozen during the year, units were encouraged to allocate an incremental 1% of base salaries toward additional bonus and incentive pay programs. In addition, vacation expense increased as employees earned more vacation than they took.

FIGURE 3

UNIVERSITY OPERATING EXPENSES FY04 ($2.4 BILLION)



> Depreciation expense increased 9% to $197 million in FY04 from $181 million in FY03, reflecting a full year of depreciation expense on large buildings placed in service at the end of FY03, such as the Clark Center, the Lokey Laboratory Building and the SLAC User Lodging Facility. During FY04 the Offsite Library Storage facility was completed as well as a number of renovation projects.

> Other operating expenses increased 2% to $740 million in FY04, compared to $724 million in FY03. Increased research activity resulted in an increase of approximately $33 million. This was partially offset by continued decreases in expenses achieved through tight budgetary controls.

OTHER CHANGES IN UNRESTRICTED NET ASSETS. In total, unrestricted net assets of the University increased $1.2 billion. The increase in unrestricted net assets was due almost entirely to increases in the market value of investments of approximately $1.2 billion, which were transferred to the endowment. This is net of the $400 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 to operations, and the excess is invested in the endowment. In FY04, the total investment return of the EFP was $162 million, of which $122 million was invested in the endowment.

TEMPORARILY RESTRICTED NET ASSETS. Temporarily restricted net assets increased $92 million to $474 million in FY04. 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 recorded $189 million of new temporarily restricted gifts and pledges in FY04, net of discounts and allowances. During the year, $46 million of temporarily restricted net assets were released from their restrictions and utilized to fund operating activities. In addition, $45 million of capital and other gifts for use by the University and Hospitals were released to unrestricted net assets to fund capital and other non-operating activities.

PERMANENTLY RESTRICTED NET ASSETS. Permanently restricted net assets increased by $234 million to $3.2 billion during FY04. 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 was due to the receipt of $167 million in new gifts and pledges to the endowment, net of discounts and allowances, and $71 million in gains on investments held in the endowment.

FINANCIAL POSITION

The University's Statement of Financial Position reflects the strong investment returns experienced during its current fiscal year. In FY04, total University assets increased $1.4 billion to $16 billion, while total University liabilities decreased $114 million to $3 billion.

Highlights of the Statement of Financial Position are as follows:

> Cash and cash equivalents increased $275 million in FY04. The increase was due, in part, to $50 million of unexpended funds raised through the CEFA S bond offering in June 2004. In addition, funds invested in the EIFP, which was newly created in FY04, are required to be maintained in money market funds, which are considered cash equivalents. The balance in the EIFP was $236 million at August 31, 2004.

> Net pledges receivable decreased approximately $6 million to $411 million in FY04. Cash payments on prior year pledges exceeded new pledges recorded in FY04 by more than $40 million. Valuation allowances were recorded for pledges that may not be collectible or where the pledge terms may be extended.

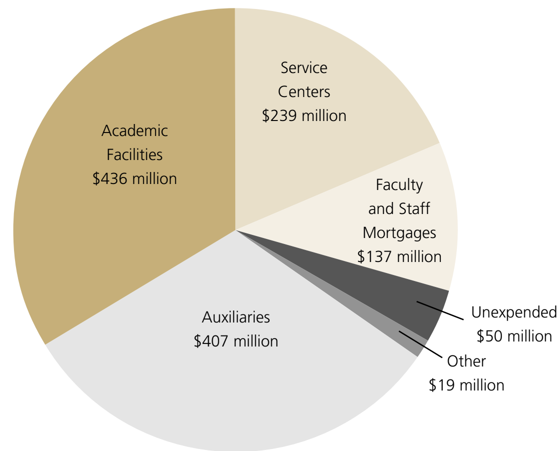
> Total investments, consisting primarily of endowment assets and expendable funds, increased by $1.1 billion, or 10%, to $12 billion.

> Plant facilities, net of accumulated depreciation, decreased $25 million to $2.3 billion in FY04. Net additions to plant facilities in FY04 totaled $158 million, bringing gross plant facilities before accumulated depreciation to $4.1 billion. As previously discussed, several new academic, support and housing facilities were completed in FY03, resulting in increased depreciation and an overall decrease in net plant facilities in the current year.

> Deferred rental income, consisting of prepaid rents on properties leased by the University, was $370 million at August 31, 2004. The majority of this amount, $325 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 FY04 ($1.3 BILLION)



> Notes and bonds payable were $1.3 billion at August 31, 2004, an increase of $13 million from FY03. As described in note 7, the University issued $181 million in new bonds in FY04. The majority of the proceeds, however, were used to refinance existing debt and to pay down tax-exempt commercial paper balances. As of August 31, 2004, $436 million in debt has been allocated to academic facilities; $407 million to auxiliaries, primarily residential housing and dining facilities; $239 million to service centers, primarily for utility infrastructure projects, information technology and communications purposes; $137 million for faculty and staff mortgage loans; and $19 million for other miscellaneous projects. Additionally, $50 million in funds raised through the bond offering was still unexpended at year end. See Figure 4. 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 Stanford Hospital and Clinics (SHC) and the Lucile Packard Children's Hospital (LPCH) are combined in the consolidated financial statements under the "Hospitals" column. The University is the sole corporate member of each of the Hospitals.

The Hospitals had another year of improved financial performance, resulting in a combined operating surplus of $148 million for FY04, up 54% from $96 million in FY03. At August 31, 2004, the Hospitals' net assets were $895 million versus $685 million at August 31, 2003, an increase of $210 million or 31%. During FY04, a number of initiatives were undertaken to continue to enhance the quality of care and improve financial performance. The following summarizes the individual financial results of SHC and LPCH.

STANFORD HOSPITAL AND CLINICS. SHC experienced strong financial performance during FY04, reporting an excess of revenues over expenses from operations of $101 million, up from $46 million in FY03. The operating margin was 8% in FY04, compared to 4% in FY03. SHC's net assets increased $98 million to $345 million at August 31, 2004. Net patient revenues grew 19% to $1.1 billion in FY04, compared to $918 million in FY03. This increase is primarily due to increased volumes in patient days and patient admissions. Total patient days increased 9%, and patient admissions were up 10% over the prior year. Inpatient surgeries increased 11%, and emergency room visits were 3% higher than in FY03. Inpatient revenue grew 15% from FY03 and now represents 54% of net patient revenues. Outpatient revenue was up 25% over the prior year and comprises 46% of net patient revenues. SHC continues to see growth in outpatient services.

Among the initiatives that contributed to SHC's financial improvement in FY04 were the following:

> Days cash on hand increased to 184 days in FY04 from 159 days in FY03.

> Financial management and collection efforts reduced the bad debt expense by $14 million, or 25% in FY04. Bad debt expense as a percentage of net patient revenue was 4% in FY04 compared to 6% in FY03.

> SHC also improved its cash position and liquidity by 31% in FY04. Cash, cash equivalents and investments, less restricted assets, were $518 million at August 31, 2004, versus $396 million at August 31, 2003.

> Continued cost containment through tighter budgetary controls helped to control operating expenses.

SHC's increase in total revenues in FY04 was enhanced by the opening of the new state-of-the-art, 165,000 square foot cancer center in March 2004. The center provides new diagnostic and treatment options to patients. In addition, the Laboratory Outreach Program was expanded to include 40 patient centers in nine Bay Area counties by August 31, 2004. The program is jointly operated by SHC and the University's School of Medicine.

LUCILE PACKARD CHILDREN'S HOSPITAL. LPCH experienced continued strong financial performance in FY04, reporting an excess of revenues over expenses from operations of $47 million, down from $60 million in FY03. The operating margin was 11% in FY04, compared to 15% in FY03. LPCH's total net assets increased $112 million, or 25%, to $550 million at August 31, 2004.

Significant accomplishments during FY04 include:

> The Campaign for Children's Health, a fundraising effort initiated in FY02, reached its $500 million goal. LPCH and the pediatric programs of the University's School of Medicine are the beneficiaries of the funds raised by the campaign.

> The initial phase of LPCH's long-term facility master plan was launched in FY04. The first significant project, a 30,000 square foot ambulatory care center, was completed and opened.

> A patient progression initiative was successfully completed, providing additional capacity throughout the hospital. As a result, average occupancy reached 85%, representing an average daily census of 215 patients, compared to 200 in FY03.

> Inpatient days increased 7.8% to 78,860 in FY04 from 73,187 in FY03.

> Total revenue grew by $24 million, or 7%, due to volume growth, increased rates and increased patient acuity, for which LPCH is reimbursed at higher levels.

> LPCH's community benefits, including services to patients under Medi-Cal and other publicly sponsored programs that reimburse at amounts less than the cost of services provided to the recipients, were $54 million in FY04 compared to $38 million in FY03.

> Cash on hand increased to $210 million, or 209 days on hand, from $168 million, or 203 days on hand, in FY03.

> Investments increased by $42 million to $181 million at August 31, 2004.

FUTURE CHALLENGES

Despite two consecutive years of improved financial results, the University and the Hospitals continue to be cautious in both spending and investing. As noted last year, there are still many factors that could impact the financial position of the University and the Hospitals. These include:

> Federal sponsored research funding for American universities is not expected to grow significantly over the next several years. In addition, Stanford's indirect cost rate will decrease from 60% in FY04 to 57% in FY05 and 56% in FY06.

> Continued increases in health care costs for employees and retirees are expected to lead to significant increases in the University's and Hospitals' expense base.

> Volatility in the financial markets continues as the economic recovery remains sluggish.

> To remain competitive, the University and Hospitals will need to make major investments in new facilities. The University is planning to construct eight new science, engineering and medicine buildings during the next decade, several of which will replace existing facilities. SHC and LPCH are both planning major facility renovations and additions during the same period. These facilities will require significant additional debt and donor financial support.

> The Hospitals continue to face 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.

The University and Hospitals have accomplished a great deal in the past fiscal year, increasing consolidated net assets to allow for necessary future growth. We will continue to identify and address opportunities for growth while working to protect and increase Stanford's resources. We remain strongly committed to excellence in teaching, research and health care. 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

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

M. Suzanne Calandra

M. SUZANNE CALANDRA
Controller
Stanford University

Roy Santarella

ROY T. SANTARELLA
Chief Financial Officer
Stanford Hospital and Clinics

Keith S. Grundy

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

SELECTED FINANCIAL DATA

Fiscal year ended August 31

	2004	2003	2002	2001	2000
			(In millions of dollars)		
STATEMENT OF ACTIVITIES DATA:					
Student income (A)	$ 332	$ 318	$ 305	$ 300	$ 280
Sponsored research support	924	860	802	727	674
Health care services (B)	1,501	1,277	1,181	1,010	464
Current year gifts in support of operations	105	113	104	111	113
Net assets released from restrictions	64	72	51	64	58
Investment income distributed for operations	489	514	454	445	514
Special program fees and other income	329	320	292	275	236
Total Revenues	3,744	3,474	3,189	2,932	2,339
Total Expenses	3,589	3,332	3,156	2,886	2,160
Excess of revenues over expenses	155	142	33	46	179
Other changes in net assets	1,584	1,022	(494)	(637)	3,008
Total Net Assets, beginning of year	12,237	11,073	11,534	12,125	8,938
Total Net Assets, end of year	**$ 13,976**	**$ 12,237**	**$ 11,073**	**$ 11,534**	**$ 12,125**
FINANCIAL POSITION HIGHLIGHTS:					
Cash and cash equivalents	$ 1,030	$ 914	$ 522	$ 817	$ 534
Pledges receivable, net	454	475	513	527	481
Investments at fair value	12,926	11,494	9,520	10,141	10,784
Plant facilities, net of accumulated depreciation	2,743	2,723	2,527	2,365	2,204
Notes and bonds payable:					
University	1,288	1,275	1,246	1,218	1,135
Hospitals	587	591	224	228	235
University endowment	9,992	8,614	7,613	8,250	8,886

	2004	2003	2002	2001	2000
STUDENTS:					
ENROLLMENT: (C)					
Undergraduate	6,753	6,654	6,731	6,637	6,548
Graduate	8,093	7,800	7,608	7,536	7,700
DEGREES CONFERRED:					
Bachelor degrees	1,713	1,788	1,692	1,676	1,737
Advanced degrees	2,931	2,855	2,777	2,936	2,904
FACULTY:					
MEMBERS OF THE ACADEMIC COUNCIL	1,410	1,396	1,377	1,384	1,368
ANNUAL UNDERGRADUATE TUITION RATE (IN DOLLARS)	$ 28,563	$ 27,204	$ 25,917	$ 24,441	$ 23,058

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

(B) A portion of fiscal year 2000 Health care services revenue was reported on an equity basis.

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

At August 31, 2004 and 2003 (In thousands of dollars)

	2004 UNIVERSITY	2004 HOSPITALS	2004 CONSOLIDATED	2003 CONSOLIDATED
ASSETS				
Cash and cash equivalents	$ 795,985	$ 234,409	$ 1,030,394	$ 913,566
Accounts receivable, net	185,821	228,485	414,306	329,781
Receivables (payables) from SHC and LPCH, net	31,909	(31,909)	–	–
Inventories, prepaid expenses and other assets	33,344	53,035	86,379	81,172
Pledges receivable, net	411,366	42,845	454,211	474,481
Student loans receivable, net	61,952	–	61,952	63,245
Faculty and staff mortgages and other loans receivable, net	253,498	–	253,498	248,912
Investments at fair value, including securities pledged or on loan of $378,301 and $303,251 for 2004 and 2003, respectively	11,963,733	962,612	12,926,345	11,494,213
Plant facilities, net of accumulated depreciation	2,344,984	398,304	2,743,288	2,723,023
Collections of works of art	–	–	–	–
TOTAL ASSETS	**$16,082,592**	**$ 1,887,781**	**$17,970,373**	**$16,328,393**
LIABILITIES AND NET ASSETS				
LIABILITIES:				
Accounts payable and accrued expenses	$ 484,728	$ 405,715	$ 890,443	$ 822,373
Pending trades	91,893	–	91,893	378,307
Liabilities under security agreements	431,652	–	431,652	343,741
Deferred rental income	370,440	–	370,440	369,008
Income beneficiary share of living trust investments	281,498	–	281,498	258,261
Notes and bonds payable	1,288,242	586,949	1,875,191	1,866,496
U.S. government refundable loan funds	53,527	–	53,527	53,597
TOTAL LIABILITIES	**3,001,980**	**992,664**	**3,994,644**	**4,091,783**
NET ASSETS:				
Unrestricted	9,390,073	665,867	10,055,940	8,670,578
Temporarily restricted	473,807	79,775	553,582	458,703
Permanently restricted	3,216,732	149,475	3,366,207	3,107,329
TOTAL NET ASSETS	**13,080,612**	**895,117**	**13,975,729**	**12,236,610**
TOTAL LIABILITIES AND NET ASSETS	**$16,082,592**	**$ 1,887,781**	**$17,970,373**	**$16,328,393**

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

CONSOLIDATED STATEMENTS OF ACTIVITIES

For the years ended August 31, 2004 and 2003 (In thousands of dollars)

	2004 UNIVERSITY	2004 HOSPITALS	2004 CONSOLIDATED	2003 CONSOLIDATED
UNRESTRICTED NET ASSETS ACTIVITY				
REVENUES:				
Student income:				
Undergraduate programs	$ 191,708	$ –	$ 191,708	$ 185,277
Graduate programs	182,254	–	182,254	166,580
Room and board	86,483	–	86,483	82,062
Student financial aid	(128,055)	–	(128,055)	(116,102)
TOTAL STUDENT INCOME	**332,390**	**–**	**332,390**	**317,817**
Sponsored research support (primarily federal):				
Direct costs – University	525,475	–	525,475	496,702
Direct costs – Stanford Linear Accelerator Center	233,874	–	233,874	219,687
Indirect costs	164,159	–	164,159	143,921
TOTAL SPONSORED RESEARCH SUPPORT	**923,508**	**–**	**923,508**	**860,310**
Health care services:				
Patient care, net	–	1,493,369	1,493,369	1,266,976
Physicians' services and support – SHC and LPCH, net	221,771	(221,771)	–	–
Physicians' services and support – other facilites, net	8,180	–	8,180	10,091
TOTAL HEALTH CARE SERVICES	**229,951**	**1,271,598**	**1,501,549**	**1,277,067**
CURRENT YEAR GIFTS IN SUPPORT OF OPERATIONS	**105,222**	**–**	**105,222**	**112,885**
Net assets released from restrictions:				
Payments received on prior year pledges	27,632	–	27,632	27,419
Prior year gifts released from donor restrictions	18,600	17,436	36,036	45,000
TOTAL NET ASSETS RELEASED FROM RESTRICTIONS	**46,232**	**17,436**	**63,668**	**72,419**
Investment income distributed for operations:				
Endowment	399,950	–	399,950	391,416
Expendable funds pool and other investment income	77,280	11,832	89,112	122,884
TOTAL INVESTMENT INCOME DISTRIBUTED FOR OPERATIONS	**477,230**	**11,832**	**489,062**	**514,300**
SPECIAL PROGRAM FEES AND OTHER INCOME	**258,768**	**69,759**	**328,527**	**319,817**
TOTAL REVENUES	**2,373,301**	**1,370,625**	**3,743,926**	**3,474,615**
EXPENSES:				
Salaries and benefits	1,428,619	671,768	2,100,387	1,950,083
Depreciation	197,134	44,971	242,105	219,023
Other operating expenses	740,141	506,099	1,246,240	1,163,720
TOTAL EXPENSES	**2,365,894**	**1,222,838**	**3,588,732**	**3,332,826**
EXCESS OF REVENUES OVER EXPENSES	**$ 7,407**	**$ 147,787**	**$ 155,194**	**$ 141,789**

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

CONSOLIDATED STATEMENTS OF ACTIVITIES

For the years ended August 31, 2004 and 2003 (In thousands of dollars)

	2004 UNIVERSITY	2004 HOSPITALS	2004 CONSOLIDATED	2003 CONSOLIDATED
UNRESTRICTED NET ASSETS ACTIVITY (CONTINUED)				
EXCESS OF REVENUES OVER EXPENSES	**$ 7,407**	**$ 147,787**	**$ 155,194**	**$ 141,789**
OTHER CHANGES IN UNRESTRICTED NET ASSETS:				
Expendable gifts invested in the endowment	9,150	–	9,150	12,965
Investment gains not included in operations	1,178,145	15,867	1,194,012	772,965
Hospital equity transfers	13,900	(13,900)	–	–
Change in equity investment in UCSF-Stanford Health Care	–	–	–	(6,547)
Capital and other gifts released from restrictions	41,858	21,976	63,834	95,791
Capital gifts released from University	–	3,627	3,627	41,000
Decrease (increase) in minimum pension liability	24,784	11,442	36,226	(57,851)
Net assets released from permanent restrictions	–	–	–	49,134
Transfer to temporarily restricted net assets	(19,158)	–	(19,158)	–
Swap interest and unrealized losses	(6,968)	–	(6,968)	–
Other	(45,587)	(4,968)	(50,555)	1,098
NET CHANGE IN UNRESTRICTED NET ASSETS	**1,203,531**	**181,831**	**1,385,362**	**1,050,344**
TEMPORARILY RESTRICTED NET ASSETS ACTIVITY				
Gifts and pledges, net	189,133	35,010	224,143	122,252
Investment gains	1,374	7,891	9,265	16,020
Living trust investment income and actuarial adjustment	1,906	–	1,906	2,204
Net assets released to operations	(46,232)	(17,436)	(63,668)	(72,419)
Capital and other gifts released to unrestricted net assets	(41,858)	(21,976)	(63,834)	(95,791)
Capital gifts released to Hospitals' unrestricted net assets	(3,627)	–	(3,627)	(41,000)
Transfer from unrestricted net assets	19,158	–	19,158	–
Transfer to permanently restricted net assets	(32,651)	–	(32,651)	–
Other	4,187	–	4,187	(2,620)
NET CHANGE IN TEMPORARILY RESTRICTED NET ASSETS	**91,390**	**3,489**	**94,879**	**(71,354)**
PERMANENTLY RESTRICTED NET ASSETS ACTIVITY				
Gifts and pledges, net	166,544	24,338	190,882	191,829
Investment gains	71,330	–	71,330	26,435
Living trust investment income (loss) and actuarial adjustment	(33,070)	–	(33,070)	1,630
Net assets released from restrictions	–	–	–	(49,134)
Transfer from temporarily restricted net assets	32,651	–	32,651	–
Other	(2,915)	–	(2,915)	13,626
NET CHANGE IN PERMANENTLY RESTRICTED NET ASSETS	**234,540**	**24,338**	**258,878**	**184,386**
NET CHANGE IN TOTAL NET ASSETS	**1,529,461**	**209,658**	**1,739,119**	**1,163,376**
Total net assets, beginning of year	11,551,151	685,459	12,236,610	11,073,234
TOTAL NET ASSETS, END OF YEAR	**$13,080,612**	**$ 895,117**	**$13,975,729**	**$12,236,610**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended August 31, 2004 and 2003 (In thousands of dollars)

	2004 UNIVERSITY	2004 HOSPITALS	2004 CONSOLIDATED	2003 CONSOLIDATED
CASH FLOW FROM OPERATING ACTIVITIES				
Change in net assets	$ 1,529,461	$ 209,658	$ 1,739,119	$ 1,163,376
Adjustments to reconcile change in net assets to net cash provided by (used for) operating activities:				
Depreciation, amortization and loss on disposal of fixed assets	203,411	44,841	248,252	232,266
Net realized and unrealized gains on investments and security agreements	(1,478,724)	(15,867)	(1,494,591)	(1,074,178)
Net realized and unrealized (gains) losses on derivatives	2,189	–	2,189	(7,132)
Actuarial change on living trust obligations	7,454	–	7,454	(20,346)
Change in equity in UCSF-Stanford Health Care	–	–	–	6,547
Permanently restricted investment income	(1,602)	(6,900)	(8,502)	(7,860)
Gifts restricted for long-term investments	(215,970)	(59,348)	(275,318)	(307,900)
Net (increase) decrease in accounts receivable, pledges receivable and receivables from SHC and LPCH	(71,193)	21,801	(49,392)	(28,019)
Increase (decrease) in U.S. government refundable loan funds	(70)	–	(70)	892
Decrease (increase) in inventories, prepaid expenses and other assets	(3,188)	(2,449)	(5,637)	(18,222)
Increase in accounts payable and accrued expenses	24,779	26,648	51,427	95,447
Increase in deferred rental income	1,432	–	1,432	359,979
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	**(2,021)**	**218,384**	**216,363**	**394,850**
CASH FLOW FROM INVESTING ACTIVITIES				
Land, building and equipment purchases	(160,159)	(95,207)	(255,366)	(414,033)
Student, faculty and other loans:				
New loans made	(57,396)	–	(57,396)	(56,268)
Principal collected	54,103	–	54,103	70,138
Purchases of investments	(6,663,588)	(401,234)	(7,064,822)	(6,544,649)
Sales and maturities of investments	6,710,107	57,734	6,767,841	5,844,393
Distribution of assets from UCSF-Stanford Health Care, net of pension liabilities	–	–	–	(8,257)
Cash transferred from UCSF-Stanford Health Care	–	–	–	28,189
NET CASH USED FOR INVESTING ACTIVITIES	**(116,933)**	**(438,707)**	**(555,640)**	**(1,080,487)**
CASH FLOW FROM FINANCING ACTIVITIES				
Gifts and reinvested income of endowment, capital projects and other restricted purposes	289,902	59,348	349,250	366,639
Increase in investment income for restricted purposes	1,602	6,900	8,502	7,860
Proceeds from borrowing	202,200	231	202,431	448,868
Repayment of notes and bonds payable	(189,154)	(4,045)	(193,199)	(49,875)
Increase in liabilities under security agreements	87,911	–	87,911	314,896
Other financing	1,210	–	1,210	(11,380)
NET CASH PROVIDED BY FINANCING ACTIVITIES	**393,671**	**62,434**	**456,105**	**1,077,008**
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**274,717**	**(157,889)**	**116,828**	**391,371**
Cash and cash equivalents, beginning of year	521,268	392,298	913,566	522,195
CASH AND CASH EQUIVALENTS, END OF YEAR	**$ 795,985**	**$ 234,409**	**$ 1,030,394**	**$ 913,566**
SUPPLEMENTAL DATA:				
Gifts of equipment	$ 4,389	$ –	$ 4,389	$ 300
Interest paid during the year	$ 56,678	$ 18,105	$ 74,783	$ 71,747

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 1,780 faculty and more than 14,845 graduate and undergraduate students. The "University" category presented in the financial statements comprises all of the accounts of the University, including the Stanford Alumni Association (SAA), the Hoover Institution and other institutes and research centers and the 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 and related receivables from the DOE.

> *Hospitals* – The health care activities of SHC and LPCH (the Hospitals), including revenues, expenses, assets and liabilities, are consolidated in these financial statements. In fiscal year 2003, the Hospitals category included the final accounting for the University's share of UCSF-Stanford Health Care, whose dissolution was completed in December 2003.
>
> The Hospitals are California nonprofit, public benefit corporations. The University is the sole member of the Hospitals. The Hospitals operate to 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 jointly control a captive insurance company.

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 that relate to the University's or the Hospitals' core activities and 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 initially recorded as temporarily restricted and 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 investment gains not included in operations, capital and other gifts released from restrictions, expendable gifts invested in the endowment, minimum pension liability and certain other non-operating changes, which are reported in other changes in unrestricted net assets.

Temporarily Restricted Net Assets: Temporarily restricted net assets include investments and pledges that are subject to donor-imposed restrictions that expire with the passage of time, payment of pledges or specific actions to be undertaken by the University or the Hospitals, at which time they are released and reclassified to unrestricted support. Temporarily restricted net assets comprise approximately 30% capital projects and 70% 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 consisting of U.S. Treasury bills, bankers' acceptances, commercial paper, certificates of deposit, money market funds and all 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, are classified as investments.

STUDENT LOANS RECEIVABLE Student loans receivable are carried at cost, less an allowance for doubtful accounts.

INVESTMENTS Investments are generally recorded at fair value. Securities transactions are reported on a trade-date basis. The values of publicly traded fixed income and 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 the limited partnership investments is based on valuations provided by the external investment managers as of June 30, adjusted for cash receipts, cash disbursements, significant known valuation changes in market values of publicly held securities contained in the portfolio and securities distributions through August 31. The University believes the carrying amounts of these investments 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 5).

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, 2004 and 2003 are as follows:

	UNIVERSITY	HOSPITALS
Buildings	20–40 years	7–40 years
Land and building improvements	10–40 years	7–40 years
Equipment, books and software	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 $1,000,000 for unemployment, disability, workers' compensation, property losses, certain health care plans and general and professional liability losses. The Hospitals self-insure up to $1,000,000 for workers' compensation and medical malpractice losses. Third party insurance is purchased to cover liabilities above the self-insurance limits. 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 third party payers including Medicare, Medi-Cal and other payers. 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 care revenue. The Hospitals also provide services to other 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 $22,526,000 and $14,429,000 for the years ended August 31, 2004 and 2003, respectively. Estimated costs in excess of reimbursements for Medi-Cal and county services for the years ended August 31, 2004 and 2003 were $90,162,000 and $69,025,000, 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.

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.

2. ACCOUNTS RECEIVABLE

Accounts receivable at August 31, 2004 and 2003, in thousands of dollars, are as follows:

	2004	2003
UNIVERSITY:		
U.S. Government	$ 83,783	$ 63,431
Nongovernment sponsors	8,837	12,496
Due from brokers	52,949	29,304
Accrued interest on investments	11,650	16,346
Student	3,917	2,995
Other	26,864	29,425
	188,000	153,997
Less allowances for losses	2,179	2,528
University accounts receivable, net	185,821	151,469
HOSPITALS:		
Gross patient receivables	615,072	550,785
Other	16,485	6,894
	631,557	557,679
Less contractual and bad debt allowances	403,072	379,367
Hospitals accounts receivable, net	228,485	178,312
CONSOLIDATED ACCOUNTS RECEIVABLE, NET	**$ 414,306**	**$ 329,781**

3. 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, 2004 and 2003 were approximately $129,476,000 and $301,276,000, respectively. Pledges are recorded at the present value of the discounted future cash flows, net of allowances. At August 31, 2004 and 2003, pledges receivable are as follows, in thousands of dollars:

	2004			2003
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
One year or less	$ 84,518	$ 27,557	$ 112,075	$ 126,327
Between one year and five years	400,954	17,864	418,818	339,356
More than five years	68,512	4,565	73,077	245,159
	553,984	49,986	603,970	710,842
Less discount/allowance	142,618	7,141	149,759	236,361
PLEDGES RECEIVABLE, NET	**$ 411,366**	**$ 42,845**	**$ 454,211**	**$ 474,481**

4. FACULTY AND STAFF MORTGAGES

In a program to attract and retain excellent faculty and senior staff, the University provides home mortgage financing assistance. Notes amounting to $252,811,000 and $248,423,000 at August 31, 2004 and 2003, respectively, from University faculty and staff are included in faculty and staff mortgages and other loans receivable in the consolidated statement of financial position and are collateralized by deeds of trust on properties concentrated in the region surrounding the University.

5. INVESTMENTS

Investments held by the University and the Hospitals at August 31, 2004 and 2003 are reported as follows, in thousands of dollars:

	2004			2003
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
Cash and short-term investments	$ 1,016,449	$ 285,034	$ 1,301,483	$ 1,348,119
Bonds and mutual funds	817,196	428,523	1,245,719	1,525,272
Public equities and investment funds	5,388,475	22,460	5,410,935	4,158,814
Assets held by other trustees (net of income beneficiary share of $70,225 and $59,357 at August 31, 2004 and 2003, respectively)	81,599	–	81,599	68,395
Real estate and improvements, including Stanford Shopping Center and Research Park	1,213,671	–	1,213,671	1,287,184
Limited partnership investments	3,627,450	–	3,627,450	3,061,357
Other	45,488	–	45,488	45,072
	12,190,328	736,017	12,926,345	11,494,213
Hospitals' investment in the University's Merged Endowment Pool	(226,595)	226,595	–	–
INVESTMENTS AT FAIR VALUE	**$11,963,733**	**$ 962,612**	**$12,926,345**	**$11,494,213**

The Hospitals' investments, with a combined market value of $632,569,000 and $256,210,000 at August 31, 2004 and 2003, respectively, are managed by the University.

Total investment return reflected in the statement of activities for the years ended August 31, 2004 and 2003, in thousands of dollars, is as follows:

	2004			2003
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
Investment income	$ 239,609	$ 19,723	$ 259,332	$ 269,810
Net realized and unrealized gains	1,478,724	15,867	1,494,591	1,074,178
TOTAL INVESTMENT RETURN	**$ 1,718,333**	**$ 35,590**	**$ 1,753,923**	**$ 1,343,988**

For the years ended August 31, 2004 and 2003, total investment returns of $1,251,408,000 and $819,253,000, respectively, were reinvested by the University and Hospitals after the distribution to operations and living trust beneficiaries. 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, 2004 and 2003, in thousands of dollars, the University's investments are held in various pools or in specific instruments to comply with donor requirements:

	2004	2003
UNIVERSITY:		
Expendable Funds Pool	$ 1,147,139	$ 1,151,888
Merged Endowment Pool	10,615,767	9,250,907
Living trusts	536,755	524,492
Other investments	1,030,588	878,081
	13,330,249	11,805,368
Less funds cross-invested in endowment pools (including the Hospitals' investment of $226,595 and $130,212 in 2004 and 2003, respectively, in the University's Merged Endowment Pool)	1,366,516	963,782
	11,963,733	10,841,586
HOSPITALS:		
Investments	962,612	652,627
INVESTMENTS AT FAIR VALUE	**$12,926,345**	**$11,494,213**

The Expendable Funds Pool (EFP) and Endowment Income Funds Pool (EIFP) are the principal investment vehicles for the University's expendable funds. A substantial portion of the EFP is cross-invested in the Merged Endowment Pool (MEP). The EIFP was established in fiscal year 2004 to segregate income to be distributed to holders of permanently restricted endowment funds and to allow for different asset allocations to be applied to the EFP. The EIFP is invested in money market instruments and is included in the consolidated statement of position as cash and cash equivalents. The payout policy for the EIFP is to distribute the total return to fund holders. For the year ended August 31, 2004, the distribution was $1,644,000.

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 interest rates be made available to support current operations. The difference between the actual return of this pool and the required distribution amount is deposited or withdrawn from funds functioning as endowment. For the years ended August 31, 2004 and 2003, the results of the EFP, in thousands of dollars, are as follows:

	2004	2003
Total investment return of the EFP	$ 162,422	$ 121,592
Less distribution to operations	40,143	84,722
AMOUNTS INVESTED IN THE ENDOWMENT	**$ 122,279**	**$ 36,870**

The University's endowment (see Note 10) 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 2004 and 2003 as follows, in thousands of dollars:

	2004	2003
Endowment income	$ 185,840	$ 192,807
Realized gains and previously reinvested income	214,110	198,609
APPROVED PAYOUT	**$ 399,950**	**$ 391,416**

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 variable rate bonds and commercial paper (see Note 7). Options and futures contracts are used for the purpose of reducing the risk level of investments or serving as a temporary surrogate for investment in stocks and bonds.

The University's derivative positions included foreign currency forward contracts, interest rate swaps and options and futures contracts. The net unrealized appreciation (depreciation) on these derivatives was ($7,389,000) and $31,054,000 at August 31, 2004 and 2003, 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.

The University holds certain investment properties that it leases to third parties. Future minimum rental income due from the Stanford Shopping Center, Research Park and other properties under noncancelable leases in effect with tenants at August 31, 2004 is as follows, in thousands of dollars:

YEAR	RENTAL INCOME
2005	$ 49,187
2006	49,430
2007	43,085
2008	40,127
2009	39,968
Thereafter	809,841
TOTAL	**$ 1,031,638**

6. PLANT FACILITIES

Plant facilities at August 31, 2004 and 2003, in thousands of dollars, are as follows:

	2004			2003
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
Land and improvements	$ 241,400	$ 6,562	$ 247,962	$ 239,787
Buildings	2,484,235	588,170	3,072,405	2,837,061
Equipment, books and software	1,242,780	211,469	1,454,249	1,319,372
Construction in progress	102,989	65,233	168,222	298,243
Plant facilities	4,071,404	871,434	4,942,838	4,694,463
Less accumulated depreciation	1,726,420	473,130	2,199,550	1,971,440
PLANT FACILITIES, NET OF ACCUMULATED DEPRECIATION	**$ 2,344,984**	**$ 398,304**	**$ 2,743,288**	**$ 2,723,023**

7. UNIVERSITY NOTES AND BONDS PAYABLE

Notes and bonds payable at August 31, 2004 and 2003, in thousands of dollars, are as follows:

	YEAR OF MATURITY	EFFECTIVE INTEREST RATE 2004	OUTSTANDING PRINCIPAL 2004	OUTSTANDING PRINCIPAL 2003
TAX-EXEMPT:				
California Educational Facilities Authority (CEFA) Fixed Rate Revenue Bonds:				
Series M	2026	5.3%	$ 28,320	$ 28,320
Series N	2027	5.2%	180,000	180,000
Series O	2031	5.1%	89,555	89,555
Series P	2013–2023	5.1%	110,440	110,440
Series Q	2032	5.3%	101,860	101,860
Series R	2011–2021	4.9%	111,585	111,585
CEFA Variable Rate Revenue Notes and Bonds:				
Series L	2014–2022	1.0%	83,818	115,033
Series S	2039–2050	1.1%*	181,200	–
Commercial Paper			–	72,600
TAXABLE:				
Fixed Rate Notes and Bonds:				
Stanford University Bonds	2024	6.9%	150,000	150,000
Medium Term Notes	2009–2026	6.6%	150,000	150,000
Other	2004–2015	various	10,319	25,517
Variable Rate Notes and Bonds:				
Stanford University Bonds PARS	2032	1.4%	50,000	50,000
Commercial Paper	2004	1.1%*	40,974	87,400
Other	2004–2016		–	2,500
University notes and bonds payable			1,288,071	1,274,810
Premiums			171	386
TOTAL			**$ 1,288,242**	**$ 1,275,196**

*Exclusive of interest rate swaps.

At August 31, 2004 and 2003, the fair value of these debt instruments approximated their recorded value.

In June 2004, the University issued $181,200,000 of variable rate CEFA S revenue bonds. The bonds are comprised of $130,000,000 of Auction Rate Securities (ARS) and $51,200,000 of Variable Rate Demand bonds (VRDB). The ARS rate is determined by periodic auction. The ARS may be redeemed at the option of the University, in whole or in part, on the interest payment date immediately following the end of any auction period as defined in the bond's official statement. The VRDB may be redeemed at the option of the University, either in whole or in part, no less than 15 days and no more than 60 days prior to the date fixed for redemption as defined in the bond's official statement. The VRDB may be tendered for purchase at the option of the bondholder, in whole or in part, on any business day with seven days notice. The interest rate on all of the CEFA S bonds may be converted to a different variable rate mode or a fixed rate at the option of the University. The bonds mature from 2039 through 2050.

The University uses interest rate swaps to manage the interest rate exposure of its variable rate debt portfolio. Under the terms of these agreements, the University pays a fixed interest rate, determined at inception, and receives a variable rate on the underlying notional principal amount. At August 31, 2004, the University had swap agreements expiring November 1, 2039 to pay an interest rate of approximately 3.69% based on an amount equal to the $130,000,000 outstanding balance of the CEFA S ARS bonds and swap agreements expiring through 2011 to pay an interest rate of approximately 6.36% on approximately $76,600,000 of the variable rate commercial paper (see Note 5).

The University incurred interest expense of approximately $54,617,000 and $51,891,000 for fiscal years 2004 and 2003, respectively, which is net of approximately $734,000 and $4,853,000, respectively, in interest capitalized as a cost of construction. Interest payments on swap agreements, which are included in other changes in unrestricted net assets, totaled $4,781,000 and $4,955,000 for fiscal years 2004 and 2003, respectively.

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, 2004 was $40,974,000. The weighted average days to maturity were 25.7 and the weighted average effective interest rate was 1.65% as of August 31, 2004.

The University also has a tax-exempt commercial paper credit facility that allows for borrowings up to $150,000,000 through CEFA. There was no balance outstanding at August 31, 2004.

The University's School of Law has an $8,000,000 line of credit with the Student Loan Corporation. There was no outstanding balance at August 31, 2004, and $2,560,000 was outstanding at August 31, 2003.

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

YEAR	PRINCIPAL
2005 Commercial Paper	$ 40,974
2005 Other	614
2006	662
2007	715
2008	771
2009	50,833
Thereafter	1,193,502
TOTAL	**$ 1,288,071**

8. HOSPITALS NOTES AND BONDS PAYABLE

Bonds and certificates of participation at August 31, 2004 and 2003, in thousands of dollars, are as follows:

	YEAR OF MATURITY	EFFECTIVE INTEREST RATE 2004	OUTSTANDING PRINCIPAL 2004	2003
SHC:				
California Health Facilities Financing Authority (CHFFA) Bonds:				
Series B Fixed Rate Bonds	2031	5.0%	$ 180,520	$ 183,465
Fixed Rate Bonds	2006–2023	2.0%–5.0%	100,000	100,000
Variable Rate Bonds	2036	1.27%*	150,000	150,000
LPCH:				
Variable Rate Certificates of Participation (Certificates)	2023	1.34%*	35,900	37,000
California Health Facilities Financing Authority (CHFFA) :				
Auction Rate Revenue Bonds	2027–2033	1.05%	60,000	60,000
Fixed Rate Revenue Bonds	2013–2027	4.88%	55,000	55,000
Hospital notes and bonds payable			581,420	585,465
Premiums			5,529	5,835
TOTAL			**$ 586,949**	**$ 591,300**

*Exclusive of interest rate swaps.

The estimated fair value of the debt instruments at August 31, 2004 and 2003 approximated the recorded value.

At August 31, 2004, 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 2004 Variable Rate Bonds.

At August 31, 2004, 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.

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.

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 2015. LPCH may redeem the certificates, in whole or in part, prior to the stated maturities at par value. LPCH has the option to convert the certificates to a fixed rate.

The University is not an obligor or guarantor with respect to any obligations of SHC or LPCH, nor are SHC or LPCH obligors or grantors with respect to obligations of the University.

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

YEAR	PRINCIPAL
2005	$ 4,190
2006	4,445
2007	8,300
2008	9,200
2009	9,135
Thereafter	546,150
TOTAL	**$ 581,420**

9. LIABILITIES UNDER SECURITY AGREEMENTS

At August 31, 2004 and 2003, the University held $391,917,000 and $311,790,000, 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 $39,735,000 and $31,951,000 at August 31, 2004 and 2003, respectively. These amounts are included as assets and liabilities in the University's financial statements. The estimated market value of securities on loan at August 31, 2004 and 2003, was $378,301,000 and $303,251,000, respectively.

10. UNIVERSITY ENDOWMENT

The University manages a substantial portion of its financial resources within its endowment. These assets include pure endowment funds, term endowments, funds functioning as endowment and funds subject to living trust agreements. Depending on the nature of the donor's stipulation, these resources are recorded as permanently restricted, temporarily restricted or unrestricted net assets.

Pure endowment funds are subject to the restrictions of the gift instruments requiring that the principal be invested in perpetuity and the income and an appropriate portion of gains only be spent as provided for under the California Uniform Management of Institutional Funds Act (CUMIFA). In the absence of further donor restrictions, the amount of gains that are to be expended in a given year is determined through the endowment payout policy discussed in Note 5. The University classifies the original endowment gift and any donor-imposed restricted gains as permanently restricted net assets and reports all remaining reinvested gains as unrestricted net assets. The University recognizes the limitations 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, 2004 and 2003, in thousands of dollars, are as follows:

	2004	2003
ENDOWMENT, BEGINNING OF YEAR	**$ 8,613,805**	**$ 7,612,769**
INVESTMENT RETURNS:		
Earned endowment income	188,513	194,484
Unrealized and realized gains	1,175,843	962,252
Total investment returns	1,364,356	1,156,736
Amounts distributed for operations	(399,950)	(391,416)
Gifts	208,770	189,943
Funds invested in endowment	15,925	4,139
EFP returns invested in endowment	122,279	36,870
Actuarial adjustment to living trusts	(7,454)	20,346
Other	4,310	(15,582)
Net increase in endowment	1,308,236	1,001,036
ENDOWMENT, END OF YEAR	**$ 9,922,041**	**$ 8,613,805**

II. 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, 2004 and 2003, per the statement of activities reconciled to the cash basis (as reported by OOD), in thousands of dollars:

	2004	2003
Current year gifts in support of operations	$ 105,222	$ 112,885
Expendable gifts invested in the endowment	9,150	12,965
Temporarily restricted – general	165,863	66,466
Temporarily restricted – capital	23,270	28,718
Permanently restricted – endowment	166,535	157,226
Permanently restricted – student loans	9	46
TOTAL PER STATEMENT OF ACTIVITIES	**470,049**	**378,306**
ADJUSTMENTS TO GIFT TOTAL AS REPORTED BY OOD:		
Pledges, net	(179,149)	(150,269)
Payments made on pledges	185,124	196,654
Nongovernment grants, recorded as sponsored research support when earned	54,595	61,465
Other	(6,405)	(81)
TOTAL AS REPORTED BY OOD	**$ 524,214**	**$ 486,075**

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.

12. FUNCTIONAL EXPENSES

Expenses for each of the years ended August 31, 2004 and 2003 are categorized on a functional basis as follows, in thousands of dollars:

	2004	2003
UNIVERSITY:		
Organized research (direct costs)	$ 782,005	$ 737,741
Instruction and departmental research	817,904	744,004
Auxiliary activities	294,475	332,351
Administration and general	223,111	233,197
Libraries	111,107	101,068
Development	49,739	45,245
Student services	65,053	59,175
SLAC construction	22,500	12,949
	2,365,894	2,265,730
HOSPITALS:		
Health care services	1,222,838	1,067,096
TOTAL CONSOLIDATED EXPENSES	**$ 3,588,732**	**$ 3,332,826**

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, other activities and certain patient care provided by the SoM faculty.

13. 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 (post retirement medical benefits).

DEFINED CONTRIBUTION PLAN 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, which are vested immediately to participants, amounted to approximately $72,582,000 and $68,724,000 for the years ended August 31, 2004 and 2003, respectively.

DEFINED BENEFIT PENSION PLAN Retirement benefits for certain nonexempt employees are provided through a noncontributory defined benefit pension plan (the Pension plan). 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 $24,784,000 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.

POST RETIREMENT MEDICAL BENEFIT PLAN The University's employees may become eligible for 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 payers or health maintenance organizations, whose charges are based on either 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 medical 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 $2,500 for spouses, and for post-Medicare plans at $3,200 for retirees and $2,000 for spouses.

The Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act) was signed into law in December 2003. In January 2004, the Financial Accounting Standards Board (FASB) issued FASB Staff Position 106-1, which permits companies to elect to defer accounting for the effects of the Act. The University has not elected this deferral. The change in benefit obligation and costs disclosed below include an actuarial gain of $2,344,000 associated with the federal subsidy provided by the Act.

The University uses June 30 as the measurement date to value the plan assets and the benefit obligation of the Pension plan and the Post Retirement Medical Benefit plan.

The change in Pension and Post Retirement Medical Benefit plan assets, the related change in benefit obligation and the amounts recognized in the financial statements, in thousands of dollars, are as follows:

	PENSION		POST RETIREMENT MEDICAL	
	2004	2003	2004	2003
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	$ 221,253	$ 232,599	$ 39,690	$ 27,790
Actual return on plan assets	40,810	7,189	5,489	2,559
Employer contributions	–	–	20,014	15,563
Plan participants' contributions	–	–	4,795	4,894
Benefits paid	(19,183)	(18,535)	(13,364)	(11,116)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	**$ 242,880**	**$ 221,253**	**$ 56,624**	**$ 39,690**
CHANGE IN BENEFIT OBLIGATION				
Benefit obligation at beginning of year	$ 267,377	$ 238,136	$ 206,297	$ 292,512
Effect of curtailment	–	(1,860)	–	–
Service cost	5,877	4,097	6,876	4,161
Interest cost	15,446	15,773	12,091	11,786
Plan participants' contributions	–	–	4,795	4,894
Amendments	–	–	–	(119,902)
Actuarial loss (gain)	(299)	29,766	8,791	23,962
Benefits paid	(19,183)	(18,535)	(13,364)	(11,116)
BENEFIT OBLIGATION AT END OF YEAR	**$ 269,218**	**$ 267,377**	**$ 225,486**	**$ 206,297**
AMOUNTS RECOGNIZED IN CONSOLIDATED FINANCIAL STATEMENTS				
Plan assets minus benefit obligation	$ (26,338)	$ (46,124)	$ (168,862)	$ (166,607)
Contributions after the measurement date	6,000	–	4,409	6,865
Unrecognized prior service cost (benefit)	6,026	7,051	(47,619)	(52,910)
Unrecognized net actuarial loss	17,696	43,759	170,595	173,558
NET AMOUNT RECOGNIZED IN THE STATEMENT OF FINANCIAL POSITION	**$ 3,384**	**$ 4,686**	**$ (41,477)**	**$ (39,094)**
Accrued benefit liability	$ (11,852)	$ (36,359)		
Intangible asset	6,026	7,051		
Minimum pension liability	9,210	33,994		
NET AMOUNT RECOGNIZED	**$ 3,384**	**$ 4,686**		

Net benefit expense related to the Pension and Post Retirement Medical Benefit plans for the years ended August 31, 2004 and 2003, in thousands of dollars, includes the following components:

	PENSION		POST RETIREMENT MEDICAL	
	2004	2003	2004	2003
Service cost	$ 5,877	$ 4,097	$ 6,876	$ 4,161
Interest cost	15,446	15,773	12,091	11,786
Expected return on plan assets	(16,886)	(19,367)	(3,175)	(2,432)
Amortization of transition asset	–	(4)	–	–
Amortization of prior service cost	1,025	1,025	(5,291)	(5,291)
Recognized net actuarial loss	1,840	–	9,440	8,279
Plan curtailment expenses	–	1,667	–	–
NET PERIODIC BENEFIT EXPENSE	**$ 7,302**	**$ 3,191**	**$ 19,941**	**$ 16,503**

ACTUARIAL ASSUMPTIONS The weighted average assumptions used in the accounting for the Pension and Post Retirement Medical Benefit plans are shown below:

	PENSION		POST RETIREMENT MEDICAL	
	2004	2003	2004	2003
Discount rate	6.00%	6.00%	6.00%	6.00%
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%
Covered payroll growth rate	5.52%	5.52%	N/A	N/A

To develop the 8% expected long-term rate of return on assets assumption, the University considered historical returns and future expectations for returns in each asset class, as well as the target asset allocation of the portfolios.

To determine the accumulated post retirement medical benefit obligation as of June 30, 2004, a 15% annual rate of increase in the pre-65 per capita costs and a range of 10%–16% annual rate of increase in the post-65 per capita costs of covered health care was assumed for 2005–2006, declining gradually to 5% by 2014 and remaining at this rate thereafter. For covered dental plans, a 7% annual rate of increase was assumed for 2005–2006, declining to 5% by 2009 and remaining at this rate thereafter.

Assumed health care cost trend rates have a modest effect on the amounts reported for the health care plans due to the cap on benefits. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated post retirement medical benefit obligation by $4,568,000 and the aggregate service and interest cost by $691,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post retirement medical benefit obligation by $3,851,000 and the aggregate service and interest cost by $582,000.

PLAN ASSETS Asset allocations by asset category at August 31 are as follows:

	PENSION		POST RETIREMENT MEDICAL	
	2004	2003	2004	2003
ASSET CATEGORY				
Domestic equity	54%	57%	73%	75%
International equity	16%	15%`	–	–
Real estate	16%	11%	–	–
Fixed income	12%	16%	23%	22%
Short term	1%	–	–	–
Other	1%	1%	4%	3%
TOTAL PORTFOLIO	**100%**	**100%**	**100%**	**100%**

The weighted average target asset allocation for the Pension plan is 45% domestic equity, 30% fixed income, 15% international equity and 10% real estate. Weighted average target asset allocations for the Post Retirement Medical Benefit plan are 60% domestic equity and 40% fixed income. These target asset allocations are meant to result in a favorable long-term rate of return from a diversified portfolio of equity, fixed income and real estate investments.

EXPECTED CONTRIBUTIONS The University made a contribution to the Pension plan on September 1, 2004 in the amount of $3,686,000. No other contributions are expected to be made to the Pension plan for the fiscal year ending August 31, 2005. The University expects to contribute $17,315,000 to its Post Retirement Medical Benefit plan during fiscal year ending August 31, 2005.

EXPECTED BENEFIT PAYMENTS The following benefit payments, which reflect expected future service, are expected to be paid, in thousands of dollars, for the fiscal years ending August 31:

FISCAL YEAR	PENSION PLAN	POST RETIREMENT MEDICAL
2005	$ 22,646	$ 12,483
2006	19,645	13,171
2007	19,922	13,457
2008	19,488	14,353
2009	20,064	16,326
2010–2014	97,633	89,000

14. HOSPITALS RETIREMENT PLANS

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

DEFINED CONTRIBUTION PLAN Employer contributions to the defined contribution retirement plan are discretionary and are based on a percentage of participant annual compensation. Employer contributions to this plan amounted to approximately $28,144,000 and $25,506,000 for the years ended August 31, 2004 and 2003, respectively.

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.

During the year ended August 31, 2004, SHC assumed the Staff Pension Plan liability of the employees leased to LPCH. SHC received $3,077,000 in cash which represented the pension liability as of August 31, 2003 and current year pension expenses related to LPCH leased employees.

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 $11,442,000 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.

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 consolidated statements of financial position.

The Hospitals did not elect to defer accounting for the effects of the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act). The change in benefit obligation for 2004 includes actuarial gains of $4,555,000 each for SHC and LPCH related to the Act.

The Hospitals use June 30 as a measurement date to value the plan assets and the benefit obligation of their Pension and Post Retirement Medical Benefit plans.

The change in Pension and Post Retirement Medical Benefit plan assets, the related change in benefit obligation and the amounts recognized in the financial statements, in thousands of dollars, are as follows:

	PENSION		POST RETIREMENT MEDICAL	
	2004	2003	2004	2003
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	$ 99,381	$ 100,827	$ –	$ –
Actual return on plan assets	18,482	6,789	–	–
Employer contributions	3,635	190	3,838	2,827
Benefits paid	(4,982)	(3,911)	(3,838)	(2,827)
Transfer of assets to UC Retirement Plan	–	(4,514)	–	–
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	**$ 116,516**	**$ 99,381**	**$ –**	**$ –**
CHANGE IN BENEFIT OBLIGATION				
Benefit obligation at beginning of year	$ 149,437	$ 122,681	$ 81,756	$ 71,648
Service cost	2,064	1,761	2,188	2,150
Interest cost	8,815	8,433	4,790	4,893
Actuarial (gain) loss	(4,982)	20,473	(10,233)	5,892
Benefits paid	(4,230)	(3,911)	(3,838)	(2,827)
BENEFIT OBLIGATION AT END OF YEAR	**$ 151,104**	**$ 149,437**	**$ 74,663**	**$ 81,756**
AMOUNTS RECOGNIZED IN CONSOLIDATED FINANCIAL STATEMENTS				
Plan assets minus benefit obligation	$ (34,588)	$ (50,056)	$ (74,663)	$ (81,756)
Contributions after the measurement date	635	47	–	–
Estimated net benefit payments	–	–	686	594
Unrecognized prior service cost	–	–	1,418	2,051
Unrecognized loss	19,734	33,533	4,385	15,953
NET AMOUNT RECOGNIZED IN THE STATEMENT OF FINANCIAL POSITION	**$ (14,219)**	**$ (16,476)**	**$ (68,174)**	**$ (63,158)**
Accrued benefit liability	$ (28,303)	$ (42,017)		
Minimum pension liability	14,084	25,541		
NET AMOUNT RECOGNIZED	**$ (14,219)**	**$ (16,476)**		

Net benefit expense related to the plans for the years ended August 31, 2004 and 2003, in thousands of dollars, includes the following components:

	PENSION 2004	PENSION 2003	POST RETIREMENT MEDICAL 2004	POST RETIREMENT MEDICAL 2003
Service cost	$ 2,064	$ 1,761	$ 2,188	$ 2,150
Interest cost	8,815	8,433	4,790	4,893
Expected return on plan assets	(9,125)	(9,215)	–	–
Amortization of prior service cost	–	–	633	633
Recognized net actuarial loss	212	62	1,335	834
Other	–	(487)	–	(539)
NET PERIODIC BENEFIT EXPENSE	**$ 1,966**	**$ 554**	**$ 8,946**	**$ 7,971**

ACTUARIAL ASSUMPTIONS The weighted average assumptions used in the accounting for the Pension and Post Retirement Medical plans are shown below:

	PENSION 2004	PENSION 2003	POST RETIREMENT MEDICAL 2004	POST RETIREMENT MEDICAL 2003
Discount rate	6.3%	6.0%	6.3%	6.0%
Expected return on plan assets	3.0–8.0%	4.5–8.0%	N/A	N/A
Covered payroll growth rate	5.5%	5.5%	N/A	N/A

To develop the expected long-term rate of return on assets, the Hospitals considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

The assumed health care cost trend rate used to measure the accumulated post retirement benefit obligation at August 31, 2004 was 10%-11% for the year ending August 31, 2005. The rate was assumed to decrease by 2% for the next two years and 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 post retirement medical benefit plan. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated post retirement benefit obligation by $3,737,000 and the aggregate service and interest cost by $366,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post retirement benefit obligation by $3,451,000 and the aggregate service and interest cost by $322,000.

PLAN ASSETS Asset allocations by asset category at August 31 for the Hospitals' Pension plan are as follows:

	PENSION 2004	PENSION 2003
ASSET CATEGORY		
Equity securities	72%	71%
Fixed income	22%	23%
Real estate	6%	6%
TOTAL PORTFOLIO	**100%**	**100%**

The weighted average target asset allocation of 62% equity securities, 30% fixed income and 8% real estate is meant to result in a favorable long-term rate of return from a diversified portfolio of equity, debt and real estate investments.

EXPECTED CONTRIBUTIONS The Hospitals expect to contribute $3,202,000 and $4,002,000 to their Staff Pension Plan and Post Retirement Medical Benefit Plan, respectively, during the fiscal year ending August 31, 2005.

EXPECTED BENEFIT PAYMENTS The following benefit payments, which reflect expected future service, are expected to be paid for the fiscal years ending August 31, in thousands of dollars:

FISCAL YEAR	PENSION PLAN	POST RETIREMENT MEDICAL
2005	$ 5,054	$ 4,002
2006	5,069	4,283
2007	5,101	4,524
2008	5,144	4,904
2009	5,199	5,260
2010–2014	28,299	32,960

15. OPERATING LEASES

The University and the Hospitals lease certain equipment and facilities under operating leases expiring at various dates. Total rental expense, included in other operating expenses in the consolidated statements of activities, under these leases for the years ended August 31, 2004 and 2003 was $27,000,000 and $14,000,000, respectively, for the University and $21,242,000 and $16,608,000, respectively, for the Hospitals.

Net minimum future operating lease payments and related present value assuming a 6% discount rate for periods subsequent to August 31, 2004, in thousands of dollars, are as follows:

	MINIMUM LEASE PAYMENTS		PRESENT VALUE OF MINIMUM LEASE PAYMENTS	
YEAR	UNIVERSITY	HOSPITALS	UNIVERSITY	HOSPITALS
2005	$ 20,999	$ 21,384	$ 20,434	$ 20,808
2006	18,264	17,494	16,766	16,060
2007	16,923	17,619	14,656	15,259
2008	12,344	15,858	10,086	12,956
2009	12,042	14,422	9,282	11,116
Thereafter	70,571	38,618	48,598	26,481
TOTAL	**$ 151,143**	**$ 125,395**	**$ 119,822**	**$ 102,680**

16. RELATED PARTY TRANSACTIONS

Members of the University's Board of Trustees and senior management may, from time to time, be associated, either directly or through interlocking board memberships, with companies doing business with the University. The University employs a conflict of interest policy that requires any such associations to be disclosed in writing on an annual basis. When such associations exist, measures are taken to mitigate any actual or perceived conflict, including recusal of the board member from any decisions involving the company doing business with the University. Except as noted below, these associations are not considered to be significant.

Investments amounting to $282,306,000 at August 31, 2004 are held in a public company for which an officer of the University is a board member.

A total of $50,000,000 of the CEFA S bonds was underwritten by an investment banking firm for which a member of the Board of Trustees is an Advisory Director. A total of $80,000,000 of the CEFA S bonds was underwritten by an investment banking firm for which a member of the Board of Trustees is a Managing Director.

17. 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 investigations 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 employees and 55% of 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 outcomes 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, 2004, the University had contractual obligations of approximately $68,096,000 in connection with major construction projects. Remaining expenditures on construction in progress are estimated to be $154,050,000, which will be financed with certain unexpended plant funds, gifts and debt.

At August 31, 2004, the remaining commitment on contracts for the construction and remodeling of Hospital facilities was approximately $14,985,000.

The University has committed to invest in numerous investment partnerships over a period of years pursuant to provisions of the individual partnership agreements. As of August 31, 2004, the aggregated amount of such unfunded commitments was $2,126,540,000.

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 are not expected to be material. As a result, the University has not recorded any liabilities related to guarantees and indemnities as of August 31, 2004.

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, 2004 and 2003, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

San Francisco, California
December 13, 2004

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 believe 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 2004

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 $12.0 BILLION OF ENDOWMENT AND TRUST ASSETS, TEMPORARILY INVESTED 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 approximately $10.0 billion as of June 30, 2004. MEP performance measurements are calculated on the 12 months ended June 30, 2004 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 18.0% investment return for the 12 months ended June 30, 2004. Over the past 10 years, the MEP achieved an annualized rate of return of 15.1%, growing from $2.6 billion to $10.0 billion. This investment performance places Stanford in the top 5% of all reporting university and college endowments during this period, according to the consulting firm of Cambridge Associates.

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 for the 12 months ended June 30, 2004 was relatively calm and upward trending across most of the MEP's major asset classes. After three consecutive years of extremely volatile and generally punitive market conditions, investors' risk aversion changed abruptly. Investors, frustrated by the lowest interest rates in modern financial history, aggressively went in search of return. Almost all risky assets rebounded from their market lows of April 2003—the riskier the assets, the greater the rebound. Investors, fatigued after months of earning only 1% on their money market funds, went in search of yield, bidding up the prices of high yield bonds and sending REIT prices to all-time highs. Although we are happy to collect an 18% return for the past year, as we look forward, we take more caution than comfort from recent performance.

As a perpetual pool of capital, the MEP's investment strategies are commensurately long-term in nature, and meaningful performance can only be gauged over longer measurement periods. SMC endeavors to invest thoughtfully without being burdened by considerations of short-term performance or volatile market sentiment. The MEP's three-year annualized performance of 7.8% since June 30, 2001 should be regarded as the minimum period upon which a meaningful review of recent endowment results can be conducted. This three-year investment return places Stanford in the top 6% of all reporting university and college endowments during this period, according to Cambridge Associates. 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 conditions.

One SMC investment strategy that bears mention came on the heels of the corporate accounting scandals of late 2001 and early 2002, which 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 have reduced this overweight to corporate credit investments.

The market's current appetite for yield has compelled us to de-emphasize most forms of high yielding investments: REITs, stabilized private real estate, high yield bonds and fixed income more broadly. To us, many of these assets now feel more like momentum plays than value plays. The nominal and real interest rate on capital is low, and the market is projecting a low-return and stable inflation rate environment going forward. Risk premia, as thin as they may have seemed in the spring of 2003, have clearly compressed with the ensuing dramatic appreciation in financial asset pricing. Many of the U.S.-based alternative investment strategies that were so productive for the endowment in the 1990s appear to be over-supplied with new capital. At the same time, the U.S. economy is running the largest current account deficit in its history. In the face of this set of issues, SMC has been focusing its marginal time and endowment capital on international opportunities. Although the MEP remains a heavily U.S.-weighted portfolio, we are more internationally tilted than at any previous point in our history.

The strategic asset allocation targets for the MEP as of June 30, 2004 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%

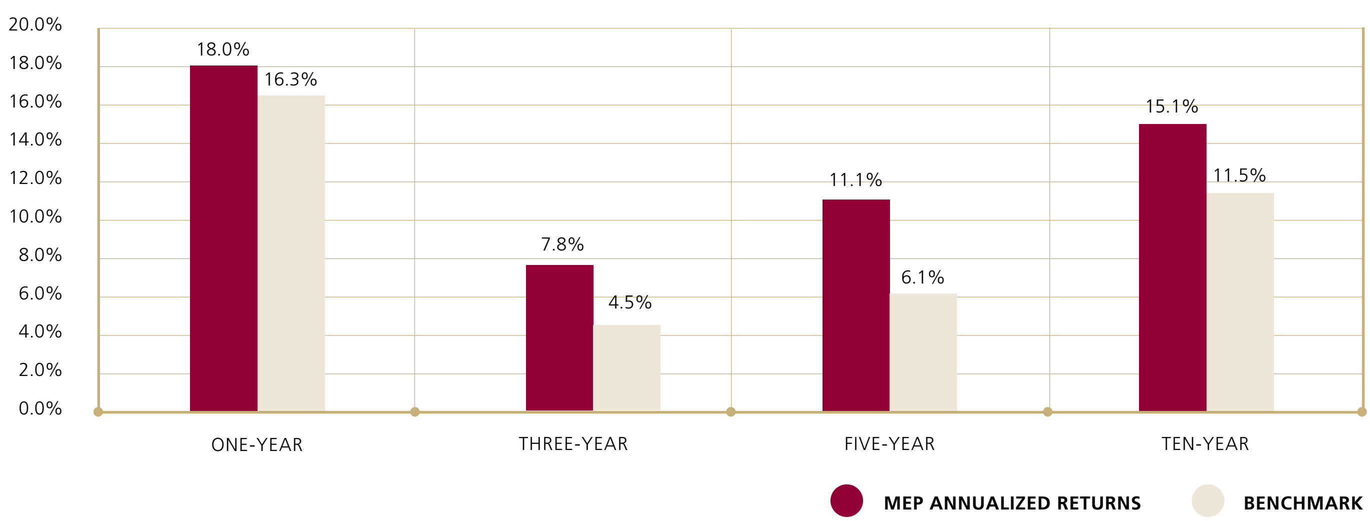
STANFORD MEP PERFORMANCE COMPARED TO INFLATION The table below outlines annualized returns for various periods ending June 30, 2004 and illustrates the performance of the MEP in a long-term context. Stanford's objective is to return a minimum of 6.25% over the rate of inflation. If this real return target 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	18.0%	7.8%	11.1%	15.1%
GDP Deflator	2.6%	1.9%	2.0%	1.9%
Real Endowment Return	15.4%	5.9%	9.1%	13.2%

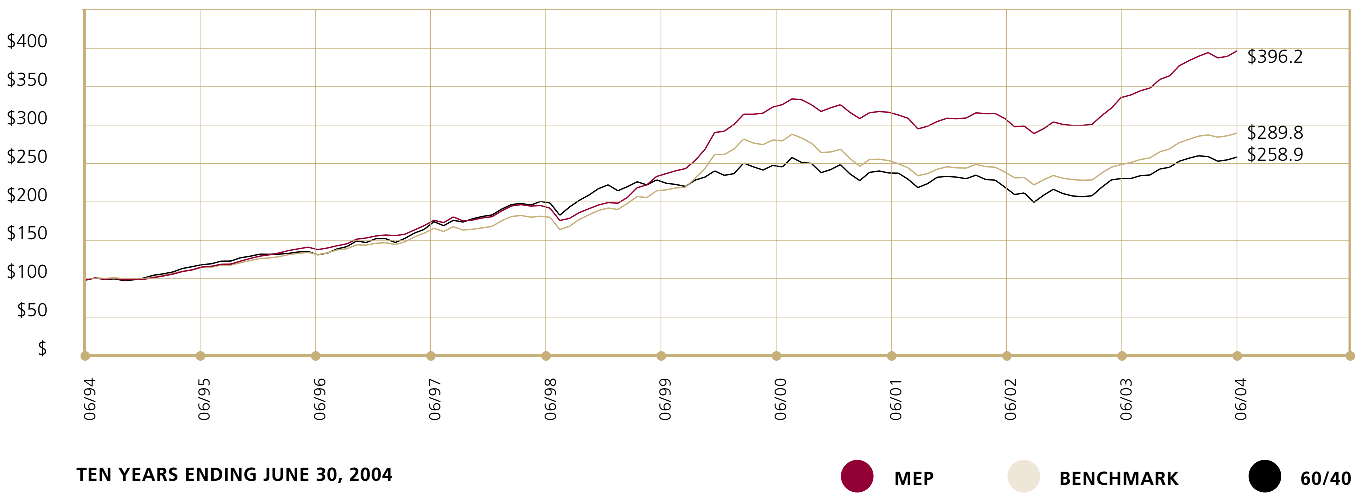
STANFORD MEP PERFORMANCE COMPARED TO BENCHMARKS SMC evaluates the performance of investment managers by comparing their returns to benchmarks that are appropriate for each individual asset class. SMC may alter an asset class benchmark to allow for a change in investment style, a shift in mix within an 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, 2004.

STANFORD MEP VS. STANFORD COMPOSITE BENCHMARK



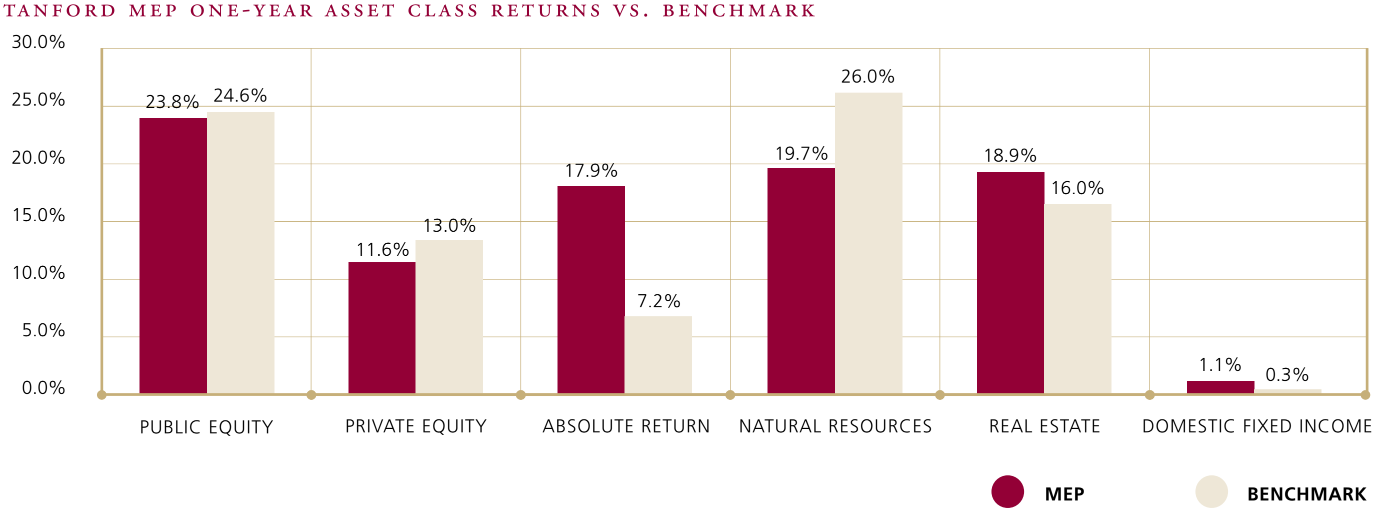
SMC's effectiveness in implementing its investment strategies through superior manager selection has resulted in a consistent and long-term performance advantage over the composite benchmark. The cumulative return chart below compares the growth of $100 in Stanford's endowment with that of the composite 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 "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 1994 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 four years. During the four years since the market peak in June of 2000 ending in June of 2004, the U.S. stock market was down more than 16% cumulatively while the MEP's investment performance was up 22.5% 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, 2004 relative to each asset class benchmark is illustrated in the graph below:

STANFORD MEP ONE-YEAR ASSET CLASS RETURNS VS. BENCHMARK



Relative performance of the MEP versus its benchmark was strong for the one-year period with an overall portfolio alpha (return over benchmark) of 1.7%. The alpha was driven primarily by outperformance in the Absolute Return asset class. Total return in almost every asset class also improved from one year ago, with the exception of Fixed Income. However, we have not seen, and do not expect to see, a return of the broad-based bull market of 1982-2000. The last four 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 over-expansion. The 20-year secular decline in interest rates appears to have bottomed out. The view at SMC is that the tailwinds of the bull market have become the headwinds of today's challenging investment environment.

Stanford's Public Equity portfolio benefited from its substantial exposure to international equity markets. In particular, emerging market equities performed the strongest during the last 12 months. The equity portfolio is also tilted toward "quality" stocks—companies with lower leverage, lower interest rate sensitivity and generally more consistent history of delivering high return on equity to shareholders. Currently, we believe there is better relative value in quality companies versus the broader market. Over the last 12 months, however, this quality tilt underperformed broader equity market benchmarks, as riskier stocks have demonstrated the best relative performance.

Private Equity, a combination of venture capital and leveraged buyout limited partnerships, had its best showing in recent years. We maintain 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 10 years, venture capital investment gains have added more than $2.5 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 and bond 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, 2004 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 30 months. Over the last 24 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.

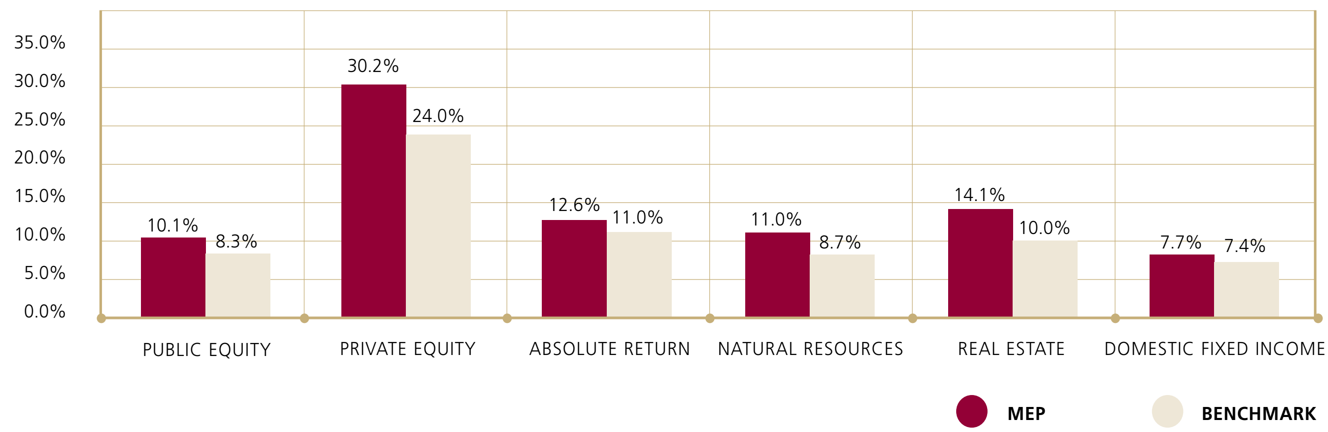
The Natural Resources portfolio is comprised of domestic and international investments in timber, direct oil and gas assets and oil and gas private equity partnerships. The natural resources sector enjoyed generally strong performance over the last 12 months, buoyed by higher commodity prices. SMC continues 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 REITs. 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.

The Fixed Income asset class is facing a challenging, low-interest rate environment. With the yield on 10-year Treasury bonds hovering at recent historic lows, it is hard to be sanguine about the total return opportunity available in bonds.

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 18.0% return for the 12 months ended June 30, 2004, we are more focused upon, and encouraged by, the MEP's three-year annualized return of 7.8%. This three-year period was characterized by repeated challenges to the global financial markets, including a significant recession, the terrorist attacks of September 11th, the unwinding of the dot-com and telecom bubbles, corporate malfeasance and a war in the Middle East. Each of these unexpected crises represented 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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