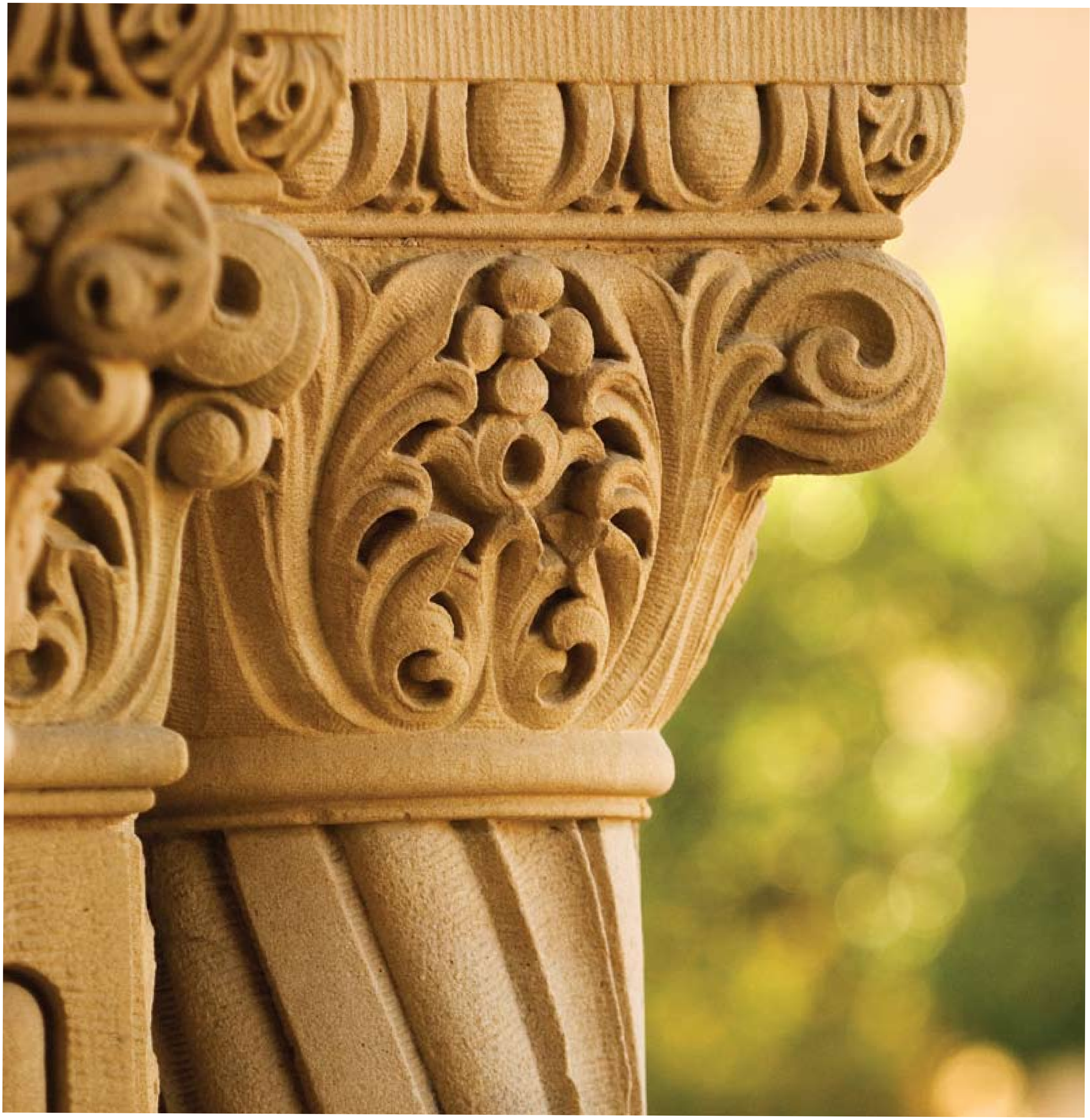

MEETING THE STANFORD CHALLENGE

STANFORD
2006 ANNUAL REPORT

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STANFORD FACTS

ENROLLMENT (October 2006):
- Undergraduate Students: **6,689**
- Graduate Students: **8,201**

DEGREES AWARDED (2005-06):
- Bachelor's: **1,756**
- Master's: **2,139**
- Doctoral: **954**

THE STANFORD PROFESSORIATE (December 2006): **1,807**

NOBEL LAUREATES: **17**

PULITZER PRIZE WINNERS: **4**

MACARTHUR FELLOWS: **24**

NATIONAL MEDAL OF SCIENCE WINNERS: **20**

NATIONAL MEDAL OF TECHNOLOGY WINNERS: **3**

AMERICAN ACADEMY OF ARTS AND SCIENCES MEMBERS: **228**

NATIONAL ACADEMY OF SCIENCES MEMBERS: **134**

NATIONAL ACADEMY OF ENGINEERING MEMBERS: **83**

AMERICAN PHILOSOPHICAL SOCIETY MEMBERS: **43**

NATIONAL ACADEMY OF EDUCATION MEMBERS: **29**

WOLF FOUNDATION PRIZE WINNERS: **7**

KORET FOUNDATION PRIZE WINNERS: **6**

PRESIDENTIAL MEDAL OF FREEDOM RECIPIENTS: **3**

ON THE COVER: Architectural detail from the Stanford University Main Quadrangle. (Photo by Linda A. Cicero of the Stanford News Service.)

Meeting the Stanford Challenge

More than a century ago when Jane and Leland Stanford established this "University of high degree," they charged us "to qualify students for personal success and direct usefulness in life; and to promote the public welfare by exercising an influence on behalf of humanity and civilization."

Throughout Stanford's history we have been guided by their words. Driven by the pioneering spirit of our founders, we are dedicated to research that makes a positive contribution to our world and to education that produces graduates who become leaders in all sectors of society and around the world.

In the last several years we have searched for ways to make even more meaningful contributions. As the world's peoples, economies and cultures become more and more connected through advances in technology, problems faced by different societies are increasingly shared, increasingly global and more complex than ever. Although our knowledge in many fields is advancing at an unprecedented rate, the challenges are also growing and range from environmental degradation to international strife and instability to new challenges to human health. Driven by these concerns, we have developed new approaches to further strengthen Stanford's research and educational programs to more effectively address these problems and to better prepare our graduates to be effective contributors in the globalized world of the 21st century.

I believe that this is an opportunity for Stanford University — with its breadth and excellence, pioneering faculty and exceptional students — to step forward and play a critical role in addressing these issues. We have a long history of transferring research to the public arena both through policy initiatives and through technology transfer. In recent years, we have developed more collaborative approaches to research and teaching that will better prepare our students to respond to the changing demands of their time. We have established university-wide, multidisciplinary research initiatives in an effort to address problems in human health, the environment and international affairs.

In October, we launched The Stanford Challenge. It is our response to the charge by Jane and Leland Stanford to use the resources of this university for the benefit of the world. An ambitious campaign, it seeks to raise $4.3 billion to support research that searches for solutions to contemporary social and scientific challenges, to educate the next generation of leaders and to sustain Stanford's overall excellence.

THE STANFORD CHALLENGE

"The Initiative on Human Health" in this annual report details the progress we have made on a key research initiative: finding new solutions for problems in human health. Through Bio-X, our pioneering research initiative in the biosciences and bioengineering, we have learned a great deal about creating an environment in which collaborative, cross-school research flourishes. The human health initiative has grown to encompass five programs focused on "translational research," or what is often referred to as "bench-to-bedside" research.

Environmental issues are among the greatest challenges faced by societies around the world, and "The Initiative on the Environment and Sustainability" describes our efforts in this area. If we are to build a sustainable world for our children — and for the "children's children's children" that Jane Stanford envisaged — it will require new approaches based on fundamental scientific advances as well as aligned economic incentives.

In recent years, it has become painfully clear that new approaches to ensuring peace, improving governance and enhancing human development are vitally needed, and that these issues are fundamentally interrelated. Faculty and researchers throughout the university are collaborating on projects through the Freeman Spogli Institute for International Studies, and these efforts are outlined in "The International Initiative" section in this report.

As we think about the challenges our graduates will face in this century, we increasingly see a need for students to have skills beyond a single discipline and to be able to work in teams with others with different skill sets. "Engaging the Arts and Creativity" describes how we are strengthening core programs in the arts and providing opportunities for students to engage in creative collaboration across disciplines. "Reinventing Graduate Education" further addresses the changing needs of today's graduate students, and "Improving K-12 Education" details our commitment to addressing this critical national need.

Of course, at the heart of these initiatives is our exceptional faculty. As is noted in this report, this was an extraordinary year for them. Two Stanford School of Medicine faculty were awarded Nobel Prizes: Andrew Fire, professor of pathology and of genetics, shared the 2006 Nobel Prize in physiology or medicine for groundbreaking work in RNA interference; and Professor Roger Kornberg was awarded the 2006 Nobel Prize in chemistry for discoveries that reveal how DNA is converted into RNA. Roger came to Stanford as a young boy with his father, Professor Arthur Kornberg, who founded the Biochemistry Department and won the Nobel Prize in 1959. The celebration for Roger's Nobel was truly a Stanford family celebration.

Thinking back over this past year — with its remarkable achievements, extraordinary opportunities and ambitious undertakings — has given me a tremendous sense of optimism about Stanford. I believe that these innovations in our research and teaching will help us realize great advances and better serve the world.

The Stanfords in founding this university understood their historic responsibility and built an institution that was forward looking. More than a century has passed, but this goal is still the Stanford challenge. We have accomplished much in the first 115 years of our existence, and if we continue to be bold, to utilize our broad excellence and to have the committed support and encouragement of our alumni, we can accomplish even more.

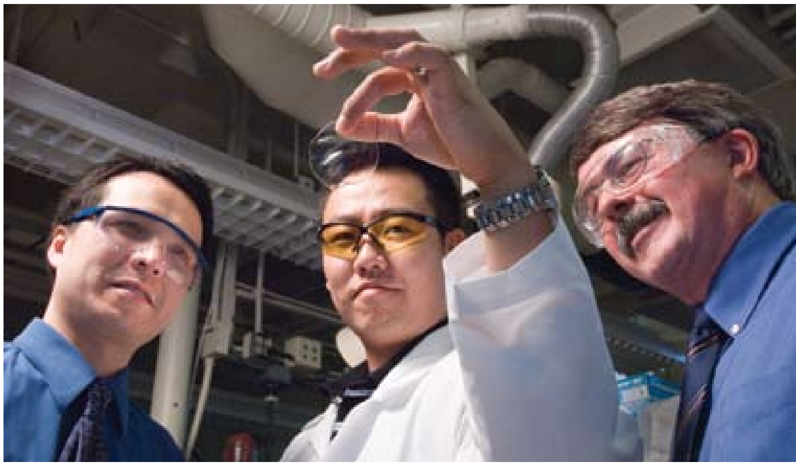
John L. Hennessy
President

The Initiative on Human Health

TRANSLATIONAL RESEARCH THAT CREATES BREAKTHROUGHS IN HUMAN HEALTH

Curtis Frank, the W.M. Keck Sr. Professor in Engineering, announced to the 2006 annual meeting of the American Chemical Society in San Francisco a novel biomimetic material that is finding its way into artificial corneas. Called a hydrogel, or polymer that holds water, it promises hope for some 10 million people worldwide who are blind because of damaged or diseased corneas and many millions more who are nearsighted or farsighted due to misshapen corneas.

The research was funded by the Bio-X program. The interdisciplinary project, involving polymer scientists, physicians, chemical engineers and bioengineers, is part of an ongoing effort to create viable artificial corneas. It reflects the mission of the Initiative on Human Health: to translate discoveries spurred by multidisciplinary research into improvements in human health.



MD/PhD student David Myung holds a sample of the hydrogel, a product of interdisciplinary collaboration led by Christopher Ta, assistant professor of ophthalmology (left), and Curtis Frank, the W.M. Keck Sr. Professor in Engineering.

The Initiative on Human Health draws on Stanford's broad accomplishments in basic scientific research. In 2006, for instance, School of Medicine faculty members won two Nobel Prizes for fundamental scientific discoveries. Geneticist Andrew Fire, professor of pathology and of genetics, shared the Nobel Prize in physiology or medicine for discoveries related to RNA interference that he made at the Carnegie Institution. Structural biologist Roger Kornberg, the Mrs. George A. Winzer Professor in Medicine, was awarded the Nobel Prize in chemistry for his research—much of it conducted at the Stanford Synchrotron Radiation Laboratory at the Stanford Linear Accelerator Center—in how DNA is converted into RNA, a process known as transcription.

Stanford's Initiative on Human Health comprises five programs, each of which emphasizes multidisciplinary translational research—that is, research combining the knowledge of experts in many disciplines to pursue discoveries that lead to improvements in human health.

The initiative had its genesis in the 1999 creation of **Bio-X**, housed in the innovative James H. Clark Center. The Clark

A LOOK BACK AT SELECTED STANFORD EVENTS DURING THE CALENDAR YEAR 2006.

JANUARY

STANFORD DAILY EDITOR CAMILLE RICKETTS IS CHOSEN AS THE 2006 DANIEL PEARL MEMORIAL JOURNALISM INTERN AT THE *WALL STREET JOURNAL.*

SCIENCE WATCH IDENTIFIES PATRICK BROWN, PROFESSOR OF BIOCHEMISTRY, AS ONE OF THE MOST CITED RESEARCHERS IN BIOMEDICINE OVER THE PAST DECADE.

STANFORD BECOMES THE SECOND UNIVERSITY IN THE COUNTRY TO ADOPT A POLICY FOR FEMALE GRADUATE STUDENTS THAT ALLOWS THEM TIME OFF FOR LATE-STAGE PREGNANCY AND THE CARE OF A NEWBORN CHILD.

PRESIDENT BUSH NOMINATES GRADUATE SCHOOL OF BUSINESS ECONOMIST AND HOOVER INSTITUTION SENIOR FELLOW EDWARD LAZEAR AS CHAIRMAN OF THE WHITE HOUSE COUNCIL OF ECONOMIC ADVISERS.

FEBRUARY

THE SCHOOL OF MEDICINE BEGINS THE FIRST U.S. TRIAL OF A NEW VACCINE AGAINST AVIAN FLU.

Center was specifically designed to facilitate interdisciplinary research and teaching. The Bio-X Interdisciplinary Initiative Program, a venture fund for new multidisciplinary faculty collaborations, has helped lead to the success of Bio-X and created a model for subsequent initiatives. In 2006, 24 new interdisciplinary proposals received Bio-X funding for research into areas ranging from prostate cancer to stem cells to neuron signaling, bringing the total of funded proposals to 64. Funded proposals have, in turn, attracted about $70 million in externally funded grants from an initial $6-million investment.

Bio-X contributed to the creation of the **Bioengineering Department**, a joint program of the schools of Medicine and Engineering. The department fuses engineering and the life sciences to promote the development of biomedical technologies and therapies through research and education.

The department boasts a remarkable faculty. In 2006, Kwabena Boahen, associate professor of bioengineering, won a National Institutes of Health Director's Pioneer Award, which provides $2.5 million over five years to pursue new research directions that are not already funded. This is the third year that a Bioengineering faculty member has won the award. Also in 2006, the Stanford Microfluidics Foundry was opened, headed by Bioengineering Professor Stephen Quake, to manufacture novel "labs on a chip" for academic researchers.

The Stanford Comprehensive Cancer Center, also part of the human health initiative, brings together more than 260 cancer specialists in such fields as developmental biology, imaging, genetics, cell transplantation, law, health policy, engineering, computer science and environmental studies. Center clinicians are involved in more than 250 trials of new diagnostic, prevention and treatment strategies. In 2006, the center received a major boost with a $25-million gift from Stanford alumni Jill and John Freidenrich to aid in translational research in cancer and other diseases.

Roger Kornberg (left), the Mrs. George A. Winzer Professor in Medicine, won the 2006 Nobel Prize in chemistry, and Andrew Fire (right), professor of pathology and of genetics, shared the 2006 Nobel Prize in physiology or medicine. With them is Arthur Kornberg, who won the Nobel Prize in 1959.

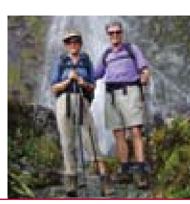
The gift is one of the largest single contributions in the School of Medicine's history.

The Stanford Institute for Stem Cell Biology and Regenerative Medicine is a multidisciplinary research center that builds on a prestigious history. In the 1980s, Stanford researchers were the first to discover and isolate blood-forming stem cells. Stanford was the first institution to have successfully translated adult stem cell research discoveries into patient therapies.

In 2006, Stanford received $1.2 million from the California Institute for Regenerative Medicine to train the next generation of stem cell researchers. In addition, the School of Medicine received $20 million from the Virginia and D.K. Ludwig Fund to establish the Ludwig Center for Cancer Stem Cell Research and Medicine.

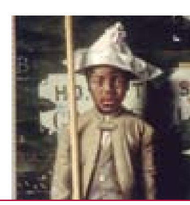
The Neuroscience Institute at Stanford advances well-being through multidisciplinary basic and clinical research into the biology of perception, memory, movement, emotion and other neurological functions to someday mitigate, prevent and cure such ailments as Alzheimer's, Parkinson's and autism.

THREE SCHOLARS ARE NAMED TO THE NATIONAL ACADEMY OF ENGINEERING: GARY GLOVER (RADIOLOGY), JOHN LINEHAN (BIOENGINEERING) AND AROGYASWAMI PAULRAJ (ELECTRICAL ENGINEERING).

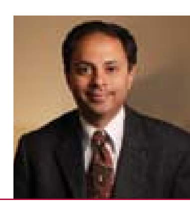


TRUSTEE AND ALUMNUS WARD WOODS AND HIS WIFE, PRISCILLA, COMMIT $30 MILLION TO THE STANFORD INSTITUTE FOR THE ENVIRONMENT TO SUPPORT INNOVATIVE ENVIRONMENTAL PROGRAMS AND COLLABORATIVE RESEARCH.

STANFORD RECEIVES A RECORD 22,223 APPLICATIONS FOR UNDERGRADUATE ADMISSION.



"AMERICAN ABC: CHILDHOOD IN THE 19TH CENTURY" IS DEVELOPED AND DEBUTS AT THE CANTOR ARTS CENTER BEFORE TRAVELING TO WASHINGTON FOR THE REOPENING OF THE SMITHSONIAN'S AMERICAN ART MUSEUM.



THE NATIONAL CANCER INSTITUTE ALLOTS $20 MILLION OVER FIVE YEARS TO THE MEDICAL SCHOOL FOR A CENTER FOR CANCER NANOTECHNOLOGY, LED BY PROFESSOR OF RADIOLOGY AND BIOENGINEERING SANJIV SAM GAMBHIR.

MARCH

STANFORD TEAMS UP WITH UCLA, THE UNIVERSITY OF CALIFORNIA AT SANTA BARBARA AND THE UNIVERSITY OF CALIFORNIA AT BERKELEY TO LAUNCH WHAT WILL BE ONE OF THE WORLD'S LARGEST JOINT RESEARCH PROGRAMS FOCUSING ON "SPINTRONICS."

Sarah Billington, associate professor of civil and environmental engineering, and her colleagues envision a world in which building materials are derived from plants, agricultural waste or construction waste itself. These "biocomposites" could be used to construct the buildings in which we live. When the materials reach the end of one useful life, they can be transformed again rather than thrown away.

This work is an example of the multidisciplinary environmental research under way as part of Stanford's Initiative on the Environment and Sustainability. Collaborating with Billington are Craig Criddle, professor of civil and environmental engineering, and Perry McCarty, the Silas H. Palmer Professor of Civil Engineering, Emeritus.

Stanford's Initiative on the Environment and Sustainability is helping societies meet the demands of populations for energy, food, water and other vital needs without undermining the ability of our planet to provide for future generations. The initiative draws on all seven schools, plus Stanford's independent labs, to leverage the university's historic strengths in interdisciplinary research, teaching, outreach and technology transfer. It is headed by Jeff Koseff, the William Alden and Martha Campbell Professor of Civil and Environmental Engineering; Barton "Buzz" Thompson, the Robert E. Paradise Professor of Natural Resources Law; and Pamela Matson, the Naramore Dean of the School of Earth Sciences.

The Initiative on the Environment and Sustainability, launched in 2004, received two major boosts in 2006: a $30-million gift from Stanford trustee Ward Woods and his wife, Priscilla, created the Woods Institute for the

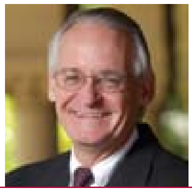
Craig Criddle, professor of civil and environmental engineering, and Sarah Billington, associate professor in civil and environmental engineering (far right), are developing "biocomposites," which can be used to construct buildings. Their graduate students are Sarah Christian, Molly Morse and Allison Pieja.

Environment; and Stanford alumnus Jay Precourt committed $30 million to establish the Precourt Institute for Energy Efficiency.

At the core of the initiative is the Woods Institute. It serves as a unifying force and interdisciplinary hub for research,

DAVID EPEL, PROFESSOR OF BIOLOGICAL SCIENCES AT THE HOPKINS MARINE STATION, WINS THE 2006 ED RICKETTS MEMORIAL AWARD FOR LIFETIME ACHIEVEMENT IN MARINE SCIENCE.

A $10-MILLION GIFT FROM ARTHUR AND TONI REMBE ROCK CREATES THE ROCK CENTER FOR CORPORATE GOVERNANCE AT THE LAW SCHOOL.



UNDERGRADUATE ADMISSION DEAN RICK SHAW ANNOUNCES THAT FAMILIES WITH ANNUAL INCOMES LESS THAN $45,000 WILL NO LONGER BE EXPECTED TO CONTRIBUTE TO THE COST OF TUITION AT STANFORD, AND REQUIREMENTS FOR MIDDLE-INCOME FAMILIES WILL BE CUT IN HALF.

ALBERT BANDURA, THE DAVID STARR JORDAN PROFESSOR IN PSYCHOLOGY, RECEIVES THE LIFETIME ACHIEVEMENT AWARD FROM THE AMERICAN ACADEMY OF HEALTH BEHAVIOR.

THE FRED KAVLI BUILDING AT THE STANFORD LINEAR ACCELERATOR CENTER, WHICH HOUSES THE KAVLI INSTITUTE FOR PARTICLE ASTROPHYSICS AND COSMOLOGY, IS DEDICATED.

THE 13TH ANNUAL BOOK CELEBRATION AT THE STANFORD HUMANITIES CENTER FETES 66 BOOKS AND FIVE CDS.

teaching and problem-solving. The initiative carries out its mission by:

- seeking solutions to challenges through research,
- educating and training environmental leaders, and
- moving ideas into action by collaborating with decision makers.

The Precourt Institute's mission is to improve the efficiency of energy use. It will emphasize research, decision-making and policy in the discovery and adoption of energy-efficient technologies, systems and practices. Initial work will focus on improving energy efficiency in buildings, the transportation sector, fuels and power distribution.

Both institutes will be housed in the new Environment and Energy Building, slated for completion in late 2007. The building, part of the university's second science and engineering quadrangle, or SEQ2, will be a model for high-performance design, minimizing waste and reducing the consumption of water and energy. It will house more than 40 faculty members and 200 graduate students and will serve as a hub for some 200 additional environmental scholars campuswide. The building also will house the undergraduate Earth Systems Program, the Interdisciplinary Graduate Program in Environment and Resources, the Center for Conservation Biology, the Global Climate and Energy Project, the Environmental and Natural Resources Law and Policy Program, Civil and Environmental Engineering and the Bill Lane Center for the Study of the North American West.

In 2006, Environmental Venture Program research grants, which provide seed money for interdisciplinary problem-solving, were given by the Woods Institute to:

- **Pattern and Process of Coral Reef Adaptation: Remote Sensing, Environmental Genetics and a Laboratory Model System for Testing Climate-Change Effects on Coral**, Stephen Palumbi, professor of biological sciences; Kevin Arrigo, associate professor of geophysics; and John Pringle, professor of genetics.

The new Environment and Energy Building is slated for completion in 2007.

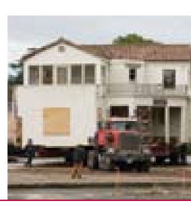
- **Quantitative Natural Resource Ethics**, Kenneth Arrow, the Joan Kenney Professor of Economics, Emeritus, and professor emeritus of operations research; and Debra Satz, associate professor of philosophy.

- **Water, Health and Environment: Childhood Survival in Mozambique**, Jennifer Davis, assistant professor of civil and environmental engineering and Woods Institute fellow; Alexandria Boehm, the Clare Booth Luce Assistant Professor of Civil and Environmental Engineering; and Gary Schoolnik, professor of medicine and of microbiology and immunology.

- **From Bangalore to the Bay Area: Comparative Urban Growth Patterns Across the Pacific Rim**, Karen Seto, assistant professor of geological and environmental sciences, and Margaret O'Mara, acting assistant professor of history and associate director of the Bill Lane Center for the Study of the North American West.

- **Indoor Air Pollution and Health in Developing Countries: An Intervention Study in Bangladesh**, N. Grant Miller, assistant professor of medicine; Lynn Hildemann, associate professor of civil and environmental engineering; and Paul Wise, the Richard E. Behrman Professor in Child Health.

RETIRED SUPREME COURT JUSTICE AND STANFORD ALUMNA SANDRA DAY O'CONNOR JOINS CURRENT JUSTICE AND FELLOW ALUMNUS ANTHONY KENNEDY AT THE LAW SCHOOL IN EXPLORING THE CONTRIBUTIONS OF THE LATE CHIEF JUSTICE WILLIAM REHNQUIST, ALSO A STANFORD GRADUATE.



ROGERS, MARIPOSA AND SERRA HOUSES ARE MOVED TO NEW LOCATIONS IN PREPARATION FOR CONSTRUCTION OF THE MUNGER GRADUATE RESIDENCES.

LAW SCHOOL ALUMNUS WILLIAM NEUKOM GIVES $20 MILLION FOR THE CONSTRUCTION OF A NEW ACADEMIC BUILDING AT THE STANFORD LAW SCHOOL TO STIMULATE INTERDISCIPLINARY STUDIES.

APRIL

PHYSICS PROFESSOR SAVAS DIMOPOULOS WINS THE 2006 J.J. SAKURAI AWARD IN ADVANCED THEORETICAL PARTICLE PHYSICS FOR "HIS CREATIVE IDEAS ON DYNAMICAL SYMMETRY BREAKING, SUPERSYMMETRY AND EXTRA SPATIAL DIMENSIONS."

A $3.3-MILLION GIFT FROM THE MALONE FAMILY FOUNDATION WILL FUND THE FIRST ONLINE HIGH SCHOOL FOR GIFTED STUDENTS, DEVELOPED BY STANFORD'S EDUCATION PROGRAM FOR GIFTED YOUTH.

THE ALFRED P. SLOAN FOUNDATION GIVES RESEARCH FELLOWSHIPS TO ZHENAN BAO (ABOVE, CHEMICAL ENGINEERING), SIMON BRENDLE (MATHEMATICS), ANNE BRUNET (GENETICS), MURIEL NIEDERLE (ECONOMICS) AND TIM ROUGHGARDEN (COMPUTER SCIENCE).

The International Initiative

MULTIDISCIPLINARY APPROACHES TO GLOBAL CHALLENGES

Researchers involved in a collaboration supported by the International Initiative are studying the political economies of authoritarian systems to determine why some authoritarian governments are able to transition to democracy and create stable growth and institutions, while others prove predatory and unstable.

They are integrating approaches from history, archaeology, political science and economics to develop a new framework with which scholars, students and policymakers can understand authoritarian governments. The researchers are Stephen Haber, the A.A. and Jeanne Welch Milligan Professor of Political Science and the Peter and Helen Bing Senior Fellow at the Hoover Institution; Beatriz Magaloni, assistant professor of political science; Ian Morris, the Jean and Rebecca Willard Professor of Classics; and Jennifer Trimble, associate professor of classics. Stanford's International Initiative, led by the Freeman Spogli Institute for International Studies (FSI), encourages collaborative approaches to global challenges in three areas: peace and security, governance and human well-being. FSI comprises five research centers and six programs that draw on more than 150 faculty members from all seven schools.

The International Initiative, headed by Coit Blacker, director of the Freeman Spogli Institute for International Studies and the Olivier Nomellini Family University Fellow in Undergraduate Education, and Elisabeth Paté-Cornell, the Burton J. and DeeDee McMurtry Professor in Engineering and chair of Management Science and Engineering, stresses research focused on problem-solving. In 2006, six research projects received $1.05 million in the first round of faculty research awards made by the Presidential Fund for

Ian Morris, the Jean and Rebecca Willard Professor of Classics; Jennifer Trimble, associate professor of classics; and Stephen Haber, the A.A. and Jeanne Welch Milligan Professor of Political Science, are conducting multi-disciplinary research to determine why some authoritarian governments transition to stable democracies, while others prove predatory and unstable.

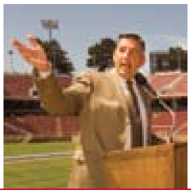
Innovation in International Studies. Besides "Governance Under Authoritarian Rule," previously described, they are:

PAUL MILGROM, THE SHIRLEY R. AND LEONARD W. ELY JR. PROFESSOR IN HUMANITIES AND SCIENCES, IS ELECTED TO THE NATIONAL ACADEMY OF SCIENCES.

THE AMERICAN ACADEMY OF ARTS AND SCIENCES ELECTS EIGHT TO MEMBERSHIP: LAWRENCE BOBO (ABOVE, SOCIOLOGY), SAVAS DIMOPOULOS (PHYSICS), MARGARET FULLER (DEVELOPMENTAL BIOLOGY), LARRY KRAMER (LAW), LAWRENCE LESSIG (LAW), SUSAN MCCONNELL (BIOLOGICAL SCIENCES), FRANCO MORETTI (ENGLISH) AND STEPHEN SHENKER (PHYSICS).

LANE LIBRARY, ONE OF THE OLDEST MEDICAL LIBRARIES IN THE WEST, CELEBRATES ITS 100TH BIRTHDAY.

PRESIDENT BUSH VISITS CAMPUS TO MEET WITH SCHOLARS AT THE HOOVER INSTITUTION.



UNIVERSITY OF IOWA DIRECTOR OF ATHLETICS BOB BOWLSBY IS NAMED ATHLETIC DIRECTOR, SUCCEEDING INTERIM DIRECTOR BILL WALSH.

Political scientist Judith Goldstein, the Fisher Family Director of the Division of International Comparative and Area Studies, leads a group of researchers asking why Latin America was left behind in recent worldwide prosperity gains.

- **Addressing Institutional and Interest Conflicts: Governance Structures for Global Infrastructure Development**, Raymond Levitt, professor of civil and environmental engineering; Douglas McAdam, professor of sociology; and W. Richard Scott, professor emeritus of sociology.

- **Combating HIV/AIDS in Southern Africa: The Treatment Revolution and Its Impact on Health, Well-Being and Governance**, David Katzenstein, professor of medicine, and Jeremy Weinstein, assistant professor of political science.

- **Evaluating Institutional Responses to Market Liberalization: Why Latin America Was Left Behind**, Judith Goldstein, professor of political science; Avner Greif, the Bowman Family Professor in Humanities and Sciences; Stephen Haber, the A.A. and Jeanne Welch Milligan Professor of Political Science; Herb Klein, professor of history; N. Grant Miller, assistant professor of medicine; and Barry Weingast, the Ward C. Krebs Family Professor of Political Science.

- **Feeding the World in the 21st Century: Exploring the Connections Between Food Production, Health, Environmental Resources and International Security**, Rosamond Naylor, FSI/economics; Stephen Stedman, FSI/ political science; Peter Vitousek, the Clifford G. Morrison Professor of Population and Resource Studies; and Gary Schoolnik, professor of medicine and of microbiology and immunology.

- **The Political Economy of Cultural Diversity**, James Fearon, the Theodore and Frances Geballe Professor in Humanities and Sciences; and Romain Wacziarg, associate professor in the Graduate School of Business.

International Initiative working groups are encouraging interdisciplinary dialogue in the following areas:

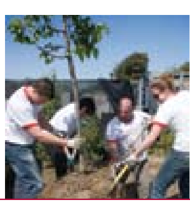
- **Developing Resilience to Non-Traditional Security Threats** looks at how new technologies and the integration of engineering, socioeconomic factors and regulatory policy can reduce the risk of natural and human-made catastrophes.

- **International Influences on Domestic Governance** looks at how domestic governance can be influenced by such factors as economic trade and investment and incorporates issues of democracy promotion.

- **Human Well-Being** focuses on the effect of labor laws, diseases and civil strife on children.

- **Program on International Health** will consider a new Stanford International Health Program to address complex health issues by integrating such diverse areas as finance, law, biomedical sciences, computer sciences and education.

- **International University Collaboration Program** will propose long-term academic associations between Stanford and universities in developing countries to contribute faculty knowledge in teaching and research.



STANFORD'S FIRST COMMUNITY PARTNERSHIP DAY SENDS MORE THAN 200 FACULTY, STAFF AND STUDENT VOLUNTEERS INTO THE SURROUNDING COMMUNITIES TO SERVE GOVERNMENT OR NOT-FOR-PROFIT ORGANIZATIONS.

MAY

THE INSTITUTE FOR RESEARCH ON WOMEN AND GENDER IS RENAMED IN RECOGNITION OF A $3-MILLION GIFT FROM ALUMNA MICHELLE CLAYMAN, MATCHED WITH FUNDS FROM THE WILLIAM AND FLORA HEWLETT FOUNDATION.

ALUMNUS JOHN POWERS IS CHOSEN TO HEAD THE STANFORD MANAGEMENT COMPANY, SUCCEEDING MIKE MCCAFFERY.

STANFORD IN WASHINGTON IS RENAMED FOR HELEN AND PETER BING, WHO MAKE A GIFT THAT IS MATCHED BY THE WILLIAM AND FLORA HEWLETT FOUNDATION.

STANFORD SOLAR PHYSICIST J. TODD HOEKSEMA, A SENIOR SCIENTIST AT THE HANSEN EXPERIMENTAL PHYSICS LABORATORY, WINS A NASA DISTINGUISHED PUBLIC SERVICE MEDAL FOR HIS LEADERSHIP IN "SUN-SOLAR SYSTEM CONNECTION SCIENCE."

DONALD BARR, ASSOCIATE TEACHING PROFESSOR OF SOCIOLOGY AND HUMAN BIOLOGY, AND LAW SCHOOL PROFESSOR MICHAEL WALD RECEIVE THE MIRIAM AARON ROLAND VOLUNTEER SERVICE PRIZE, AWARDED BY THE HAAS CENTER FOR PUBLIC SERVICE.

Improving K-12 Education

PROMOTING THE PUBLIC WELFARE BY INVESTING IN THE NEXT GENERATION

Stanford's efforts to improve K-12 education reflect the university's founding principle to promote the public welfare by investing in the ability of the next generation to meet the challenges of a rapidly changing world. The initiative is working to develop educational leaders, create model learning environments and suggest improvements to education nationwide through policy research.

In 2006, a loan-forgiveness program at the School of Education was created to encourage students to become K-12 teachers. The program significantly reduces the debt for students in the Stanford Teacher Education Program (STEP) who teach for four years either in public schools or in private schools in underserved communities. It was made possible by a $10-million gift from alumna Judy Avery, chair of the Durfee Foundation. Her gift was matched by a $10-million allocation from the president's discretionary funds.

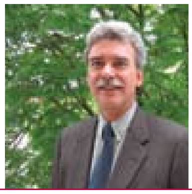
Deborah Stipek, the I. James Quillen Endowed Dean of the School of Education

Under the $20-million program, half of a student's loan will be canceled when the eligible graduate has taught two years. After four years, the loan balance will be forgiven. Research has shown that teachers who pursue teaching for three years are more likely to stay in the field.

"Well-trained teachers are desperately needed in low-income communities," said Deborah Stipek, the I. James Quillen Endowed Dean of the School of Education, "and the teachers most likely to teach in and remain in these communities grew up in them. To attract promising prospective teachers from these communities, we need to make a Stanford degree more affordable."

Also in 2006, the Stanford Schools Corporation opened a public charter K-8 elementary school—East Palo Alto Academy: Elementary School—for some 150 students. The university's other charter school, East Palo Alto Academy: High School, graduated 54 students in 2006, and more than 90 percent planned to attend post-secondary institutions. School of Education faculty members are involved with the professional development of charter school teachers and help plan the instructional program. Both schools serve as sites for training STEP students and for developing and assessing educational innovations.

Many of the school's outreach programs are housed in the newly built Barnum Family Center for School and Community Partnerships, which opened in 2006. Besides STEP and the charter schools, the K-12 initiative encompasses the John W. Gardner Center, which supports youth development, and the Institute for Research on Education Policy and Practice.



JUNE

THE OFFICE OF PUBLIC AFFAIRS PRESENTS COMMUNITY PARTNERSHIP AWARDS TO THE FOUNDATION FOR A COLLEGE EDUCATION, PLANTING FOR THE SECOND HUNDRED YEARS AND RAVENSWOOD FAMILY HEALTH CENTER.

THE LARGE AREA TELESCOPE, WHICH IS THE PRIMARY INSTRUMENT FOR THE GAMMA-RAY LARGE AREA SPACE TELESCOPE, BUILT AT THE STANFORD LINEAR ACCELERATOR CENTER, ARRIVES IN WASHINGTON, D.C., IN PREPARATION FOR ITS LAUNCH INTO SPACE.

GABRIEL GARCIA, PROFESSOR OF MEDICINE, IS APPOINTED TO HEAD THE HAAS CENTER, SUCCEEDING LEN ORTOLANO.

ALUMNUS JOHN ARRILLAGA GIVES $100 MILLION TO STANFORD IN THE LARGEST INDIVIDUAL GIFT TO DATE.

THE STANFORD GENOMIC RESOURCES TEAM, WHICH PROVIDES BIOINFORMATIC RESOURCES VIA THE INTERNET, CELEBRATES ITS 100-MILLIONTH WEB HIT.

BING NURSERY SCHOOL, A LABORATORY FOR CHILD-DEVELOPMENT STUDIES, CELEBRATES ITS 40TH YEAR.

Engaging the Arts and Creativity

ENCOURAGING ORIGINALITY AND RISK-TAKING WHILE IMPROVING OUR CULTURE

Stanford is bolstering its offerings in the arts in recognition of their crucial place in our culture. The university also believes that the arts can spark creativity and imagination and support the university's overall research and teaching mission.

In 2006, the Stanford Institute for Creativity and the Arts (SICA) was created as the hub for the university's new arts initiative. Codirected by Jonathan Berger, associate professor of music, and Bryan Wolf, the Jeanette and William Hayden Jones Professor in American Art and Culture, SICA builds creative thinking through artistic experiences and interdisciplinary research collaborations.

At the core of the initiative is creating a systematic, university-wide "culture of creativity" linking the arts with every area of study, from science and engineering to business and medicine. To that end, SICA is increasing opportunities for students to study, create and experience art through new undergraduate programs; hosting artists in residence; administering new multidisciplinary graduate programs; awarding grants for multidisciplinary arts research and teaching; and supporting collaborative performances and exhibitions.

A centerpiece of the effort is a new world-class concert hall made possible by a $50-million gift from Helen and Peter Bing, '55, whose generosity has touched nearly every corner of the university. Plans call for a 900-seat facility that will accommodate live performances presented by Stanford Lively Arts and the Department of Music. It will be adjacent to the Frances C. Arrillaga Alumni Center and within sight of the Iris & B. Gerald Cantor Center for Visual Arts.

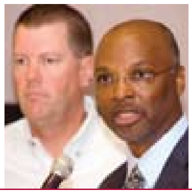
Peter and Helen Bing

SICA builds on the strength in the university's existing arts and creativity offerings, including the new Hasso Plattner Institute of Design, which combines arts and engineering; new undergraduate and graduate programs in film and media studies; the Iris & B. Gerald Cantor Center for Visual Arts; the Lively Arts performing arts program; programs for artists in residence, including the St. Lawrence String Quartet and New York's Public Theater; and writing programs, including the Stegner Fellowships.

LEONARD HERZENBERG, PROFESSOR EMERITUS OF GENETICS, WINS THE 2006 KYOTO PRIZE, THE JAPANESE EQUIVALENT OF THE NOBEL PRIZE, FOR DEVELOPING THE FLUORESCENCE-ACTIVATED CELL SORTER.

DEAN ROBERT JOSS ANNOUNCES THAT THE GRADUATE SCHOOL OF BUSINESS IS REDESIGNING ITS MBA PROGRAM TO ALLOW STUDENTS TO CUSTOMIZE THEIR EDUCATIONAL EXPERIENCE.

ERIC HANUSHEK, THE PAUL AND JEAN HANNA SENIOR FELLOW IN EDUCATION AT THE HOOVER INSTITUTION, IS APPOINTED A MEMBER OF THE NATIONAL ACADEMY OF EDUCATION.



ALUMNUS SCOTT MCNEALY OF SUN MICROSYSTEMS JOINS JERRY HARRIS, PROFESSOR OF GEOPHYSICS, TO DEDICATE THE NEW STANFORD CENTER FOR COMPUTATIONAL EARTH AND ENVIRONMENTAL SCIENCE.

NEWSMAN AND STANFORD FATHER TOM BROKAW ADDRESSES UNDERGRADUATES, AND CARNEGIE FOUNDATION LEADER AND STANFORD ALUMNUS VARTAN GREGORIAN ADDRESSES GRADUATE STUDENTS AT A SPLIT COMMENCEMENT.

PRESIDENT JOHN HENNESSY; LAW SCHOOL DEAN LARRY KRAMER; FORMER DEAN KATHLEEN SULLIVAN; CHARLES MUNGER, VICE CHAIRMAN OF BERKSHIRE HATHAWAY; AND HIS WIFE AND STANFORD ALUMNA, NANCY MUNGER, BREAK GROUND FOR THE NEW MUNGER GRADUATE RESIDENCE.

Reinventing Graduate Education

ENHANCING GRADUATE STUDENTS' DEPTH OF KNOWLEDGE AND BREADTH OF EXPERIENCE

Patricia Gumport, professor of education and director of the Stanford Institute for Higher Education Research, will lead the university's efforts to enhance graduate studies as the vice provost for graduate education. In 2006, she was appointed to fill the new position by Provost John Etchemendy.

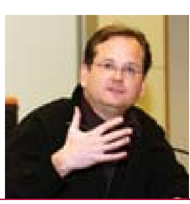
The creation of the position was one of the main recommendations in the report of the Commission on Graduate Education. The commission assessed graduate education at the university and suggested enhancements to the graduate student curriculum and educational experience.

Gumport will provide leadership to facilitate interaction and innovation that will strengthen graduate education across the university. She and her senior staff are already working collaboratively with many groups across Stanford's seven schools. The initial priorities are to promote diversity in the graduate student population, expand the Stanford Graduate Fellowships Program and create educational opportunities in new areas. Key will be expanding interdisciplinary opportunities for graduate students to become exposed to other academic areas and to pursue research across disciplinary boundaries. Another goal is to develop a leadership curriculum that will provide training in skills that complement disciplinary expertise, such as public speaking and negotiation.

The commission's report articulated a vision for graduate education that offers "a highly rated and diverse set of graduate offerings, characterized by disciplinary depth and excellence in delivery; a critical mass of diverse and highly capable graduate students, most of whom live in close proximity on one campus; and a decentralized decision-making process which allows many innovative ideas to be tested."

Patricia Gumport, vice provost for graduate education

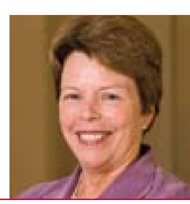
In 2006, ground was broken on the Munger Graduate Residences, which will embody many of the recommendations of the report by housing graduate students in an environment that encourages interdisciplinary exchanges. Also in 2006, trustee approval was given for a new Learning and Knowledge Center at the Medical School, and planning began for a new Graduate School of Business campus, thanks to a $100-million pledge from alumnus Philip Knight, founder of Nike, Inc.



SIX STANFORD LAW SCHOOL FACULTY ARE RECOGNIZED AMONG THE *NATIONAL LAW JOURNAL*'S 100 MOST INFLUENTIAL LAWYERS IN AMERICA: JEFFREY FISHER, JOSEPH GRUNDFEST, MARK LEMLEY, LAWRENCE LESSIG (ABOVE), KATHLEEN SULLIVAN, THOMAS GOLDSTEIN.

JULY

ROBERT REIDY, VICE PROVOST FOR LAND AND BUILDINGS, IS APPOINTED TO THE NEW POSITION OF VICE PRESIDENT FOR LAND, BUILDINGS AND REAL ESTATE.



ANN ARVIN, ASSOCIATE DEAN OF RESEARCH AND CHIEF OF THE INFECTIOUS DISEASES DIVISION OF THE PEDIATRICS DEPARTMENT AND LUCILE PACKARD CHILDREN'S HOSPITAL, IS NAMED VICE PROVOST AND DEAN OF RESEARCH BY PROVOST JOHN ETCHEMENDY.

AUGUST

STANFORD TEAMS UP WITH CHEVRON MOLECULARDIAMOND TECHNOLOGIES TO DEVELOP NANOMATERIALS DERIVED FROM PETROLEUM THROUGH A FOUR-YEAR, $1.2-MILLION RESEARCH INITIATIVE.

NIKE CHAIRMAN AND STANFORD ALUMNUS PHILIP KNIGHT PLEDGES $100 MILLION TO THE GRADUATE SCHOOL OF BUSINESS TO CONSTRUCT A NEW CAMPUS FOR THE SCHOOL.

MAUREEN POWERS, VICE PRESIDENT FOR STUDENT AFFAIRS AT THE CITY COLLEGE OF NEW YORK, IS NAMED DEAN OF STUDENTS BY VICE PROVOST FOR STUDENT AFFAIRS GREG BOARDMAN.

BEHAVIORAL SCIENCES

Male murderers with stereotypically "black-looking" features are more than twice as likely to get the death sentence than lighter-skinned African American defendants found guilty of killing a white person, but the relationship disappears when both murderer and victim are black, according to research published in *Psychological Science* by JENNIFER EBERHARDT, associate professor of psychology.

BIOSCIENCES

Scientists at Stanford and the Carnegie Institution write in *Proceedings of the National Academy of Sciences* that photosynthetic cyanobacteria living in scalding hot springs in Yellowstone National Park have different metabolic identities for day and night.

HOWARD CHANG, assistant professor of dermatology, writes in *Public Library of Science-Genetics* that specialized skin cells use a mapping system similar to a global positioning system to identify where they belong in the body and how to act once they arrive.

JUDITH FRYDMAN, associate professor of biological sciences, writes in *Molecular Cell* and *Nature Cell Biology* with her colleagues about how the ring-shaped chaperonin TRiC/CCT binds the tumor suppressor VHL and disease-causing forms of Huntington's, which could shed light on diseases such as cancer, Prion and Huntington's.

OR GOZANI, assistant professor of biological sciences, leads researchers reporting in *Nature* that they have determined how the Inhibitor of Growth—ING2—is able to promote protective cellular responses against injured DNA.

Science names research by DAVID KINGSLEY, professor of developmental biology, on the evolutionary adaptations of the freshwater sticklebacks as a 2005 "Breakthrough of the Year."

SUSAN MCCONNELL, the Susan B. Ford Professor of Biological Sciences, leads a team that reports in *Proceedings of the National Academy of Sciences* about a gene necessary for the development of connections between the brain and the spinal cord.

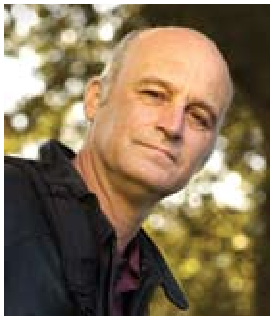
ROBERT SAPOLSKY, the John A. and Cynthia Fry Gunn Professor of Biological Sciences, coauthors a study in the *Journal of Neuroscience* explaining how he and colleagues designed a gene that enhances memory and learning in animals under stress and might lead to gene therapies to reduce neurological side effects of steroids.

BUSINESS

KEITH KREHBIEL, the Edward B. Rust Professor of Political Science at the Graduate School of Business, determines in a GSB Research Paper that appointments to the U.S. Supreme Court have minimal effect on policy because the overall political outlook of the court shifts very little.

Uncertainty about the value of items holds down their price on online auctions, according to an article in the *Journal of Industrial Economics* by JOHN MCMILLAN, the Jonathan B. Lovelace Professor of Economics and codirector of the business school's Center for Global Business and the Economy.

EARTH SCIENCES



Geophysicists GREGORY BEROZA and PAUL SEGALL tell members of the American Geophysical Union that the 1906 Great San Francisco Earthquake ruptured farther and faster than previously reported.

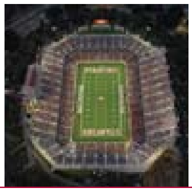
C. PAGE CHAMBERLAIN (right), professor of geological and envi-

THE STANFORD SCHOOLS CORPORATION LAUNCHES ITS FIRST PUBLIC CHARTER K-8 SCHOOL IN EAST PALO ALTO.

THE STANFORD LAW SCHOOL LAUNCHES THE STANFORD CONSTITUTIONAL LAW CENTER, HEADED BY KATHLEEN SULLIVAN, THE STANLEY MORRISON PROFESSOR OF LAW.

SEPTEMBER

A NEW STANFORD MEDICAL CENTER POLICY PROHIBITS PHYSICIANS FROM ACCEPTING INDUSTRY GIFTS TO LIMIT THE INFLUENCE OF PHARMACEUTICAL AND OTHER BIOMEDICAL COMPANIES IN ITS DAY-TO-DAY CLINICAL AND EDUCATIONAL ACTIVITIES.



THE NEW STANFORD STADIUM OPENS AFTER A $90-MILLION RENOVATION.

ALUMNI JILL AND JOHN FREIDENRICH GIVE $25 MILLION TO THE SCHOOL OF MEDICINE TO CREATE A CENTER FOR TRANSLATIONAL RESEARCH AND MEDICINE IN CANCER AND OTHER DISEASES.

JOHN CIOFFI, THE HITACHI AMERICA PROFESSOR IN ENGINEERING AND AUTHOR OF THE INTERNATIONAL STANDARD FOR DIGITAL SUBSCRIBER LINE (DSL) TECHNOLOGY, IS NAMED THE 2006 MARCONI FELLOW, THE HIGHEST AWARD IN TELECOMMUNICATIONS.

ronmental sciences, and colleagues ANDREAS MULCH and STEPHAN GRAHAM write in *Science* that the Sierra Nevada is at least 40 million years old.

PAUL SEGALL, professor of geophysics, is lead author of a study in *Nature* warning that "silent earthquakes," which produce no seismic waves, can trigger swarms of tiny conventional temblors.

EDUCATION

Associate Professor of Education SUSANNA LOEB (above) is leading a team of more than 30 researchers nationwide in the largest independent investigation ever of how California governs and finances education.

School of Education Dean DEBORAH STIPEK and her student SARAH MILES report in *Child Development* that low-income students who are poor readers in their early school years are later assessed by their teachers as more aggressive.

ENGINEERING

Researchers from Lawrence Livermore National Laboratory and WEI CAI, assistant professor of mechanical engineering, publish a study in *Nature* describing new insights into the physical strength of crystalline materials.

CRAIG CRIDDLE, professor of civil and environmental engineering, reports in *Environmental Science and Technology* about a technique for cleaning up uranium from severely contaminated areas by harnessing the powers of microbes already in the soil.

FABIAN PEASE, the William E. Ayer Professor of Electrical Engineering, offers a theory in *Physical Review Letters* explaining how the electrons in a scanning electron microscope cause nanotubes to emit their own electrons, making them detectable, and suggesting new applications.

KRISHNA SHENOY, assistant professor of electrical engineering, heads a team working on brain-computer interfaces that reports in *Nature* about a faster way to process signals from the brain for use in guiding prosthetic devices for the paralyzed.

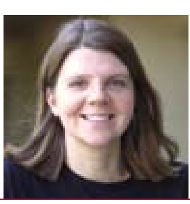
Members of the Trio project, led by Computer Science Professor JENNIFER WIDOM, describe in *IEEE Data Engineering Bulletin* a new prototype database system that is the first to have both data uncertainty and lineage built in, enabling diverse applications such as tracking wildlife or fighting crime.

ENVIRONMENT

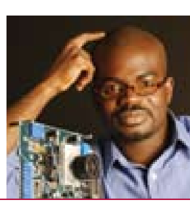
Ecologists working at Jasper Ridge Biological Preserve report in *Proceedings of the National Academy of Sciences* that climate change may be altering complementarity in plant colonies—a process that reduces their competition for resources.

A survey conducted with ABC News and *TIME* magazine under the auspices of the Woods Institute by JON KROSNICK, the Frederic O. Glover Professor of Humanities and Social Sciences, shows that most Americans are pessimistic about the environment and want action taken.

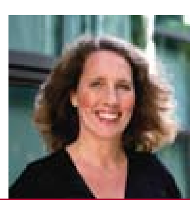
HAROLD MOONEY, the Paul S. Achilles Professor of Environmental Biology, and his student SASHA KRAMER coauthor a study in the *Proceedings of the National Academy of Sciences* that suggests the value of organic farming and finds that fertilizing apple trees with synthetic chemicals produces more adverse environmental effects than feeding them with organic manure or alfalfa.



CLAIRE TOMLIN, ASSOCIATE PROFESSOR OF AERONAUTICS AND ASTRONAUTICS, IS NAMED A MACARTHUR FELLOW.



THREE STANFORD FACULTY MEMBERS ARE AWARDED NATIONAL INSTITUTES OF HEALTH DIRECTOR'S PIONEER AWARDS TO PURSUE NEW RESEARCH DIRECTIONS: KWABENA BOAHEN (ABOVE,



BIOENGINEERING), KARLA KIRKEGAARD (ABOVE, MICROBIOLOGY AND IMMUNOLOGY) AND DAVID RELMAN (MICROBIOLOGY AND IMMUNOLOGY).

OCTOBER

ANDREW FIRE, PROFESSOR OF PATHOLOGY AND OF GENETICS, SHARES THE NOBEL PRIZE IN PHYSIOLOGY OR MEDICINE WITH CRAIG MELLO OF THE UNIVERSITY OF MASSACHUSETTS MEDICAL SCHOOL FOR DISCOVERIES RELATED TO RNA INTERFERENCE.

ROGER KORNBERG, THE MRS. GEORGE A. WINZER PROFESSOR IN MEDICINE AT THE SCHOOL OF MEDICINE, IS AWARDED THE NOBEL PRIZE IN CHEMISTRY FOR HIS WORK IN UNDERSTANDING HOW DNA IS CONVERTED INTO RNA, A PROCESS KNOWN AS TRANSCRIPTION.

ALUMNA JUDY AVERY GIVES \$10 MILLION—MATCHED BY \$10 MILLION FROM STANFORD—FOR A LOAN-FORGIVENESS PROGRAM FOR STANFORD TEACHER EDUCATION PROGRAM GRADUATES.

STEPHEN PALUMBI, professor of biological sciences at the Hopkins Marine Station, coauthors a study published in *Science* that predicts all species of wild seafood will collapse within 50 years.

HUMANITIES AND SOCIAL SCIENCES

A study in the *Du Bois Review* by Sociology Professor DAVID GRUSKY and his student EMILY RYO (above) reveals that Hurricane Katrina did not change American awareness of social inequalities or become the watershed event in the debate over poverty that popular news coverage suggested.

HANS ULRICH GUMBRECHT, the Albert Guérard Professor in Literature, publishes *In Praise of Athletic Beauty*, a study of athletic aesthetics that explores our culture's fascination with watching sports.

MATTHEW KOHRMAN, assistant professor of cultural and social anthropology, is applying his expertise to China to help address its smoking epidemic.

STEVEN ZIPPERSTEIN, the Daniel E. Koshland Professor in Jewish Culture and History, and GABRIELLA SAFRAN, associate professor of Slavic Languages and Literatures, edit *The Worlds of S. An-Sky*.

LAW

JOSEPH BANKMAN, the Ralph M. Parsons Professor of Law and Business, coauthors a bill to simplify tax filing by giving low-income taxpayers the option of receiving a ReadyReturn completed tax return prepared by the state.

DANIEL HO, assistant professor of law, is corecipient of the McGraw-Hill Award for the best paper on law and courts for "Supreme Court During Crisis: How War Affects Only Non-War Cases" in the *New York University Law Review.*

DEBORAH RHODE, the Ernest W. McFarland Professor of Law, authors *In Pursuit of Knowledge: Scholars, Status and Academic Culture,* which focuses on academic life and how pursuit of status undermines pursuit of knowledge.

A U.S. district judge rules in favor of the plaintiff, represented by Stanford's Environmental Law Clinic, and stops the development of the Eagle Mountain Landfill, located on federal land bordering Joshua Tree National Park.

MEDICINE

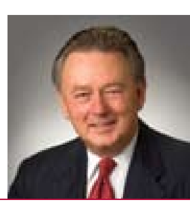
EUAN ASHLEY, assistant professor of cardiology, followed endurance athletes for a study in the *Journal of the American College of Cardiology* that shows that one gene variant can predict the extent to which the heart will tire during exercise.

CHRISTOPHER CONTAG, associate professor of microbiology and immunology and of pediatrics, is lead author of a study in *Science* that shows that the combination of two proven anti-tumor therapies—immune cells and a modified virus—eliminates cancers in mice.

A study published by Pathology Professor STEPHEN GALLI in *Science* found that, contrary to long-held beliefs, the body's immune system unleashes proteins that help break down the most toxic elements of some types of snake venom.

Researchers in the School of Medicine, led by AMATO GIACCIA, professor of radiation oncology, report in *Nature* about a protein that may explain why tumors in a low-oxygen environment are so deadly.

PETER AND HELEN BING GIVE $50 MILLION TO BUILD A NEW WORLD-CLASS CONCERT HALL ON CAMPUS.



ALUMNUS JAY PRECOURT COMMITS $30 MILLION TO ESTABLISH THE PRECOURT INSTITUTE FOR ENERGY EFFICIENCY.

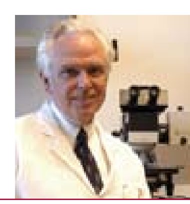
THE STANFORD CHALLENGE

PRESIDENT JOHN HENNESSY ANNOUNCES THE FIVE-YEAR, $4.3-BILLION STANFORD CHALLENGE.

REUNION HOMECOMING ATTRACTS A RECORD-SETTING 8,300 ATTENDEES, AND THE LAW SCHOOL ALUMNI REUNION AND GRADUATE SCHOOL OF BUSINESS REUNION BRING THE TOTAL ALUMNI HOSTED TO MORE THAN 10,000 OVER A FOUR-DAY PERIOD.

NOVEMBER

TEN FACULTY ARE ELECTED TO THE AMERICAN ASSOCIATION FOR THE ADVANCEMENT OF SCIENCE: STEVEN BLOCK (APPLIED PHYSICS), HENRY GREELY (LAW), KEITH HODGSON (SLAC), CHAITAN KHOSLA (CHEMICAL ENGINEERING), JOSEPH LIPSICK



(PATHOLOGY), WILLIAM MOBLEY, ABOVE, (MEDICINE), MARTIN PERL (SLAC), SHAUNA SOMERVILLE (BIOLOGICAL SCIENCES), TERESA S.-F. WANG (PATHOLOGY) AND JEFFREY WINE (PSYCHOLOGY).

SEUNG KIM, associate professor of developmental biology, reveals in *Nature* the central role calcineurin plays in the insulin-producing pancreatic beta cells, suggesting new approaches to studying and treating diabetes.

A newly discovered genetic marker for cellular aging in a variety of species was reported in a study published in *Public Library of Science-Genetics* by STUART KIM, professor of developmental biology and of genetics.

ALEX MACARIO, professor of anesthesia, is lead author of a study in *Archives of Surgery* that outlines how tiny chips called radio-frequency ID tags can be used to locate remaining sponges in the body before operations end.

ASHIMA MADAN, neonatologist at Lucile Packard Children's Hospital, is lead author of a study in the *Journal of Pediatrics* that shows Asian-Indian women born in the United States are more likely than their Mexican-American peers to deliver low birth-weight infants.

Researchers at the School of Medicine and Lucile Packard Children's Hospital, led by WILLIAM MOBLEY, the John E. Cahill Family Professor and director of Packard's Down Syndrome Center, identified in *Neuron* a possible cause of mental retardation: a gene that, when overexpressed, causes neurons for attention and memory to shrivel.

A study in the *Archives of Pediatrics and Adolescent Medicine* by THOMAS ROBINSON, associate professor of pediatrics, found that the more time third-graders spent watching TV or playing video games, the more often they asked an adult to buy them items they saw on the screen.

A study by RANDALL STAFFORD, associate professor of medicine at the Stanford Prevention Research Center, in *Archives of Internal Medicine* shows doctors often prescribe medicine for patients despite a lack of conclusive U.S. Food and Drug Administration evidence of effectiveness and safety.

MARCIA STEFANICK (at left), professor of medicine at the Stanford Prevention Research Center, is lead author of a study in the *Journal of the American Medical Association* that confirms there is no evidence that taking estrogen alone increases the risk of breast cancer in postmenopausal women.

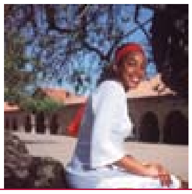
PHYSICAL SCIENCES

STEVE ALLEN, assistant professor at the Kavli Institute for Particle Astrophysics and Cosmology, leads a team that publishes a study in the *Monthly Notices of the Royal Astronomical Society* estimating the efficiency of black holes and illustrating how they generate enormous energy.

Stanford Linear Accelerator physicist UWE BERGMANN and Classics Professor REVIEL NETZ contribute to an effort to use SLAC technology to uncover the last unreadable pages of a 1,000-year-old work of mathematician Archimedes.

MARUSA BRADAC of the Kavli Institute for Particle Astrophysics and Cosmology and her colleagues report in the *Astrophysical Journal* and *Astrophysical Journal Letters* on landmark observations of dark matter in isolation.

PHILIP SCHERRER, research professor in physics, and his colleagues reveal a technique to view the far side of the sun using data from the Solar and Heliospheric Observatory.



TWO ALUMNI AND TWO SENIORS ARE AWARDED RHODES SCHOLARSHIPS: NADIYA FIGUEROA, '04 (ABOVE); GINGER TURNER, '05; JACOB LEMIEUX, '07; AND JULIE VEROFF, '07.

THE HOOVER INSTITUTION IS AWARDED THE 2006 NATIONAL HUMANITIES MEDAL BY PRESIDENT GEORGE BUSH.

THE VIRGINIA AND D.K. LUDWIG FUND GIVES $20 MILLION TO THE MEDICAL SCHOOL TO LAUNCH THE LUDWIG CENTER FOR CANCER STEM CELL RESEARCH AND MEDICINE.

GOOGLE INC. PLEDGES $2 MILLION TO SUPPORT THE LAW SCHOOL'S CENTER FOR INTERNET AND SOCIETY, A PUBLIC INTEREST TECHNOLOGY LAW AND POLICY PROGRAM.

DECEMBER

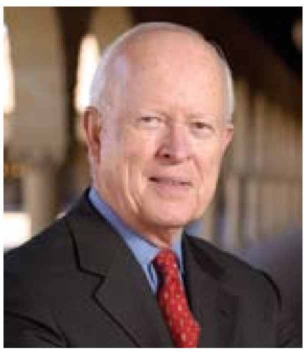
UNIVERSITY OF CHICAGO PROVOST RICHARD SALLER IS APPOINTED DEAN OF THE SCHOOL OF HUMANITIES AND SCIENCES EFFECTIVE APRIL 2007, SUCCEEDING SHARON LONG.

PRESIDENT JOHN HENNESSY ANNOUNCES A FIVE-YEAR PILOT PROGRAM PROVIDING $5,000 ANNUALLY IN RESEARCH FUNDING FOR HUMANITIES FACULTY MEMBERS.

Setting a Bold Agenda

A MESSAGE FROM THE CHAIR OF THE BOARD OF TRUSTEES

With The Stanford Challenge, the university has set for itself the boldest research and education agenda in its history. As chair of the Board of Trustees, I am delighted to report that the university takes up the challenge from a position of unprecedented strength.



The Stanford Management Company reported a gain of 19.5 percent in university investments for the year ending June 30, 2006. This is the second consecutive year the university's return has exceeded 19 percent.

Longer-term growth has also been strong. For instance, during the five years that ended in June 2006, Stanford's portfolio achieved an annualized performance of 12.3 percent, compared with a U.S. stock market that gained, on average, 3 percent per year during that period.

We are grateful to the Stanford Management Company for these excellent returns, but we recognize that past performance is no guarantee of future results. Nevertheless, we aim to continue to be excellent stewards of Stanford's endowment and new gifts. Because of such careful stewardship, philanthropic dollars can go a very long way at Stanford.

The university's endowment grew considerably during the last year not only because of strong investment returns but also because of a remarkable surge in new gifts and pledges. During 2005–06, alumni, parents, friends, foundations and companies were again extremely generous in their support of the university.

This continued vote of confidence is greatly appreciated. It has also helped lay the foundation for The Stanford Challenge, a five-year effort that promises to make Stanford the exemplar of the 21st-century university.

But our ambitions go far beyond the Stanford campus. We are determined to help train future generations of leaders, as well as to enlist Stanford's world-class researchers and educators in addressing some of the most intractable problems and greatest opportunities in human health, environmental sustainability, and international peace and security.

As you will see elsewhere in this report, several extraordinarily generous gifts and pledges helped inaugurate The Stanford Challenge. Crucial support has also come from a multitude of smaller gifts that together are making a big impact. In 2005–06, Stanford alumni and friends made a total of 115,195 gifts to the university.

Such numbers can give the impression The Stanford Challenge has already been met. But while support for Stanford's initiatives has been astonishing, the scope of our ambitions is vast.

As we enter the first full year of The Stanford Challenge, we are both humbled and inspired by the confidence our donors have already shown in the important work the university has begun. We are tremendously grateful to all of you who made a gift to the university last year. We hope you and the rest of the Stanford community will join with us in continuing to meet The Stanford Challenge in the year ahead.

Sincerely,

Burton J. McMurtry

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

2006 Financial Review

STANFORD UNIVERSITY

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Discussion of Financial Results

Stanford has experienced substantial growth in its consolidated net assets over the past several years. In the 2005-2006 fiscal year (FY06) consolidated net assets increased $3 billion to end the year at $19.9 billion. See Figure 1. Strong investment performance, substantial new gifts and solid operating results for both the Hospitals and the University were responsible for the increase.

In FY06, Stanford's consolidated operating revenues exceeded expenses by $299 million, about the same as in the 2004-2005 fiscal year (FY05). The University, excluding the Hospitals, reported a surplus from operations of $141 million in FY06 versus $130 million in FY05. The Hospitals reported a surplus of $158 million in FY06, compared with $169 million in FY05.

UNIVERSITY

The University ended the year with a surplus from operations of $141 million. Total revenues and expenses each were 9% higher than in FY05.

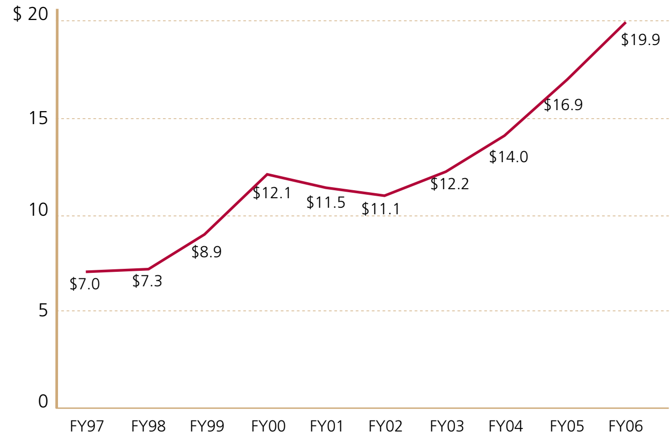
Some of the highlights of FY06 included:

Outstanding Investment Performance. The University had another year of strong investment performance in FY06 with total investment returns of $2.5 billion, down slightly from $2.7 billion in FY05. See the report from the Stanford Management Company on page 55 for an in-depth analysis of University investment strategies and performance.

Record Donor Support. The University was fortunate to experience unprecedented levels of giving in FY06. During the year, the University received over 115,000 gifts from more than 72,000 donors with record support to The Stanford Fund, the Graduate School of Business, the Schools of Earth Sciences, Engineering, and Humanities and Sciences, as well as the Department of Athletics and the Hoover Institution. Highlights of gift activity included:

> Alumnus John Arrillaga gave $100 million to support various programs and capital projects at the University, including the new Stanford Stadium.

FIGURE 1
CONSOLIDATED NET ASSETS (IN BILLIONS)



> Alumnus Philip H. Knight pledged $100 million for the construction of the Knight Management Center, a new Graduate School of Business campus.

> Two $30 million commitments were received for the Initiative on the Environment and Sustainability: one from Priscilla B. and Ward W. Woods, alumnus and trustee, to fund the Woods Institute for the Environment, where environmental programs and collaborative research will be undertaken, and one from alumnus Jay A. Precourt to establish the Precourt Institute for Energy Efficiency.

> Arthur and Toni Rembe Rock gave $10 million to create the Rock Center for Corporate Governance at the Law School.

In October 2006, President Hennessy announced The Stanford Challenge, a $4.3 billion fund raising campaign, the funds from which will be used in seeking solutions to today's complex global problems and educating students to become tomorrow's leaders. Many of the gifts received by the University in FY06 were in anticipation of this campaign.

STATEMENT OF ACTIVITIES

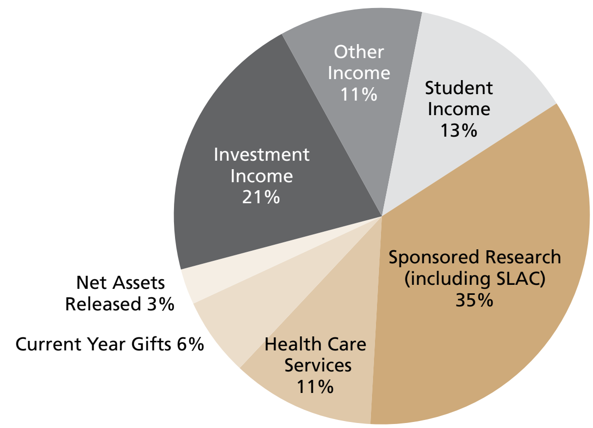
The Statement of Activities details operating revenues and expenses and other non-operating changes in net assets during the year. University total net assets increased $2.7 billion in FY06 compared with a $2.6 billion increase in FY05. The increase resulted primarily from significant increases in the value of the University's investments and new gifts and pledges.

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.

The components of the University's $2.9 billion in operating revenues are shown in Figure 2. Sponsored research support accounts for 35% of total revenues with an additional 21% resulting from investment income distributed for operations and 9% from gifts and pledges in support of operations and net assets released from donor restrictions. Highlights of the University's operating activities are summarized below:

FIGURE 2
FY06 UNIVERSITY OPERATING REVENUES ($2.9 BILLION)



> Student income increased 6% to $376 million in FY06. As a percentage of total revenues, student income represented 13% of University operating revenues, compared to 14% in the prior year. Undergraduate tuition increased by 4% and graduate tuition increased by 6%. Offsetting tuition and room and board revenues is financial aid. Consistent with prior years, financial aid was 28% of gross student income.

> Sponsored research support increased $21 million, or 2%, to $994 million in FY06, representing 35% of University operating revenues. Direct costs, excluding SLAC, decreased $40 million or 7% from FY05, as some large, multi-year research projects such as Gravity Probe B began winding down. Revenues generated from SLAC activities increased $61 million, due mostly to increased construction expenditures for the Linac Coherent Light Source, which will be the world's first x-ray free electron laser when it becomes operational in 2009. Indirect cost recovery was flat at $172 million in FY06.

> Health care services revenues for the University increased $49 million or 18% in FY06 to $316 million, representing 11% of University revenues. Health care services revenues consist primarily of payments made by the Hospitals to the University, including $274 million to the School of Medicine for faculty physicians' services, the blood center and other essential services. An additional $26 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 increase is due primarily to higher professional services revenues being paid by the Hospitals to the School of Medicine. These amounts are eliminated in consolidation. Faculty physicians also generated $16 million in revenues from services provided to external parties, including the Santa Clara Valley Medical Center and the Palo Alto Veterans Administration Hospital.

> The increases in both current year gifts and net assets released from restrictions are a reflection of the University's record setting fund raising efforts in FY06:

- Current year gifts in support of operations increased to $168 million in FY06, from $144 million in FY05. 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 gifts released from donor restrictions, totaled $94 million compared to $82 million in FY05.

> Total investment income included in operations represented 21% of University revenues.

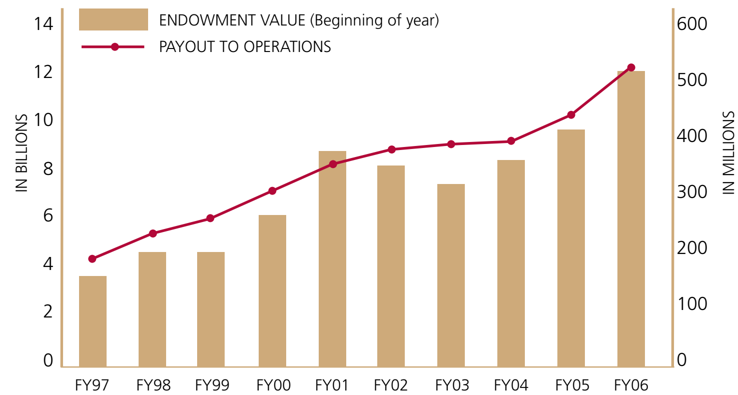
THE UNIVERSITY'S ENDOWMENT

The University's Endowment is a collection of gift funds and reserves that are set aside and invested to support the University's teaching and research missions. The Endowment grew to $14.1 billion as of August 31, 2006, representing approximately 77% of the University's net assets. The Endowment includes pure endowment funds, endowed lands, term endowment funds and funds functioning as endowment.

During FY06, the University determined that living trust agreements, which do not provide current income for operations, should be excluded from the reported Endowment balance. Had funds subject to living trust agreements been excluded from the Endowment in FY05, the balance at the end of the year would have been $11.9 billion instead of the $12.2 billion previously reported.

The increase in the Endowment of approximately $2.2 billion in FY06, after payout to operations of $535 million, resulted from $2.2 billion of investment returns, $253 million in new gifts and transfers of $285 million of expendable funds into the Endowment. Payout to operations from the Endowment is a significant source of operating revenue for the University, covering approximately 19.6% of expenses in FY06 compared to 18.1% in FY05. Distributions in FY06 and FY05 were approximately 4.5% and 4.6%, respectively, of the beginning of year Endowment value.

FIGURE 3
ENDOWMENT VALUE vs PAYOUT TO OPERATIONS



- Endowment income distributed for operations was $535 million in FY06, up from $452 million in FY05. The University's Endowment (see insert at left) is intended to generate investment income that can be used to support operating activities of the University. The largest component of endowment income is the payout from Endowment funds invested in the University's Merged Endowment Pool (MEP). In FY06, the MEP payout was $459 million, up from $385 million in FY05. Over the last ten years, the payout amount has grown appreciably due primarily to strong investment returns, substantial new gifts and transfers of expendable funds into the Endowment. Also included in endowment income is rental income from ground leases of the University's endowed lands including the Stanford Research Park and the Hyatt Senior Living facility, which opened in July 2005. The remainder results mostly from income on funds functioning as endowment that are invested on behalf of the Graduate School of Business and the Hoover Institution. See Figure 3 for a comparison of payout to Endowment value.

- Other investment income was $74 million in FY06 compared to $62 million in FY05. This category includes the payout to operations from the Expendable Funds Pool (EFP), the Endowment Income Funds Pool (EIFP) and the faculty and staff mortgage loan program income. The EFP payout policy seeks to achieve a stable payout to operations, while also providing that amounts in excess of the guidelines be added to the Endowment. EIFP fund holders receive total return. The combined EFP and EIFP payout was approximately $57 million in FY06, compared to $46 million in FY05.

> Special program fees and other income totaled $318 million in FY06, a 9% increase over FY05. This revenue category consists of the external revenues generated by auxiliary enterprises and service centers, executive education, corporate affiliate 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, and revenues from the Stanford West Apartments and from intercollegiate athletic activities. Increases were primarily in patent and royalty revenues and corporate affiliate, summer conferences and other program revenues.

Total expenses increased $236 million, or 9%, to $2.7 billion in FY06. As depicted in Figure 4, salaries and benefits comprise approximately 60% of the University's total expenses, depreciation expense was 7% and other operating expenses represented approximately 33%.

> Salaries and benefits increased 11% in FY06 to $1.6 billion. Increases in salaries were related to the University's merit program and certain targeted increases to address equity and retention. In addition, staff headcount increased by approximately 3% during the year. Benefits expense increased due to increases in health care insurance costs and to changes in the University's post retirement medical benefit plan in January 2006.

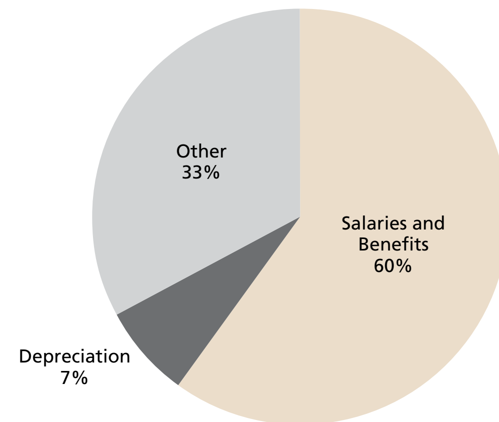
> Depreciation expense increased 3% to $198 million in FY06 from $192 million in FY05 as a number of new projects were placed in service during the year.

> Other operating expenses increased 7% to $900 million in FY06 compared to $839 million in FY05. The majority of the increase is the result of the increased construction activities at SLAC.

Other Changes in Unrestricted Net Assets

In total, unrestricted net assets of the University, including $141 million from operations, increased $1.9 billion. The increase in other changes in unrestricted net assets was due primarily to a $1.8 billion increase in the market value of investments, net of $535 million of endowment income and $74 million of EFP and other investment 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 added to the Endowment. In FY06, total investment return of the EFP was $241 million, of which $180 million was added to the Endowment.

FIGURE 4
FY06 UNIVERSITY OPERATING EXPENSES ($2.7 BILLION)



Temporarily Restricted Net Assets

Temporarily restricted net assets increased $441 million to $1.0 billion in FY06. 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 $591 million of new temporarily restricted gifts and pledges in FY06, net of discounts and allowances. During the year, $94 million of temporarily restricted net assets were released from their restrictions and utilized to fund operating activities. Another $50 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. Finally, $55 million of pending funds were moved into permanently restricted endowed funds, following donor instructions.

Permanently Restricted Net Assets

Permanently restricted net assets increased by $328 million to almost $4 billion during FY06. The principal value of these funds must be invested in perpetuity to generate endowment income to be used only for purposes designated by donors. The increase was due primarily to the receipt of $205 million in new gifts and pledges to the Endowment, net of discounts and allowances, and $61 million in gains on investments held in the Endowment that were reinvested per the donor's instruction. In addition, $55 million in funds previously pending designation was transferred from temporarily restricted net assets and $31 million of previously unrestricted funds were transferred to permanently restricted net assets, in order to satisfy matching gift conditions.

FINANCIAL POSITION

The University's Statement of Financial Position reflects the strong investment returns, increased giving and the solid operating results experienced during its current fiscal year. In FY06, total University assets increased $2.8 billion to $21.8 billion, while total University liabilities increased only $106 million to $3.4 billion.

Highlights of the Statement of Financial Position are as follows:

> Cash and cash equivalents increased $25 million in FY06. The University closely manages its cash balances to maximize returns on its funds through short term investments.

> Net pledges receivable increased approximately $110 million to $583 million in FY06, another reflection of the strong year for giving. Valuation allowances were recorded for pledges that may not be collectible or where the pledge terms may be extended.

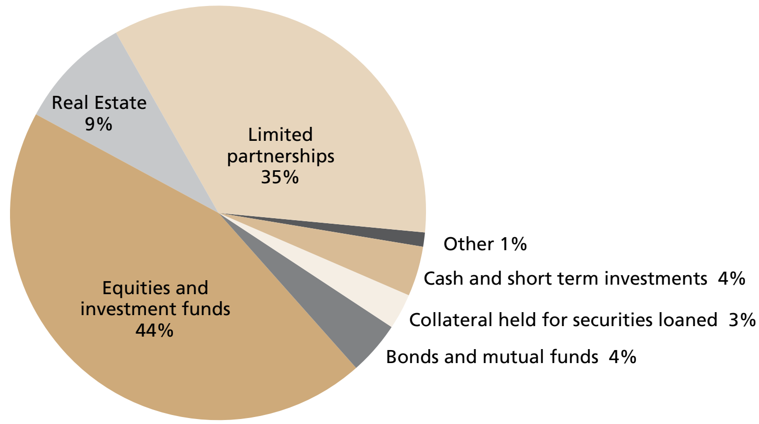
> Total investments increased by $2.4 billion, or 16%, to $17.5 billion. See Figure 5 for investment asset allocation as of August 31, 2006.

> Plant facilities, net of accumulated depreciation, increased $193 million to $2.5 billion in FY06. Net additions to plant facilities in FY06 totaled $337 million, bringing gross plant facilities before accumulated depreciation to $4.6 billion. Additions to the University's plant facilities in FY06 included the newly renovated Stanford Stadium, the Arrillaga Family Recreation Center, the Kavli Institute for Particle Astrophysics and Cosmology at SLAC and the purchase of a 35-acre technology park in Redwood City to be developed to allow for off campus growth.

> Deferred rental income, consisting of prepaid rents on properties leased by the University, was $368 million at August 31, 2006. These amounts are recognized as revenue ratably over the terms of the associated leases. Of this amount, $312 million relates to the Stanford Shopping Center 51-year ground lease, which the University entered into in 2003.

> Notes and bonds payable were $1.3 billion at August 31, 2006, up slightly from FY05 due to increased use of commercial paper during FY06. The University's debt policy governs the amount and type of debt Stanford may incur and is intended to preserve long term debt capacity, financial flexibility and access to capital markets at competitive rates. The University uses a combination of fixed and variable rate debt to fund a number of projects, including academic facilities, residential housing and dining facilities, faculty and staff mortgage loans and other miscellaneous projects.

FIGURE 5
INVESTMENT ASSET ALLOCATION



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 member of each of the Hospitals.

In 2006, management of the University revised the operating measure for the Hospitals to exclude all investment returns. All unrestricted investment returns that were previously included in operations have been reclassified to other changes in unrestricted net assets.

The Hospitals had a combined operating surplus of $158 million, down 7% from $169 million in FY05. At August 31, 2006, the Hospitals' net assets were $1.5 billion versus $1.1 billion at August 31, 2005, an increase of $337 million or 30%. The following discussion summarizes the individual financial results of SHC and LPCH as shown in the consolidated financial statements.

STANFORD HOSPITAL AND CLINICS

SHC continued to strengthen its financial position in FY06, generating income from operations of $115 million, down 6% from $122 million in FY05.

STATEMENT OF ACTIVITIES

Revenues increased by 10% to $1.5 billion.

> Patient revenues increased by 9%, to $1.4 billion. Inpatient revenues, which make up 55% of the total, grew by 11% on continuing increases in patient volume. Despite significant capacity limitations, total patient days were up by 6%. Outpatient revenues increased by 8%, accounting for 45% of the total.

> Other income, which includes the results of the outreach laboratory and various related entities, was up by 36% to $67 million.

> Net assets released from restrictions were virtually unchanged from FY05 at $4 million.

Expenses increased by 12% to $1.4 billion.

> Salaries and benefits grew by 13% to $596 million. The number of employees was up 6% in response to growth in patient volumes, while salaries were increased to maintain SHC's position in the competitive market for health care professionals.

> Physician services and support increased by 16% to $267 million. This category includes all payments to the University for services, the majority of which are payments to the School of Medicine for physician services. Payments for physician services increased significantly in FY06.

> Depreciation remained essentially unchanged from FY05 at $39 million.

> Other Expense includes such categories as supplies, purchased and professional services, and bad debt expense. These expenses were up 10% to $469 million as a result of both increases in patient volumes and increases in prices.

Total net assets increased $195 million to $650 million.

> Unrestricted net assets increased by $187 million to $624 million. Most of this growth came from SHC's income from operations of $115 million and from investment income and gains of $54 million.

> Temporarily restricted net assets increased by $7 million to $23 million and permanently restricted net assets increased by $1 million to $4 million in FY06.

FINANCIAL POSITION

SHC's Statement of Financial Position reflects continued investments in the facilities and systems required to be the provider of choice for complex care in the communities it serves.

Net assets increased to $650 million in FY06 as SHC continued to strengthen its financial position to support the expansion of services to the community and to support the shared missions of the Hospital and the School of Medicine. Some highlights for the year were:

> Unrestricted cash and investments were $749 million at the end of FY06, an increase of $107 million. As a result, days cash on hand increased from 198 to 205.

> Assets held by a trustee, included in investments in the consolidated financial statements, increased by $291 million to $403 million. The increase represents the unexpended proceeds of the 2006 bond issue, which will be spent on new outpatient facilities, a new electronic clinical information system, and other facilities and systems projects.

> Property and equipment, net of depreciation, increased $133 million to $404 million during FY06. The largest elements of the increase were the purchase of facilities in Redwood City that will be developed to expand the availability of outpatient care, and initial expenditures on the new clinical information system.

> Bonds payable increased to $855 million with the issuance of $428 million in new debt in March 2006. The proceeds of this issue are being used to fund improved and expanded facilities, and new and improved equipment and information systems.

LUCILE PACKARD CHILDREN'S HOSPITAL

LPCH continued its strong financial performance in FY06, generating income from operations of $43 million, down slightly from $47 million in FY05. Net assets increased $142 million to $829 million at August 31, 2006, while net patient revenues grew 6% to $470 million. LPCH has been able to stem the rise in medical inflation through continuous management focus on costs and operational improvements.

Other financial highlights for LPCH:

- Inpatient net revenues, which make up approximately 83% of total net patient revenues, grew by less than 4% as a result of an increase in services provided to Medi-Cal beneficiaries, as well as the Hospital's continued capacity limitations, which have limited its ability to expand inpatient services. The Medi-Cal program reimburses LPCH significantly less than commercial payers. Medi-Cal patients represented 39% of gross patient revenues in FY06 and 33% in FY05.

- Outpatient visits increased by 2% from FY05 and resulted in increased net revenues of $12 million.

- 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 $105 million in FY06 compared with $78 million in FY05. LPCH also invests in improving the health of the children of San Mateo and Santa Clara counties through a range of community based programs.

- Unrestricted cash and investments increased by $15 million to $304 million at August 31, 2006. Though this represents a slight decrease in days cash on hand from 252 to 249, this is a direct result of an acquisition of ground leases for future expansion, which will be reimbursed through a release of bond proceeds in FY07. It is anticipated that these sites will be used for future expansion to meet the continued high demand for complex children's and obstetrics services.

LPCH continues to struggle with inpatient capacity issues. These issues are being addressed by current and planned expansions of bed and operating room capacity, as well as adding additional LPCH managed satellite operations throughout the greater community. Construction of additional beds and new outpatient centers for heart, dialysis and cancer, as well as surgical suites and enhancements to diagnostic laboratory and radiology services, are scheduled to be completed by the summer of 2008.

FUTURE FINANCIAL CHALLENGES

Notwithstanding the excellent financial performance of the past several years, the University and the Hospitals face several financial challenges:

- **Federal Research Funding.** Federal funding for research is expected to decline over the next several years as government resources are allocated to other initiatives. This continues to be an area of concern for the University, whose largest source of operating revenues is federally funded research. As funding for research from the federal government declines, the University will need to seek other funding sources for the important research being performed. Such funding could come from non-federal sponsors, University funds and gifts.

- **Affordable Housing.** The residential area surrounding Stanford has some of the highest housing costs in the country, creating a significant obstacle in recruiting and retaining faculty and senior staff. In response to this challenge, the University provides housing assistance salary subsidies, and low-current-interest and deferred-interest mortgages. Housing assistance subsidies were $10 million in FY06 and $9.2 million in FY05. Faculty and staff mortgages increased to $297 million in FY06 from $268 million in FY05.

- **Health Care Services Costs.** Nursing and other hospital personnel compensation, as well as pharmaceutical and equipment costs, are increasing as fast, or faster than, medical reimbursement rates. Due to inpatient capacity constraints, the Hospitals have limited ability to absorb these increased costs through greater volume. As a result, the Hospitals may be challenged to sustain operating margins at FY06 levels.

- **State Reimbursement of Health Care Services Costs.** Low Medi-Cal reimbursement is a statewide issue that has a significant impact on the Hospitals, especially at LPCH, where Medi-Cal volumes have increased substantially over the past year. The Hospitals' estimated cost in excess of reimbursements for Medi-Cal and county services was $154 million in FY06, up from $118 million in FY05. The Hospitals continually interface with their state representatives, as well as with the local Medi-Cal managed care plans, in a long-term effort to bring reimbursement for these patients closer to cost.

> **Commute Trip Limitations.** The number of automobiles entering and departing the campus during peak commute hours is limited under an agreement with the county in which the University is located. As a result, the University is exploring various means of reducing traffic to and from the main campus. In early FY06, the University purchased a nearby technology park to facilitate off campus growth. In addition, the University funds programs to encourage the use of public transportation. These programs cost approximately $5 million in FY06 and the costs are expected to increase in the future.

> **Seismic Risk.** The University is located in a region that is subject to seismic activity. The 1906 San Francisco and 1989 Loma Prieta earthquakes inflicted substantial damage to University facilities. Despite investments in seismic upgrades and retrofits over the past several years, in the event of a significant future earthquake, the University could suffer substantial damage to its facilities and disruption to its operations. The University carries no third-party insurance for facilities damage sustained from a seismic event.

> **Data and Network Security.** Stanford's computer network and enterprise applications are essential to its academic, research and business operations. The network is constantly under attack by individuals outside the University in an attempt to gain access to restricted data or to cause damage to the network in a variety of ways. In response to these threats, the University expends millions of dollars annually in network security services. This type of activity is expected to continue to evolve over time and the cost of preventing these attacks is likely to continue to increase along with the sophistication of those perpetrating the attacks.

The University and Hospitals continued to demonstrate solid fiscal management, further strengthening our financial position. Despite several years of solid performance, we remain mindful of our responsibility to protect and increase Stanford's resources. The University's success is due in large part to the many faculty, staff, students, trustees, alumni, parents and others who have helped to support us in our endeavors to remain a leading edge research university. We look forward to their continued support, which will allow us to build on the past years' financial successes and sustain the University's future.

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

M. SUZANNE CALANDRA
Controller
Stanford University

DAVID R. EBEL
Interim Chief Financial Officer
Stanford Hospital and Clinics

TIMOTHY W. CARMACK
Chief Financial Officer
Lucile Salter Packard Children's Hospital

Selected Financial Data

FISCAL YEARS ENDED AUGUST 31

	2006	2005	2004	2003	2002	2001
			(in millions of dollars)			
STATEMENT OF ACTIVITIES DATA:						
Student income (A)	$ 376	$ 356	$ 332	$ 318	$ 305	$ 300
Sponsored research support	994	973	924	860	802	727
Health care services	1,851	1,699	1,501	1,277	1,181	1,010
Current year gifts in support of operations	168	144	105	113	104	111
Net assets released from restrictions	117	104	64	72	51	64
Investment income distributed for operations	609	514	460	495	436	411
Special program fees and other income	396	351	329	320	292	275
Total Revenues	4,511	4,141	3,715	3,455	3,171	2,898
Total Expenses	4,212	3,842	3,572	3,319	3,145	2,877
Excess of revenues over expenses	299	299	143	136	26	21
Other changes in net assets	2,709	2,598	1,596	1,028	(487)	(612)
Net change in total net assets	$ 3,008	$ 2,897	$ 1,739	$ 1,164	$ (461)	$ (591)
FINANCIAL POSITION HIGHLIGHTS:						
Cash and cash equivalents	$ 579	$ 629	$ 638	$ 602	$ 522	$ 444
Pledges receivable, net	619	507	454	475	513	527
Investments at fair value	19,263	16,351	13,318	11,806	9,520	10,514
Plant facilities, net of accumulated depreciation	3,164	2,800	2,743	2,723	2,527	2,365
Notes and bonds payable:						
University	1,309	1,266	1,288	1,275	1,246	1,218
Hospitals	1,006	582	587	591	224	228
Total net assets, end of year	19,881	16,873	13,976	12,237	11,073	11,534
University endowment	14,085	12,205	9,922	8,614	7,613	8,250

STUDENTS:						
ENROLLMENT: (B)						
Undergraduate	6,689	6,705	6,753	6,654	6,731	6,637
Graduate	8,201	8,176	8,093	7,800	7,608	7,536
DEGREES CONFERRED:						
Bachelor degrees	1,756	1,790	1,713	1,788	1,692	1,676
Advanced degrees	3,093	2,945	2,931	2,855	2,777	2,936
FACULTY:						
MEMBERS OF THE ACADEMIC COUNCIL	1,418	1,400	1,410	1,396	1,377	1,384
ANNUAL UNDERGRADUATE TUITION RATE (IN DOLLARS)	$ 31,200	$ 29,847	$ 28,563	$ 27,204	$ 25,917	$ 24,441

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

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

Consolidated Statements of Financial Position

AT AUGUST 31, 2006 AND 2005 (in thousands of dollars)

	2006			2005
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
ASSETS				
Cash and cash equivalents	$ 459,871	$ 119,213	$ 579,084	$ 629,215
Accounts receivable, net	257,015	309,701	566,716	466,849
Receivables (payables) from SHC and LPCH, net	41,704	(41,704)	-	-
Inventories, prepaid expenses and other assets	34,173	128,758	162,931	110,933
Pledges receivable, net	583,171	35,634	618,805	506,872
Student loans receivable, net	63,374	-	63,374	63,148
Faculty and staff mortgages and other loans receivable, net	297,956	-	297,956	268,928
Investments at fair value, including securities pledged or on loan of $573,229 and $555,025 for 2006 and 2005, respectively	17,524,666	1,738,545	19,263,211	16,351,384
Plant facilities, net of accumulated depreciation	2,546,480	617,450	3,163,930	2,800,418
Works of art and special collections	-	-	-	-
TOTAL ASSETS	**$ 21,808,410**	**$ 2,907,597**	**$ 24,716,007**	**$ 21,197,747**
LIABILITIES AND NET ASSETS				
LIABILITIES:				
Accounts payable and accrued expenses	$ 570,128	$ 422,082	$ 992,210	$ 942,353
Pending trades	105,796	-	105,796	183,870
Liabilities under security agreements	658,196	-	658,196	631,955
Deferred rental income	367,565	-	367,565	362,164
Income beneficiary share of living trust investments	344,921	-	344,921	301,896
Notes and bonds payable	1,308,562	1,006,202	2,314,764	1,848,892
U.S. government refundable loan funds	52,394	-	52,394	54,005
TOTAL LIABILITIES	**3,407,562**	**1,428,284**	**4,835,846**	**4,325,135**
NET ASSETS:				
Unrestricted	13,448,790	1,174,473	14,623,263	12,423,390
Temporarily restricted	1,001,137	114,079	1,115,216	653,899
Permanently restricted	3,950,921	190,761	4,141,682	3,795,323
TOTAL NET ASSETS	**18,400,848**	**1,479,313**	**19,880,161**	**16,872,612**
TOTAL LIABILITIES AND NET ASSETS	**$ 21,808,410**	**$ 2,907,597**	**$ 24,716,007**	**$ 21,197,747**

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

Consolidated Statements of Activities

FOR THE YEARS ENDED AUGUST 31, 2006 AND 2005 (in thousands of dollars)

	2006			2005
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
UNRESTRICTED NET ASSETS ACTIVITY				
REVENUES:				
Student income:				
Undergraduate programs	$ 213,352	$ -	$ 213,352	$ 204,287
Graduate programs	210,380	-	210,380	197,867
Room and board	95,327	-	95,327	90,936
Student financial aid	(142,898)	-	(142,898)	(137,171)
TOTAL STUDENT INCOME	**376,161**	**-**	**376,161**	**355,919**
Sponsored research support:				
Direct costs - University	523,886	-	523,886	563,968
Direct costs - Stanford Linear Accelerator Center	297,979	-	297,979	237,317
Indirect costs	172,249	-	172,249	172,094
TOTAL SPONSORED RESEARCH SUPPORT	**994,114**	**-**	**994,114**	**973,379**
Health care services:				
Patient care, net	-	1,835,058	1,835,058	1,692,658
Physicians' services and support - SHC and LPCH, net	300,176	(300,176)	-	-
Physicians' services and support - other facilities, net	16,098	-	16,098	6,514
TOTAL HEALTH CARE SERVICES	**316,274**	**1,534,882**	**1,851,156**	**1,699,172**
CURRENT YEAR GIFTS IN SUPPORT OF OPERATIONS	**167,700**	**-**	**167,700**	**144,331**
Net assets released from restrictions:				
Payments received on prior year pledges	60,098	-	60,098	45,169
Prior year gifts released from donor restrictions	34,003	22,943	56,946	58,261
TOTAL NET ASSETS RELEASED FROM RESTRICTIONS	**94,101**	**22,943**	**117,044**	**103,430**
Investment income distributed for operations:				
Endowment	534,734	-	534,734	451,959
Expendable funds pool and other investment income	74,149	-	74,149	62,315
TOTAL INVESTMENT INCOME DISTRIBUTED FOR OPERATIONS	**608,883**	**-**	**608,883**	**514,274**
SPECIAL PROGRAM FEES AND OTHER INCOME	**318,490**	**77,868**	**396,358**	**350,087**
TOTAL REVENUES	**2,875,723**	**1,635,693**	**4,511,416**	**4,140,592**
EXPENSES:				
Salaries and benefits	1,636,697	822,741	2,459,438	2,209,224
Depreciation	198,005	56,329	254,334	243,782
Other operating expenses	900,284	598,467	1,498,751	1,388,476
TOTAL EXPENSES	**2,734,986**	**1,477,537**	**4,212,523**	**3,841,482**
EXCESS OF REVENUES OVER EXPENSES	**$ 140,737**	**$ 158,156**	**$ 298,893**	**$ 299,110**

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

Consolidated Statements of Activities

FOR THE YEARS ENDED AUGUST 31, 2006 AND 2005 (in thousands of dollars)

	2006			2005
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
UNRESTRICTED NET ASSETS ACTIVITY (continued)				
EXCESS OF REVENUES OVER EXPENSES	**$ 140,737**	**$ 158,156**	**$ 298,893**	**$ 299,110**
Other changes in unrestricted net assets:				
Expendable gifts invested in the endowment	3,215	-	3,215	5,512
Investment returns not included in operations	1,753,061	108,663	1,861,724	2,123,657
Hospital equity transfers	22,364	(22,364)	-	-
Capital and other gifts released from restrictions	49,588	11,824	61,412	37,946
Capital gifts released from University	-	764	764	6,580
(Increase) decrease in minimum pension liability	13,149	33,462	46,611	(26,774)
Transfer to permanently restricted net assets	(30,917)	-	(30,917)	(13,128)
Transfer to temporarily restricted net assets	(6,726)	-	(6,726)	(14,503)
Swap interest and unrealized losses	(12,965)	-	(12,965)	(11,019)
Cumulative effect of change in accounting principle for asset retirement obligations	(13,021)	(4,876)	(17,897)	-
Other	(17,145)	12,904	(4,241)	(39,931)
NET CHANGE IN UNRESTRICTED NET ASSETS	**1,901,340**	**298,533**	**2,199,873**	**2,367,450**
TEMPORARILY RESTRICTED NET ASSETS ACTIVITY				
Gifts and pledges, net	590,633	43,141	633,774	249,999
Investment gains	49,408	11,849	61,257	28,256
Change in value of living trust agreements, net	(3,085)	-	(3,085)	(15,894)
Net assets released to operations	(94,101)	(22,943)	(117,044)	(103,430)
Capital and other gifts released to unrestricted net assets	(49,588)	(11,824)	(61,412)	(37,946)
Capital gifts released to Hospitals unrestricted net assets	(764)	-	(764)	(6,580)
Transfer from unrestricted net assets	6,726	-	6,726	14,503
Transfer to permanently restricted net assets	(55,169)	-	(55,169)	(32,055)
Other	(2,786)	(180)	(2,966)	3,464
NET CHANGE IN TEMPORARILY RESTRICTED NET ASSETS	**441,274**	**20,043**	**461,317**	**100,317**
PERMANENTLY RESTRICTED NET ASSETS ACTIVITY				
Gifts and pledges, net	204,993	18,579	223,572	266,078
Investment gains	61,225	-	61,225	133,427
Change in value of living trust agreements, net	(28,273)	-	(28,273)	735
Transfer from unrestricted net assets	30,917	-	30,917	13,128
Transfer from temporarily restricted net assets	55,169	-	55,169	32,055
Other	3,749	-	3,749	(16,307)
NET CHANGE IN PERMANENTLY RESTRICTED NET ASSETS	**327,780**	**18,579**	**346,359**	**429,116**
NET CHANGE IN TOTAL NET ASSETS	**2,670,394**	**337,155**	**3,007,549**	**2,896,883**
Total net assets, beginning of year	15,730,454	1,142,158	16,872,612	13,975,729
TOTAL NET ASSETS, END OF YEAR	**$ 18,400,848**	**$ 1,479,313**	**$ 19,880,161**	**$ 16,872,612**

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

Consolidated Statements of Cash Flows

FOR THE YEARS ENDED AUGUST 31, 2006 AND 2005 (in thousands of dollars)

	2006			2005
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
CASH FLOW FROM OPERATING ACTIVITIES:				
Change in net assets	$ 2,670,394	$ 337,155	$ 3,007,549	$ 2,896,883
Adjustments to reconcile change in net assets to net cash provided by operating activities:				
Cumulative effect of change in accounting principle for asset retirement obligations	13,021	4,876	17,897	-
Depreciation, amortization and loss on disposal of fixed assets	202,346	56,709	259,055	245,033
Net realized and unrealized (gains) losses on investments and security agreements	(2,126,785)	(70,678)	(2,197,463)	(2,544,173)
Net realized and unrealized losses on derivatives	(12,965)	(11,594)	(24,559)	5,810
Actuarial change on living trust obligations	18,493	-	18,493	492
Permanently restricted investment loss (income)	36	(9,463)	(9,427)	(8,687)
Gifts restricted for long term investments	(64,188)	(61,720)	(125,908)	(312,420)
Net (increase) decrease in accounts receivable, pledges receivable and receivables from SHC and LPCH	(54,933)	(343,870)	(398,803)	3,436
Decrease (increase) in inventories, prepaid expenses and other assets	19,827	(49,036)	(29,209)	(21,188)
Increase (decrease) in accounts payable and accrued expenses	75,142	(33,607)	41,535	57,300
Increase (decrease) in deferred rental income	5,401	-	5,401	(8,276)
(Decrease) increase in U.S. government refundable loan funds	(1,611)	-	(1,611)	478
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	**744,178**	**(181,228)**	**562,950**	**314,688**
CASH FLOW FROM INVESTING ACTIVITIES:				
Land, building and equipment purchases	(395,108)	(210,568)	(605,676)	(311,695)
Student, faculty and other loans:				
New loans made	(69,691)	-	(69,691)	(58,481)
Principal collected	40,437	-	40,437	41,855
Purchases of investments	(9,852,862)	(232,348)	(10,085,210)	(9,041,954)
Sales and maturities of investments	9,489,338	72,324	9,561,662	8,758,703
NET CASH USED FOR INVESTING ACTIVITIES	**(787,886)**	**(370,592)**	**(1,158,478)**	**(611,572)**
CASH FLOW FROM FINANCING ACTIVITIES:				
Gifts and reinvested income of endowment, capital projects and other restricted purposes	6,753	61,720	68,473	294,077
(Decrease) increase in investment income for restricted purposes	(36)	9,528	9,492	7,529
Proceeds from borrowing	63,000	428,500	491,500	5,932
Bond issuance costs	-	(18,987)	(18,987)	-
Repayment of notes and bonds payable	(20,877)	(4,445)	(25,322)	(25,993)
Increase in liabilities under security agreements	26,241	-	26,241	11,431
Other financing	(6,000)	-	(6,000)	(5,354)
NET CASH PROVIDED BY FINANCING ACTIVITIES	**69,081**	**476,316**	**545,397**	**287,622**
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**25,373**	**(75,504)**	**(50,131)**	**(9,262)**
Cash and cash equivalents, beginning of year	434,498	194,717	629,215	638,477
CASH AND CASH EQUIVALENTS, END OF YEAR	**$ 459,871**	**$ 119,213**	**$ 579,084**	**$ 629,215**
SUPPLEMENTAL DATA:				
Gifts of equipment	$ 16,550	$ 77	$ 16,627	$ 1,439
Interest paid during the year	$ 65,480	$ 31,466	$ 96,946	$ 82,032
Cash collateral received under securities lending agreements	$ 599,191	$ -	$ 599,191	$ 580,789

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. These reclassifications had no impact on the change in net assets or total net assets.

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 1,807 faculty and 14,890 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. Each of the Hospitals is a California not-for-profit public benefit corporation. The University is the sole member of each of the Hospitals. The Hospitals support the mission of medical education and clinical research of the University's School of Medicine. 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.

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, expenses, investment income and inter-entity receivables and payables consistent with categories in these consolidated financial statements.

BASIS OF ACCOUNTING The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. 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 based on 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 the asset is placed in service. 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, hospital equity transfers, 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 gifts 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. Of the amounts included in temporarily restricted net assets, approximately 45% are for capital projects and 55% are for other institutional support.

Permanently Restricted Net Assets
Permanently restricted net assets consist principally of endowment, annuity and life income funds, which are subject to donor-imposed restrictions requiring that the principal be invested in perpetuity. Permanently restricted net assets may also include funds reclassified from other classes of net assets as a consequence of donor-imposed stipulations.

CASH AND CASH EQUIVALENTS Cash and cash equivalents consist 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. These amounts are carried at cost, which approximates market. Cash and cash equivalent amounts held in the merged endowment pool, collateral held for securities loaned and certain cash restricted in its use are classified as investments.

PLEDGES RECEIVABLE Unconditional promises to give 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.

ACCOUNTS AND STUDENT LOANS RECEIVABLE Accounts and student loans receivable are carried at cost, less an allowance for doubtful accounts.

INVESTMENTS Investments are recorded at fair value. Securities transactions are reported on a trade-date basis. The values of publicly traded fixed income, equity securities and mutual funds 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 and hedge fund 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 fair value at the date of acquisition. Under the original endowment from Senator Leland and Mrs. Jane Stanford, a significant portion of University land may not be sold.

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 the years ended August 31, 2006 and 2005 are as follows:

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

WORKS OF ART AND SPECIAL COLLECTIONS Works of art, historical treasures, literary works and artifacts, which are preserved and protected for educational, research and public exhibition purposes, are not capitalized. Purchases of such collections are recorded as operating expenses in the period in which they are acquired.

SELF-INSURANCE The University self-insures at varying levels for unemployment, disability, workers' compensation, property losses, certain health care plans and general and professional liability losses. The Hospitals self-insure at varying levels for health care plans, 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 revenues 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, cost reimbursement or negotiated charges.

The University has entered into various operating agreements with the Hospitals for professional services of faculty members from the School of Medicine, telecommunications services and other services and facilities charges.

CHARITY CARE The Hospitals provide care to patients who meet certain criteria under their charity care policies without charge or at amounts less than their established rates. Amounts determined to qualify as charity care are not reported as net patient-service revenue. The amount of charity care services, quantified at established rates, was $37,988,000 and $20,057,000 for the years ended August 31, 2006 and 2005, respectively. 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. Estimated cost in excess of reimbursements for Medi-Cal and county services for the years ended August 31, 2006 and 2005 was $153,975,000 and $117,616,000, respectively.

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.

ASSET RETIREMENT OBLIGATIONS In 2006, the University and the Hospitals adopted Financial Accounting Standards Board Interpretation No. 47 (FIN 47), Accounting for Conditional Asset Retirement Obligations. FIN 47 requires recognition of a liability for the fair value of a legal obligation to perform asset retirement activities that are conditional on a future event if the amount can be reasonably estimated. Asset retirement obligations arise primarily from regulations that specify how to dispose of asbestos if facilities are demolished or undergo major renovations or repairs. The obligation to remove asbestos was estimated using a per square foot estimate.

As a result of an evaluation of available asbestos remediation estimates, the University and the Hospitals recorded liabilities of $13,021,000 and $6,254,000, respectively, for their asset retirement obligations. Accumulated depreciation was measured from 1977, the date the liabilities and capitalized assets would have been recognized if FIN 47 were in effect when the liabilities were incurred. The capitalized assets associated with these asset retirement obligations are considered to be fully depreciated. The cumulative effect of this change in accounting principle was recorded as a reduction of other changes in unrestricted net assets.

CHANGE IN PRESENTATION OF OPERATING RESULTS FOR THE HOSPITALS In 2006, management revised the presentation of operating revenues for the Hospitals to exclude all investment returns. Accordingly, the consolidated statement of activities for the year ending August 31, 2006 reflects all unrestricted investment returns as other changes in unrestricted net assets. For purposes of comparability, the consolidated statement of activities for the year ended August 31, 2005 has been revised to conform its presentation to the current year. This change in presentation had no impact on the total change in unrestricted net assets or the total change in net assets as previously reported. The effects of this change in presentation on the accompanying 2005 consolidated financial statements are as follows, in thousands of dollars:

	AS PREVIOUSLY REPORTED	ADJUSTMENT	AS REPORTED
Investment income distributed for operations	$ 84,537	$ (22,222)	$ 62,315
Total revenues	4,162,814	(22,222)	4,140,592
Excess of revenues over expenses	321,332	(22,222)	299,110
Other changes in unrestricted net assets -			
Investment returns not included in operations	2,101,435	22,222	2,123,657
Net change in unrestricted net assets	2,367,450	-	2,367,450
Net change in total net assets	2,896,883	-	2,896,883

RECENT PRONOUNCEMENTS In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158 (FAS 158), Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R). FAS 158 requires organizations to recognize a net liability or asset to report the funded status of their defined benefit pension and other post retirement benefit plans in their statement of financial position. It also requires that plan assets and benefit obligations be measured as of the date of an employer's statement of financial position. The recognition and disclosure provisions of FAS 158 are effective for the University and the Hospitals for their fiscal year ending August 31, 2007. The provision to measure plan assets and benefit obligations as of the end of the fiscal year is effective for the University and the Hospitals for the fiscal year ending August 31, 2009. Adoption of FAS 158 will reduce unrestricted net assets.

2. Accounts Receivable

Accounts receivable at August 31, 2006 and 2005, in thousands of dollars, are as follows:

	2006	2005
UNIVERSITY:		
U.S. government	$ 79,555	$ 38,353
Non-government sponsors	27,896	29,977
Due from brokers	99,673	80,474
Accrued interest on investments	16,385	15,610
Student	5,689	3,328
Other	29,744	25,828
	258,942	193,570
Less allowances for losses	(1,927)	(2,332)
University accounts receivable, net	257,015	191,238
HOSPITALS:		
Patient receivables	400,759	346,232
Other	14,718	15,639
	415,477	361,871
Less bad debt allowances	(105,776)	(86,260)
Hospitals accounts receivable, net	309,701	275,611
CONSOLIDATED ACCOUNTS RECEIVABLE, NET	**$ 566,716**	**$ 466,849**

3. Pledges Receivable

Pledges are recorded at the present value of the discounted future cash flows, net of allowances. At August 31, 2006 and 2005, pledges receivable are as follows, in thousands of dollars:

	2006			2005
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
One year or less	$ 6,690	$ 22,224	$ 28,914	$ 41,926
Between one year and five years	377,320	17,318	394,638	533,974
More than five years	444,544	1,760	446,304	85,853
	828,554	41,302	869,856	661,753
Less discount/allowance	(245,383)	(5,668)	(251,051)	(154,881)
PLEDGES RECEIVABLE, NET	**$ 583,171**	**$ 35,634**	**$ 618,805**	**$ 506,872**

Conditional pledges for the University, which depend on the occurrence of a specified future and uncertain event, were $43,545,157 and $72,578,157 at August 31, 2006 and 2005, respectively. The Hospitals do not have any conditional pledges.

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 $296,851,000 and $268,344,000 at August 31, 2006 and 2005, respectively, from University faculty and staff are included in "Faculty and staff mortgages and other loans receivable, net" in the consolidated statements of financial position and are collateralized by deeds of trust on properties concentrated in the region surrounding the University.

5. Investments

Investments held by the University and the Hospitals at August 31, 2006 and 2005 are as follows, in thousands of dollars:

	2006 UNIVERSITY	2006 HOSPITALS	2006 CONSOLIDATED	2005 CONSOLIDATED
Cash, short-term investments and derivatives	$ 680,887	$ 695,060	$ 1,375,947	$ 1,670,901
Collateral held for securities loaned	599,191	-	599,191	580,789
Bonds and mutual funds	671,925	306,116	978,041	1,507,800
Public equities and investment funds	8,164,650	10,585	8,175,235	6,675,189
Assets held by other trustees (net of income beneficiary share of $78,667 and $76,440 at August 31, 2006 and 2005, respectively)	89,912	15,021	104,933	97,333
Real estate and improvements, including Stanford Shopping Center and Research Park	1,542,698	-	1,542,698	1,488,174
Limited partnership investments	6,417,208	-	6,417,208	4,256,695
Other	69,958	-	69,958	74,503
	18,236,429	1,026,782	19,263,211	16,351,384
The Hospitals' investment in University's Merged Endowment Pool	(711,763)	711,763	-	-
INVESTMENTS AT FAIR VALUE	**$ 17,524,666**	**$ 1,738,545**	**$ 19,263,211**	**$ 16,351,384**

The University manages a portion of the Hospitals' investments, with a combined market value of $1,171,472,000 and $923,338,000 at August 31, 2006 and 2005, respectively.

Total investment returns reflected in the statements of activities for the years ended August 31, 2006 and 2005, in thousands of dollars, are as follows:

	2006 UNIVERSITY	2006 HOSPITALS	2006 CONSOLIDATED	2005 CONSOLIDATED
Investment income	$ 344,629	$ 50,126	$ 394,755	$ 267,005
Net realized and unrealized gains	2,126,785	70,386	2,197,171	2,544,173
TOTAL INVESTMENT RETURN	**$ 2,471,414**	**$ 120,512**	**$ 2,591,926**	**$ 2,811,178**

Investment returns are net of investment management expenses, including both internal University salaries, benefits and operating expenses and external management fees. For the years ended August 31, 2006 and 2005, total investment returns of $1,952,849,000 and $2,271,721,000, respectively, were reinvested by the University and Hospitals after the distributions 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.

The University's investments are held in various pools or in specific instruments to comply with donor requirements as indicated in the following table, as of August 31, 2006 and 2005, in thousands of dollars:

	2006	2005
UNIVERSITY:		
Expendable Funds Pool	$ 1,516,479	$ 1,420,809
Merged Endowment Pool	15,848,335	13,334,966
Living trusts	666,394	603,978
Other investments	1,716,507	1,629,563
	19,747,715	16,989,316
Less funds cross-invested in investment pools (including the Hospitals' investment of $711,763 and $443,039 in 2006 and 2005, respectively, in the University's Merged Endowment Pool)	(2,223,049)	(1,857,686)
	17,524,666	15,131,630
HOSPITALS:		
Investments	1,738,545	1,219,754
INVESTMENTS AT FAIR VALUE	**$ 19,263,211**	**$ 16,351,384**

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 segregates income to be distributed to holders of permanently restricted endowment funds. The EIFP is invested in money market instruments and is included in the statement of position as cash and cash equivalents. The payout policy for the EIFP is to distribute total return to fund holders. For the years ended August 31, 2006 and 2005, the distributions were $7,896,000 and $4,165,000, respectively.

The Board has established a policy for the distribution of the investment returns of the EFP. The difference between the actual return of this pool and the required payout is deposited in or withdrawn from funds functioning as endowment. For the years ended August 31, 2006 and 2005, the results of the EFP, in thousands of dollars, are as follows:

	2006	2005
Total investment return of the EFP	$ 240,958	$ 256,654
Less distributions to fund holders and operations	(61,202)	(50,559)
AMOUNTS ADDED TO THE ENDOWMENT	**$ 179,756**	**$ 206,095**

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

To meet the Board-authorized payout rate, earned income and realized gains were distributed for operations in fiscal years 2006 and 2005, as follows, in thousands of dollars:

	2006	2005
Endowment income	$ 258,093	$ 184,102
Realized gains	276,641	267,857
APPROVED PAYOUT	**$ 534,734**	**$ 451,959**

The University utilizes derivatives and other strategies to reduce investment risk, to serve as a temporary surrogate for investment in stocks and bonds, or to achieve specific exposure to foreign currencies. The University's derivative positions include forward contracts, swaps, options and futures contracts. The net unrealized depreciation on these derivatives was $52,820,000 and $71,246,000 at August 31, 2006 and 2005, 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.

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, 2006 is as follows, in thousands of dollars:

YEAR	RENTAL INCOME
2007	$ 52,625
2008	47,420
2009	47,000
2010	44,556
2011	38,815
Thereafter	1,137,522
TOTAL	**$ 1,367,938**

6. Plant Facilities

Plant facilities at August 31, 2006 and 2005, in thousands of dollars, are as follows:

	2006			2005
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
Land and improvements	$ 268,951	$ 30,102	$ 299,053	$ 255,502
Buildings	2,771,609	634,785	3,406,394	3,169,699
Equipment, books and software	1,345,267	302,630	1,647,897	1,508,280
Construction in progress	191,499	225,644	417,143	273,058
Plant facilities	4,577,326	1,193,161	5,770,487	5,206,539
Less accumulated depreciation	(2,030,846)	(575,711)	(2,606,557)	(2,406,121)
PLANT FACILITIES, NET OF ACCUMULATED DEPRECIATION	**$ 2,546,480**	**$ 617,450**	**$ 3,163,930**	**$ 2,800,418**

At August 31, 2006, $905,000,000 of fully depreciated plant facilities were still in use.

7. Liabilities Under Security Agreements

At August 31, 2006 and 2005, the University held $599,191,000 and $580,789,000, 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 $59,005,000 and $51,166,000 at August 31, 2006 and 2005, respectively. These amounts are included as investments and liabilities in the University's financial statements. The estimated market value of securities on loan at August 31, 2006 and 2005, was $573,229,000 and $555,025,000, respectively. It is the University's policy to require receipt of collateral on securities lending contracts and repurchase agreements equal to a minimum of 102% of the fair market value of the security loaned.

8. University Notes and Bonds Payable

Notes and bonds payable at August 31, 2006 and 2005, in thousands of dollars, are as follows:

	YEAR OF MATURITY	EFFECTIVE INTEREST RATE 2006	OUTSTANDING PRINCIPAL 2006	OUTSTANDING PRINCIPAL 2005
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	3.3%	83,818	83,818
Series S	2039-2050	3.2% *	181,200	181,200
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	2015-2016	various	9,042	9,704
Variable Notes and Bonds:				
Stanford University Bonds PARS	2032	5.2%	50,000	50,000
Commercial Paper	2006	5.3% *	63,000	20,000
University notes and bonds payable			1,308,820	1,266,482
Discounts			(258)	(43)
TOTAL			**$ 1,308,562**	**$ 1,266,439**

*Exclusive of interest rate swaps.

At August 31, 2006 and 2005, the fair value of these debt instruments approximated their recorded value.

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, 2006, the University had swap agreements expiring November 1, 2039 to pay an interest rate of approximately 3.69% on $130,000,000 of the outstanding balance of the CEFA S auction rate bonds and swap agreements expiring through 2011 to pay an interest rate of approximately 6.04% on approximately $53,563,000 of the variable rate commercial paper.

The University incurred interest expense of approximately $65,352,000 and $59,383,000 for fiscal years 2006 and 2005, respectively, which is net of approximately $804,000 and $905,000, 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 $1,624,000 and $4,998,000 for fiscal years 2006 and 2005, 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, 2006 was $63,000,000. The weighted average days to maturity were 31.7 and the weighted average effective interest rate was 5.3% as of August 31, 2006.

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, 2006.

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

YEAR ENDING AUGUST 31	PRINCIPAL
2007 Commercial Paper	$ 63,000
2007 Other	715
2008	771
2009	50,833
2010	899
2011	50,972
Thereafter	1,141,630
TOTAL	**$ 1,308,820**

9. Hospitals Notes and Bonds Payable

Bonds and certificates of participation at August 31, 2006 and 2005, in thousands of dollars, are as follows:

	YEAR OF MATURITY	EFFECTIVE INTEREST RATE 2006	OUTSTANDING PRINCIPAL 2006	OUTSTANDING PRINCIPAL 2005
SHC:				
California Health Facilities Financing Authority (CHFFA) Bonds:				
1998 Series B Fixed Rate Bonds	2031	5.0%	$ 174,185	$ 177,430
2003 Series A Fixed Rate Bonds	2007-2023	2.0%-5.0%	100,000	100,000
2003 Series B, C and D Variable Rate Bonds	2036	3.20% *	150,000	150,000
2006 Series A Variable Rate Bonds	2040	3.23% *	260,300	-
2006 Series B Variable Rate Bonds	2045	3.33% *	168,200	-
LPCH:				
Variable Rate Certificates of Participation (Certificates)	2023	3.45% *	33,600	34,800
California Health Facilities Financing Authority (CHFFA):				
Auction Rate Revenue Bonds	2027-2033	2.93%	60,000	60,000
Fixed Rate Revenue Bonds	2013-2027	4.88%	55,000	55,000
Hospitals notes and bonds payable			1,001,285	577,230
Premiums			4,917	5,223
TOTAL			**$ 1,006,202**	**$ 582,453**

*Exclusive of interest rate swaps.

At August 31, 2006 and 2005 the fair value of these debt instruments approximated their recorded value.

In March 2006, the California Health Facilities Financing Authority (CHFFA) issued, on behalf of SHC, bonds in the aggregate principal amount of $428,500,000. The 2006 bonds were comprised of $260,300,000 of 2006 Series A Variable Rate Bonds that were issued as Series A-1, Series A-2 and Series A-3; and $168,200,000 of 2006 Series B Variable Rate Bonds that were issued as Series B-1 and Series B-2.

At August 31, 2006, SHC had swap agreements expiring through November 15, 2040 to pay an interest rate of approximately 3.365% on the 2003 Variable Rate Bonds, 3.73% on the 2006 Series A Variable Rate Bonds and 3.63% on the 2006 Series B Variable Rate Bonds based on an amount equal to the outstanding balance of the bonds.

At August 31, 2006, 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 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.

SHC and LPCH are each subject to separate Master Trust Indentures that 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 guarantors with respect to obligations of the University.

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

YEAR ENDING AUGUST 31	PRINCIPAL
2007	$ 8,300
2008	9,200
2009	9,135
2010	10,060
2011	10,450
Thereafter	954,140
TOTAL	**$ 1,001,285**

10. University Endowment

The University manages a substantial portion of its financial resources within its Endowment. These assets include pure endowment funds, endowed lands, term endowment funds and funds functioning as endowment. 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 and endowed lands 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 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.

The University's Endowment is intended to generate investment income that can be used to support the current operations of the University. During 2006, management reviewed the components of the Endowment and determined that funds subject to living trust agreements should be excluded from the Endowment, as they do not currently generate revenue that can be distributed for operations.

Changes in the University's Endowment, excluding pledges, for the years ended August 31, 2006 and 2005, in thousands of dollars, are as follows:

	2006	2005
ENDOWMENT, BEGINNING OF YEAR	$ 12,205,035	$ 9,922,041
Less living trust agreements	(321,500)	-
Endowment, beginning of year, as adjusted	11,883,535	9,922,041
INVESTMENT RETURNS:		
Earned endowment income	257,702	184,829
Unrealized and realized gains	1,940,801	2,082,917
Total investment returns	2,198,503	2,267,746
Amounts distributed for operations	(534,734)	(451,959)
Gifts	252,572	235,598
Funds invested in endowment	105,989	51,989
EFP returns invested in endowment	179,756	206,095
Other	(945)	(26,475)
Net increase in endowment	2,201,141	2,282,994
ENDOWMENT, END OF YEAR	**$ 14,084,676**	**$ 12,205,035**

11. 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, 2006 and 2005, per the statement of activities reconciled to the cash basis (as reported by OOD), in thousands of dollars:

	2006	2005
Current year gifts in support of operations	$ 167,700	$ 144,331
Expendable gifts invested in the endowment	3,215	5,512
Temporarily restricted - general	573,092	190,639
Temporarily restricted - capital	17,541	23,264
Permanently restricted - endowment	204,847	243,365
Permanently restricted - student loans	146	6
TOTAL PER STATEMENT OF ACTIVITIES	**966,541**	**607,117**
Adjustments to gift total as reported by OOD:		
New pledges	(542,319)	(300,016)
Payments made on pledges	286,447	203,903
Non-government grants, recorded as sponsored research support when earned	58,870	71,415
Pledge discounts and other adjustments	141,569	29,513
Other	55	(8,346)
TOTAL AS REPORTED BY OOD	**$ 911,163**	**$ 603,586**

Gifts restricted to particular purposes are used for those purposes subject to the University's restricted fund policy. Under this policy, 8% of the expenditure from restricted funds is allocated for space and infrastructure charge. Gifts for building projects and payout from endowments whose primary purpose is to fund financial aid, undergraduate research and tenure-line faculty salaries are exempt from the infrastructure charge. 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, 2006 and 2005 are categorized on a functional basis as follows, in thousands of dollars:

	2006	2005
UNIVERSITY:		
Organized research (direct costs)	$ 814,231	$ 809,781
Instruction and departmental research	878,124	811,341
Auxiliary activities	499,222	418,798
Administration and general	192,221	182,660
Libraries	137,514	126,281
Development	55,572	45,975
Student services	83,742	76,019
SLAC construction	74,360	27,950
	2,734,986	2,498,805
HOSPITALS:		
Health care services	1,477,537	1,342,677
TOTAL CONSOLIDATED EXPENSES	**$ 4,212,523**	**$ 3,841,482**

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

13. University Retirement Plans

The University provides retirement benefits through both contributory and noncontributory retirement plans for substantially all of its employees. The University also 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 $83,000,000 and $78,200,000 for the years ended August 31, 2006 and 2005, respectively.

DEFINED BENEFIT PENSION PLAN Retirement benefits for certain 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 the accumulated benefit obligation exceeds plan assets and accrued pension liabilities. The University had no minimum liability for 2006. For 2005, the University had a minimum liability of $13,149,000. The increase or decrease in the minimum liability is reported in other changes in unrestricted net assets.

POST RETIREMENT MEDICAL BENEFIT PLAN The University's employees may become eligible for post retirement medical 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.

The University uses June 30 as the measurement date to value the plan assets and the benefit obligation of the 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	
	2006	2005	2006	2005
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	$ 262,427	$ 242,880	$ 70,444	$ 56,624
Actual return on plan assets	30,963	28,739	4,102	5,911
Employer contributions	-	9,686	16,313	17,209
Plan participants' contributions	-	-	5,000	4,332
Benefits paid	(18,956)	(18,878)	(14,670)	(13,632)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	**$ 274,434**	**$ 262,427**	**$ 81,189**	**$ 70,444**
CHANGE IN PROJECTED BENEFIT OBLIGATION				
Benefit obligation at beginning of year	$ 282,486	$ 269,218	$ 328,847	$ 225,486
Service cost	5,425	5,306	10,257	6,862
Interest cost	14,288	15,474	16,966	13,155
Plan participants' contributions	-	-	5,000	4,332
Amendments	5,029	-	-	122,184
Actuarial (gain) loss	(20,494)	11,366	(83,347)	(29,540)
Benefits paid	(18,956)	(18,878)	(14,670)	(13,632)
BENEFIT OBLIGATION AT END OF YEAR	**$ 267,778**	**$ 282,486**	**$ 263,053**	**$ 328,847**
AMOUNTS RECOGNIZED IN CONSOLIDATED FINANCIAL STATEMENTS				
Plan assets minus projected benefit obligation	$ 6,656	$ (20,059)	$ (181,864)	$ (258,403)
Contributions after the measurement date	-	-	3,035	3,553
Unrecognized prior service cost	9,005	5,001	72,251	79,856
Unrecognized net actuarial (gain) loss	(11,809)	19,498	42,528	130,479
NET AMOUNT RECOGNIZED IN THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION	**$ 3,852**	**$ 4,440**	**$ (64,050)**	**$ (44,515)**
Prepaid (accrued) benefit liability	$ 3,852	$ (13,710)		
Intangible asset	-	5,001		
Minimum pension liability	-	13,149		
NET AMOUNT RECOGNIZED	**$ 3,852**	**$ 4,440**		
ACCUMULATED BENEFIT OBLIGATION	**$ 260,560**	**$ 276,137**		

Net benefit expense related to the Pension and Post Retirement Medical Benefit plans for the years ended August 31, 2006 and 2005, in thousands of dollars, includes the following components:

	PENSION		POST RETIREMENT MEDICAL	
	2006	2005	2006	2005
Service cost	$ 5,425	$ 5,306	$ 10,257	$ 6,862
Interest cost	14,288	15,474	16,966	13,155
Expected return on plan assets	(20,150)	(19,175)	(5,636)	(4,530)
Amortization of prior service cost	1,025	1,025	7,605	(5,291)
Recognized net actuarial losses	-	-	6,138	9,195
NET PERIODIC BENEFIT EXPENSE	**$ 588**	**$ 2,630**	**$ 35,330**	**$ 19,391**

ACTUARIAL ASSUMPTIONS The weighted average assumptions used to determine the benefit obligations for the Pension and Post Retirement Medical Benefit plans are shown below:

	PENSION		POST RETIREMENT MEDICAL	
	2006	2005	2006	2005
Discount rate	6.25%	5.25%	6.25%	5.25%
Covered payroll growth rate	5.52%	5.52%	N/A	N/A

The weighted average assumptions used to determine the net periodic benefit cost for the Pension and Post Retirement Medical Benefit plans are shown below:

	PENSION		POST RETIREMENT MEDICAL	
	2006	2005	2006	2005
Discount rate	5.25%	6.00%	5.25%	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 for the Pension and Post Retirement Medical Benefit plans, 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, 2006, a 10% annual rate of increase in the per capita costs of covered health care was assumed for 2007-2008, declining gradually to 5% by 2012 and remaining at this rate thereafter. For covered dental plans, a 6.5% annual rate of increase was assumed for 2007-2008, declining to 5% by 2009 and remaining at this rate thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated post retirement medical benefit obligation by $39,866,000 and the aggregate annual service and interest cost by $5,072,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post retirement medical benefit obligation by $32,490,000 and the aggregate annual service and interest cost by $4,015,000.

PLAN ASSETS Asset allocations by asset category at June 30 are as follows:

	PENSION		POST RETIREMENT MEDICAL	
	2006	2005	2006	2005
ASSET CATEGORY				
Domestic equity	29%	54%	-	69%
International equity	9%	18%	-	-
Fixed income	26%	15%	85.7%	23%
Short term investments	20%	-	-	-
Real estate	15%	12%	14.3%	4%
Other	1%	1%	-	4%
TOTAL PORTFOLIO	100%	100%	100%	100%

The weighted-average target asset allocation for the Pension plan is 45% equity and 55% fixed income. For the Post Retirement Medical Benefit plan the weighted-average target asset allocation is 38% domestic equity, 37% international equity and 25% fixed income. These target asset allocations are meant to result in a favorable long-term rate of return from a diversified portfolio. The Pension and Post Retirement Medical Benefit plans moved their assets to a new investment manager on September 1, 2006. In preparation for the transition, certain investments were liquidated, causing actual asset allocations to differ significantly from target allocations at June 30, 2006.

EXPECTED CONTRIBUTIONS No contributions are expected to be made to the Pension plan for the fiscal year ending August 31, 2007. The University expects to contribute $17,240,000 to its Post Retirement Medical Benefit plan during the fiscal year ending August 31, 2007.

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:

		POST RETIREMENT MEDICAL	
FISCAL YEAR	PENSION PLAN	EXCLUDING MEDICARE SUBSIDY	WITH MEDICARE SUBSIDY
2007	$ 21,990	$ 11,673	$ 10,543
2008	19,923	12,762	11,472
2009	19,804	13,969	12,539
2010	20,672	15,251	13,680
2011	21,421	16,415	14,691
2012 - 2016	98,444	98,820	93,156

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 based on a percentage of participant annual compensation. Employer contributions to this plan amounted to approximately $38,013,000 and $33,241,000 for the years ended August 31, 2006 and 2005, respectively.

DEFINED BENEFIT PLANS Certain employees of the Hospitals are covered by a noncontributory, defined benefit pension plan (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.

A minimum liability adjustment is required when the actuarial present value of the accumulated benefit obligation exceeds plan assets and accrued pension liabilities. The Hospitals had a minimum liability of $3,593,000 and $37,055,000 for 2006 and 2005, respectively. The increase or decrease in the minimum liability is reported in other changes in unrestricted net assets.

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 statements of financial position.

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	
	2006	2005	2006	2005
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	$ 123,886	$ 116,516	$ -	$ -
Actual return on plan assets	13,469	9,956	-	-
Employer contributions	10,690	3,015	3,982	3,803
Benefits paid	(7,321)	(5,601)	(3,982)	(3,803)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	**$ 140,724**	**$ 123,886**	**$ -**	**$ -**
CHANGE IN PROJECTED BENEFIT OBLIGATION				
Benefit obligation at beginning of year	$ 181,797	$ 151,104	$ 67,719	$ 74,663
Service cost	2,144	1,848	1,954	2,134
Interest cost	9,374	9,286	3,298	4,327
Amendments	-	-	-	(6,787)
Actuarial (gain) loss	(28,432)	25,160	(492)	(2,815)
Benefits paid	(7,321)	(5,601)	(3,982)	(3,803)
BENEFIT OBLIGATION AT END OF YEAR	**$ 157,562**	**$ 181,797**	**$ 68,497**	**$ 67,719**
AMOUNTS RECOGNIZED IN CONSOLIDATED FINANCIAL STATEMENTS				
Plan assets minus projected benefit obligation	$ (16,838)	$ (57,911)	$ (68,497)	$ (67,719)
Contributions made after measurement date	-	618	-	-
Estimated net benefit payments	-	-	705	582
Unrecognized prior service cost	-	-	(4,253)	(5,087)
Unrecognized net actuarial loss	9,188	43,763	115	667
NET AMOUNT RECOGNIZED IN THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION	**$ (7,650)**	**$ (13,530)**	**$ (71,930)**	**$ (71,557)**
Accrued benefit liability	$ (12,092)	$ (51,203)		
Prepaid benefit liability	849	-		
Contributions after the measurement date	-	618		
Minimum pension liability	3,593	37,055		
NET AMOUNT RECOGNIZED	**$ (7,650)**	**$ (13,530)**		
ACCUMULATED BENEFIT OBLIGATION	**$ 152,503**	**$ 175,089**		

Net benefit expense related to the plans for the years ended August 31, 2006 and 2005, in thousands of dollars, includes the following components:

	PENSION		POST RETIREMENT MEDICAL	
	2006	2005	2006	2005
Service cost	$ 2,144	$ 1,848	$ 1,954	$ 2,134
Interest cost	9,374	9,286	3,298	4,327
Expected return on plan assets	(9,729)	(9,161)	-	-
Amortization of prior service cost	-	-	(834)	39
Recognized net actuarial losses	2,403	335	60	582
NET PERIODIC BENEFIT EXPENSE	**$ 4,192**	**$ 2,308**	**$ 4,478**	**$ 7,082**

ACTUARIAL ASSUMPTIONS The weighted average assumptions used to determine the benefit obligations for the Pension and Post Retirement Medical Benefit plans are shown below:

	PENSION		POST RETIREMENT MEDICAL	
	2006	2005	2006	2005
Discount rate	6.49 - 6.53%	5.25%	6.42%	5.00%
Covered payroll growth rate	5.50%	5.50%	N/A	N/A

The weighted average assumptions used to determine the net periodic benefit cost for the Pension and Post Retirement Medical Benefit plans are shown below:

	PENSION		POST RETIREMENT MEDICAL	
	2006	2005	2006	2005
Discount rate	5.25%	6.25%	5.00%	5.75%
Expected return on plan assets	3.00 - 8.00%	3.00 - 8.00%	N/A	N/A
Covered payroll growth rate	5.50%	5.50%	N/A	N/A

To develop the expected long-term rate of return on assets assumptions, 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.

To determine the accumulated post retirement medical benefit obligation as of June 30, 2006, an 11.3% annual rate of increase in the pre-65 per capita costs, a 12.5% annual rate of increase in the post-65 prescription drug per capita costs and a 10% rate of increase in the post-65 per capita cost of all other medical benefits were assumed for 2006-2007, declining gradually to 5% by 2011-2014 and remaining at this rate thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated post retirement medical benefit obligation by $2,338,000 and the aggregate annual service and interest cost by $205,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post retirement medical benefit obligation by $2,107,000 and the aggregate annual service and interest cost by $186,000.

PLAN ASSETS Asset allocations by asset category at June 30 are as follows:

	PENSION	
ASSET CATEGORY	2006	2005
Equity securities	67%	70%
Fixed income	22%	22%
Real estate	11%	8%
TOTAL PORTFOLIO	100%	100%

The weighted-average target asset allocation of 62% equity securities, 30% fixed income, 8% real estate and less than 1% cash and cash equivalents is meant to result in a favorable long-term rate of return from a diversified portfolio.

EXPECTED CONTRIBUTIONS The Hospitals expect to contribute $1,152,000 and $4,379,000 to their Pension plan and Post Retirement Medical Benefit plan, respectively, during the fiscal year ending August 31, 2007.

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:

		POST RETIREMENT MEDICAL	
FISCAL YEAR	PENSION PLAN	EXCLUDING MEDICARE SUBSIDY	WITH MEDICARE SUBSIDY
2007	$ 6,884	$ 4,672	$ 4,379
2008	7,339	5,088	4,743
2009	7,858	5,452	5,046
2010	8,427	5,825	5,351
2011	9,024	6,241	5,701
2012 - 2016	55,988	36,378	32,651

15. Operating Leases

The University and the Hospitals lease certain equipment and facilities under operating leases expiring at various dates. Total rental expense under these leases for the years ended August 31, 2006 and 2005 was $29,760,000 and $29,732,000, respectively, for the University and $35,990,000 and $32,173,000, respectively, for the Hospitals.

Net minimum future operating lease payments and related present value assuming a 5.25% discount rate for periods subsequent to August 31, 2006, in thousands of dollars, are as follows:

	MINIMUM LEASE PAYMENTS		PRESENT VALUE OF MINIMUM LEASE PAYMENTS	
YEAR ENDING AUGUST 31	UNIVERSITY	HOSPITALS	UNIVERSITY	HOSPITALS
2007	$ 18,807	$ 28,751	$ 18,363	$ 28,072
2008	14,646	24,231	13,587	22,479
2009	14,688	20,974	12,947	18,487
2010	12,312	17,698	10,311	14,821
2011	9,825	15,002	7,817	11,937
Thereafter	56,055	58,394	40,250	41,930
TOTAL	**$ 126,333**	**$ 165,050**	**$ 103,275**	**$ 137,726**

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 indirectly, with companies doing business with the University. For senior management, the University requires annual disclosure of significant financial interests in, or employment or consulting relationships with, entities doing business with the University. These annual disclosures cover both senior management and their immediate family members. When such relationships exist, measures are taken to appropriately manage the actual or perceived conflict in the best interests of the University. The University has a written conflict of interest policy that requires, among other things, that no member of the Board of Trustees can participate in any decision in which he or she (or an immediate family member) has a material financial interest and requires each trustee to certify compliance with the conflict of interest policy on an annual basis if the University does business with an entity in which a trustee has a material financial interest. When such relationships exist, measures are taken to mitigate any actual or perceived conflict, including requiring that such transactions be conducted at arm's length, for good and sufficient consideration, based on terms that are fair and reasonable to and for the benefit of the University, and in accordance with applicable conflict of interest laws. No such associations are considered to be significant.

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 and 51% 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 outcome cannot be determined at this time, management is of the opinion that the liability, if any, resulting from these legal actions will not have a material adverse effect on the University's consolidated financial position.

CONTRACTUAL COMMITMENTS At August 31, 2006, the University had contractual obligations of approximately $55,822,000 in connection with major construction projects. Remaining expenditures on construction in progress are estimated to be $188,167,000, which will be financed with certain unexpended plant funds, gifts and debt. At August 31, 2006, the remaining commitment on contracts for the construction and remodeling of Hospital facilities was approximately $65,769,000.

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, 2006, the aggregated amount of such unfunded commitments was $5,727,143,000.

GUARANTEES AND INDEMNIFICATIONS The University (including the Hospitals) enters into mutual indemnification agreements in the normal course of its business. The impact of these agreements is not expected to be material. As a result, no liabilities related to guarantees and indemnifications have been recorded as of August 31, 2006.

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, 2006 and 2005, 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 15, 2006

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.

M. Suzanne Calandra

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

M. SUZANNE CALANDRA
Controller
Stanford University

David R. Ebel

DAVID R. EBEL
Interim Chief Financial Officer
Stanford Hospital and Clinics

TIMOTHY W. CARMACK
Chief Financial Officer
Lucile Salter Packard Children's Hospital

Report from the Stanford Management Company

The Stanford Management Company (SMC) was established in 1991 and manages Stanford's financial 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 $18.0 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 $15.3 billion as of June 30, 2006. MEP performance measurements are calculated on the 12 months ended June 30, 2006, to facilitate the comparison of returns with results of other endowments and foundations. The following discussion of endowment performance relates solely to investments in the MEP. The MEP generated a 19.5% investment return for the 12 months ended June 30, 2006. Over the past 10 years, the MEP achieved an annualized rate of return of 14.8%, growing from $3.6 billion to $15.3 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, Cambridge Associates.

SMC, with assistance from its board, actively manages the MEP, 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. The portfolio is designed to optimize long-term returns, create consistent annual payouts to the University's operating budget and preserve purchasing power for future generations of Stanford faculty and students.

During the 12 months ended June 30, 2006, the S&P 500 Stock Index was up 8.6% and the Lehman Aggregate U.S. Bond Index was down 0.8%. The MEP's 19.5% return was driven by a diverse set of assets that performed well during this period, including International Equities, Private Equity and Natural Resources. Most pronounced over this period was the substantial movement in Natural Resources and International Equities. The year began with a barrel of oil costing $57, and it finished with a barrel of oil costing $74—an increase of 30%. The Natural Resources asset class within the MEP returned 61% for the year as the MEP realized gains on a number of investments made in prior years in an environment of substantially lower commodity prices. Despite the surge in commodity prices, the U.S. economy performed well and inflation expectations and interest rates remained in check, with market volatility near historic lows. Over this period, as the Federal Reserve moved its Federal Funds Target Rate from 3.25% to 5.25%, the yield on longer-duration fixed income instruments remained stable. This was, in part, due to the volume of international capital flowing into the United States.

During FY 2006, Stanford Management Company worked through significant organizational change, both at the senior management level and within the individual asset classes. The strong performance of the MEP is both a testimony to former CEO Mike McCaffery and CIO Mike Ross and their team, as well as an important reminder of the power of a patient, long-horizon investment model. For a perpetual pool of capital, three-year annualized performance should be regarded as the minimum period upon which a meaningful review of recent MEP results can be conducted. Since June 30, 2003, the MEP annualized performance of 19.0% places Stanford in the top 4% 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. We are excited to inherit a very strong portfolio, and motivated by the opportunity to make the investments in research, team, processes and risk management to continue the strong performance of the MEP.

STANFORD MEP ASSET ALLOCATION Given the perpetual nature of the University, SMC's investment horizon is 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.

In fact, this broad-based strength of performance came about in an extremely benign interest rate environment, and tight credit spreads supported continued economic expansion in the United States, even in the face of rising energy prices. Inexpensive credit supported the robust private equity industry and gains in domestic real estate. International markets continued to reflect slow recovery in Europe and rapid economic expansion in Asia, as China and India continued to grow their economies at a rapid rate. The common theme was that inexpensive credit lubricated the world's markets to an unusual degree. We expect to look back to this period as a rare period where positive returns were achieved across nearly every asset class.

The strategic asset allocation targets for the MEP as of June 30, 2006, 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%

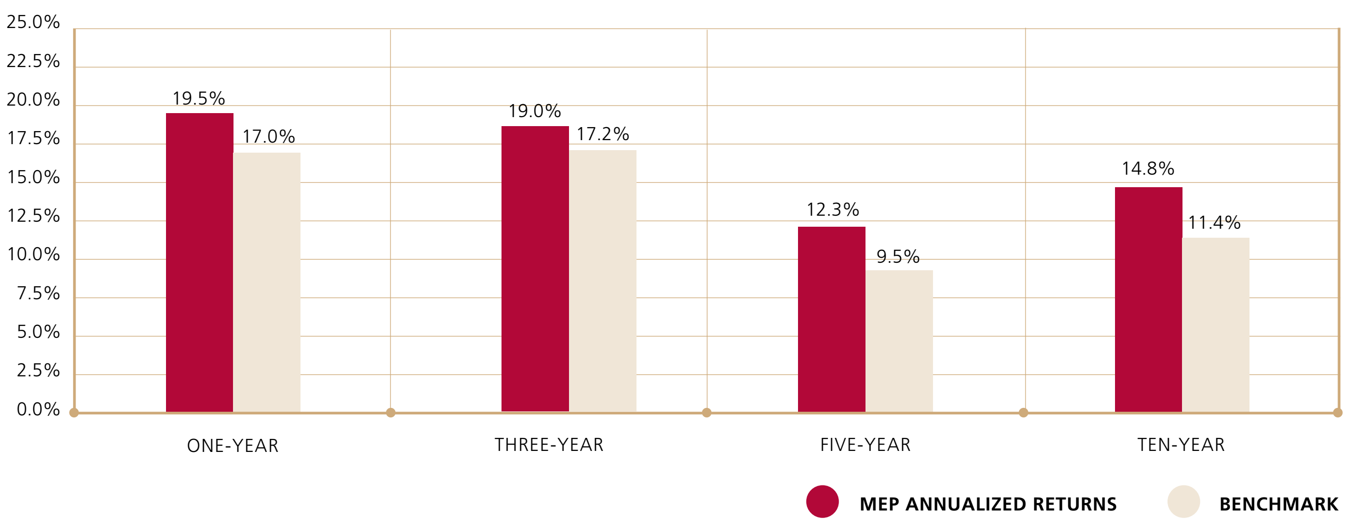
STANFORD MEP PERFORMANCE COMPARED TO INFLATION The table below outlines annualized returns for various periods ending June 30, 2006, and illustrates the performance of the MEP in a long-term context. Stanford's objective is to return a minimum of 6.25% over the rate of inflation. If this real return target is achieved over time, the value of the MEP will be maintained, net of annual payouts to support operating activities. Over the past one-, three-, 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	19.5%	19.0%	12.3%	14.8%
GDP Deflator	3.3%	3.0%	2.5%	2.1%
Real Endowment Return	16.2%	16.0%	9.8%	12.6%

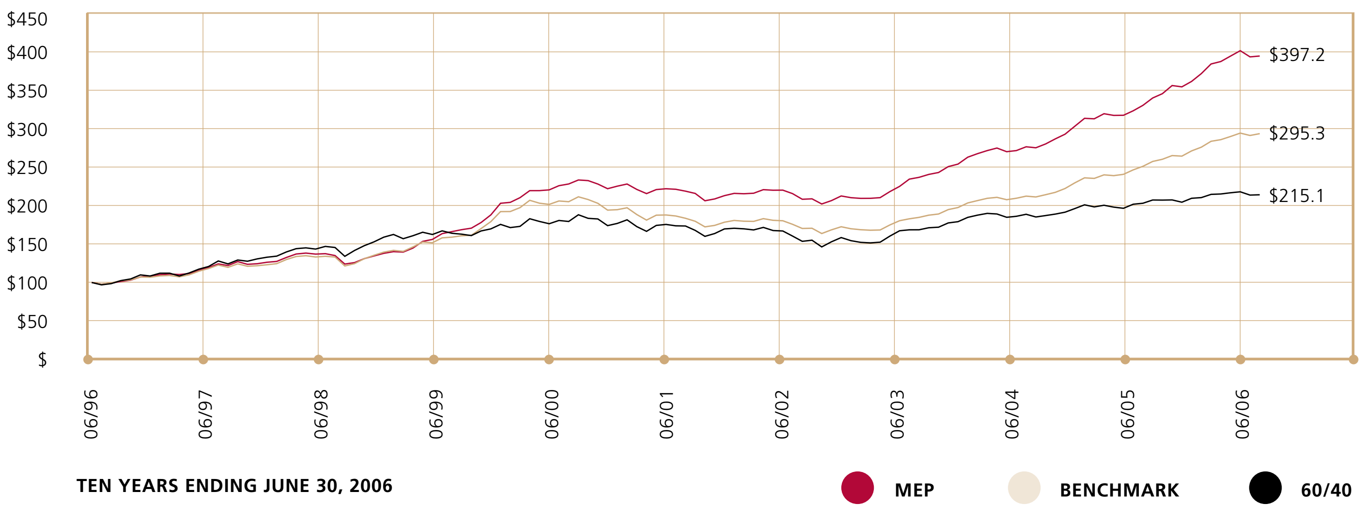
STANFORD MEP PERFORMANCE COMPARED TO BENCHMARKS SMC evaluates the performance of investment managers by comparing their returns to benchmarks that are appropriate for each individual asset class. SMC may alter an asset class benchmark to allow for a change in investment style, a shift in mix within an 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, 2006.

STANFORD MEP vs. STANFORD COMPOSITE BENCHMARK



SMC's effectiveness in implementing its investment strategies through top-level 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 MEP with that of the composite benchmark over the past 10 years. The MEP performance advantage (relative to benchmark returns) attributable to active manager selection has added in excess of $3.5 billion to the value of the MEP 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.

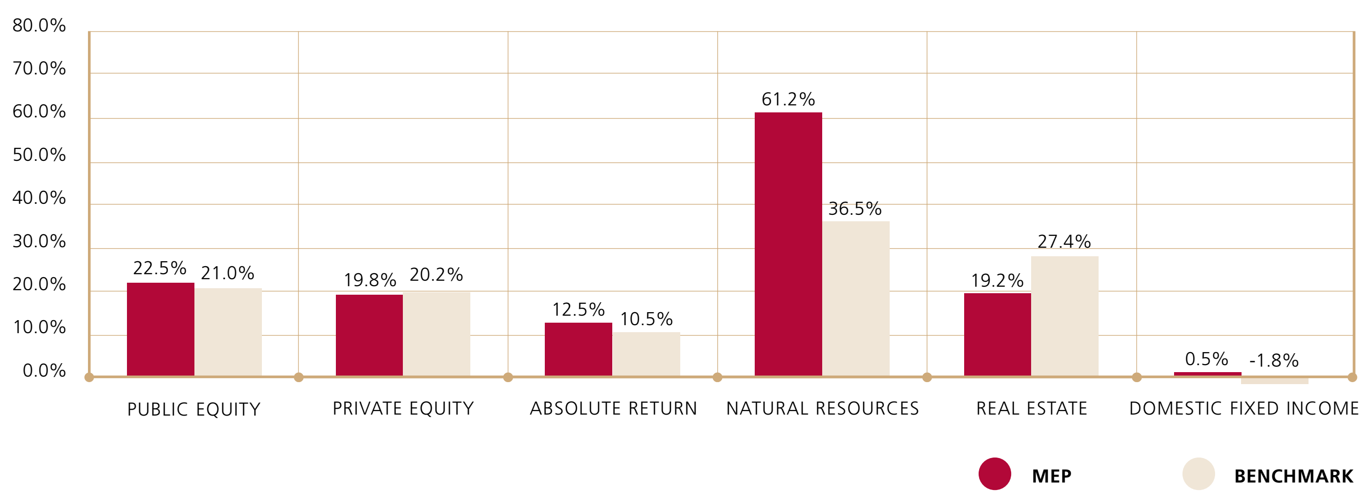
STANFORD MEP vs. STANFORD COMPOSITE BENCHMARK vs. PASSIVE 60% EQUITY/40% BOND COMPOSITE



Relative performance of the MEP versus its benchmark was strong for the one-year period with an overall portfolio alpha (return over benchmark) of 2.5%. The alpha was driven primarily by outperformance in the Natural Resources and Public Equity asset classes. Total return in most asset classes was strong for the year, as all asset classes, save fixed income, exhibited double-digit annual returns.

INDIVIDUAL ASSET CLASS PERFORMANCE The performance of individual asset classes for the 12 months ended June 30, 2006, relative to each asset class benchmark, is illustrated in the graph below:

STANFORD MEP ONE-YEAR ASSET CLASS RETURNS vs. BENCHMARK



Stanford's Public Equity portfolio benefited from its substantial exposure to the 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 a more consistent history of delivering high return on equity to shareholders. We continue to 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 superior relative performance.

Private Equity performance was achieved primarily by returns generated by our buyout managers; the liquidity in the financing markets, coupled with the increasing amount of private equity capital available, drove strong exits in this asset class. Our increasing exposure to growth equity in emerging markets also contributed to the overall performance.

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 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. Since inception, venture capital investment gains have added more than $2 billion to the value of the MEP. 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, emerging markets, distressed debt, fixed income relative value and multi-strategy arbitrage funds. One-year results for the period ended June 30, 2006, demonstrate the successful execution of all of these strategies. As with the previous year ended June 30, 2005, we maintained a particular focus on distressed debt investing, which continued to perform well. SMC remains committed to a well-diversified Absolute Return portfolio, but is cautious about the current environment due to substantial increases in capital commitments from institutional investors into many hedge fund investment strategies.

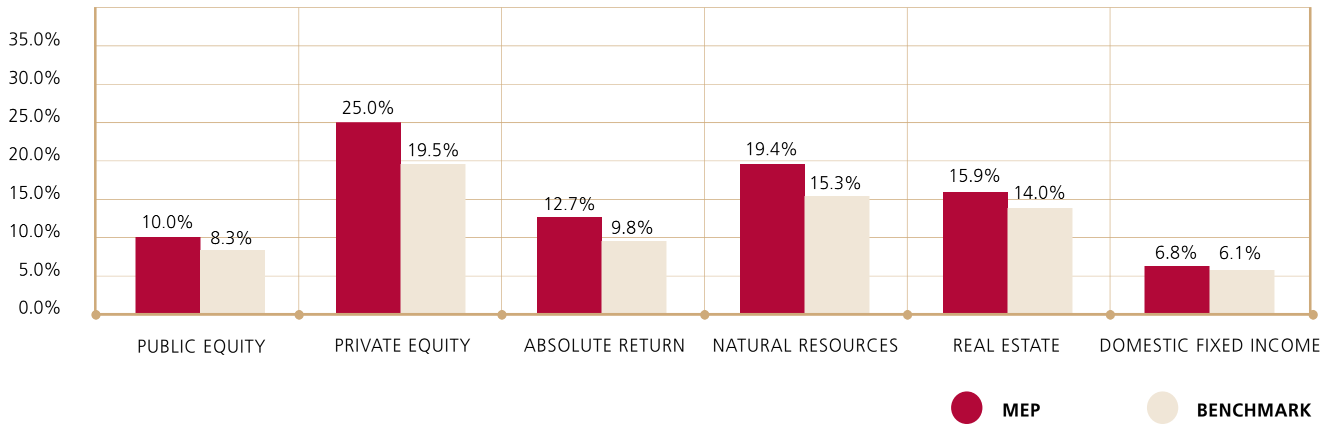
Driven by appreciating commodity prices, the Natural Resources portfolio continued to deliver extremely strong returns. SMC holds a diverse portfolio of outstanding managers in the oil, gas, energy and timber industries.

Stanford's endowment historically has had 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 MEP's global Real Estate portfolio created strong returns through value-added activities and the continued demand for well-positioned assets.

The Fixed Income asset class continued to face a challenging, low-interest rate environment. With the yield on 10-year Treasury bonds hovering in the 4.0–5.0% range, low volatility and tight credit spreads, we see limited total return opportunities available in bonds. Ten-year Treasury yields rose about 120 bps, depressing returns associated with benchmark-oriented funds.

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



In closing, we are honored and excited by the opportunity to lead this organization and manage the University's investment assets. We are committed to maintaining the Management Company's long tradition of strong, risk-adjusted returns over long time horizons. The endowment is invested with a solid roster of diverse investment managers and measured portfolio tilts. We believe it is well-positioned to serve Stanford's long-term funding requirements and growth objectives, even as we begin to implement our vision of SMC's style and direction.

We are pleased with the portfolio's 12-month return of 19.5%, but remain more focused and satisfied with the portfolio's three-year and five-year annual returns of 19.0% and 12.3%, respectively. 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.

John F. Powers
President and Chief Executive Officer
Stanford Management Company

Eric B. Upin
Chief Investment Officer
Stanford Management Company

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