# Stanford

BUILDING FOR THE NEW CENTURY

# Annual Report 2007

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## STANFORD FACTS

ENROLLMENT (October 2007):
- Undergraduate Students: 6,759
- Graduate Students: 8,186

DEGREES AWARDED (2006–07):
- Bachelor's: 1,709
- Master's: 2,131
- Professional: 249
- Doctoral: 720

THE STANFORD PROFESSORIATE (December 2007): 1,829

NOBEL LAUREATES: 16

PULITZER PRIZE WINNERS: 4

MACARTHUR FELLOWS: 23

NATIONAL MEDAL OF SCIENCE WINNERS: 20

NATIONAL MEDAL OF TECHNOLOGY WINNERS: 2

AMERICAN ACADEMY OF ARTS AND SCIENCES MEMBERS: 239

NATIONAL ACADEMY OF SCIENCES MEMBERS: 132

NATIONAL ACADEMY OF ENGINEERING MEMBERS: 85

AMERICAN PHILOSOPHICAL SOCIETY MEMBERS: 41

NATIONAL ACADEMY OF EDUCATION MEMBERS: 28

WOLF FOUNDATION PRIZE WINNERS: 7

KORET FOUNDATION PRIZE WINNERS: 6

PRESIDENTIAL MEDAL OF FREEDOM RECIPIENTS: 3

ON THE COVER: The new Jerry Yang and Akiko Yamazaki Environment and Energy Building reflects Stanford's commitment to sustainable design and construction. It uses 56 percent less energy than a comparable but traditional structure and 30 percent less potable water. Photos by Linda A. Cicero of the Stanford News Service.

# Building for the New Century

Throughout Stanford's history, its presidents have reflected on the question of what a university should be. This year marks my 30th year at Stanford University — as professor, dean, provost and for the past seven years as president. That milestone has prompted me to reflect on the course of our history, on the advances of the past 50 years and on the possibilities ahead.

*President John Hennessy*

When Jane and Leland Stanford founded this University, they were investing in the future. They were seeing "a hundred years ahead" and thinking differently about what might be possible. They defined this university's mission in the Founding Grant: to be a "University of high degree" and to prepare its graduates to become effective and productive citizens.

Fifty years ago the University was a small institution whose reputation hardly extended beyond the West Coast. The teaching-focused medical school was in San Francisco. Research expenditures and graduate programs were tiny, with less than $6 million in government-sponsored research and about 3,000 graduate students. The entire budget of the University was less than $16 million, or just over 3 percent (in real dollars) of the 2007–08 budget. California was a farming economy; Fairchild Semiconductor, the world's first semiconductor company, had just started in 1957 and Hewlett-Packard had just had its IPO and would post record revenues that year of $28 million, or about $200 million in today's dollars. Companies like Intel, Cisco and Yahoo! were not even dreams. And, while World War II had certainly banished the ardor for strict isolationism as a viable U.S. strategy, the United States still remained largely decoupled from the rest of the world economically and culturally.

Over the course of the last half-century the world, California and Stanford have been transformed. Stanford University has become one of the world's leading research and teaching institutions. The medical school moved to the core campus, expanded its basic science departments and became one of the great medical schools in the country. The Stanford Linear Accelerator was built and became the tool that explained the role of quarks as the constituents of atomic particles; the seminal research conducted there led to three Nobel Prizes. Research support grew by more than a factor of 25 in real dollars, and the graduate student population doubled. California, whose population more than doubled, became the center of the technological world. And globalization linked us inexorably with peoples around the world, economically, environmentally and culturally.

These rapid and ongoing changes are leading us to think deeply about the role of the University in this new century. What is the responsibility of the 21st-century university in helping to meet the challenges generated by a more complex, rapidly changing and highly interconnected world? How can we prepare today's generation of students for the roles they must assume in tomorrow's world?

The farsighted leadership of President Sterling and Provost Terman 50 years ago paved the way for Stanford's rise to international prominence at the end of the 20th century. Similarly, our willingness to proactively address the research and educational challenges of the 21st century will determine if Stanford will be a leader 50 years in the future. In this introduction, I want to highlight five ways in which Stanford is evolving to ensure that it remains a leader.

FIRST, we are increasingly looking outward as we develop new research and teaching programs. This shift is driven by our view that universities are the primary institutions that can produce the new discoveries and inventions that can help address global challenges such as sustaining our environment, improving human health and increasing peace, security and economic prosperity around the world. Traditionally, society has relied on universities to produce an educated workforce, and research universities have always contributed to our knowledge base. With the dramatic changes in government and industry leading to a smaller investment by them in long-term research, universities must play a larger role as the source for innovation.

Our research initiatives in human health, the environment and sustainability, and international peace and security utilize more collaborative approaches to conduct research across disciplines and schools. "Expanding Stanford's Contributions to Solving Global Challenges" details many of these innovations and advances made by our scholars and researchers over the past year.

This is not to say that all our research must be driven to find an immediate application or solution to a problem. The role of basic research motivated by a desire to understand nature or the human condition is also critical. In 1980, when Stanford Professor Paul Berg received the Nobel Prize in chemistry for his pioneering research on nucleic acids, he said, "I have the conviction, absolutely unshakeable, that what we learn is going to be useful. It may take a generation or so, but what we are finding out will fit into the great puzzles." Less than a generation later, his discoveries and insights have helped improve human health. The University in the 21st century must continue to value and support contributions to basic research. Stanford's ongoing commitment to advancing basic research is featured in "Research Highlights."

> "We are building for this new century an institution from which the light of original research blazes."

SECOND, Stanford, like other great universities of this century, is becoming increasingly global in outlook. This is affecting both our research and teaching. How can the University contribute to prosperity and sustainable development in underprivileged parts of the world? How do we balance the preservation of our ecosystem with increased demands on natural resources in developing countries? How should we best prepare our students for a world where so many aspects of their lives will be global and will require frequent interaction with people around the world? Clearly, one-on-one experiences through overseas studies as well as interactions with international students on campus will continue to be crucial. Increasingly, we see globalization as a theme that affects our teaching and research activities across the campus.

THIRD, our research and teaching are becoming increasingly multidisciplinary. Simply put, the complex problems we seek to address in our research and the challenges of preparing students for the 21st century demand a different approach. The research problems we face require a collaborative approach among scholars from different disciplines. Educating students to be leaders in a global, complex and fast-moving world demands that we help them understand knowledge and master skills from different disciplines.

Our work on K–12 education provides a good example. In 1983, the National Science Board set a goal for pre-college students in the United States to be "the best in the world by 1995" in science and math. Twenty years later, we not only failed to achieve this goal, we actually fell further behind comparatively. The 2003 Trends in International Mathematics and Science Study determined that secondary students in the United States scored in the bottom third of 26 OECD countries in math and in the bottom half in science.

Addressing these challenges of educating our youth to be world leaders in science and math will not be easy. Working together, pedagogical experts from education and subject matter experts can help us to understand how to develop good teachers in science and math and how to improve student learning. It is vital that we determine how to effectively implement change in our K–12 system and measure the effectiveness of our changes. Theory and practice must be brought together to address the challenges that are faced every day in the classroom.

FOURTH, we are improving the way we educate students to prepare them for leadership roles in the 21st century. Obviously, a key part of this education is more exposure to global issues, both through curriculum and personal experiences. Our plans also include extensive enhancements and redesign of graduate education through curriculum development in the professional schools, the creation of new joint degree programs and the establishment of new leadership courses available to students throughout the University.

Developing specific skills is not, however, sufficient; we also must increase the ability of students to think creatively. Here the arts and humanities play a key role, both as the basis of a liberal undergraduate education and through new opportunities created for graduate students. The Arts Initiative is one of several key components aimed at increasing the capacity for creative thinking.

FIFTH, sustainability must become a core value in everything we do. We already have made great progress in creating research programs aimed at improved sustainability, as well as reducing our day-to-day impact on our environment. As a community we are committed to developing our core campus in a sustainable fashion that preserves what we cherish, that demonstrates leadership in the University's commitment to be a good environmental steward and that safeguards the ability for future generations to thrive at Stanford. "Reaffirming Stanford's Original Master Plan" describes how we are developing our campus to include new and renovated facilities that incorporate the best sustainability practices while maintaining what is special and unique about this place.

This is a pivotal moment in our University's history, a time in which we can make a difference in shaping our world for the better. The large, complex problems we are tackling require broad and deep excellence in many disciplines. Pursuing these goals over the past seven years already has made Stanford a leader among its peers. Nonetheless, the road before us is long, and we will need continued leadership and innovation by our faculty and students and the support and encouragement of our alumni, parents and friends.

At the beginning of the last century, Stanford's first president, David Starr Jordan, anticipated the importance of integrating research with teaching and of students learning from scholars committed to and actively involved in research. He explained to the Class of 1908:

"The real university is a school of research. A true university is not a collection of colleges. It is not a college with an outer fringe of professional schools. It is not a cluster of professional schools. It is an association of scholars. It is the institution from which in every direction blazes the light of original research."

The search for new knowledge renews and rejuvenates the University. The Stanford Challenge — the challenge of this century — draws upon the synergy of our combined teaching and research missions. I believe we are on the right path, and as demonstrated in the pages that follow, we are making significant progress. We are building for this new century an institution from which the light of original research blazes.

# Expanding Stanford's Contributions to Solving Global Challenges

## MULTIDISCIPLINARY INITIATIVES TRANSFORM THE UNIVERSITY

Stanford is transforming itself through multidisciplinary initiatives in human health, the environment and sustainability, and international affairs to expand the University's role in contributing solutions to global challenges. Stanford also is piloting programs focused on improving K–12 education, increasing the role of the arts in the education of our students and enhancing graduate education.

**Initiative on Human Health**

The Initiative on Human Health promotes collaboration among life scientists, medical scientists, engineers, physicists and computer scientists to facilitate discovery and expedite translation of those discoveries from the laboratory to the patient's bedside.

Among the researchers whose work exemplifies the initiative's goals is Howard Chang, assistant professor of dermatology. Chang and his colleagues reported this year that they are using radiology scans to help doctors avoid biopsies and still obtain molecular details of skin tumors or diseases. Their work combines dermatology, radiology, genomics and computational biology.

Neurobiologist Carla Shatz was appointed in 2007 to head the Stanford Program for Bioengineering, Biomedicine and Biosciences (Bio-X), one of five components of the initiative. Shatz has been cited for leadership in

*Carla Shatz, professor of biological sciences and neurobiology, directs Stanford's Bio-X program.*

developing research programs, contributions to understanding the relationship between brain development and the immune system and breaking ground for women in science.

Other components of the initiative include the Institute for Stem Cell Biology and Regenerative Medicine, which received more than $33 million from Stanford alumnus Lorry Lokey for a stem cell research facility. Stanford researchers were awarded more than $41 million from the California Institute for Regenerative Medicine, the largest amount received by any institution.

*January*

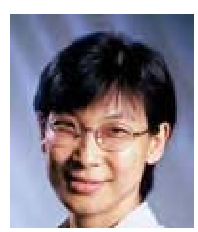
The Institute of Electrical and Electronics Engineers announces that Thomas Kailath, professor emeritus of electrical engineering, will receive the Medal of Honor—its highest award.

Stanford is one of four schools earning an "A-" in the first report card on greening practices and endowment policies in the United States and Canada, issued by a Massachusetts research institute.

President John Hennessy announces a new fund to stimulate multidisciplinary research among faculty in the humanities.

*February*

The University commits $5 million in financial aid to ease the burden on middle-income families.



The National Academy of Engineering elects four electrical engineering professors to membership: Robert Gray, Mark Horowitz, Teresa Meng (above) and Sebastian Thrun.

University trustee Jerry Yang and his wife, Akiko Yamazaki, both Stanford graduates, pledge $75 million for multidisciplinary programs, the bulk to be committed to the new Environment and Energy Building, renamed in their honor.


*Chris Field, Terry Root, Stephen Schneider and Thomas Heller are among the scientists from around the world who contributed to the United Nations' Intergovernmental Panel on Climate Change, which shared the 2007 Nobel Peace Prize with former Vice President Al Gore.*

The Stanford Cancer Center, also part of the initiative, received designation in 2007 from the National Cancer Institute as a cancer center, recognizing the broad nature of Stanford's excellence, from basic cancer biology to new therapies.

## Initiative on the Environment and Sustainability

The Jerry Yang and Akiko Yamazaki Environment and Energy Building, focus of the Initiative on the Environment and Sustainability, sets a standard for eco-friendly construction. The building—called Y2E2—is the new 166,000-square-foot home of the Woods Institute for the Environment, the Department of Civil and Environmental Engineering, the Precourt Institute for Energy Efficiency and other environmental programs.

The building, which will be dedicated in 2008, reflects the objectives of the initiative in its construction and design. It uses 56 percent less energy than a comparable but traditional structure and 30 percent less potable water. An atrium provides natural light and ventilation, photovoltaic systems generate 15 kilowatts and a heat recovery system uses warm air leaving the building to heat fresh air coming in. Workspaces are designed around themes rather than disciplines to facilitate cross-disciplinary exchange.

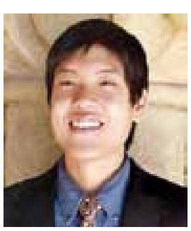
The Woods Institute, the hub of multidisciplinary environmental programs, hosted the 2007 meeting of the Society of Environmental Journalists. More than 900 people attended.

Among the scholars who contributed as lead authors to the reports of the 2007 Nobel Peace Prize–winning United Nations Intergovernmental Panel on Climate Change (IPCC) were Stephen Schneider, the Melvin and Joan Lane Professor for Interdisciplinary Environmental Studies; Terry Root, Woods Institute senior fellow; Christopher Field, professor of biological sciences; and Thomas Heller, the Lewis Talbot and Nadine Hearn Shelton Professor of International Legal Studies. The IPCC shared the prize with former Vice President Al Gore "for efforts to build up and disseminate greater knowledge about man-made climate change, and to lay the foundations for the measures that are needed to counteract such change."

## International Initiative

Stanford scholars, funded by the International Initiative, are helping redefine the way students learn, from remote wildlife parks in Tanzania, in teacher-training colleges in Chile or at a university in Colombia. Their "One World" project uses mobile phone technology to teach a Stanford-developed interactive course on international environmental education.

Lorry Lokey, founder of Business Wire and a Stanford alumnus, donates more than $33 million for a home for the Institute for Stem Cell Biology and Regenerative Medicine.

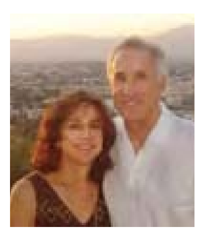


Four current or former students are named Gates Cambridge Scholars: Albert Chiou (above), Weston Tyler Hester, Shamsher Samra and alumna Elizabeth Dzeng.

### *March*

Ben Bernanke, chairman of the Federal Reserve, is keynote speaker at the Stanford Institute for Economic Policy Research's Economic Summit.

The Freeman Spogli Institute and the Law School are named partner institutions of a National War Powers Commission chaired by former secretaries of state James Baker and Warren Christopher, a Stanford alumnus.



Alumni John and Terry Levin give the Law School $3.75 million to establish the John and Terry Levin Center for Public Service and Public Interest Law.

The Law School's Fair Use Project and Cyberlaw Clinic help Acting Professor of English Carol Shloss win the right to publish scholarship on James and Lucia Joyce.

*Stephen Stedman, Freeman Spogli Institute senior fellow, leads the expanded master's degree program in international policy studies.*

The project is an example of the research programs under the auspices of the International Initiative, which promotes collaboration in pursuing peace and security; improving governance locally, nationally and internationally; and advancing human well-being.

The International Policy Studies program, a master's program administered by the Freeman Spogli Institute for International Studies (FSI) and the School of Humanities and Sciences, was expanded, thanks to a $7.5 million gift from Susan Ford Dorsey. The gift was matched by funds from the Hewlett Foundation to create a $15 million endowment. The program provides breadth in the first year and, in the second year, specialization in environment and natural resources, global health, political economy or international security. FSI Senior Fellow and alumnus Stephen Stedman, former research director of the U.N. High-Level Panel on Threats, Challenges and Change, leads the program.

The Presidential Fund for Innovation in International Studies awarded $1 million in 2007 to faculty-led research projects that will assess the implications of China's shortage of females, create incentives for health-care services in rural China and investigate higher education's rapid expansion in developing countries.

## K–12 Initiative

Kenji Hakuta, professor in the School of Education, and Helen Quinn, professor of physics at the Stanford Linear Accelerator Center, were appointed in 2007 to lead the new K–12 initiative, which combines advances in pedagogy with the University's academic and research strengths to improve K–12 education and undergraduate teaching.

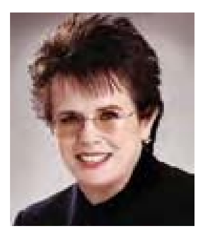
Key to evaluating these new approaches is Stanford New Schools, through which the University oversees East Palo Alto Academy, a K–12 public charter school. The school provides education for students living in a disadvantaged area, serves as a training ground for the School of Education and enables researchers to develop new teaching models.

Another program, the School Redesign Network and its initiative, Leadership for Equity and Accountability in Districts and Schools, provides support for districts and schools that are creating high-performing classrooms to meet the needs of underserved students. A third initiative program, the Institute for Research on Education Policy & Practice (IREPP), is improving education through empirical research. In 2007, IREPP laid the groundwork for reform of California's educational system through the largest independent investigation of how California governs and funds education.

## Arts Initiative

In 2007, Kären Nagy, executive dean of the School of Humanities and Sciences, was named assistant vice president for the arts, joining faculty leaders Jonathan Berger, the Billie Bennett Achilles Professor in Music, and Bryan Wolf, the Jeanette and William Hayden Jones Professor in American Arts and Culture. The Arts Initiative seeks to foster a "culture of creativity" and link the arts to virtually every field of study.

Nagy is overseeing groups that are planning new arts facilities, including a performing arts center with a 900-seat concert hall, and a proposed art/film building adjacent to the Cantor Arts Center.



*April*

Perry McCarty, the Silas H. Palmer Professor, Emeritus, wins the Stockholm Water Prize for work in the design and operation of water and wastewater systems.

Gary Mukai, director of the Program on International and Cross-Cultural Education at the Freeman Spogli Institute, and his colleagues win the 2007 Franklin R. Buchanan Prize for "China's Cultural Revolution."

Milbrey McLaughlin, the David Jacks Professor of Education, receives the Distinguished Contributions to Research in Education Award, the highest honor of the American Educational Research Association.

Gravity Probe B mission scientists release initial findings from their space-based orbiting satellite, launched April 2004, suggesting that Albert Einstein's general theory of relativity is correct.

Tennis great Billie Jean King speaks as part of a conference on "Title IX at 35."

The Department of Radiology celebrates the 50th anniversary of the medical linear accelerator, used to treat cancer.

*Actors from New York's Public Theater worked with Stanford alumnus David Henry Hwang to workshop his new play,* Yellow Face, *during a weeklong residency.*

As part of Stanford's three-year collaboration with the New York Public Theater, alumnus and playwright David Henry Hwang—author of *M Butterfly*—visited to develop a new play, *Yellow Face,* exploring cultural identity and racial politics.

Increased collaboration between the Stanford Institute for Creativity in the Arts and the Lively Arts performance program led to a 2007 season that opened with the West Coast premiere of *Book of Longing*, combining the poetry of Leonard Cohen and the music of Philip Glass.

## Graduate Education

The Stanford Interdisciplinary Graduate Fellowships program was created in 2007, modeled on the existing Stanford Graduate Fellowships. Eventually, about 100 three-year fellowships will be available to Ph.D. students pursuing interdisciplinary research. The University received a $25 million anonymous pledge to start the program, which is administered by Vice Provost for Graduate Education Patricia Gumport.

The program is central to the graduate education initiative, which stresses multidisciplinary approaches to global problems. Stanford schools are teaching more "outward-facing" courses for graduate students, including "Thinking Like a Lawyer," in which about 40 students learned core legal concepts from 12 Law School faculty. The University offers more than 20 joint degree programs that allow students to complete two coordinated graduate degrees.

Other new programs for graduate students include the Stanford Graduate Summer Institute, which offered five weeklong interdisciplinary courses on such subjects as global warming and managing groups and teams, and the four-week Summer Institute for Entrepreneurship.

*Vice Provost for Graduate Education Patricia Gumport, Law School Dean Larry Kramer and Graduate School of Business Dean Robert Joss discuss improvements to graduate education before the Academic Council.*

Provost John Etchemendy announces increased financial assistance for childcare to help junior faculty cope with the twin pressures of raising families and winning tenure.

Biochemist Paul Berg and his wife, Millie, give $4 million to help build the School of Medicine's Learning and Knowledge Center.

The U.S. Army awards $105 million to a consortium led by Stanford to create a new home for the Army High-Performance Computing Research Center, headed by Charbel Farhat, professor of mechanical engineering.

President John Hennessy announces improvements to the University's living wage policy, which covers contract workers on the Stanford campus.

A $2.5-million gift from Tricia and Jeff Raikes through their foundation, matched by the Hewlett Foundation, expands the Center for Comparative Studies in Race and Ethnicity.

Stanford Law School marks the 20th anniversary of the first loan forgiveness program at any law school, which is now named for Miles and Nancy Rubin.

# Reaffirming Stanford's Original Master Plan

**THE UNIVERSITY RETURNS TO THE ORIGINAL CAMPUS VISION**

In the coming years, new or redesigned buildings are proposed in the schools of Medicine, Engineering, Law and Business, as well as new residences, an Arts District and an expansion of the social science complex that will include the Hoover Institution, the Stanford Institute for Economic Policy Research and Encina Hall.

To support this campus renaissance, Stanford has reaffirmed principles established by Leland and Jane Stanford, who collaborated with landscape architect Frederick Law Olmsted in the original plan for the University.

The Stanfords and Olmsted envisioned expansion through a series of quadrangles developed laterally on an east-west axis from the Main Quad. Earthquakes, wars and the Depression intervened, and the campus plan drifted from the initial concepts. Under President Gerhard Casper, the University began a planning process that has led back to the original design. Today, campus planning emphasizes:

- academic and residential quads oriented in an east-west direction, complementing the north-south axis of Palm Drive and the Oval;
- academic precincts with cohesive master plans and flexible buildings that support multidisciplinary research and education;
- construction that integrates sustainability principles and sites buildings to incorporate the advantages of daylight and shading;
- a balance of intensive-use areas, formal spaces and natural environments;
- use of native or low-water-using plants; and
- infill that maintains a compact urban core and substantial open space in the core campus and surrounding rural districts.

The Main Quadrangle remains the dominant feature of the Stanford campus, with Memorial Church as its focus.

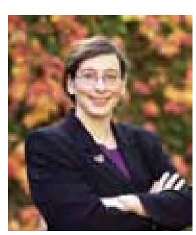
TO THE WEST, the Science and Engineering Quadrangle will feature the new Jerry Yang and Akiko Yamazaki Environment and Energy Building. It will be joined by a new School of Engineering Center, which will include a rotunda that will highlight a state-of-the-art digital library. Other new buildings will house nanotechnology and bioengineering.

TO THE EAST, a new quad is envisioned, anchored by Toyon Hall, Encina Commons and a new dorm complex. This new hub would set the benchmark for an undergraduate housing master plan that creates residential neighborhoods, with

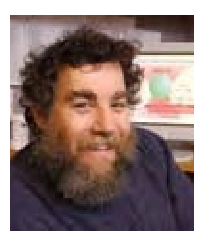
*May*

English in Action, Fresh Lifelines for Youth and the Mural Music and Arts Project receive Community Partnership Awards from the Office of Public Affairs.

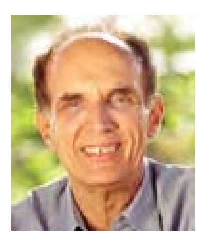
Terry Karl (above), the Gildred Professor in Latin American Studies, and James Patell, the Herbert Hoover Professor of Public and Private Management, win Roland Prizes from the Haas Center for volunteer service.



The American Academy of Arts and Sciences elects eight faculty to membership: William Dally (Computer Science), Persis Drell (SLAC), Darrell Duffie (Business), Pat Hanrahan (Computer Science, Electrical Engineering), Robert Pogue Harrison (Italian Literature), Pamela Karlan (Law) (above), Chaitan Khosla (Chemical Engineering), Ivan Sag (Linguistics).



Five faculty members are elected to the National Academy of Sciences: Steven Block (Humanities and Sciences) (above), Karen Cook (Sociology), Michael Fayer (Chemistry), David Laitin (Political Science), W.E. Moerner (Chemistry).



The White House announces that Gordon Bower, the Albert Ray Lang Professor of Psychology, Emeritus, and Brad Efron (above), the Max H. Stein Professor and professor of statistics, will receive the National Medal of Science.

different types of residences pulled together by a commons. The Hoover Institution will expand on the current site of the Cummings Art Building. A new seven-building, "living-and-learning" Graduate School of Business campus, called the Knight Management Center, will extend east to the end of Serra Street at Campus Drive.

TO THE NORTH, the Medical School campus will be transformed through the new Learning and Knowledge Center. The center will be at the intersection of two walkways. The clinical, or "Discovery," walk will link the Medical School to the hospitals in one direction and to the Science and Engineering Quadrangle in the other. A research walk will run east and west past the Clark Center to the biology and chemistry buildings and will highlight milestones in medical innovation.

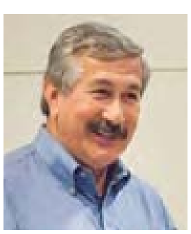
The adjacent hospitals will be replaced to comply with state seismic safety mandates. Under proposals submitted to the city of Palo Alto, Stanford Hospital would give way to a structure nearly twice as large, with a capacity of 600 beds and modern patient and procedure rooms. Lucile Packard Children's Hospital would add 425,000 square feet, bringing its capacity to 361 beds.


*The Stanford Medical School campus will be transformed through the new Learning and Knowledge Center.*

A new Arts District will emerge on both sides of Palm Drive over the next few decades, integrating academic arts departments (music, drama, dance, art, film studies) with Frost Amphitheater, the Cantor Arts Center, Memorial Auditorium and the Thomas Welton Stanford Art Gallery. A world-class performing arts center, including the Bing Concert Hall, will be built to face the Cantor Center. A new building for the Department of Art and Art History is also proposed.

TO THE SOUTH, a new Law School campus is emerging next to the soon-to-be-constructed Munger Residence, a 600-bed facility for graduate students off Campus Drive East. The commons at Munger will open to a new 66,000-square-foot Law School academic building in the Crown Quadrangle. A courtyard will be named for the late Stanford graduate William Rehnquist, chief justice of the U.S. Supreme Court.

As space becomes an increasing challenge, Stanford is pursuing off-campus locations to accommodate growth in the core campus for academic priorities. A proposed campus in Redwood City will house medical clinics at a complex off Highway 101 and may eventually be expanded to accommodate administrative offices.



*June*

Al Camarillo, the Miriam and Peter Haas Centennial Professor in Public Service, is named special assistant to the provost for faculty diversity.

The School of Medicine enters into a partnership to help India establish a sweeping 911-type emergency response system.

Deborah Warshawsky and Alice Hadley win Truman Scholarships, awarded to juniors committed to careers in public service, while Carl Erickson wins a Churchill Scholarship for study at Cambridge.

Former Peruvian President and Stanford alumnus Alejandro Toledo is named a Payne Distinguished Visiting Lecturer at the Freeman Spogli Institute and the Center on Democracy, Development and the Rule of Law.

The School of Education is named one of the nation's top education research programs in a report by the Education Schools Project that is critical of most programs as unfocused, under-resourced and weak in quality and rigor.

Engin Ayaz, a senior majoring in civil and environmental engineering, wins one of 14 national American Dream fellowships from the Merage Foundation, which recognizes outstanding immigrant students.

Sustainability has become crucial. Responsible stewardship of its lands, environmentally conscious design and efficient use of University resources are priorities. An estimated 98 percent of Stanford's emissions are generated by energy used in buildings, while just 2 percent comes from Stanford-owned vehicles. One of Stanford's top sustainability goals is to minimize the impact that current and future buildings have on the environment. With the 2007 establishment of the Department of Sustainability and Energy Management, Stanford is positioned to be a leader in carbon and water-use reduction programs.

In 2007, a carbon inventory was filed with the California Climate Action Registry, enabling the University to track its progress in reducing carbon emissions in the coming years. In addition, a new sustainability initiative—Sustainable Stanford—has been launched with more than 20 departments participating, led by the Sustainability Working Group. The initiative focuses on such issues as water conservation, energy efficiency and recycling.

*The proposed new School of Engineering Center will feature a hexagonal rotunda containing a digital engineering library.*

*The new Graduate School of Business campus, called the Knight Management Center, will extend east to the end of Serra Street at Campus Drive.*

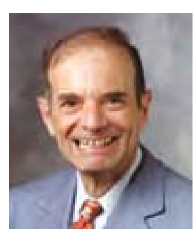
The School of Medicine receives $4.1 million from the California Institute for Regenerative Medicine to renovate laboratory areas for human embryonic stem cell research and training.

Stanford graduate Dana Gioia, chairman of the National Endowment for the Arts, encourages graduates to "trade easy pleasures for more complex and challenging ones."

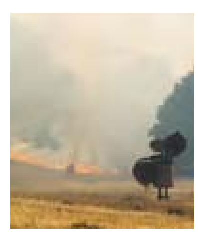
Meg Whitman, eBay CEO, gives the keynote address at the Stanford Institute for Economic Policy Research Forum on Innovation Policy for the Next President.

*July*

The BP Foundation awards a $7.5 million grant to the Freeman Spogli Institute's Program on Energy and Sustainable Development for research on modern energy markets.



Lubert Stryer, the Mrs. George A. Winzer Professor of Cell Biology, Emeritus, and professor emeritus of neurobiology, receives the 2006 National Medal of Science at a White House ceremony.



Two grass fires that burn nearly 200 acres temporarily close the Dish area.

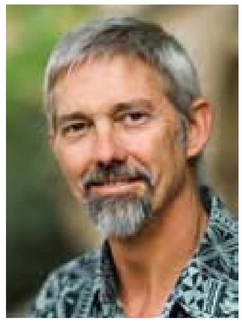
# Stanford University Research Highlights

Scholars and researchers continued contributing to the creation of new knowledge during 2007. Following are examples.

**Biological Sciences**

Researchers led by KARL DEISSEROTH (above), assistant professor of bioengineering and psychiatry, describe in *Nature* a technique to control brain cell activity with light, which could lead to therapies for such disorders as depression or Parkinson's.

Researchers from the Department of Music and the School of Medicine, led by VINOD MENON, associate professor of psychiatry, behavioral



*Steve Palumbi*

sciences and neurosciences, write in *Neuron* that music engages areas of the brain involved with paying attention, making predictions and updating memory.

STEVE PALUMBI, the Harold A. Miller Professor in Marine Sciences at Hopkins Marine Station, is among the researchers writing in *Proceedings of the National Academy of Sciences* that gray whales in the Pacific were once three to five times as plentiful as they now are.

IRVING WEISSMAN, director of the Stanford Institute for Stem Cell Biology and Regenerative Medicine and the Stanford Cancer Center and the Virginia and D.K. Ludwig Professor, reports in *Nature* that, as stem cells in the blood grow older, genetic mutations accumulate that could be at the root of blood diseases that strike people as they age.

**Business and Economics**

The work of the Shuzo Nishihara Professor in Environmental and Resource Economics, LAWRENCE GOULDER, explores the "sustainability" of consumption and is used to pass California Assembly Bill 32, the first comprehensive greenhouse gas regulatory program in the United States.

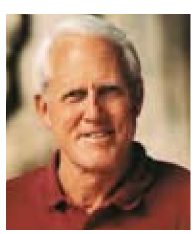
Research by JOHN SHOVEN, the Wallace R. Hawley Director of the Stanford Institute for Economic Policy Research, suggests that human age should be measured by life cycle rather than years to better understand issues such as retirement and savings behavior.

ROBERT SUTTON, professor of management science and engineering, wins a Quill Award for the best business book for *The No Asshole Rule: Building a Civilized Workplace and Surviving One That Isn't*.

Tom Black, registrar at the University of Chicago, is named the new registrar.

*August*

Former trustee and environmental champion Mel Lane dies at 85.



Hall of Fame football coach Bill Walsh, former Cardinal coach and sports administrator, dies at 75.

A team of Stanford students is named one of seven winners of Google's "Build Your Campus in 3D Competition."

The School of Medicine bans tobacco use on its campus.

President John Hennessy travels to South America on an educational mission led by U.S. Secretary of Education Margaret Spellings.

## Education

KENJI HAKUTA, the Lee L. Jacks Professor of Education, leads a study published in *EdSource* that identifies practices associated with higher performance among elementary English-learner students: using assessment data, ensuring access to good teachers and resources, aligning curriculum with state standards and setting ambitious goals.

Researchers led by SUSANNA LOEB (right), associate professor of education, head an investigation into California's K–12 education system, finding that millions of students will be able to attain the state's standards only if the system is overhauled.

## Engineering

Chemical Engineering Associate Professor ZHENAN BAO is among the authors of a study in *Nature* pointing the way toward manufacturing useful flexible electronics with high-performance organic transistors.

A team led by NICK MCKEOWN, associate professor of electrical engineering and computer science, launches the Clean Slate Design

*Nick McKeown*

program, funded by the National Science Foundation, to improve the Internet by designing a new backbone network.

KRISHNA SHENOY (below), assistant professor of electrical engineering, leads a team reporting in *Neuron* that the brain is not wired for consistency, meaning that each time the brain solves a problem involving movement, it does so anew.

Electrical Engineering Professor GREGORY KOVACS is principal investigator for an experiment launching *E. coli* into space aboard an Air Force Minotaur 1 rocket to test the effects of space on living organisms.

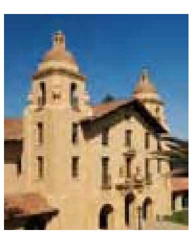
## Environmental Sciences and Energy

A research team led by BINBIN JIANG and MICHAEL JACKSON at the Program on Energy and Sustainable Development concludes that natural gas won't replace coal for power generation in China and India, but can play a growing role in niche markets, with air quality regulation and market reforms influencing gas penetration.

KAREN SETO (above), assistant professor of geological and environmental sciences, is the first to use satellite images to demonstrate a link between city growth and rainfall patterns, as well as to assess compliance with an international treaty

### *September*

Language designed to further protect against discrimination based on gender identity is added to the University's nondiscrimination statement.



Old Union reopens after an extensive renovation to serve again as a center for student and religious activities.

The Center for Excellence in Genomic Science receives a $14-million, five-year grant from the National Institutes of Health to continue studying how new traits evolve in natural populations.

Thomas Clandinin, assistant professor of neurobiology, and Mark Schnitzer, assistant professor of biological sciences and applied physics, receive 2007 National Institutes of Health Pioneer Awards.

### *October*

The Institute for Research in the Social Sciences opens a new Secure Data Center on campus that will give researchers access to the Census Bureau and the National Center for Health Statistics, as well as other federal centers with sensitive data.

The School of Education, through Professor Sam Wineburg, and George Mason University are awarded $7 million by the U.S. Department of Education to establish a virtual federal clearinghouse for history education.

Mark Jacobson

to protect wetlands in research published in *Global Environmental Change* and *Journal of Climate*.

A study by MARK JACOBSON, professor of civil and environmental engineering, in *Environmental Science & Technology,* shows that ethanol-fueled vehicles pose as high a health risk as vehicles fueled by gasoline.

JONATHAN PAYNE, assistant professor of geological and environmental sciences, presents evidence in the *Geological Society of America Bulletin* that a massive, rapid release of carbon may have triggered an extinction 250 million years ago, providing clues to current global carbon cycle changes.

## Humanities and Social Sciences

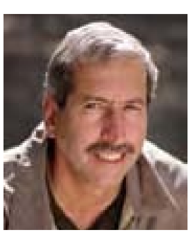
*Passages of Martin Luther King*, a play by historian CLAYBORNE CARSON, director of the Martin Luther King Jr. Papers Project, plays to capacity crowds for five nights in Beijing.

JON KROSNICK, the Frederic O. Glover Professor of Communication and Political Science, conducts a survey through the Woods Institute showing that 85 percent of Americans believe global warming is probably happening.

In a study in *Child Development*, Eaton Psychology Professor CAROL DWECK (right) shows that at one New York City junior high school, students' mindsets about intelligence affected their math grades, suggesting ways for teachers to help underperforming students.

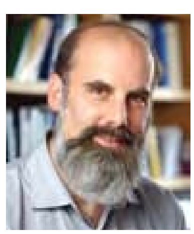
In *The Age of Independence: Interracial Unions, Same-Sex Unions and the Changing American Family*, sociologist MICHAEL ROSENFELD says that an increase in non-

Clayborne Carson



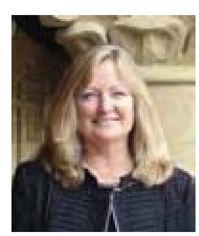
Geophysicist Mark Zoback announces that scientists at the San Andreas Fault Observatory at Depth have extracted rock samples from two miles beneath the surface of the fault, opening new doors for earthquake research.

Beth Pruitt, assistant professor of mechanical engineering, leads an effort funded by a $2 million grant from the National Science Foundation to generate heart tissue with stem cells.



The Institute of Medicine of the National Academy of Sciences elects three faculty members of the School of Medicine: Ron Levy, Michael Longaker and Matthew Scott (above).

Reunion Homecoming attracts more than 9,000 participants—the most ever—and features a roundtable on global challenges moderated by law alumnus and journalist Carlos Watson (above).



Five faculty members are elected to the American Association for the Advancement of Science: Steven Artandi (Medicine), Laura Attardi (Radiation Oncology), Christopher Chidsey (Chemistry), Karen Cook (Sociology) (above), Friedrich Prinz (Mechanical Engineering).

*Anthony Wagner and Brice Kuhl*

traditional unions is unprecedented in U.S. history and has long-term implications for society.

*Crowds*, published by the Stanford University Press and edited by JEFFREY SCHNAPP, the Rosina Pierotti Professor in Italian Literature, and MATTHEW TIEWS, associate director of the Stanford Humanities Center, wins the Modernist Studies Association's prize as the best book in the field.

ANTHONY WAGNER, associate professor of psychology, and doctoral student BRICE KUHL announce in *Nature Neuroscience* that they have used functional magnetic resonance imaging to determine that the brain's ability to suppress irrelevant memories makes it easier to remember what's really important.

**Law**

One of the leading books in the field—*The Law of Democracy: Legal Structure of the Political Process*—co-authored by PAMELA KARLAN, the Kenneth and Harle Montgomery Professor of Public Interest Law, is published in its third edition.

AMALIA KESSLER, associate professor of law and Helen L. Crocker Faculty Scholar, publishes *A Revolution in Commerce*, the first comprehensive account of the merchant court of 18th-century Paris.

The Youth and Education Law Project, led by WILLIAM KOSKI, the Eric and Nancy Wright Professor of Clinical Education, settles a landmark case against the California School for the Deaf that establishes a special needs class for deaf and hard-of-hearing children with moderate to severe developmental disabilities.

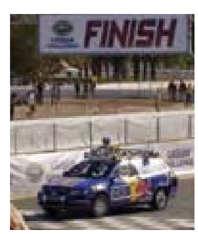
**Medicine**

MICHAEL CLARKE, the Karel H. and Avice N. Beekhuis Professor in Cancer Biology, is lead author of a study in the *New England Journal of Medicine* that reports researchers have found 186 genes that can predict the recurrence risk of breast cancer.

CRAIG GARNER, professor of psychiatry and behavioral sciences, leads a study published in *Nature Neuroscience* that shows that short-term treatment with a drug compound improved learning and memory in mice with Down syndrome symptoms.

DOUGLAS LEVINSON, professor of psychiatry and behavioral sciences, leads a team reporting in the *American Journal of Psychiatry* that it has located on one chromosome a region that may predispose people to severe depression.

A study in *Archives of Pediatrics & Adolescent Medicine* by THOMAS ROBINSON, director of the Center for Healthy Weight at Packard Children's Hospital and Schulman Professor in Child Health, shows in research of fast food that even young children are swayed by brand preference.




*November*

Nobel laureate Arthur Kornberg, professor emeritus of biochemistry, dies.

Alumni Laurel Gabler and Scott Thompson and student Aaron Polhamus are named 2008 Rhodes Scholars—three of 32 Americans selected.

Stanford acquires the library of one of the foremost Egyptologists of the 20th century, documenting Egyptian history from about 650 B.C. to about A.D. 1000.

The Annenberg Foundation grants the Hoover Institution $10 million to support entrepreneurial public policy development in economics, national security and foreign policy.

Junior, the robotic car of the Stanford Racing Team, wins $1 million for finishing second in the Pentagon's Defense Advanced Research Projects Agency Urban Challenge.

The Center for Comparative Studies in Race and Ethnicity, directed by Professor of Psychology Hazel Markus, celebrates its 10th anniversary.

MINNIE SARWAL, associate professor of pediatrics, is the senior author of research published in *Proceedings of the National Academy of Sciences* that identifies a pattern of gene expression shared by transplant patients who are able to stay healthy without anti-rejection drugs.

DAVID SPIEGEL, Wilson Professor of Medicine, writes in *Cancer* that participation in support groups doesn't extend the lives of women with metastatic breast cancer, despite previous research indicating otherwise.

GARY STEINBERG, the Bernard and Ronni Lacroute–William Randolph Hearst Professor in Neurosurgery and Neurosciences, leads a team that reports in *Proceedings of the National Academy of Sciences* that stem cells transplanted into the brains of rats and mice navigate toward areas damaged by stroke.

TONY WYSS-CORAY, associate professor of neurology and neurological sciences, is senior author of a study published in *Nature Medicine* that outlines a blood test that is a step toward predicting whether mild memory problems are the beginning of Alzheimer's.

**Physical Sciences**

GREGORY BEROZA, professor of geophysics, and graduate student DAVID SHELLEY write in *Nature* that tiny tremors and temblors discovered in fault zones from California to Japan are generated by slow-moving earthquakes that may foreshadow catastrophic seismic events.

STELIOS KAZANTZIDIS, of the Kavli Institute for Particle Astrophysics and Cosmology, and his colleagues report in *Science Express* on the first simulation through the use of supercomputers of the formation of a supermassive black hole created through the merger of galaxies.

Writing in *Physical Review Letters*, Stanford Linear Accelerator Center researchers, using a proton beam and advanced X-ray techniques, prove that carbon can be magnetic.

Scientists at the BaBar experiment at the Stanford Linear Accelerator Center see the transition of one type of particle, the neutral D-meson, into its antimatter particle, an observation that will be used to test the Standard Model.

Stanford physicist SHOUCHENG ZHANG and his students theorize in *Science* about a new state of matter that may pave the way for electronic devices that dissipate less energy and generate less heat.

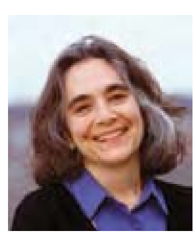
*David Shelley and Gregory Beroza*

*December*

The Cardinal beats Cal in the Big Game, snapping a five-game losing streak and recapturing the Axe.

Vice Provost Patricia Gumport announces a $4.5 million fellowship program to better prepare graduate students from diverse backgrounds for academic careers.

President John Hennessy appoints a group to explore expanding the size of the freshman class and the overall undergraduate population.



Persis Drell, professor of physics, is named director of the Stanford Linear Accelerator Center.

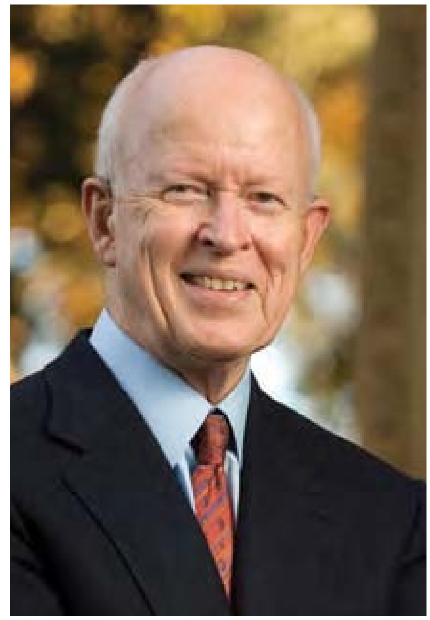
Albert Bandura, the David Starr Jordan Professor, is awarded the 2008 University of Louisville Grawemeyer Award for Psychology for work in social cognitive theory and self-efficacy.

Sean Arenson and Priyanka Narayan (above) are among 37 Americans selected for Marshall scholarships, which are financed by the British government and allow students to study at the British university of their choice.

# One Year Into The Stanford Challenge

**A MESSAGE FROM THE CHAIR OF THE BOARD OF TRUSTEES**

## As Stanford forges ahead with new efforts in research and education, donors are helping to meet the challenge.



In October 2006, the University launched The Stanford Challenge, a five-year comprehensive campaign to marshal resources campus-wide in solving complex global problems and training a new generation of leaders. The preceding pages of this report highlight Stanford's recent advances in this endeavor, from research on environmental sustainability to innovative degree programs for students. I'm pleased to report that the first year of The Stanford Challenge also included excellent financial progress.

Donors moved The Stanford Challenge forward impressively in 2006–07. In fact, the Office of Development reported that, last year, alumni and parents, companies and foundations, and other friends made more than 100,000 gifts totaling more than $832 million. As of August 31, 2007, the campaign total stood at just over $2.9 billion. That total includes nearly 300,000 gifts. Several key contributions are noted later in this publication.

One reason donors place their confidence in Stanford is the University's stewardship of their gifts. As the Stanford Management Company reports in the following pages, the University's Merged Pool of investments returned 23.4 percent for the 12 months ended June 30, 2007. For the five-year period ending that month, the Stanford portfolio achieved an annualized return of 17.7 percent, compared with average annual gains in the U.S. stock market of 10.7 percent.

But I feel certain what is really driving the success of The Stanford Challenge is the nature of Stanford's ambitions and donors' belief in our ability to succeed. Much of that confidence is inspired by the leadership of John Hennessy and his entire team.

Then there is Stanford's unique position: Where else can you find a single institution that combines expertise in so many different fields with a proven record of collaboration and innovation and an organization-wide commitment to tackling the world's toughest problems? Those who are concerned about the problems Stanford is addressing recognize The Stanford Challenge as an excellent way to have a meaningful impact on the future of our world.

To all of us at Stanford, that adds up to more than a great year. It gives us inspiration for the years ahead.

Sincerely,

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

# Discussion of Financial Results

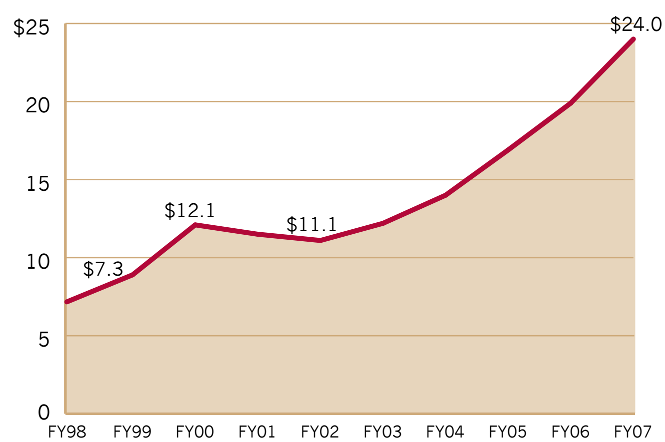
Fiscal year 2007 (FY07) was another year of outstanding operating results and significant growth for Stanford's consolidated net assets and Endowment. Consolidated net assets increased $4.1 billion to end the year at $24 billion. See Figure 1. The University's Endowment grew $3.1 billion to $17.2 billion as a result of strong investment performance and new gifts. See Figure 4. Stanford's consolidated operating revenues exceeded expenses by $384 million in FY07 compared to $299 million in fiscal year 2006 (FY06).

## University

The University ended the year with a surplus from operations of $250 million compared to $141 million in FY06. Total revenues increased by 10% while expenses increased by 6%.

**FIGURE 1**

CONSOLIDATED NET ASSETS (IN BILLIONS)




### FY07 FINANCIAL HIGHLIGHTS

> **Continued strong investment performance.** Total investment returns were $3.6 billion, up from $2.5 billion in FY06. See the report from the Stanford Management Company on page 53 for an in-depth analysis of University investment strategies and performance.

> **Strong Support from Donors.** The University enjoyed another year of outstanding donor support in FY07 with over 109,000 gifts from 69,000 donors totaling $853 million. Highlights included:

- A $52 million gift from the Virginia and D.K. Ludwig Fund to establish the Ludwig Center for Cancer Stem Cell Research and Medicine. The gift is part of a larger commitment to Stanford and five other academic centers to fund cancer research.

- Gifts toward a $75 million pledge made by alumni Jerry Yang and Akiko Yamazaki, which will be used for the Jerry Yang and Akiko Yamazaki Environment and Energy Building, for the Learning and Knowledge Center at the School of Medicine and for other purposes yet to be determined.

- Several large bequests, including $27.5 million from the estate of alumna Susanna Atwell, which will be used to provide matching for annual gifts from young alumni; $37.5 million from the estate of alumnus Ric Weiland, which will go toward various uses; and $51 million from the estate of alumnus Dudley Chambers for scholarships, faculty salaries and general support in engineering and the natural sciences.

- A final payment of $88.4 million on a $300 million pledge by the William and Flora Hewlett Foundation to the School of Humanities and Sciences (H&S), used to match qualifying gifts to H&S and for top priorities within the school.

The majority of these gifts and pledges counted toward The Stanford Challenge which was launched in October 2006 with a goal of raising $4.3 billion over five years for efforts aimed at seeking solutions to intractable global problems and educating a new generation of leaders for the complexities of today's world. At the end of FY07, the campaign total stood at $2.9 billion from nearly 300,000 gifts.

**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 $3.6 billion in FY07 compared with a $2.7 billion increase in FY06. As in prior years, 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 $3.2 billion in operating revenues are shown in Figure 2. Sponsored research support accounts for 34% of total operating revenues, with an additional 22% resulting from investment income distributed for operations and 12% each from student income and health care services revenues. The University's operating activities are summarized below:

> Student income increased 5% to $394 million in FY07, representing 12% of University operating revenues compared to 13% in the prior year. Revenues from undergraduate tuition increased by 7% and graduate tuition increased by 6%. The undergraduate student body grew by 70 students while the number of graduate students remained relatively flat. Offsetting tuition and room and board revenues is financial aid. Financial aid continues to be 28% of gross student income. Approximately 78% of undergraduate students and 75% of graduate students receive some form of financial aid.

> Sponsored research support increased $64 million, or 6%, to $1.1 billion in FY07. Total SLAC revenue increased approximately $48 million to $346 million. Of the increase, $30 million was due to increased Department of Energy funded construction activity. Sponsored research in the School of Medicine increased approximately $18 million, or 5%, and the School of Engineering had an increase of $4 million, or 4%, over FY06. Indirect cost recovery remained relatively flat at $171 million in FY07.

> Health care services revenues for the University increased $50 million or 16% in FY07 to $366 million and represented 12% of operating revenues.

Health care services revenues consist primarily of payments made by the Hospitals to the University, including $335 million to the School of Medicine for faculty physicians' services, the blood center and other essential services. An additional $18 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 $13 million in revenues from services provided to external parties, including the Santa Clara Valley Medical Center and the Palo Alto Veterans Administration Hospital. See Figure 3.

**FIGURE 2**

FY07 UNIVERSITY OPERATING REVENUES ($3.2 BILLION)

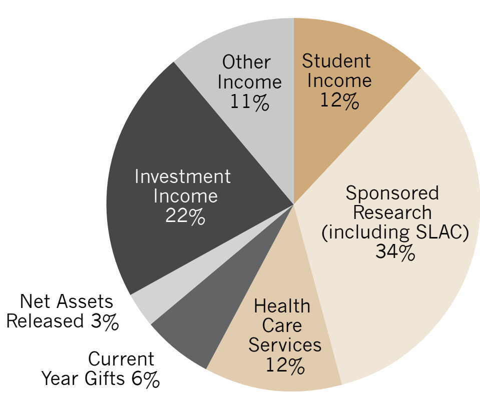
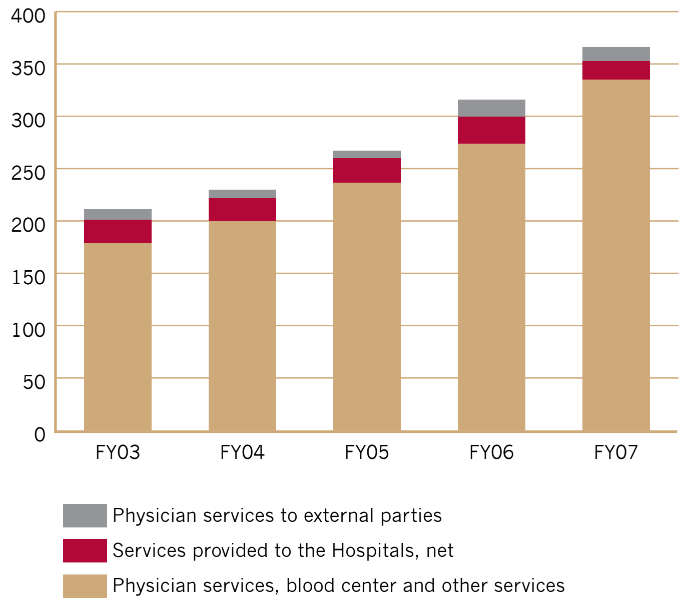


**FIGURE 3**
HEALTH CARE SERVICES REVENUES
(IN MILLIONS)




> The increase in current year gifts is a reflection of the strong fundraising activities in FY07. Current year gifts in support of operations increased to $198 million, up from $168 million in FY06 due to several large estate gifts received in FY07. 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 $96 million, relatively flat from $94 million in FY06.

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

- Endowment income distributed for operations was $609 million in FY07, up from $535 million in FY06. The University's Endowment (see insert) generates investment income that is 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 Pool (MP). In FY07, the MP payout was $541 million, up from $459 million in FY06. Over the last 10 years, the payout amount has grown appreciably due primarily to growth of endowment principal from continued strong investment returns, substantial new gifts and transfers of expendable funds into the endowment.

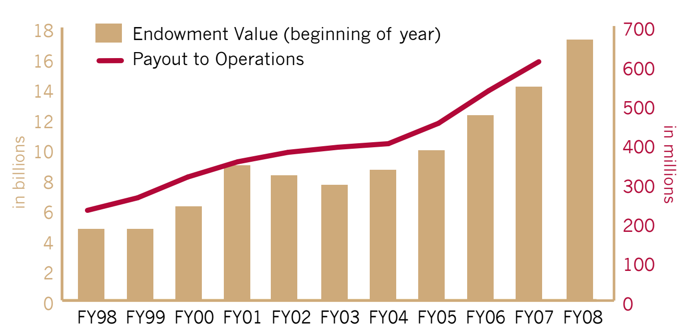
**The University's Endowment**

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. At August 31, 2007, the Endowment totaled $17.2 billion and represented approximately 78% of the University's net assets. The Endowment includes pure endowment funds, endowed lands, term endowment funds and funds functioning as endowment.

The increase in the Endowment of approximately $3.1 billion in FY07, after payout to operations of $609 million, resulted from $3 billion of investment returns, $361 million in new gifts and transfers of $334 million of expendable funds into the Endowment. Payout to operations from the Endowment is a significant and increasing source of operating revenue for the University, covering approximately 21% of expenses in FY07 compared to 19% in FY06. Distributions in FY07 and FY06 were approximately 4.3% and 4.5%, respectively, of the beginning of year endowment value.

Also included in endowment income is rental income from ground leases of the University's endowed lands, including the Stanford Research Park. See Figure 4 for a comparison of payout to endowment value.

**FIGURE 4**
ENDOWMENT VALUE vs. PAYOUT TO OPERATIONS



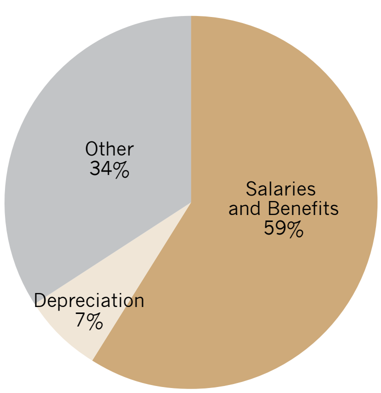
- Other investment income was $101 million in FY07 compared to $74 million in FY06. This category includes the payout to operations from the Expendable Funds Pool (EFP), the Endowment Income Funds Pool (EIFP) and income from the faculty and staff mortgage loan program. The EFP payout policy seeks to achieve a stable payout to operations, while also providing that investment returns in excess of the payout be added to the Endowment. EIFP fund holders receive total return. The combined EFP and EIFP payout was approximately $83 million in FY07, compared to $57 million in FY06.

> Special program fees and other income totaled $333 million in FY07, a 4% increase over FY06. 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, revenues from the Stanford West Apartments and from intercollegiate athletic activities. Increases were due to increased ticket sales for events in the new stadium, increased executive and other program fees and new affiliates programs.

Total expenses increased $170 million, or 6%, to $2.9 billion in FY07. As depicted in Figure 5, salaries and benefits comprised approximately 59% of the University's total expenses, depreciation expense was 7% and other operating expenses represented approximately 34%.

**FIGURE 5**

FY07 UNIVERSITY OPERATING EXPENSES ($2.9 BILLION)




> Salaries and benefits increased 5% in FY07 to $1.7 billion. Increases in salaries were a result of annual salary increases and increases in faculty and staff headcount. Benefits expense was up mostly due to increases in expenses related to the University's post retirement health plan.

> Depreciation expense increased 2% to $202 million in FY07 from $198 million in FY06. During the year, a number of new projects, including the newly renovated Old Union complex, were placed in service.

> Other operating expenses increased 10% to $991 million from $900 million in FY06. The majority of the increase is the result of the increased construction activities at SLAC and significant increases in materials and supplies.

**Other Changes in Unrestricted Net Assets**

In total, unrestricted net assets of the University increased $3 billion, with the majority coming from investment returns. Total unrestricted investment gains were $3.4 billion, of which $609 million of endowment income and $101 million of EFP and other investment income were distributed for operations. In years with strong investment performance, such as in the last few years, the University's investment returns on both the Endowment and the EFP exceed the amount of the predetermined payout to operations and the excess is transferred to the Endowment. In FY07, total investment return of the EFP was $314 million, of which $227 million was added to the Endowment.

**Temporarily Restricted Net Assets**

Temporarily restricted net assets increased $100 million to $1.1 billion in FY07. Included in this category are pledges that will become expendable upon payment, gifts pending designation by the donor, funds for which donor-imposed restrictions have not yet been met, including gifts for capital construction, and certain other purposes. The University recorded $273 million of new temporarily restricted gifts and pledges in FY07, net of discounts and allowances. During the year, $96 million of temporarily restricted net assets were released from their restrictions and utilized to fund operating activities. Another $130 million of capital and other gifts for use by the University and Hospitals were released to unrestricted net assets related to capital assets placed in service during the year and other gifts which no longer carried donor restrictions. Finally, $13 million of pending funds were moved into permanently restricted endowed funds, following donor instructions.

**Permanently Restricted Net Assets**

Permanently restricted net assets increased by $498 million to $4.4 billion during FY07. 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 to the receipt of $342 million in new gifts and pledges to the Endowment, net of discounts and allowances, and $161 million in gains on investments held in the Endowment that were reinvested in accordance with the donor's instruction. In addition, $42 million in funds previously designated as unrestricted or temporarily restricted net assets were transferred to permanently restricted net assets in order to satisfy matching gift conditions.

**FINANCIAL POSITION**

The University's Statement of Financial Position reflects continued strong investment returns, increased giving and solid operating results. Total University assets increased $4.1 billion in FY07 to end the year at $25.9 billion. Total University liabilities increased $523 million to $3.9 billion.

Highlights of the Statement of Financial Position are as follows:

> Cash and cash equivalents increased $86 million in FY07. The increase was due to cash received in connection with issuance of tax-exempt bonds that was held in highly liquid instruments at August 31, 2007.

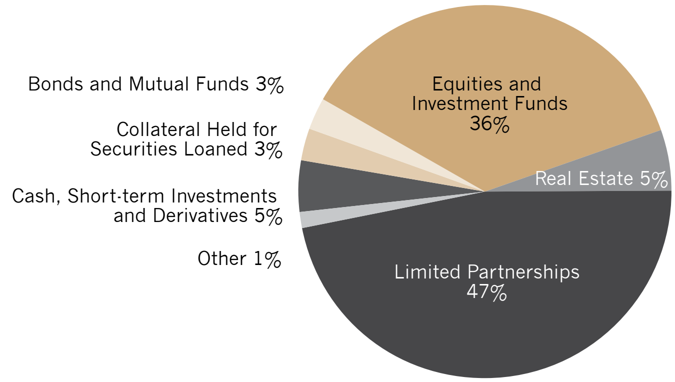
> Net pledges receivable were $667 million at August 31, 2007, an increase of $84 million over FY06. The University received a number of new pledges in FY07 in connection with The Stanford Challenge fundraising campaign. Valuation allowances were recorded for pledges that may not be collectible or where the pledge term may be extended.

> The University provides home mortgage financing assistance as a means of attracting and retaining outstanding faculty and senior staff. Total notes outstanding under this program increased $37 million to $333 million in FY07.

> Total investments increased by $3.6 billion, or 21%, to $21.2 billion. See Figure 6 for investment asset allocation at August 31.

**FIGURE 6**

INVESTMENT ALLOCATION AT AUGUST 31, 2007 ($21.2 BILLION)




> Plant facilities, net of accumulated depreciation, increased $159 million to $2.7 billion in FY07. Net additions to plant facilities in FY07 totaled $318 million, bringing gross plant facilities before accumulated depreciation to $4.9 billion. Additions to the University's plant facilities in FY07 included the newly renovated Old Union complex, the seismic retrofit of Roble Hall and the renovation of off-campus buildings occupied by the School of Medicine.

> Deferred rental income, consisting of prepaid rents on properties leased by the University, was $393 million at August 31, 2007. These amounts are recognized as revenue ratably over the terms of the associated leases. The majority of the balance, $306 million, relates to the Stanford Shopping Center 51-year ground lease which the University entered into in 2003.

> Notes and bonds payable were $1.5 billion at August 31, 2007, up $185 million from FY06 due to the issuance of $112 million of tax-exempt bonds and a $60 million increase in commercial paper borrowing. The proceeds from the bond offering will be used to fund current and future capital projects. In June 2007, the University's Board of Trustees approved a $2.4 billion, three year capital plan that includes funding for several new buildings and infrastructure projects. An important source of funding for these projects will be debt.

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 academic facilities, residential housing and dining facilities, faculty and staff mortgage loans and other projects.

# 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.

The Hospitals had a combined operating surplus of $134 million, down 15% from $158 million in FY06. At August 31, 2007, the Hospitals' net assets were $2 billion versus $1.5 billion at August 31, 2006, an increase of $501 million, or 34%. 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 improve its financial position in FY07, generating income from operations of $113 million, down 2% from $115 million in FY06.

Prior to FY07, the University had assigned to SHC the right to all revenue related to pediatric and obstetric practices of the School of Medicine (SoM) faculty. Effective September 1, 2006, LPCH assumed the right to these revenues. In FY07, the pediatric and obstetric practices earned revenue of $61 million. Payment for physicians' services related to these practices was $48 million.

### STATEMENT OF ACTIVITIES

Revenues, excluding pediatric and obstetric practice services, increased by 10% to $1.6 billion.

> Patient revenues increased by 10%, to $1.5 billion.
- Inpatient revenues, which make up 53% of the total, grew by 7% on continuing increases in patient volume. Despite significant capacity limitations, total patient days were up by 2%.
- Outpatient revenues increased by 12%, accounting for 47% of the total.

> Other income, which includes the results of the outreach laboratory and various related entities, was up by 10% to $73 million.

> Net assets released from restrictions were virtually unchanged from FY06 at $4 million.

Expenses, excluding pediatric and obstetric practice services, increased by 11% to $1.5 billion.

> Salaries and benefits grew by 12% to $665 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.

> Physicians' services and support increased by 13% from $219 million to $247 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.

> Depreciation increased by 14% to $45 million as a result of increases in capital assets.

> Other operating expenses, including such categories as supplies, purchased and professional services, and bad debt expense, increased by 5% to $492 million as a result of both higher patient volumes and prices.

Total net assets increased $251 million to $901 million.

> Unrestricted net assets increased $220 million to $844 million. The increase was due to SHC's operating surplus of $113 million and from an increase of $112 million in investment income and gains.

> Temporarily restricted net assets increased $29 million to $51 million.

> Permanently restricted net assets increased $2 million to $6 million in FY07.

### FINANCIAL POSITION

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

SHC continued to strengthen its balance sheet to support the expansion of services to the community and to support the shared missions of the Hospital and the University School of Medicine.

> Unrestricted cash and investments were $875 million at the end of FY07, an increase of $126 million. As a result, days cash on hand increased from 205 to 228.

- Assets held by a trustee decreased by $69 million to $334 million. The decrease represents the expended proceeds of the 2006 bond issue, which were used to help fund the new outpatient facility, the clinical information system and other facilities and systems projects.

- Property and equipment, net of depreciation, increased $108 million to $511 million during FY07. The largest elements of the increase were expenditures related to a new electronic clinical information system and continued investment in the Stanford Outpatient Center in Redwood City, which is being developed to expand the availability of outpatient care.

**LUCILE PACKARD CHILDREN'S HOSPITAL**

LPCH generated an excess of revenues over expenses from operations of $21 million in FY07, down from $43 million in FY06. Operating results were depressed by a number of factors in FY07 including ongoing increases in the number of Medi-Cal patients served, significant costs related to moving non-clinical operations out of LPCH for capacity reasons and costs related to installation of a new electronic medical record system.

Net assets increased $250 million to $1.1 billion at August 31, 2007. The increase in net assets stems principally from investment earnings of $92 million and restricted contributions of $160 million, which includes state funding of $74 million for expansion of facilities.

Net patient revenues grew 20% to $564 million. The unusually high step up in net patient revenue is related to LPCH absorbing the operations of the Pediatric Faculty Practice from SHC. Due to the structure of this arrangement, the ongoing net effect of this transfer on LPCH's net operating margin is immaterial.

Other financial highlights for LPCH:

- Inpatient net revenues, which make up approximately 81% of total net patient revenues, grew by slightly less than 4% as a result of an increase in services provided to Medi-Cal beneficiaries and LPCH's continued capacity limitations. Capacity issues have hampered LPCH's ability to expand inpatient services. The Medi-Cal program reimburses LPCH at significantly less than those of commercial payers. Medi-Cal patients represented 41% of gross patient revenue in FY07 and 39% in FY06.

- Outpatient visits increased by 17% over FY06, including a 5% increase in outpatient surgery visits, and resulted in increased net revenues of $15 million, a 19% increase over the prior year.

- 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 $132 million in FY07 compared with $105 million in FY06. 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 $119 million to $437 million at August 31, 2007. Despite this significant increase, days cash on hand increased only slightly, from 261 to 280, due to the dilutive effect of including the Pediatric Faculty Practice's operations in FY07. Other than cash generated from operations, the increase in unrestricted cash and investments is largely the result of reimbursement from bond proceeds for the acquisition of approximately $50 million in buildings and ground leases purchased in late FY06. 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 battle with inpatient capacity issues which are being addressed by current and planned expansions of bed and operating room capacity, as well as by 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.

## In Summary

Stanford continues to enjoy record investment returns, strong operating results and outstanding donor support. The consolidated net assets of the University and the Hospitals have nearly doubled over the last five years. Despite these excellent results, we are always mindful of the long term health of the University in our management of day-to-day operating activities.

We continue to anticipate that federal research funding will grow more slowly than the University's costs over the next several years and to seek other sources of funding for the leading edge research that is being performed.

On the health care side, we continue to see rapidly escalating costs of personnel and equipment that often exceed the increases in medical reimbursement rates. Due to inpatient capacity constraints, the Hospitals have limited ability to absorb these increased costs through greater volume. In addition, the Hospitals have begun the formal process of seeking approval from local authorities to construct new facilities to meet community health care needs.

The University and the Hospitals have achieved outstanding results in large part due 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

DANIEL J. MORISSETTE
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

| | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|---|
| | | | (in millions of dollars) | | | |
| STATEMENT OF ACTIVITIES DATA: | | | | | | |
| Student income (A) | $ 394 | $ 376 | $ 356 | $ 332 | $ 318 | $ 305 |
| Sponsored research support | 1,058 | 994 | 973 | 924 | 860 | 802 |
| Health care services | 1,999 | 1,851 | 1,699 | 1,501 | 1,277 | 1,181 |
| Current year gifts in support of operations | 198 | 168 | 144 | 105 | 113 | 104 |
| Net assets released from restrictions | 122 | 117 | 104 | 64 | 72 | 51 |
| Investment income distributed for operations | 710 | 609 | 514 | 460 | 495 | 436 |
| Special program fees and other income | 423 | 396 | 351 | 329 | 320 | 292 |
| Total revenues | 4,904 | 4,511 | 4,141 | 3,715 | 3,455 | 3,171 |
| Total expenses | 4,520 | 4,212 | 3,842 | 3,572 | 3,319 | 3,145 |
| Excess of revenues over expenses | 384 | 299 | 299 | 143 | 136 | 26 |
| Other changes in net assets | 3,673 | 2,709 | 2,598 | 1,596 | 1,028 | (487) |
| Net change in total net assets | 4,057 | 3,008 | 2,897 | 1,739 | 1,164 | (461) |
| FINANCIAL POSITION HIGHLIGHTS: | | | | | | |
| Cash and cash equivalents | $ 647 | $ 579 | $ 629 | $ 638 | $ 602 | $ 522 |
| Pledges receivable, net | 758 | 619 | 507 | 454 | 475 | 513 |
| Investments at fair value | 23,119 | 19,263 | 16,351 | 13,318 | 11,806 | 9,520 |
| Plant facilities, net of accumulated depreciation | 3,472 | 3,164 | 2,800 | 2,743 | 2,723 | 2,527 |
| Notes and bonds payable: | | | | | | |
| University | 1,494 | 1,309 | 1,266 | 1,288 | 1,275 | 1,246 |
| Hospitals | 1,015 | 1,006 | 582 | 587 | 591 | 224 |
| Total net assets, end of year | 23,938 | 19,881 | 16,873 | 13,976 | 12,237 | 11,073 |
| University endowment | 17,165 | 14,085 | 12,205 | 9,922 | 8,614 | 7,613 |

| | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|---|
| STUDENTS: | | | | | | |
| ENROLLMENT: (B) | | | | | | |
| Undergraduate | 6,759 | 6,689 | 6,705 | 6,753 | 6,654 | 6,731 |
| Graduate | 8,186 | 8,201 | 8,176 | 8,093 | 7,800 | 7,608 |
| DEGREES CONFERRED: | | | | | | |
| Bachelor's degrees | 1,709 | 1,756 | 1,790 | 1,713 | 1,788 | 1,692 |
| Advanced degrees | 3,100 | 3,093 | 2,945 | 2,931 | 2,855 | 2,777 |
| FACULTY: | | | | | | |
| Members of the Academic Council | 1,428 | 1,418 | 1,400 | 1,410 | 1,396 | 1,377 |
| ANNUAL UNDERGRADUATE TUITION RATE (in dollars) | $ 32,994 | $ 31,200 | $ 29,847 | $ 28,563 | $ 27,204 | $ 25,917 |

(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.

# 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 51, present fairly, in all material respects, the financial position of Stanford University (the University) at August 31, 2007 and 2006, 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.

As discussed in Note 1 to the consolidated financial statements, in 2007 the University adopted Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. As described in Note 1, the fiscal year 2006 consolidated statement of cash flows has been restated.

PricewaterhouseCoopers LLP

San Francisco, California
December 18, 2007

# Consolidated Statements of Financial Position

**AT AUGUST 31, 2007 AND 2006 (in thousands of dollars)**

| | 2007 | | | 2006 |
|---|---|---|---|---|
| | University | Hospitals | Consolidated | Consolidated |
| ASSETS | | | | |
| Cash and cash equivalents | $ 546,294 | $ 100,326 | $ 646,620 | $ 579,084 |
| Accounts receivable, net | 259,642 | 397,254 | 656,896 | 566,716 |
| Receivables (payables) from SHC and LPCH, net | 56,336 | (56,336) | - | - |
| Prepaid expenses and other assets | 85,055 | 152,606 | 237,661 | 162,931 |
| Pledges receivable, net | 667,461 | 90,170 | 757,631 | 618,805 |
| Student loans receivable, net | 65,626 | - | 65,626 | 63,374 |
| Faculty and staff mortgages and other loans receivable, net | 334,268 | - | 334,268 | 297,956 |
| Investments at fair value, including securities pledged or on loan of $553,869 and $573,229 for 2007 and 2006, respectively | 21,167,073 | 1,951,582 | 23,118,655 | 19,263,211 |
| Plant facilities, net of accumulated depreciation | 2,705,877 | 766,492 | 3,472,369 | 3,163,930 |
| Works of art and special collections | - | - | - | - |
| **TOTAL ASSETS** | **$ 25,887,632** | **$ 3,402,094** | **$ 29,289,726** | **$ 24,716,007** |
| LIABILITIES AND NET ASSETS | | | | |
| LIABILITIES: | | | | |
| Accounts payable and accrued expenses | $ 576,485 | $ 340,287 | $ 916,772 | $ 856,230 |
| Accrued post retirement benefit costs | 210,309 | 66,964 | 277,273 | 135,980 |
| Pending trades | 141,838 | - | 141,838 | 105,796 |
| Liabilities under security agreements | 648,723 | - | 648,723 | 658,196 |
| Deferred rental income | 392,999 | - | 392,999 | 367,565 |
| Income beneficiary share of split interest agreements | 413,403 | - | 413,403 | 344,921 |
| Notes and bonds payable | 1,493,761 | 1,014,746 | 2,508,507 | 2,314,764 |
| U.S. government refundable loan funds | 52,685 | - | 52,685 | 52,394 |
| **TOTAL LIABILITIES** | **3,930,203** | **1,421,997** | **5,352,200** | **4,835,846** |
| NET ASSETS: | | | | |
| Unrestricted | 16,407,029 | 1,507,241 | 17,914,270 | 14,623,263 |
| Temporarily restricted | 1,101,035 | 247,456 | 1,348,491 | 1,115,216 |
| Permanently restricted | 4,449,365 | 225,400 | 4,674,765 | 4,141,682 |
| **TOTAL NET ASSETS** | **21,957,429** | **1,980,097** | **23,937,526** | **19,880,161** |
| **TOTAL LIABILITIES AND NET ASSETS** | **$ 25,887,632** | **$ 3,402,094** | **$ 29,289,726** | **$ 24,716,007** |

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

# Consolidated Statements of Activities

## FOR THE YEARS ENDED AUGUST 31, 2007 AND 2006 (in thousands of dollars)

| | 2007 | | | 2006 |
|---|---|---|---|---|
| | University | Hospitals | Consolidated | Consolidated |
| UNRESTRICTED NET ASSETS | | | | |
| REVENUES: | | | | |
| Student income: | | | | |
| Undergraduate programs | $ 227,359 | $ - | $ 227,359 | $ 213,352 |
| Graduate programs | 222,858 | - | 222,858 | 210,380 |
| Room and board | 99,907 | - | 99,907 | 95,327 |
| Student financial aid | (156,062) | - | (156,062) | (142,898) |
| **TOTAL STUDENT INCOME** | **394,062** | **-** | **394,062** | **376,161** |
| Sponsored research support: | | | | |
| Direct costs - University | 541,073 | - | 541,073 | 523,886 |
| Direct costs - Stanford Linear Accelerator Center | 345,725 | - | 345,725 | 297,979 |
| Indirect costs | 171,360 | - | 171,360 | 172,249 |
| **TOTAL SPONSORED RESEARCH SUPPORT** | **1,058,158** | **-** | **1,058,158** | **994,114** |
| Health care services: | | | | |
| Patient care, net | - | 1,986,267 | 1,986,267 | 1,835,058 |
| Physicians' services and support - SHC and LPCH, net | 353,308 | (353,308) | - | - |
| Physicians' services and support - other facilities, net | 13,170 | - | 13,170 | 16,098 |
| **TOTAL HEALTH CARE SERVICES** | **366,478** | **1,632,959** | **1,999,437** | **1,851,156** |
| **CURRENT YEAR GIFTS IN SUPPORT OF OPERATIONS** | **198,454** | **-** | **198,454** | **167,700** |
| Net assets released from restrictions: | | | | |
| Payments received on prior year pledges | 53,878 | - | 53,878 | 60,098 |
| Prior year gifts released from donor restrictions | 41,807 | 26,748 | 68,555 | 56,946 |
| **TOTAL NET ASSETS RELEASED FROM RESTRICTIONS** | **95,685** | **26,748** | **122,433** | **117,044** |
| Investment income distributed for operations: | | | | |
| Endowment | 608,969 | - | 608,969 | 534,734 |
| Expendable funds pool and other investment income | 100,580 | - | 100,580 | 74,149 |
| **TOTAL INVESTMENT INCOME DISTRIBUTED FOR OPERATIONS** | **709,549** | **-** | **709,549** | **608,883** |
| **SPECIAL PROGRAM FEES AND OTHER INCOME** | **332,694** | **89,816** | **422,510** | **396,358** |
| **TOTAL REVENUES** | **3,155,080** | **1,749,523** | **4,904,603** | **4,511,416** |
| EXPENSES: | | | | |
| Salaries and benefits | 1,711,691 | 917,029 | 2,628,720 | 2,459,438 |
| Depreciation | 201,944 | 64,267 | 266,211 | 254,334 |
| Other operating expenses | 991,070 | 634,240 | 1,625,310 | 1,498,751 |
| **TOTAL EXPENSES** | **2,904,705** | **1,615,536** | **4,520,241** | **4,212,523** |
| **EXCESS OF REVENUES OVER EXPENSES** | **$ 250,375** | **$ 133,987** | **$ 384,362** | **$ 298,893** |

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

# Consolidated Statements of Activities

**FOR THE YEARS ENDED AUGUST 31, 2007 AND 2006 (in thousands of dollars)**

| | 2007 | | | 2006 |
|---|---|---|---|---|
| | University | Hospitals | Consolidated | Consolidated |
| UNRESTRICTED NET ASSETS (continued) | | | | |
| **EXCESS OF REVENUES OVER EXPENSES** | **$ 250,375** | **$ 133,987** | **$ 384,362** | **$ 298,893** |
| Other changes in unrestricted net assets: | | | | |
| Investment returns not included in operations | 2,665,705 | 202,816 | 2,868,521 | 1,861,724 |
| Current year gifts not included in operations | 38,365 | - | 38,365 | 3,215 |
| Hospital equity transfers | 10,844 | (10,844) | - | - |
| Capital and other gifts released from restrictions | 127,763 | 15,065 | 142,828 | 61,412 |
| Capital gifts released to Hospitals | - | 2,547 | 2,547 | 764 |
| Decrease in minimum pension liability | - | 3,593 | 3,593 | 46,611 |
| Transfer to permanently restricted net assets | (29,140) | (11,536) | (40,676) | (30,917) |
| Transfer to temporarily restricted net assets | (14,598) | - | (14,598) | (6,726) |
| Swap interest and unrealized losses | (2,262) | 438 | (1,824) | (12,965) |
| Cumulative effect of change in accounting principle | (93,286) | 11,054 | (82,232) | (17,897) |
| Other | 4,473 | (14,352) | (9,879) | (4,241) |
| **NET CHANGE IN UNRESTRICTED NET ASSETS** | **2,958,239** | **332,768** | **3,291,007** | **2,199,873** |
| TEMPORARILY RESTRICTED NET ASSETS | | | | |
| Gifts and pledges, net | 273,399 | 162,196 | 435,595 | 633,774 |
| Investment gains | 60,540 | 14,833 | 75,373 | 61,257 |
| Change in value of split interest agreements, net | (9,769) | - | (9,769) | (3,085) |
| Net assets released to operations | (95,685) | (26,748) | (122,433) | (117,044) |
| Capital and other gifts released to unrestricted net assets | (127,763) | (15,065) | (142,828) | (61,412) |
| Capital gifts released to Hospitals' unrestricted net assets | (2,547) | - | (2,547) | (764) |
| Transfer from unrestricted net assets | 14,598 | - | 14,598 | 6,726 |
| Transfer to permanently restricted net assets | (12,875) | (599) | (13,474) | (55,169) |
| Other | - | (1,240) | (1,240) | (2,966) |
| **NET CHANGE IN TEMPORARILY RESTRICTED NET ASSETS** | **99,898** | **133,377** | **233,275** | **461,317** |
| PERMANENTLY RESTRICTED NET ASSETS | | | | |
| Gifts and pledges, net | 342,284 | 18,646 | 360,930 | 223,572 |
| Investment gains | 161,332 | - | 161,332 | 61,225 |
| Change in value of split interest agreements, net | (39,130) | - | (39,130) | (28,273) |
| Transfer from unrestricted net assets | 29,140 | 11,536 | 40,676 | 30,917 |
| Transfer from temporarily restricted net assets | 12,875 | 599 | 13,474 | 55,169 |
| Other | (8,057) | 3,858 | (4,199) | 3,749 |
| **NET CHANGE IN PERMANENTLY RESTRICTED NET ASSETS** | **498,444** | **34,639** | **533,083** | **346,359** |
| **NET CHANGE IN TOTAL NET ASSETS** | **3,556,581** | **500,784** | **4,057,365** | **3,007,549** |
| Total net assets, beginning of year | 18,400,848 | 1,479,313 | 19,880,161 | 16,872,612 |
| **TOTAL NET ASSETS, END OF YEAR** | **$ 21,957,429** | **$ 1,980,097** | **$ 23,937,526** | **$ 19,880,161** |

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

# Consolidated Statements of Cash Flows

## FOR THE YEARS ENDED AUGUST 31, 2007 AND 2006 (in thousands of dollars)

| | 2007 | | | 2006 |
|---|---|---|---|---|
| | University | Hospitals | Consolidated | Consolidated |
| CASH FLOW FROM OPERATING ACTIVITIES: | | | | (as restated, note 1) |
| Change in net assets | $ 3,556,581 | $ 500,784 | $ 4,057,365 | $ 3,007,549 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | | | |
| Cumulative effect of change in accounting principle | 93,286 | (11,054) | 82,232 | 17,897 |
| Depreciation, amortization and loss on disposal of fixed assets | 215,186 | 65,936 | 281,122 | 242,505 |
| Net realized and unrealized gains on investments and security agreements | (3,291,636) | (85,600) | (3,377,236) | (2,197,463) |
| Net realized and unrealized losses (gains) on derivatives | 2,262 | 106 | 2,368 | (24,559) |
| Actuarial change on split interest agreements | 46,966 | 3,858 | 50,824 | 18,493 |
| Permanently restricted investment (income) loss | (38,891) | 11,753 | (27,138) | (9,427) |
| Gifts restricted for long-term investments | (273,545) | (82,107) | (355,652) | (317,604) |
| Gifts of securities | (219,696) | - | (219,696) | (205,055) |
| Net increase in accounts receivable, pledges receivable and receivables from SHC and LPCH | (52,801) | (58,155) | (110,956) | (398,803) |
| Increase in prepaid expenses and other assets | (50,064) | (58,145) | (108,209) | (29,209) |
| Increase (decrease) in accounts payable and accrued expenses | 48,963 | (27,801) | 21,162 | 18,872 |
| Increase in accrued post retirement costs | 45,395 | 2,702 | 48,097 | 5,670 |
| Increase in deferred rental income | 25,434 | - | 25,434 | 5,401 |
| Increase (decrease) in U.S. government refundable loan funds | 291 | - | 291 | (1,611) |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | **107,731** | **262,277** | **370,008** | **132,656** |
| CASH FLOW FROM INVESTING ACTIVITIES: | | | | |
| Land, building and equipment purchases | (334,582) | (188,759) | (523,341) | (572,133) |
| Student, faculty and other loans: | | | | |
| New loans made | (75,645) | - | (75,645) | (69,691) |
| Principal collected | 37,112 | - | 37,112 | 40,437 |
| Purchases of investments | (13,141,515) | (236,099) | (13,377,614) | (11,124,689) |
| Sales and maturities of investments | 13,042,957 | 83,561 | 13,126,518 | 10,806,196 |
| **NET CASH USED FOR INVESTING ACTIVITIES** | **(471,673)** | **(341,297)** | **(812,970)** | **(919,880)** |
| CASH FLOW FROM FINANCING ACTIVITIES: | | | | |
| Gifts and reinvested income of endowment, capital projects and other restricted purposes | 236,267 | 82,107 | 318,374 | 260,169 |
| (Decrease) increase in investment income for restricted purposes | 38,891 | (14,371) | 24,520 | 9,492 |
| Proceeds from borrowing | 186,211 | 1,150 | 187,361 | 491,500 |
| Bond issuance costs | (816) | - | (816) | (18,987) |
| Repayment of notes and bonds payable | (715) | (8,753) | (9,468) | (25,322) |
| (Decrease) increase in liabilities under security agreements | (9,473) | - | (9,473) | 26,241 |
| Other | - | - | - | (6,000) |
| **NET CASH PROVIDED BY FINANCING ACTIVITIES** | **450,365** | **60,133** | **510,498** | **737,093** |
| **INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | **86,423** | **(18,887)** | **67,536** | **(50,131)** |
| Cash and cash equivalents, beginning of year | 459,871 | 119,213 | 579,084 | 629,215 |
| **CASH AND CASH EQUIVALENTS, END OF YEAR** | **$ 546,294** | **$ 100,326** | **$ 646,620** | **$ 579,084** |
| SUPPLEMENTAL DATA: | | | | |
| Interest paid during the year | $ 69,953 | $ 46,391 | $ 116,344 | $ 96,946 |
| Gifts of equipment | $ 1,477 | $ - | $ 1,477 | $ 16,627 |
| Gifts of securities | $ 219,696 | $ - | $ 219,696 | $ 205,055 |
| Cash collateral received under securities lending agreements | $ 583,872 | $ - | $ 583,872 | $ 599,191 |



*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 and the purchases and sales of investments in the prior year statement of cash flows have been revised to correct the presentation to be consistent with the presentation in 2007. These reclassifications and revisions had no impact on the change in net assets, total net assets or net cash used for investing activities.

**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 1,829 faculty and 14,945 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, the Stanford Management Company 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 into 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 and certain investment gains and funds functioning as endowment.

Management considers all revenues and expenses to be related to operations. Investment gains and current year gifts not included in operations, capital and other gifts released from restrictions, hospital equity transfers, minimum pension liability and certain other non-operating changes 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 53% are for capital projects and 47% 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 for investment purposes, 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. The values of publicly traded fixed income, equity securities and mutual funds are based on quoted market prices and exchange rates, if applicable. Securities transactions are reported on a trade-date basis.

Assets held by other trustees, limited partnerships, real estate and improvements, split interest agreements 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, 2007 and 2006 are as follows:

| | UNIVERSITY | HOSPITALS |
|---|---|---|
| Land improvements | 10-25 years | 10-25 years |
| Buildings and building improvements | 13-50 years | 7-40 years |
| Furniture, fixtures and medical equipment | 5-10 years | 3-20 years |
| Equipment, books and software | 3-10 years | 3-10 years |

ASSET RETIREMENT OBLIGATIONS Asset retirement obligations (AROs) are estimated costs and obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value as accrued expenses and the related asset retirement costs are recorded as an increase in other changes in unrestricted net assets. Asset retirement costs are subsequently accreted over the useful lives of the related assets.

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.

DONOR-ADVISED FUNDS The University invests gifts received from donors under donor-advised fund agreements (DAFs). These funds are owned and controlled by the University and are separately identified by donor. The donors have advisory privileges with respect to the distribution of the amounts in the funds. DAFs are recorded as unrestricted net assets at the full amount of the gift. Transfers of funds to other charitable organizations are recorded as a reduction to other changes in unrestricted net assets at the time the transfer is made.

SPLIT INTEREST AGREEMENTS Split interest agreements represent trusts with living income beneficiaries where the University has a residual interest. The discounted present value of any income beneficiary interest is reported as a liability in the statement of financial position based on actuarial tables established by the Internal Revenue Service. Gifts subject to such agreements are recorded as revenue, net of the income beneficiary share, at the date of gift. Actuarial gains or losses are included in change in value of split interest agreements in the statement of activities.

Resources that are expendable upon maturity are classified as temporarily restricted net assets; all others are classified as permanently restricted net assets.

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 of 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 $42,619,000 and $37,988,000 for the years ended August 31, 2007 and 2006, 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 costs in excess of reimbursements for Medi-Cal and county services for the years ended August 31, 2007 and 2006 were $184,774,000 and $153,975,000, 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.

RECENT PRONOUNCEMENTS In 2007, the University adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 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). FAS 158 requires organizations to recognize a net asset or liability in their statement of financial position and to reflect the funded status of their defined benefit pension and other post retirement benefit plans. It also requires changes in the funded status of the plans to be recognized in the year in which they occur in the statement of activities. The provision of FAS 158 that requires measurement of plan assets and benefit obligations as of the end of the fiscal year is effective for the University for the fiscal year ended August 31, 2009. The effect of FAS 158's adoption is discussed in notes 13 and 14 for the University and Hospitals, respectively.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 establishes a common definition for fair value to be applied to generally accepted accounting principles requiring use of fair value, establishes a framework for measuring fair value and expands the related disclosure requirements about fair value measurements. This accounting standard is effective for the University and the Hospitals for their fiscal year ending August 31, 2009. The University and the Hospitals are assessing the impact of adopting FAS 157.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115* (FAS 159). FAS 159 permits entities to choose to measure eligible items at fair value at specific election dates (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected shall be reported in earnings at each subsequent reporting period. This accounting standard is effective for the University and the Hospitals for their fiscal year ending August 31, 2009. The University and the Hospitals are assessing the impact of adopting FAS 159.

RESTATEMENT OF FISCAL YEAR 2006 CONSOLIDATED STATEMENT OF CASH FLOWS The fiscal year 2006 consolidated statement of cash flows has been restated to reflect cash activity related to long-term pledges as financing activities and the sale of contributed securities as investing activities. Previously, these amounts were classified primarily as operating and financing activities, respectively. The University historically has classified gifts of securities in operating or financing activities, depending on the nature of the gift, because the University's practice is to sell these securities immediately upon receipt. The effect of these changes on the accompanying fiscal year 2006 consolidated statement of cash flows is as follows, in thousands of dollars:

| | AS PREVIOUSLY REPORTED | ADJUSTMENT | AS RESTATED |
|---|---|---|---|
| Net cash provided by operating activities | $ 562,950 | $ (430,294) | $ 132,656 |
| Net cash used for investing activities | (1,158,478) | 238,598 | (919,880) |
| Net cash provided by financing activities | 545,397 | 191,696 | 737,093 |
| Decrease in cash and cash equivalents | (50,131) | - | (50,131) |

## 2. Accounts Receivable

Accounts receivable at August 31, 2007 and 2006, in thousands of dollars, are as follows:

| | 2007 | 2006 |
|---|---|---|
| UNIVERSITY: | | |
| U.S. government | $ 84,820 | $ 79,555 |
| Non-government sponsors | 29,428 | 27,896 |
| Due from brokers | 89,628 | 99,673 |
| Accrued interest on investments | 12,166 | 16,385 |
| Student | 6,752 | 5,689 |
| Other | 38,959 | 29,744 |
| | 261,753 | 258,942 |
| Less allowances for losses | (2,111) | (1,927) |
| University accounts receivable, net | 259,642 | 257,015 |
| HOSPITALS: | | |
| Patient receivables | 418,659 | 400,759 |
| Other | 66,916 | 14,718 |
| | 485,575 | 415,477 |
| Less bad debt allowances | (88,321) | (105,776) |
| Hospitals accounts receivable, net | 397,254 | 309,701 |
| **CONSOLIDATED ACCOUNTS RECEIVABLE, NET** | **$ 656,896** | **$ 566,716** |

## 3. Pledges Receivable

Pledges are recorded at the present value of the discounted future cash flows, net of allowances. At August 31, 2007 and 2006, pledges receivable are as follows, in thousands of dollars:

| | 2007 | | | 2006 |
|---|---|---|---|---|
| | University | Hospitals | Consolidated | Consolidated |
| One year or less | $ 67,915 | $ 39,373 | $ 107,288 | $ 75,435 |
| Between one year and five years | 548,061 | 61,295 | 609,356 | 565,841 |
| More than five years | 314,360 | 5,882 | 320,242 | 228,580 |
| | 930,336 | 106,550 | 1,036,886 | 869,856 |
| Less discount/allowance | (262,875) | (16,380) | (279,255) | (251,051) |
| **PLEDGES RECEIVABLE, NET** | **$ 667,461** | **$ 90,170** | **$ 757,631** | **$ 618,805** |

Conditional pledges for the University, which depend on the occurrence of a specified future and uncertain event, were $50,000 and $43,545,000 at August 31, 2007 and 2006, respectively. During fiscal year 2007, approximately $43,500,000 of conditional pledges related to matching gifts were satisfied. 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 $333,359,000 and $296,851,000 at August 31, 2007 and 2006, 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, 2007 and 2006 are as follows, in thousands of dollars:

| | 2007 | | | 2006 |
|---|---|---|---|---|
| | University | Hospitals | Consolidated | Consolidated |
| Cash, short-term investments and derivatives | $ 1,036,232 | $ 500,734 | $ 1,536,966 | $ 1,375,947 |
| Collateral held for securities loaned | 583,872 | - | 583,872 | 599,191 |
| Bonds and mutual funds | 589,120 | 141,968 | 731,088 | 978,041 |
| Public and private equities and investment funds | 8,213,716 | 32,333 | 8,246,049 | 8,175,235 |
| Assets held by other trustees (net of income beneficiary share of $86,263 and $78,667 at August 31, 2007 and 2006, respectively) | 156,885 | 17,655 | 174,540 | 104,933 |
| Real estate and improvements, including Stanford Shopping Center and Research Park | 1,767,651 | - | 1,767,651 | 1,542,698 |
| Limited partnership investments | 10,003,199 | - | 10,003,199 | 6,417,208 |
| Other | 75,290 | - | 75,290 | 69,958 |
| | 22,425,965 | 692,690 | 23,118,655 | 19,263,211 |
| The Hospitals' investment in University's Merged Pool | (1,258,892) | 1,258,892 | - | - |
| **INVESTMENTS AT FAIR VALUE** | **$ 21,167,073** | **$ 1,951,582** | **$ 23,118,655** | **$ 19,263,211** |

The University manages a portion of the Hospitals' investments, with a combined market value of $1,493,012,000 and $1,171,472,000 at August 31, 2007 and 2006, respectively.

Total investment returns reflected in the statements of activities for the years ended August 31, 2007 and 2006, in thousands of dollars, are as follows:

| | 2007 | | | 2006 |
|---|---|---|---|---|
| | University | Hospitals | Consolidated | Consolidated |
| Investment income | $ 337,363 | $ 49,946 | $ 387,309 | $ 394,755 |
| Net realized and unrealized gains | 3,244,670 | 170,321 | 3,414,991 | 2,197,171 |
| **TOTAL INVESTMENT RETURN** | **$ 3,582,033** | **$ 220,267** | **$ 3,802,300** | **$ 2,591,926** |

Investment returns are net of investment management expenses, including both external management fees and internal University salaries, benefits and operating expenses. For the years ended August 31, 2007 and 2006, total investment returns of $3,058,918,000 and $1,952,849,000, respectively, were reinvested by the University and Hospitals after the distributions to operations and split interest agreement 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, 2007 and 2006, in thousands of dollars:

| | 2007 | 2006 |
|---|---|---|
| UNIVERSITY: | | |
| Merged pool | $ 19,548,492 | $ 15,848,335 |
| Expendable funds pool | 1,880,264 | 1,657,595 |
| Endowment income funds pool | 287,216 | 295,758 |
| Other investment pools | 500,592 | 558,240 |
| Specific investments | 2,217,366 | 1,824,661 |
| | 24,433,930 | 20,184,589 |
| Less amounts included in cash and cash equivalents | (461,600) | (436,874) |
| Less funds cross-invested in investment pools (including the Hospitals' investment of $1,258,892 and $711,763 in 2007 and 2006, respectively, in the University's Merged Pool) | (2,805,257) | (2,223,049) |
| | 21,167,073 | 17,524,666 |
| HOSPITALS: | | |
| Investments | 1,951,582 | 1,738,545 |
| **INVESTMENTS AT FAIR VALUE** | **$ 23,118,655** | **$ 19,263,211** |

The Merged Pool (MP) is the primary investment pool in which endowment (see Note 10) and other long-term funds are invested. The MP is invested with the objective of maximizing long-term total return. It is a unitized pool in which the fund holders purchase investments and withdraw funds based on a monthly market value. The University's Board approves an annual distribution amount per share (payout) to be distributed to endowment fund holders to support operations. The policy governing the amounts paid annually from the MP to support current operations is designed to protect the value of the endowment and other long-term funds against the expected impact of inflation while also funding a relatively constant portion of the University's current operating expenditures. The sources of the payout are earned income on endowment assets (interest, dividends, rents and royalties), a portion of realized capital gains and funds functioning as endowment, as needed.

Earned income and realized gains on endowment funds were distributed for operations in fiscal years 2007 and 2006, as follows, in thousands of dollars:

| | 2007 | 2006 |
|---|---|---|
| Endowment income | $ 235,450 | $ 258,093 |
| Realized gains | 373,519 | 276,641 |
| **APPROVED PAYOUT** | **$ 608,969** | **$ 534,734** |

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 MP. The EIFP holds income previously distributed to holders of permanently restricted endowment funds that has not yet been expended. The EIFP is invested in highly liquid instruments and is included in the statement of financial position as cash and cash equivalents. The total return on investments in the EIFP is distributed to fund holders. For the years ended August 31, 2007 and 2006, the distributions were $8,393,000 and $7,896,000, 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 approved payout is deposited in, or withdrawn from, funds functioning as endowment. For the years ended August 31, 2007 and 2006, the results of the EFP, in thousands of dollars, are as follows:

| | 2007 | 2006 |
|---|---|---|
| Total investment return of the EFP | $ 314,021 | $ 240,958 |
| Less distributions to fund holders and operations | (87,155) | (61,202) |
| **AMOUNTS ADDED TO THE ENDOWMENT** | **$ 226,866** | **$ 179,756** |

The University utilizes derivatives and other strategies to reduce investment risk, to serve as a temporary surrogate for investment in stocks and bonds, to manage interest exposure on the University's variable rate debt or to achieve specific exposure to foreign currencies. The University's derivative positions include forward contracts, swaps, options and futures contracts. The net unrealized appreciation (depreciation) on these derivatives was $178,164,000 and ($52,820,000) at August 31, 2007 and 2006, respectively.

Foreign currency forward contracts, interest rate swaps and 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, 2007, is as follows, in thousands of dollars:

| YEAR | |
|---|---|
| 2008 | $ 55,247 |
| 2009 | 54,493 |
| 2010 | 52,279 |
| 2011 | 46,989 |
| 2012 | 42,883 |
| Thereafter | 1,223,354 |
| **TOTAL** | **$ 1,475,245** |

## 6. Plant Facilities

Plant facilities at August 31, 2007 and 2006, in thousands of dollars, are as follows:

| | 2007 | | | 2006 |
|---|---|---|---|---|
| | University | Hospitals | Consolidated | Consolidated |
| Land and improvements | $ 352,419 | $ 30,396 | $ 382,815 | $ 299,053 |
| Buildings and building improvements | 2,902,464 | 692,633 | 3,595,097 | 3,406,394 |
| Furniture, fixtures and medical equipment | 52,286 | 232,310 | 284,596 | 244,930 |
| Equipment, books and software | 1,338,461 | 123,563 | 1,462,024 | 1,402,967 |
| Construction in progress | 249,306 | 322,423 | 571,729 | 417,143 |
| Plant facilities | 4,894,936 | 1,401,325 | 6,296,261 | 5,770,487 |
| Less accumulated depreciation | (2,189,059) | (634,833) | (2,823,892) | (2,606,557) |
| **PLANT FACILITIES, NET OF ACCUMULATED DEPRECIATION** | **$ 2,705,877** | **$ 766,492** | **$ 3,472,369** | **$ 3,163,930** |

At August 31, 2007, $999,000,000 of fully depreciated plant facilities were still in use.

## 7. Liabilities Under Security Agreements

At August 31, 2007 and 2006, the University held $583,872,000 and $599,191,000, 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 $64,851,000 and $59,005,000 at August 31, 2007 and 2006, respectively. These amounts are included as investments and liabilities in the University's financial statements. The estimated fair value of securities on loan at August 31, 2007 and 2006, was $553,869,000 and $573,229,000, 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, 2007 and 2006, in thousands of dollars, are as follows:

| | YEAR OF MATURITY | EFFECTIVE INTEREST RATE 2007 | OUTSTANDING PRINCIPAL 2007 | OUTSTANDING PRINCIPAL 2006 |
|---|---|---|---|---|
| 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 |
| Series T-1 | 2039 | 5.0% | 111,775 | - |
| CEFA Variable Rate Revenue Notes and Bonds: | | | | |
| Series L | 2014-2022 | 3.9% | 83,818 | 83,818 |
| Series S | 2039-2050 | 3.7%* | 181,200 | 181,200 |
| Commercial Paper | 2039-2050 | 3.7% | 24,751 | - |
| 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 | 8,925 | 9,042 |
| Variable Notes and Bonds: | | | | |
| Stanford University Bonds PARS | 2032 | 5.2% | 50,000 | 50,000 |
| Commercial Paper | 2006 | 5.3%* | 98,200 | 63,000 |
| University notes and bonds payable | | | 1,480,429 | 1,308,820 |
| Premium (discounts) | | | 13,332 | (258) |
| **TOTAL** | | | **$ 1,493,761** | **$ 1,308,562** |

*Exclusive of interest rate swaps.

At August 31, 2007 and 2006, the fair value of these debt instruments approximated their recorded value.

Stanford's tax exempt debt is borrowed through the California Educational Facilities Authority (CEFA). The CEFA debt is a general obligation of the University secured by its revenues. Although CEFA is the borrower, Stanford is responsible for repayment of the tax exempt debt.

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, 2007, the University had swap agreements expiring November 1, 2039 to pay an interest rate of approximately 3.7% 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 5.8% on approximately $31,846,000 of the variable rate commercial paper.

In June 2007, the University issued CEFA T-1 Bonds (the Bonds) with a par value of $111,775,000 plus an original issue premium of $13,891,000 at an interest rate of 5.0%. The Bonds mature on March 15, 2039. The Bonds are subject to optional redemption prior to maturity at the option of the Authority at the direction of the University.
The University incurred interest expense of approximately $67,327,000 and $65,352,000 for fiscal years 2007 and 2006, respectively, which is net of approximately $3,070,000 and $804,000, 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 $600,000 and $1,624,000 for fiscal years 2007 and 2006, 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, 2007, was $98,200,000. The weighted average days to maturity were 20.8 and the weighted average effective interest rate was 5.3% as of August 31, 2007.

The University also has a tax-exempt commercial paper credit facility that allows for borrowings up to $150,000,000 through CEFA. The outstanding balance at August 31, 2007, was $24,751,000. The weighted average days to maturity were 18.3 and the weighted average effective interest rate was 3.7% as of August 31, 2007.

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

| YEAR ENDING AUGUST 31 | PRINCIPAL |
|---|---|
| 2008 tax exempt commercial paper | $ 24,751 |
| 2008 commercial paper | 98,200 |
| 2008 other | 775 |
| 2009 | 50,833 |
| 2010 | 899 |
| 2011 | 50,972 |
| 2012 | 62,635 |
| Thereafter | 1,191,364 |
| **TOTAL** | **$ 1,480,429** |

## 9. Hospitals' Notes and Bonds Payable

Bonds, certificates of participation and capital lease obligations at August 31, 2007 and 2006, in thousands of dollars, are as follows:

| | YEAR OF MATURITY | EFFECTIVE INTEREST RATE 2007 | OUTSTANDING PRINCIPAL 2007 | 2006 |
|---|---|---|---|---|
| SHC: | | | | |
| California Health Facilities Financing Authority (CHFFA): | | | | |
| 1998 Series B Fixed Rate Bonds | 2031 | 5.0% | $ 170,775 | $ 174,185 |
| 2003 Series A Fixed Rate Bonds | 2007-2023 | 2.0% - 5.0% | 96,310 | 100,000 |
| 2003 Series B, C and D Variable Rate Bonds | 2036 | 3.6% * | 150,000 | 150,000 |
| 2006 Series A Variable Rate Bonds | 2040 | 3.6% * | 260,300 | 260,300 |
| 2006 Series B Variable Rate Bonds | 2045 | 3.6% * | 168,200 | 168,200 |
| Promissory Note | 2014 | 7.0% | 1,132 | - |
| LPCH: | | | | |
| Variable Rate Certificates of Participation (Certificates) | 2023 | 3.9% * | 32,400 | 33,600 |
| California Health Facilities Financing Authority (CHFFA): | | | | |
| Auction Rate Revenue Bonds | 2027-2033 | 3.5% - 3.8% | 60,000 | 60,000 |
| Fixed Rate Revenue Bonds | 2013-2027 | 4.9% | 55,000 | 55,000 |
| Capital lease obligation | | | 16,016 | - |
| Hospitals notes and bonds payable | | | 1,010,133 | 1,001,285 |
| Premiums | | | 4,613 | 4,917 |
| **TOTAL** | | | **$1,014,746** | **$ 1,006,202** |

*Exclusive of interest rate swaps.

At August 31, 2007 and 2006, the fair value of these debt instruments approximated their recorded value.

At August 31, 2007, SHC had swap agreements expiring through November 15, 2040 to pay an interest rate of approximately 3.4% on the 2003 Variable rate bonds, 3.7% on the 2006 Series A Variable rate bonds and 3.6% on the 2006 Series B Variable rate bonds based on an amount equal to the outstanding balance of the bonds.

At August 31, 2007, LPCH had swap agreements expiring through 2023 to pay a fixed interest rate of 6.2% on an amount equal to the outstanding balance of the Certificates.

The Hospitals' tax exempt debt is borrowed through the California Health Facilities Financing Authority (CHFFA). The CHFFA debt is a general obligation of the Hospitals. Payments of principal and interest on the Hospitals' bonds are collateralized by a pledge against the revenues of the respective hospital. Although CHFFA is the borrower, the Hospitals are responsible for the repayment of the tax exempt debt. 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 which include, among other things, limitations on the incurrence of additional indebtedness, liens on property, restrictions on disposition or transfer of assets and compliance with certain financial ratios. The Hospitals may redeem the bonds and certificates, in whole or in part, prior to the stated maturities.

Holders of the Certificates have the option to tender the certificates weekly. In order to ensure the availability of funds to purchase any certificates tendered that the remarketing agent is unable to remarket, LPCH has obtained a standby bond purchase agreement that expires in September 2015. LPCH may redeem the Certificates, in whole or in part, prior to the stated maturities at par value. LPCH has the option to convert the Certificates to a fixed rate. The University is not an obligor or guarantor with respect to any obligations of SHC or LPCH, nor are SHC or LPCH obligors or guarantors with respect to obligations of the University.

SHC has two irrevocable letters of credit with a bank in the amount of $22,014,000, which are required as security for the workers' compensation self-insurance arrangement. No amounts have been drawn on these letters of credit as of August 31, 2007.

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

| YEAR ENDING AUGUST 31 | PRINCIPAL |
|---|---|
| 2008 | $ 10,034 |
| 2009 | 10,032 |
| 2010 | 11,024 |
| 2011 | 11,485 |
| 2012 | 23,489 |
| Thereafter | 944,069 |
| **TOTAL** | **$ 1,010,133** |

## 10. University Endowment

The University classifies a substantial portion of its financial resources as 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. The endowment is intended to generate investment income that can be used to support the current operations of the University.

Pure endowment funds and endowed lands are subject to the restrictions of the gift instruments requiring that the principal be held in perpetuity and the income and an appropriate portion of gains be spent only 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 as permanently restricted net assets and all reinvested gains as unrestricted net assets, except when a donor requires the gains to be reinvested as permanently restricted 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 University resources designated as endowment and are invested for long-term appreciation and current income. These assets, however, remain available and may be spent at the Board's discretion. Funds functioning as endowment are recorded as unrestricted net assets.

Changes in the University's endowment, excluding pledges, for the years ended August 31, 2007 and 2006, in thousands of dollars, are as follows:

| | 2007 | 2006 |
|---|---|---|
| ENDOWMENT, BEGINNING OF YEAR | $ 14,084,676 | $ 11,883,535 |
| Investment returns: | | |
| Earned endowment income | 235,450 | 257,702 |
| Unrealized and realized gains | 2,792,706 | 1,940,801 |
| Total investment returns | 3,028,156 | 2,198,503 |
| Amounts distributed for operations | (608,969) | (534,734) |
| Gifts and pledge payments | 361,401 | 252,572 |
| Funds invested in endowment, net | 107,473 | 105,989 |
| EFP returns invested in endowment | 226,866 | 179,756 |
| Other | (34,767) | (945) |
| Net increase in endowment | 3,080,160 | 2,201,141 |
| **ENDOWMENT, END OF YEAR** | **$ 17,164,836** | **$ 14,084,676** |

## 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, 2007 and 2006, per the statement of activities reconciled to the cash basis (as reported by OOD), in thousands of dollars:

| | 2007 | 2006 |
|---|---|---|
| Current year gifts in support of operations | $ 198,454 | $ 167,700 |
| Current year gifts not included in operations | 38,365 | 3,215 |
| Temporarily restricted — general | 261,888 | 573,092 |
| Temporarily restricted — capital | 11,511 | 17,541 |
| Permanently restricted — endowment | 342,282 | 204,847 |
| Permanently restricted — student loans | 2 | 146 |
| **TOTAL PER STATEMENT OF ACTIVITIES** | **852,502** | **966,541** |
| Adjustments to gift total as reported by OOD: | | |
| New pledges | (404,430) | (542,319) |
| Payments made on pledges | 266,416 | 286,447 |
| Pledge discounts and other adjustments | 53,724 | 141,569 |
| Donor advised funds not designated for Stanford | (19,827) | - |
| Revocable gifts | 14,085 | - |
| Non-cash gifts | 8,096 | - |
| Non-government grants, recorded as sponsored research support when earned | 60,434 | 58,870 |
| Other | 1,345 | 55 |
| **TOTAL AS REPORTED BY OOD** | **$ 832,345** | **$ 911,163** |

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, 2007 and 2006 are categorized on a functional basis as follows, in thousands of dollars:

| | 2007 | 2006 |
|---|---|---|
| UNIVERSITY: | | |
| Organized research (direct costs) | $ 820,098 | $ 814,231 |
| Instruction and departmental research | 969,687 | 878,124 |
| Auxiliary activities | 501,933 | 499,222 |
| Administration and general | 192,841 | 192,221 |
| Libraries | 140,111 | 137,514 |
| Development | 66,762 | 55,572 |
| Student services | 108,604 | 83,742 |
| SLAC construction | 104,669 | 74,360 |
| | 2,904,705 | 2,734,986 |
| HOSPITALS: | | |
| Health care services | 1,615,536 | 1,477,537 |
| **TOTAL CONSOLIDATED EXPENSES** | **$ 4,520,241** | **$ 4,212,523** |

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).

In 2007, the University adopted FAS 158. The incremental effect of adopting FAS 158 is as follows, in thousands of dollars:

| | BEFORE APPLICATION | PENSION PLAN | POST RETIREMENT MEDICAL | AFTER APPLICATION |
|---|---|---|---|---|
| CONSOLIDATED FINANCIAL STATEMENTS: | | | | |
| Prepaid expenses and other assets | $ 49,815 | $ 35,240 | $ - | $ 85,055 |
| Total assets | 25,852,392 | 35,240 | - | 25,887,632 |
| Accrued post retirement benefit costs | 81,783 | - | 128,526 | 210,309 |
| Total liabilities | 3,801,677 | - | 128,526 | 3,930,203 |
| Total net assets | 22,050,715 | 35,240 | (128,526) | 21,957,429 |
| Change in net assets | 3,649,867 | 35,240 | (128,526) | 3,556,581 |
| CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE: | | | | |
| Unrecognized net actuarial gain (loss) | $ - | $ 43,035 | $ (63,880) | $ (20,845) |
| Unrecognized prior service cost | - | (7,795) | (64,646) | (72,441) |
| | **$ -** | **$ 35,240** | **$ (128,526)** | **$ (93,286)** |

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 $89,000,000 and $83,000,000 for the years ended August 31, 2007 and 2006, 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.

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 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| CHANGE IN PLAN ASSETS | | | | |
| Fair value of plan assets at beginning of year | $ 274,434 | $ 262,427 | $ 81,189 | $ 70,444 |
| Actual return on plan assets | 32,539 | 30,963 | 17,857 | 4,102 |
| Employer contributions | - | - | 13,642 | 16,313 |
| Plan participants' contributions | - | - | 5,805 | 5,000 |
| Benefits paid | (17,327) | (18,956) | (16,412) | (14,670) |
| **FAIR VALUE OF PLAN ASSETS AT END OF YEAR** | **$ 289,646** | **$ 274,434** | **$ 102,081** | **$ 81,189** |
| CHANGE IN PROJECTED BENEFIT OBLIGATION | | | | |
| Benefit obligation at beginning of year | $ 267,778 | $ 282,486 | $ 263,053 | $ 328,847 |
| Service cost | 4,465 | 5,425 | 9,562 | 10,257 |
| Interest cost | 16,049 | 14,288 | 16,714 | 16,966 |
| Plan participants' contributions | - | - | 5,805 | 5,000 |
| Amendments | 398 | 5,029 | - | - |
| Actuarial (gain) loss | (20,809) | (20,494) | 33,454 | (83,347) |
| Benefits paid, net of federal subsidy | (17,327) | (18,956) | (15,220) | (14,670) |
| **BENEFIT OBLIGATION AT END OF YEAR** | **$ 250,554** | **$ 267,778** | **$ 313,368** | **$ 263,053** |
| AMOUNTS RECOGNIZED IN FINANCIAL STATEMENTS | | | | |
| Plan assets minus projected benefit obligation | $ 39,092 | $ 6,656 | $ (211,287) | $ (181,864) |
| Contributions after the measurement date | - | - | 978 | 3,035 |
| Unrecognized prior service cost | - | 9,005 | - | 72,251 |
| Unrecognized net actuarial (gain) loss | - | (11,809) | - | 42,528 |
| **NET AMOUNT RECOGNIZED IN THE STATEMENT OF FINANCIAL POSITION** | **$ 39,092** | **$ 3,852** | **$ (210,309)** | **$ (64,050)** |

The accumulated benefit obligation for the Pension plan was $244,939,000 and $260,560,000 as of June 30, 2007 and 2006, respectively.

Net benefit expense related to the Pension and Post Retirement Medical Benefit plans for the years ended August 31, 2007 and 2006, in thousands of dollars, includes the following components:

| | PENSION | | POST RETIREMENT MEDICAL | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Service cost | $ 4,465 | $ 5,425 | $ 9,562 | $ 10,257 |
| Interest cost | 16,049 | 14,288 | 16,714 | 16,966 |
| Expected return on plan assets | (18,421) | (20,150) | (6,750) | (5,636) |
| Amortization of prior service cost | 1,608 | 1,025 | 7,605 | 7,605 |
| Recognized net actuarial losses | - | - | 995 | 6,138 |
| **NET PERIODIC BENEFIT EXPENSE** | **$ 3,701** | **$ 588** | **$ 28,126** | **$ 35,330** |

The prior service costs and net actuarial (gain) loss expected to be amortized from change in net assets to net periodic benefit expense over the next fiscal year are as follows, in thousands of dollars:

| | PENSION | POST RETIREMENT MEDICAL |
|---|---|---|
| Net actuarial (gain) loss | $ (2,126) | $ 2,184 |
| Prior service cost | $ 1,654 | $ 7,605 |

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 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Discount rate | 6.25% | 6.25% | 6.25% | 6.25% |
| 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 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Discount rate | 6.25% | 5.25% | 6.25% | 5.25% |
| Expected return on plan assets | 7.00% | 8.00% | 8.00% | 8.00% |
| Covered payroll growth rate | 5.52% | 5.52% | N/A | N/A |

To develop the 7% and 8% expected long-term rate of return on asset assumptions for the Pension and Post Retirement Medical Benefit plans, respectively, 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, 2007, a 9% annual rate of increase in the per capita costs of covered health care was assumed for 2007-2008, declining gradually to 5% by 2016 and remaining at this rate thereafter. For covered dental plans, a 6% annual rate of increase was assumed for 2007-2008, declining to 5% by 2010 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 $45,883,000 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 $37,625,000 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 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| ASSET CATEGORY | | | | |
| Domestic equity | 33% | 29% | 38% | - |
| International equity | 11% | 9% | 37% | - |
| Fixed income | 54% | 26% | 25% | 86% |
| Short term investments | 1% | 20% | - | - |
| Real estate | - | 15% | - | 14% |
| Other | 1% | 1% | - | - |
| **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.

EXPECTED CONTRIBUTIONS No contributions are expected to be made to the Pension plan for the fiscal year ending August 31, 2008. The University expects to contribute $17,746,000 to its Post Retirement Medical Benefit plan during the fiscal year ending August 31, 2008.

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 | |
|---|---|---|---|
| FISCAL YEAR | PENSION PLAN | EXCLUDING MEDICARE SUBSIDY | WITH MEDICARE SUBSIDY |
| 2008 | $ 27,010 | $ 13,247 | $ 11,905 |
| 2009 | 21,850 | 15,024 | 13,484 |
| 2010 | 22,265 | 16,772 | 15,033 |
| 2011 | 22,253 | 18,495 | 16,532 |
| 2012 | 21,387 | 20,276 | 18,065 |
| 2013 - 2017 | 97,477 | 127,818 | 111,815 |

## 14. Hospitals' Retirement Plans

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

In 2007, the Hospitals adopted FAS 158. The incremental effect of adopting FAS 158 is as follows, in thousands of dollars:

| | BEFORE APPLICATION | PENSION PLAN | POST RETIREMENT MEDICAL | AFTER APPLICATION |
|---|---|---|---|---|
| CONSOLIDATED FINANCIAL STATEMENTS: | | | | |
| Prepaid expenses and other assets | $ 152,298 | $ 308 | $ - | $ 152,606 |
| Total assets | 3,401,786 | 308 | - | 3,402,094 |
| Accrued post retirement benefit costs | 78,326 | (3,316) | (8,046) | 66,964 |
| Total liabilities | 1,433,359 | (3,316) | (8,046) | 1,421,997 |
| Total net assets | 1,969,043 | 3,008 | 8,046 | 1,980,097 |
| Change in net assets | 489,730 | 3,008 | 8,046 | 500,784 |
| CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE: | | | | |
| Unrecognized net actuarial gain | $ - | $ 3,008 | $ 4,627 | $ 7,635 |
| Unrecognized prior service credit | - | - | 3,419 | 3,419 |
| | **$ -** | **$ 3,008** | **$ 8,046** | **$ 11,054** |

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 $45,039,000 and $38,013,000 for the years ended August 31, 2007 and 2006, 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.

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 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| CHANGE IN PLAN ASSETS | | | | |
| Fair value of plan assets at beginning of year | $ 140,724 | $ 123,886 | $ - | $ - |
| Actual return on plan assets | 23,094 | 13,469 | - | - |
| Plan participants' contributions | - | - | 680 | 525 |
| Employer contributions | 1,152 | 10,690 | 3,344 | 3,982 |
| Benefits paid | (7,514) | (7,321) | (4,024) | (4,507) |
| **FAIR VALUE OF PLAN ASSETS AT END OF YEAR** | **$ 157,456** | **$ 140,724** | **$ -** | **$ -** |
| CHANGE IN PROJECTED BENEFIT OBLIGATION | | | | |
| Benefit obligation at beginning of year | $ 157,562 | $ 181,797 | $ 68,497 | $ 67,719 |
| Service cost | 1,720 | 2,144 | 1,660 | 1,954 |
| Interest cost | 10,062 | 9,374 | 4,257 | 3,298 |
| Plan participants' contributions | - | - | 680 | 525 |
| Actuarial (gain) loss | 798 | (28,432) | (4,731) | (492) |
| Benefits paid | (7,514) | (7,321) | (4,024) | (4,507) |
| **BENEFIT OBLIGATION AT END OF YEAR** | **$ 162,628** | **$ 157,562** | **$ 66,339** | **$ 68,497** |
| AMOUNTS RECOGNIZED IN FINANCIAL STATEMENTS | | | | |
| Plan assets minus projected benefit obligation | $ (5,172) | $ (16,838) | $ (66,339) | $ (68,497) |
| Contributions made after measurement date | 4,262 | - | 607 | 705 |
| Unrecognized prior service cost | - | - | - | (4,253) |
| Unrecognized net actuarial loss | - | 9,188 | - | 115 |
| **NET AMOUNT RECOGNIZED IN THE STATEMENT OF FINANCIAL POSITION** | **$ (910)** | **$ (7,650)** | **$ (65,732)** | **$ (71,930)** |

The accumulated benefit obligation for the Pension plan was $152,418,000 and $147,500,000 as of June 30, 2007 and 2006, respectively.

Net benefit expense related to the plans for the years ended August 31, 2007 and 2006, in thousands of dollars, includes the following components:

| | PENSION | | POST RETIREMENT MEDICAL | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Service cost | $ 1,720 | $ 2,144 | $ 1,660 | $ 1,954 |
| Interest cost | 10,062 | 9,374 | 4,257 | 3,298 |
| Expected return on plan assets | (10,215) | (9,729) | - | - |
| Amortization of prior service cost | - | - | (834) | (834) |
| Recognized net actuarial losses | 115 | 2,403 | 11 | 60 |
| **NET PERIODIC BENEFIT EXPENSE** | **$ 1,682** | **$ 4,192** | **$ 5,094** | **$ 4,478** |

The prior service costs and net actuarial loss expected to be amortized from change in net assets to net periodic benefit expense over the next fiscal year are as follows, in thousands of dollars:

| | PENSION | POST RETIREMENT MEDICAL |
|---|---|---|
| Net actuarial gain | $ - | $ 448 |
| Prior service credit | $ - | $ 834 |

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 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Discount rate | 6.43 - 6.47% | 6.49 - 6.53% | 6.35% | 6.42% |
| 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 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Discount rate | 6.49 - 6.53% | 5.25% | 6.42% | 5.00% |
| 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, 2007, a 9.5% annual rate of increase in the pre-65 per capita costs, an 11.5% annual rate of increase in the post-65 prescription drug per capita costs and a 9.0% rate of increase in the post-65 per capita cost of all other medical benefits was assumed for 2007-2008, declining to 5% by 2013 for the pre-65 per capita costs, 2014 for the post-65 prescription drug per capita cost and 2011 for the post-65 per capita costs of all other medical benefits 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 $2,063,000 and the aggregate annual service and interest cost by $185,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post retirement medical benefit obligation by $1,858,000 and the aggregate annual service and interest cost by $165,000.

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

| | PENSION | |
|---|---|---|
| | 2007 | 2006 |
| ASSET CATEGORY | | |
| Cash equivalents | 3% | 4% |
| Equity securities | 66% | 64% |
| Fixed income | 21% | 21% |
| Real estate | 10% | 11% |
| **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 No contributions are expected to be made to the Pension plan for the fiscal year ending August 31, 2008. The Hospitals expect to contribute $4,501,000 to their Post Retirement Medical Benefit plan during the fiscal year ending August 31, 2008.

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 | |
|---|---|---|---|
| FISCAL YEAR | PENSION PLAN | EXCLUDING MEDICARE SUBSIDY | WITH MEDICARE SUBSIDY |
| 2008 | $ 7,372 | $ 4,854 | $ 4,501 |
| 2009 | 7,858 | 5,201 | 4,783 |
| 2010 | 8,416 | 5,560 | 5,073 |
| 2011 | 9,023 | 5,991 | 5,438 |
| 2012 | 9,734 | 6,396 | 5,773 |
| 2013 – 2017 | 59,438 | 36,141 | 31,958 |

## 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, 2007 and 2006 was $26,716,000 and $29,760,000, respectively, for the University and $42,118,000 and $35,990,000, respectively, for the Hospitals. Net minimum future operating lease payments and related present value assuming a 6.25% discount rate for periods subsequent to August 31, 2007, in thousands of dollars, are as follows:

| | MINIMUM LEASE PAYMENTS | | PRESENT VALUE OF MINIMUM LEASE PAYMENTS | |
|---|---|---|---|---|
| YEAR ENDING AUGUST 31 | UNIVERSITY | HOSPITALS | UNIVERSITY | HOSPITALS |
| 2008 | $ 21,272 | $ 31,775 | $ 20,569 | $ 30,885 |
| 2009 | 18,790 | 27,976 | 17,101 | 25,593 |
| 2010 | 15,401 | 23,637 | 13,192 | 20,351 |
| 2011 | 11,904 | 19,360 | 9,596 | 15,688 |
| 2012 | 10,189 | 15,607 | 7,730 | 11,903 |
| Thereafter | 48,049 | 65,756 | 29,527 | 44,406 |
| **TOTAL** | **$ 125,605** | **$ 184,111** | **$ 97,715** | **$ 148,826** |

## 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. Each trustee is required to certify compliance with the conflict of interest policy on an annual basis and indicate whether 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. Costs recovered by the University in support of sponsored research are subject to audit and adjustment.

HEALTH CARE 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.

LABOR AGREEMENTS Approximately 7% of the University's, 39% of SHC's and 50% 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, 2007, the University had contractual obligations of approximately $170,812,000 in connection with major construction projects. Remaining expenditures on construction in progress are estimated to be $471,156,000 and will be financed with certain gifts, operating funds, reserves and debt.

At August 31, 2007, commitments on contracts for the construction and remodeling of Hospital facilities were approximately $199,055,000.

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, 2007, the aggregated amount of such unfunded commitments was $4,845,648,000.

GUARANTEES AND INDEMNIFICATIONS The University and the Hospitals enter into mutual indemnification agreements in the normal course of their 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, 2007.

SUBSEQUENT EVENTS In June 2007, the University entered into a forward contract with CEFA for the issuance of $25,360,000 of fixed rate CEFA T-3 revenue bonds (the CEFA T-3 Bonds). CEFA issued the T-3 Bonds and loaned the proceeds to the University on September 6, 2007. The CEFA T-3 Bonds bear interest at the rate of 5% and mature on March 15, 2026. The proceeds from the issuance will be used to refund a portion of the CEFA M Bonds redeemable on December 1, 2007. The Bonds are subject to optional redemption prior to maturity at the option of CEFA at the direction of the University.

In September 2007, CEFA issued $187,550,000 of variable rate CEFA T-2 revenue bonds (the CEFA T-2 Bonds) and loaned the proceeds to the University. The proceeds will be used to refund the CEFA N Bonds redeemable on December 1, 2007. The CEFA T-2 Bonds are Auction Rate Securities with the interest rate determined by periodic auction. The interest rate may be converted to a different variable rate mode or a fixed rate at the option of the University. The CEFA T-2 Bonds may be redeemed at the option of the University, in whole or in part, on the interest payment date immediately following the end of an auction period as defined in the official statement. The CEFA T-2 Bonds mature on March 15, 2033.

# Management Responsibility for Financial Statements

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

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

M. SUZANNE CALANDRA
Controller
Stanford University

DANIEL J. MORISSETTE
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 to manage 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, the University chief financial officer, the 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 $21.6 billion of endowment and trust assets, temporarily invested expendable funds and commercial real estate investments.

The majority of the University's endowment assets is invested through the Merged Pool (MP), which is a diversified portfolio of actively managed financial and real estate assets valued at approximately $18.8 billion as of June 30, 2007. MP performance measurements are calculated on the 12 months ended June 30, 2007, 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 MP. The MP generated a 23.4% investment return for the 12 months ended June 30, 2007. Over the past 10 years, the MP achieved an annualized rate of return of 15.1%, growing from $4.3 billion to $18.8 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.

The MP 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.

SMC, with assistance from the Board of Directors, actively manages the MP, selecting third-party managers to deploy the MP's capital. Stanford University's brand and SMC's reputation as a stable long-term source of capital enable SMC to gain access to the best third-party managers in the world. Within each asset class, we endeavor to place capital with a diversified set of managers across geographies and investment strategies. We seek to benefit from drivers of economic growth through a broadly diversified and hedged portfolio that is less subject to drawdown than the more concentrated portfolio of the late 1990's. SMC also seeks to add value through effective risk management, tactical portfolio rebalancing and opportunistic investment tilts.

STANFORD MP 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. Each June, SMC and the Board reevaluate portfolio asset allocation targets, as well as expected risk, return and correlation among asset classes. This annual review takes into account current market conditions and historical characteristics of each asset class. The strategic asset allocation targets for the MP as of June 30, 2007, are listed below:

### LONG-TERM POLICY TARGETS

| ASSET CLASS | STRATEGIC ALLOCATION |
|---|---|
| Public Equity | 37% |
| Real Estate | 16% |
| Private Equity | 12% |
| Natural Resources | 7% |
| Absolute Return | 18% |
| Fixed Income | 10% |

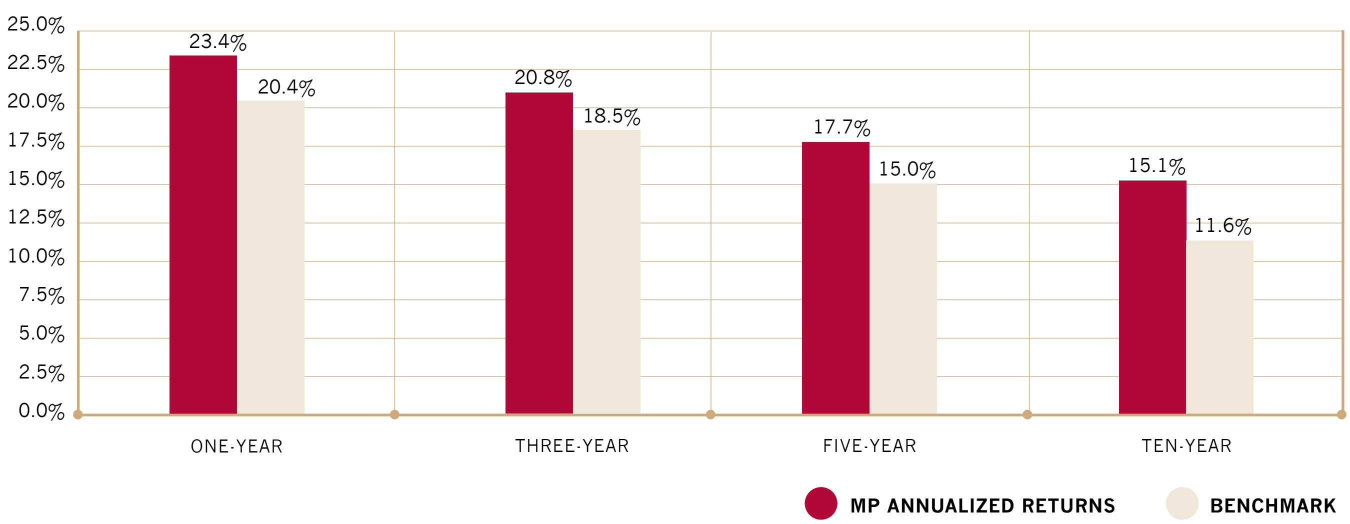
STANFORD MP PERFORMANCE COMPARED TO INFLATION The table below outlines annualized returns for various periods ending June 30, 2007. Stanford's objective is to return a minimum of 6.75% over the rate of inflation as measured by the GDP Deflator. If this real return target is achieved over time, the value of the MP, net of annual payouts to support operating activities, will be maintained. Over the past one-, three-, five- and 10-year periods, Stanford's annualized real return has substantially exceeded the 6.75% target.

### MP PERFORMANCE COMPARED TO INFLATION

| | ONE-YEAR | THREE-YEAR | FIVE-YEAR | TEN-YEAR |
|---|---|---|---|---|
| Nominal Endowment Return | 23.4% | 20.8% | 17.7% | 15.1% |
| GDP Deflator | 3.1% | 3.1% | 2.8% | 2.3% |
| Real Endowment Return | 20.3% | 17.7% | 14.9% | 12.8% |

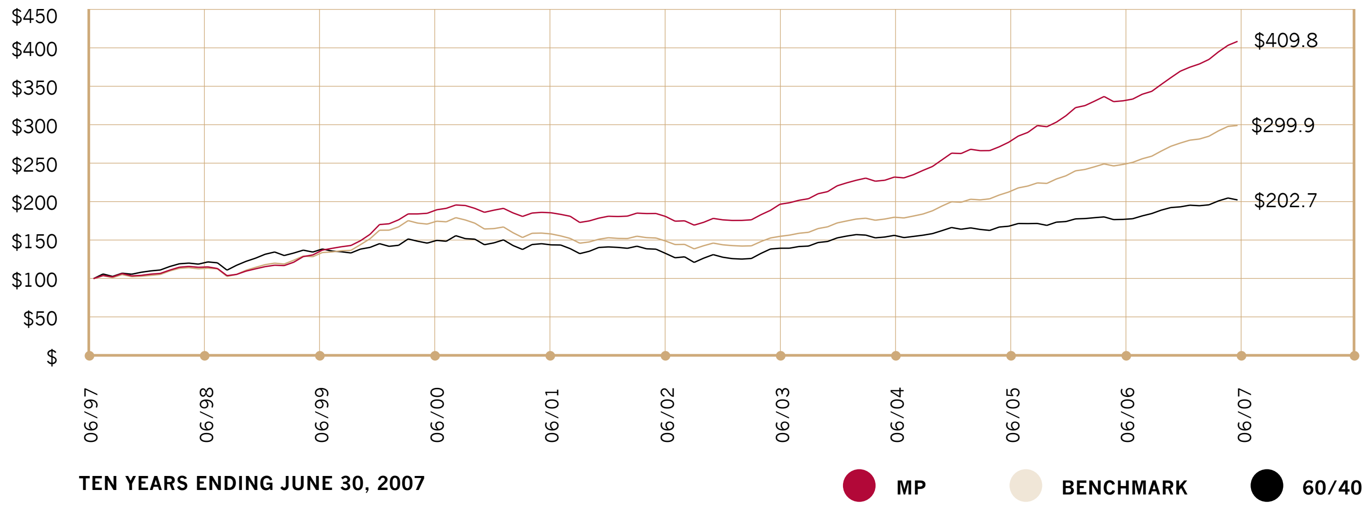
STANFORD MP PERFORMANCE COMPARED TO BENCHMARKS SMC evaluates the performance of investment managers by comparing their returns to benchmarks that are appropriate for each individual asset class. The SMC Board reviews asset class benchmarks on an annual basis to ensure comparability. SMC compares overall MP performance to the composite benchmark return, which represents a blend 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, 2007.

### STANFORD MP VS. STANFORD COMPOSITE BENCHMARK



SMC's effectiveness in implementing its investment strategies through top-level manager selection has resulted in consistent and long-term outperformance over the composite benchmark. This has added an excess of $4.8 billion to the value of the MP over this 10-year period. The cumulative return chart below compares the growth of $100 in Stanford's MP, a composite benchmark portfolio, and a 60% stock / 40% bond portfolio over the past 10 years:

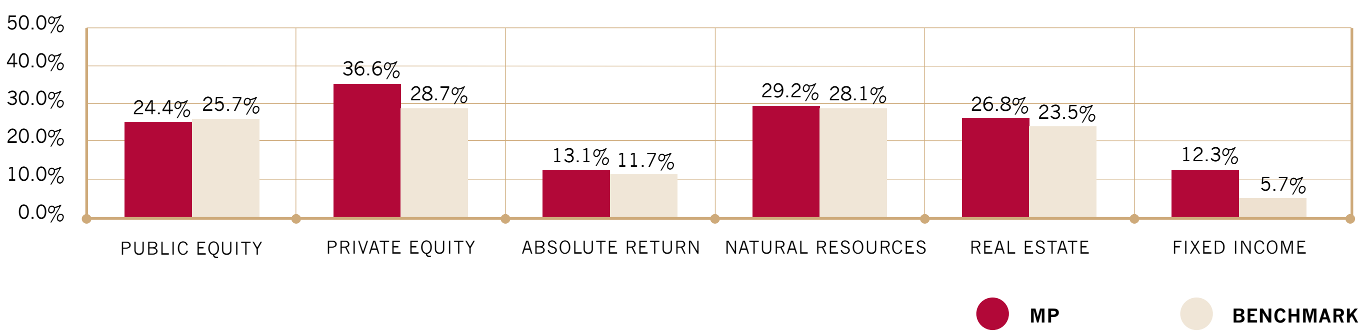
**STANFORD MP VS. STANFORD COMPOSITE BENCHMARK VS. PASSIVE 60% EQUITY/40% BOND COMPOSITE**




Relative one-year performance of the MP versus the benchmark was strong with overall portfolio excess return of 3.0% over the benchmark. This excess return was driven by outperformance in a number of asset classes, especially Private Equity and Real Estate. Total return in all asset classes was strong for the year as all asset classes exhibited double-digit annual returns.

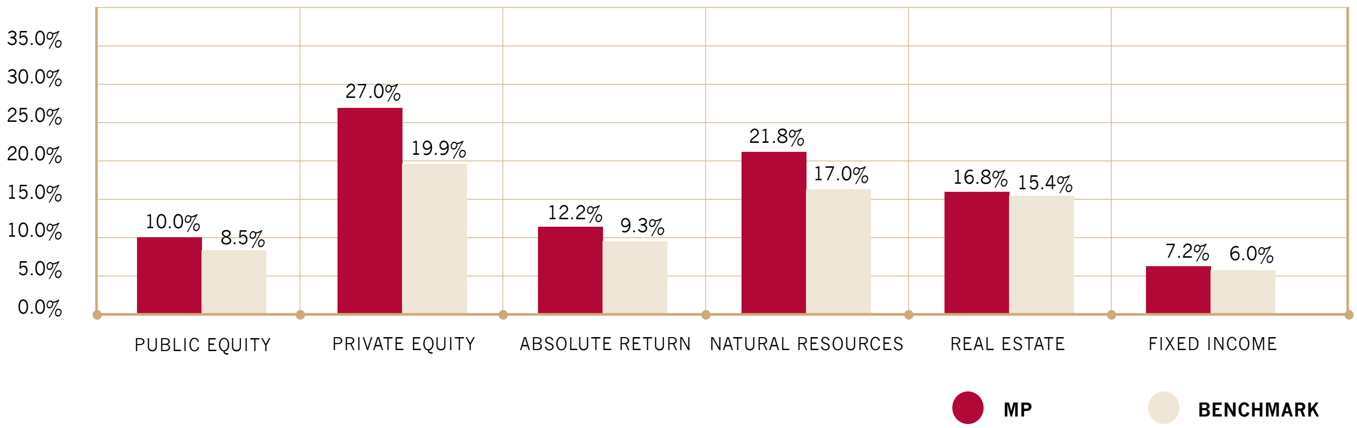
INDIVIDUAL ASSET CLASS PERFORMANCE The performance of individual asset classes for the 12 months ended June 30, 2007, relative to each asset class benchmark, is illustrated in the graph below:

**STANFORD MP ONE-YEAR ASSET CLASS RETURNS VS. BENCHMARK**



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

**STANFORD MP TEN-YEAR ANNUALIZED ASSET CLASS RETURNS VS. BENCHMARK**




The year ending June 2007 was the fourth of an extraordinary series of years during which global economic expansion and abundant liquidity from a variety of sources combined to lift virtually all markets. Public equity markets in the United States and abroad benefited from an extended economic expansion. Real estate and private equity market performance was fueled by attractive financing conditions. Natural Resources investments, particularly in energy, surged as economic growth and political uncertainty drove commodity prices higher. Finally, the Absolute Return portfolio experienced strong performance from multi-strategy hedge funds, which are able to allocate capital opportunistically across all asset classes.

The year ending June 2007 was also a pivotal year as SMC initiated an organizational transformation focused on long-term performance sustainability. After substantial turnover in the year ending June 2006, the organization was re-staffed, and significant effort was spent on refining business processes. In 2008, we will focus on the ongoing task of portfolio improvement, while looking to strengthen risk management.

While the Stanford Management Company will continue to navigate through changes and developments in the investment environment, we remain committed to protect and grow the endowment of the University. We are pleased that the MP has continued to deliver solid performance, demonstrated by a 23.4% annual return. Moreover, the MP's three-year and five-year annualized returns remained strong at 20.8% and 17.7%, respectively. Our goal is to pursue consistent and strong, risk-adjusted returns and to administer dependable and growing financial support to the University's legacy of providing the highest-quality education possible and setting a new standard of excellence.

JOHN F. POWERS
President and Chief Executive Officer
Stanford Management Company

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