STANFORD UNIVERSITY

2001 Financial Review

CONTENTS:

Discussion of Financial Results

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

Highlights of the year included:

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

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

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

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

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

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

Statement of Activities

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

Unrestricted Net Assets

Results of Operations Operating activities include all revenues and expenses that are used to support current-year teaching and research efforts and other University priorities. Compared to FY00, total University revenues increased 1.4% to more than $2.0 billion, and total expenses increased 11.1% to approximately $2.0 billion. Operations resulted in an excess of revenues over expenses of $59 million in FY01, compared to $227 million in FY00.

HOSPITALS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Temporarily Restricted Net Assets

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

Permanently Restricted Net Assets

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

Financial Position

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

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

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

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

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

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

Conclusion

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

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

M. SUZANNE CALANDRA
Controller

Report from the Stanford Management Company

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

Given the perpetual nature of the University, Stanford's strategic investment horizon must be long-term. Our objective is to develop and execute an investment strategy that generates optimal total return (income plus price appreciation) relative to the risk taken. To meet this goal, SMC was established in 1991 to manage Stanford's financial and real estate investment assets. SMC is a division of the University with oversight by a Board of Directors appointed by the University Board of Trustees. The SMC board consists of at least three trustees, several investment and real estate professionals, and University representatives. SMC directs in excess of $10 billion of endowment and trust assets, working capital, temporarily invested expendable funds, and commercial real estate investments including the Stanford Research Park.

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

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

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

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

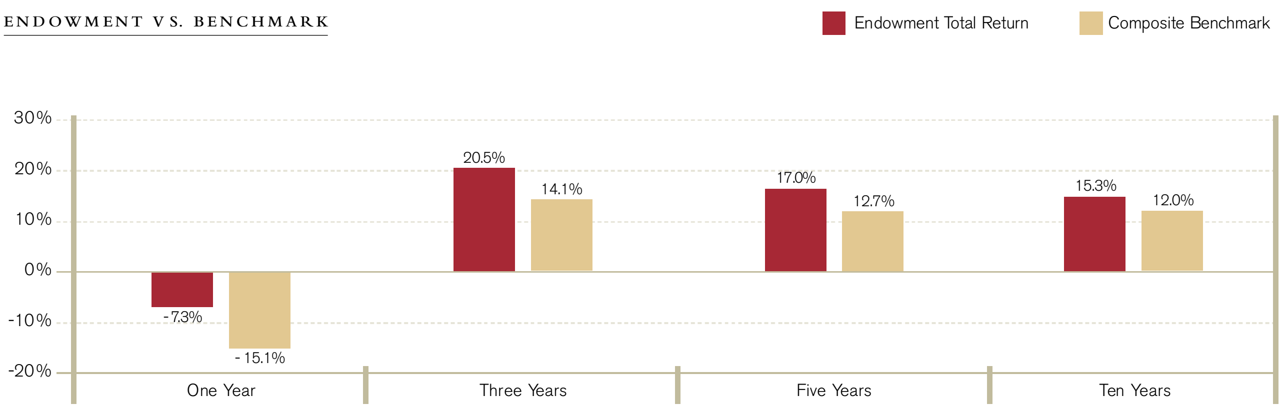
Endowment Performance Compared to Inflation > The table below illustrates annualized returns for various periods ending August 31, 2001 and shows the performance of Stanford's multi-asset strategy in a long-term context. Stanford's objective is to return a minimum of 6.25% over the rate of inflation.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

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

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

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

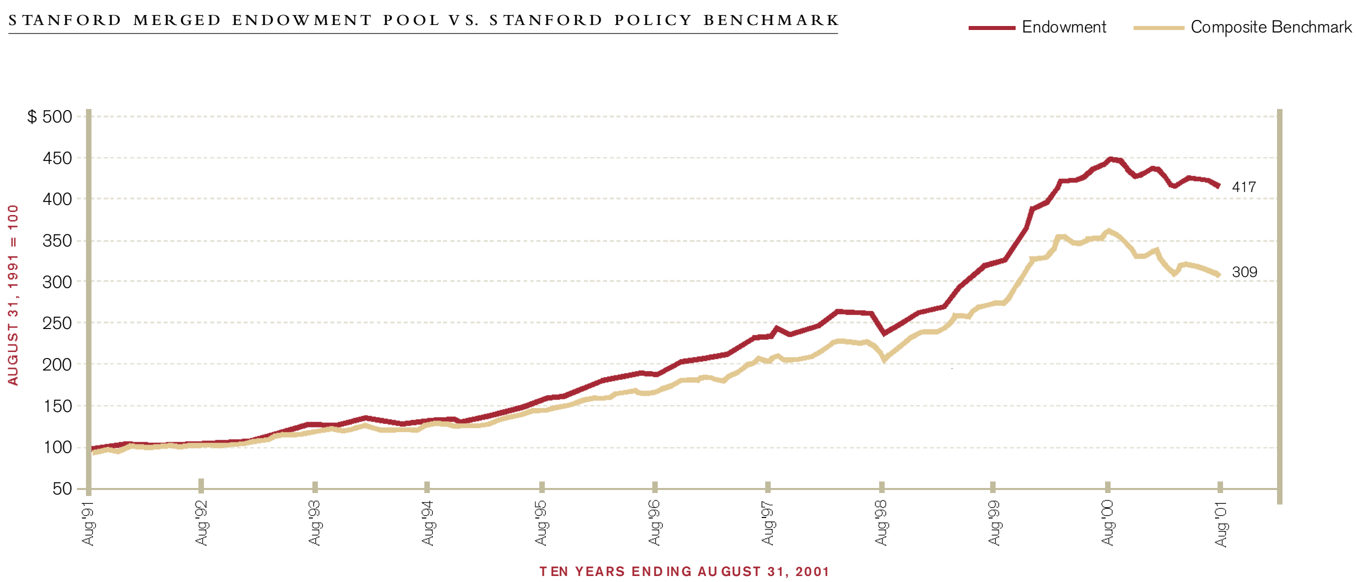
ENDOWMENT VS. BENCHMARK



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

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

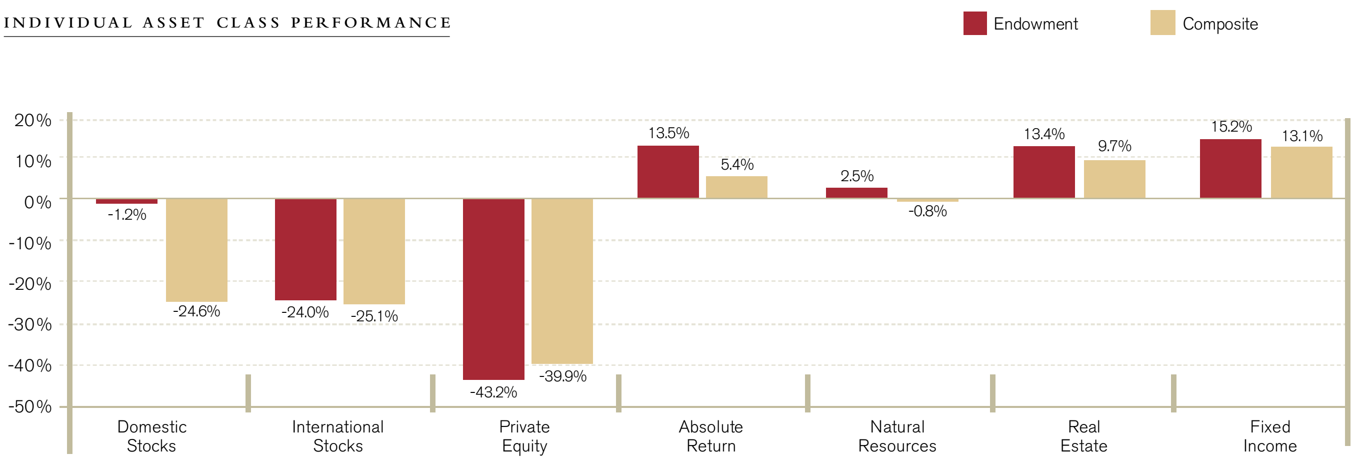
STANFORD MERGED ENDOWMENT POOL VS. STANFORD POLICY BENCHMARK



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

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

INDIVIDUAL ASSET CLASS PERFORMANCE



One year ended August 31, 2001

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

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

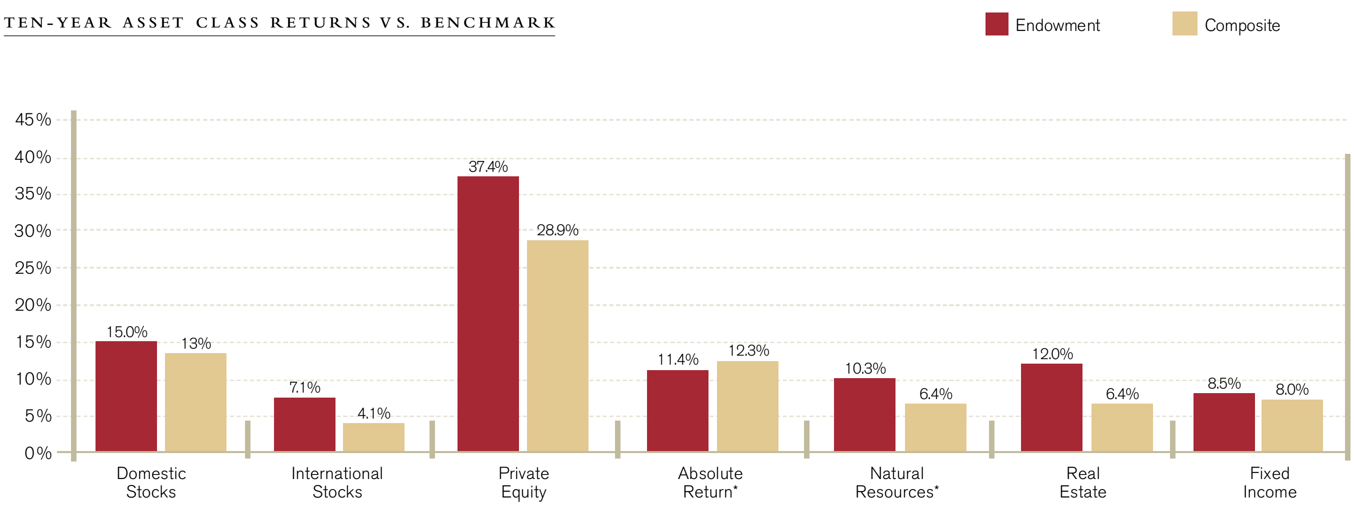
The Absolute Return portfolio is constructed to provide returns that are substantially uncorrelated to the broader equity markets. Absolute Return results for the last 12 months demonstrated successful execution of this strategy. The portfolio provided robust returns in several hedge fund categories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

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

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

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

TEN-YEAR ASSET CLASS RETURNS VS. BENCHMARK



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

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

MICHAEL G. McCAFFERY
CEO, Stanford Management Company

Decade in Review

Years ended August 31

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

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

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

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

[C] Enrollment for fall quarter immediately following fiscal year end.

Consolidated Statements of Financial Position

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

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

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

Consolidated Statements of Activities

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

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

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

Consolidated Statements of Activities (CONTINUED)

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

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

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

Consolidated Statements of Cash Flows

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

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

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

1. Basis of Presentation and Significant Accounting Policies

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

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

The University manages and operates SLAC for the Department of Energy (DOE) under a management and operating contract; therefore, the revenues and expenditures of SLAC are included in the statement of activities. As SLAC is a federally funded research and development center, the assets and liabilities of SLAC are owned by the DOE and, accordingly, are not included in the statement of financial position.

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

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

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

For financial reporting purposes, net assets and revenues, expenses, gains, and losses are classified into one of three categories—unrestricted, temporarily restricted, or permanently restricted—in accordance with generally accepted accounting principles.

Unrestricted Net Assets Unrestricted net assets are expendable resources used to support either the University's core activities of teaching and research or the Hospitals' patient care, teaching, and research missions. These net assets may be designated by the University or the Hospitals for specific purposes under internal operating and administrative arrangements or be subject to contractual agreements with external parties. Donor-restricted contributions, which relate to the University's or the Hospitals' core activities, that are received and expended, or deemed expended due to the nature of their restriction, are classified as unrestricted. Donor-restricted resources intended for capital projects are released from their temporary restrictions and reclassified as unrestricted support when spent. All expenses are recorded as a reduction of unrestricted net assets.

Unrestricted net assets include funds designated for operations, plant facilities, endowment gains and funds functioning as endowment, and the University's investment in UCSF Stanford Health Care. Unrestricted net assets were $8,190,557,000 and $9,014,073,000 at August 31, 2001 and 2000, respectively.

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

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

Permanently Restricted Net Assets Permanently restricted net assets are subject to donor-imposed restrictions requiring that the principal be invested in perpetuity. Permanently restricted net assets consist of the following balances at August 31, 2001 and 2000, in thousands of dollars:

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

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

Cash and Cash Equivalents > Cash and cash equivalents including U.S. Treasury bills, bankers' acceptances, commercial paper, certificates of deposit, money market funds, and other short-term investments with remaining maturities of 90 days or less at the time of purchase, are carried at cost, which approximates market. Cash and cash equivalent amounts held in the endowment, as well as certain cash restricted in its use by the Hospitals, are classified as investments.

Student Loans Receivable > Student loans receivable are carried at cost, less an allowance for doubtful accounts. Determination of the fair value of student loans receivable is considered impractical due to donor-restricted and federally sponsored student loans with mandated interest rates and repayment terms subject to significant restrictions as to their transfer and disposition.

Investments > Investments are generally recorded at fair value based upon quoted market prices, when available, or estimates of fair value. Donated assets are recorded at fair value at the date of donation. Those investments for which fair value is not readily determinable are carried at cost, fair value at date of donation, or at a nominal value. Developed real estate is generally valued based on discounted cash flows of existing leases. Non-developed land is reported at cost. Securities transactions are reported on a trade-date basis.

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

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

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

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

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

Collections of Works of Art > Art objects and collections are not capitalized, as the University uses the proceeds from any sales of such items to acquire other art or collection pieces.

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

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

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

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

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

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

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

2. Related Health Care Entities

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

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

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

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

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

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

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

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

3. Accounts Receivable

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

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

4. Faculty and Staff Mortgages

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

5. Investments

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

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

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

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

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

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

As indicated in the following table, as of August 31, 2001 and 2000, in thousands of dollars, the University's investments are invested in the expendable funds pool (EFP), the merged endowment pools, or in specific instruments to comply with donor requirements:

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

The EFP is a pool of funds that is intended to provide adequate liquidity as well as an opportunity for the University to earn long-term growth on a portion of the pool. Approximately half of the EFP is invested in short-term or highly liquid securities, and the balance is cross-invested in the Merged Endowment Pool. The University Board of Trustees (the Board) has established a policy for the distribution of the investment returns of the EFP. The policy requires that an amount based upon a range of pre-set interest rates be made available to support current operations. The difference between the actual return of this pool and the required distribution amount is deposited or withdrawn from funds functioning as endowment. For the years ended August 31, 2001 and 2000, the results of the EFP, in thousands of dollars, were as follows:

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

The University's endowment is invested with the objective of maximizing long-term total return. The University's policy governing the amounts paid annually from the endowment to support current operations is designed to protect the value of the endowment against the expected impact of inflation and to provide real growth of the endowment, while also funding a relatively constant portion of the University's current operating expenditures. The sources of the payout are earned income on the endowment assets (interest, dividends, rents, and royalties), previously reinvested income, and a portion of realized capital gains.

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

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

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

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

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

6. Pledges Receivable

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

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

7. Plant Facilities

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

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

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

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

8. University Notes and Bonds Payable

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

	2001	2000
TAX-EXEMPT		
CALIFORNIA EDUCATIONAL FACILITIES AUTHORITY (CEFA):		
Revenue Bonds, due serially to 2032, with interest from 4.0% to 6.0%	$ 637,250	$ 558,235
Revenue Bonds, Series L with variable interest rates	99,543	83,819
Department of Education Bonds of 1959 to 1984 due serially to 2024, with interest from 3.0% to 3.5%	3,222	3,913
TAXABLE		
Stanford University Bonds due 2024, with fixed interest of 6.875%	150,000	150,000
Medium Term Notes ($150,000 authorized) due to 2026, with fixed interest from 5.85% to 7.65%	142,100	87,100
Commercial Paper, with variable interest rates	155,000	160,500
Other, with various interest rates	29,726	93,166
University notes and bonds payable before premiums (discounts)	1,216,841	1,136,733
Net unamortized premiums (discounts)	815	(1,027)
University notes and bonds payable	$ 1,217,656	$ 1,135,706

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

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

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

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

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

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

9. Hospitals' Notes and Bonds Payable

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

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

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

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

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

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

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

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

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

10. Liabilities Under Security Agreements

At August 31, 2001 and 2000, the University held $372,962,000 and $190,432,000, respectively, of short-term U.S.Government obligations and cash as collateral deposits for certain securities loaned temporarily to brokers. These amounts are included as assets and liabilities in the University's financial statements. In addition, at August 31, 2001, the University sold a security subject to an obligation to repurchase it at a future date in the amount of $28,469,000. The borrowing has been accounted for as a financing transaction and bears interest at a rate of 3.9%. The estimated market value of securities on loan and pledged under repurchase agreements at August 31, 2001 and 2000, were $389,936,000 and $184,424,000, respectively.

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

11. University Endowment

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

Pure endowment funds are subject to the restrictions of the gift instruments requiring that the principal be invested in perpetuity and the income and an appropriate portion of gains only be spent as provided for under the California Uniform Management of Institutional Funds Act (CUMIFA). In the absence of further donor restrictions, the amount of gains that are to be expended in a given year is determined through the endowment payout policy discussed in Note 5. The University classifies the original endowment gift and any donor-imposed restricted gains as permanently restricted assets. The Financial Accounting Standards Board (FASB) has determined that the legal limitations imposed by CUMIFA on the amount of realized and unrealized gains on endowments that may be appropriated for current expenditure do not constitute restrictions for financial reporting purposes. Accordingly, the University reports the reinvested realized and unrealized gains as unrestricted net assets. Notwithstanding this FASB-mandated reporting, the University recognizes the limitations on expending such gains that are specified in CUMIFA.

Expendable endowment assets include term endowments and funds functioning as endowment. Term endowments are similar to other endowment funds except that upon the passage of a stated period of time or the occurrence of a particular event, all or part of the principal may be expended. These resources are classified as temporarily restricted net assets. Funds functioning as endowment are unrestricted University resources designated as endowment by the Board and are invested in the endowment for long-term appreciation and current income. However, these assets remain available and may be spent at the Board's discretion. Funds functioning as endowment are recorded as unrestricted net assets.

Funds subject to living trust agreements represent trusts with living income beneficiaries where the University has a residual interest. The investments of these funds are recorded at their fair market value. The discounted present value of any income beneficiary interest is reported as a liability on the statement of financial position in accordance with actuarial tables established by the Internal Revenue Service. Gifts subject to such agreements are recorded as revenue net of the income beneficiary share at the date of gift. Actuarial gains or losses are included in living trust investment income and actuarial adjustment. Resources that are expendable upon maturity are classified as temporarily restricted net assets; all others are classified as permanently restricted net assets.

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

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

12. University Gifts

The University's Office of Development (OOD) reports total gifts based on contributions received in cash or property during the fiscal year. Gifts reported for financial statement purposes are recorded on the accrual basis. The following summarizes gifts and pledges received, for the years ended August 31, 2001 and 2000, per the statement of activities reconciled to the cash basis (as reported by OOD), in thousands of dollars:

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

13. Functional Expenses

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

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

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

14. University Pension Plans and Other Postretirement Benefits

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

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

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

The University offers a defined contribution pension plan to eligible faculty and staff. University and participant contributions are invested in annuities and mutual funds. University contributions under this plan amounted to approximately $54,496,000 and $49,404,000 for the years ended August 31, 2001 and 2000, respectively.

Other Post-Retirement Benefit Plans > The University's employees may become eligible for other post-retirement benefits upon retirement. Retiree health plans are paid for in part by retiree contributions, which are adjusted annually. Benefits are provided through various insurance companies whose charges are based either on the benefits paid during the year or annual premiums. Health benefits are provided to retirees and their covered dependents. The University recognizes the cost of post-retirement benefits over the periods that employees render service. The University recognizes the prior service obligation over 20 years.

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

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

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

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

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

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

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

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

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

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

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

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated post-retirement benefit obligation by $25,607,000 and the aggregate service and interest cost by $1,800,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post-retirement benefit obligation by $20,639,000 and the aggregate service and interest cost by $1,411,000.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

16. Commitments and Contingencies

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

Sponsored Projects > The University conducts substantial research for the federal government pursuant to contracts and grants from federal agencies and departments. The University records reimbursements of direct and indirect costs (facilities and administrative costs) from grants, contracts, and SLAC as operating revenues. The Office of Naval Research is the University's cognizant federal agency for determining indirect cost rates charged to federally sponsored agreements. It is supported by the Defense Contract Audit Agency, which has the responsibility for auditing direct and indirect charges under those agreements. Direct and indirect costs recovered by the University in support of sponsored research are subject to audit and adjustment.

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

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

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

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

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

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

Management Responsibility for Financial Statements

The consolidated financial statements on the preceding pages have been prepared in conformity with generally accepted accounting principles. The management of Stanford University is responsible for the integrity and objectivity of these consolidated financial statements.

In accumulating and controlling its financial data, management maintains a highly developed system of internal accounting controls. Management believes that a high level of internal control is maintained by the establishment and communication of accounting and business policies, by the selection and training of qualified personnel, and by a program of internal audits to give it reasonable assurance at reasonable cost that the University's assets are protected and that transactions and events are recorded properly.

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

The Board of Trustees, through its Audit Committee, composed of trustees not employed by the University, is responsible for engaging the independent accountants and meeting with management, internal auditors, and the independent accountants to ensure that each is carrying out its responsibilities and to discuss auditing, internal control, and financial reporting matters. Both the internal auditors and the independent accountants have full and free access to the Audit Committee. Both meet with the Audit Committee at least annually, with and without each other, and with and without the presence of management representatives.

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

M. SUZANNE CALANDRA
Controller

Report of Independent Accountants

To The Board of Trustees
Stanford University
Stanford, California

In our opinion, based on our audits and the report of other auditors, the accompanying consolidated statements of financial position and the related consolidated statements of activities and cash flows, which appear on pages 31 through 58, present fairly, in all material respects, the financial position of Stanford University at August 31, 2001 and 2000, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University's management; our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Stanford Hospital and Clinics, an entity controlled by the University, which statements reflect total assets of $910 million and $924 million as of August 31, 2001 and 2000, respectively, and total unrestricted revenues of $1,059 million and $399 million for the years then ended. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Stanford Hospital and Clinics, is based solely on the report of the other auditors. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

San Francisco, California
November 21, 2001

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