



August 31, 2014 and 2013

# Stanford University Annual Financial Report



# STANFORD UNIVERSITY ANNUAL FINANCIAL REPORT

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# MANAGEMENT'S DISCUSSION AND ANALYSIS

## **FY14 FINANCIAL HIGHLIGHTS**

Stanford's consolidated FY14 financial results continue to benefit from excellent investment performance, strong health care services revenues, and generous donor support. Consolidated operating revenues exceeded expenses by \$535 million, compared to \$565 million in FY13. Consolidated net assets increased \$4.1 billion to end the year at \$33.8 billion. These results reflect the combined financial position and results of the University and the Hospitals, including their respective entities.

### **Excellent investment performance.**

Consolidated investment returns in FY14 were \$4.3 billion, equal to 16.1% of beginning of year investment balances. During FY14, U.S. public and private equity markets, particularly venture capital, delivered strong returns, bolstered by the low-interest-rate environment and ongoing economic recovery. Total consolidated investments at August 31, 2014 were \$30.5 billion, up \$3.5 billion over the prior year.

The Merged Pool (MP) held \$25.3 billion of the consolidated investments at August 31, 2014, including \$23.0 billion of the University's endowment and expendable fund assets and \$2.3 billion of the Hospitals' investments. The MP is a diversified portfolio of actively managed public and private equity, absolute return, natural resources and real estate assets. An analysis of the MP investment strategy and performance is included in the Report from the Stanford Management Company.

### **Strong health care services revenues.**

Consolidated health care services revenues represented approximately 50% of consolidated revenues in FY14. Over the last 5 years, health

care services have become a more substantial component of the consolidated enterprise. See additional discussion below.

**Generous donor support.** Gifts to the University and the Hospitals totaled \$982 million in FY14.

The University's Office of Development reported gifts benefiting the University and Stanford Health Care (SHC) of \$928 million from a record number of donors for the fifth year in a row—over 82,300 alumni, parents, friends, and other supporters. This amount includes \$265 million in support of the School of Medicine and SHC, but does not include \$54 million of gifts raised for Lucile Packard Children's Hospital at Stanford, which raises funds independently. These results are a testament to the direction and vision of the University and an endorsement of Stanford's mission.

Below are additional details about the University's and Hospitals' financial position, financial results and operations.

## **University**

FY14 net assets increased 14% to \$29.2 billion compared to \$25.7 billion in the prior year. The University's endowment ended the year at an all-time high of \$21.4 billion, exceeding last year's \$18.7 billion.

## **OPERATING RESULTS**

The *Statements of Activities* include results from both operating and non-operating activities of the University. Operating activities include the revenues earned and expenses incurred in the current year to support the University's core activities of teaching and research and other University priorities.

The University ended the year with a surplus from operations of \$214 million compared to \$165 million in FY13. FY14 operating revenues increased 9% compared to an increase in expenses of 8% during the same period.

Non-operating activities are discussed in the *Financial Position* section of this analysis.

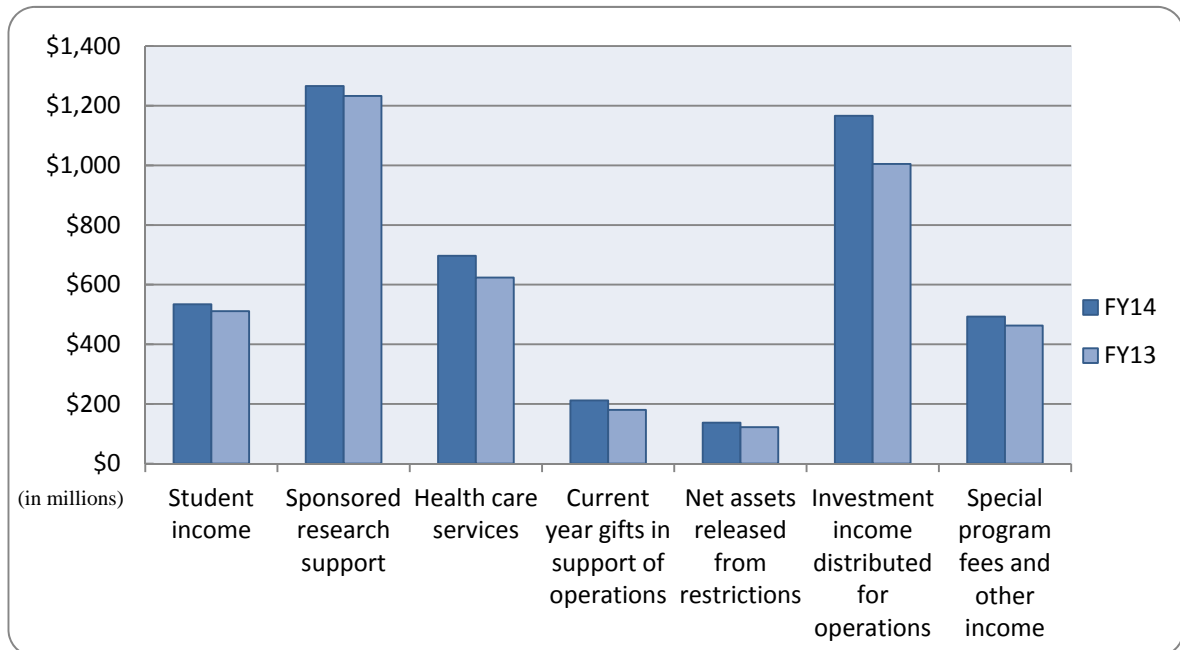
**OPERATING REVENUES**

FY14 operating revenues were \$4.5 billion, reflecting a 9% increase over FY13. The University’s operating revenue categories are shown in Figure 1.

tuition increases ranging from 3.5% to 3.9%. Revenues from room and board increased 4% in FY14 primarily due to an increase in room and board rates and higher graduate student occupancy. Average undergraduate and graduate enrollment was down .5% and up .7%, respectively, from the previous year.

Financial aid increased \$7.3 million or 3% in FY14 to \$249 million, slightly less than the increase in tuition rates and consistent with less need for aid based on current economic conditions. Stanford’s commitment to keeping a Stanford education affordable remains unchanged.

**FIGURE 1  
OPERATING REVENUES**



**Student Income**

Total student income, which represents 12% of University operating revenues, increased 4% to \$534 million in FY14. Total student income includes tuition and fees from undergraduate and graduate programs and room and board; this amount is partially offset by financial aid consisting of assistance in the form of scholarship and fellowship grants that cover a portion of tuition, living and other costs. Revenues from student tuition and fees increased nearly 4% in FY14 primarily as a result of undergraduate and graduate

Stanford is committed to a policy of “need-blind” admission for eligible U.S. citizens and permanent resident undergraduate students. In FY14, approximately 50% of undergraduates were awarded need-based scholarships and grants from Stanford. In general, eligible Stanford undergraduates receive additional financial assistance in the form of other scholarships and grants, student employment and low-interest student loans.

Graduate student financial aid is awarded based on academic merit and the availability of aid and consists of fellowships, stipends, and trainee/assistantships. For accounting purposes, fellowships are included in financial aid, stipends in other operating expenses, and trainee/assistantships in salaries and benefits. Over 85% of graduate students receive financial support, including University, federal and privately funded fellowships, and teaching and research assistantships.

Stanford participates in the Federal Perkins student loan program, available to undergraduate, graduate and professional students. Stanford also provides a gift funded institutional loan program. Student loan receivables, net of allowances for doubtful accounts, were \$81 million and \$78 million as of August 31, 2014 and 2013, respectively.

**Sponsored Research Support**

Sponsored research support represents 28% of the University’s operating revenues. FY14 sponsored research support increased to \$1.3 billion, nearly 3% over FY13.

The majority of the University’s sponsored research support (81% including the SLAC National Accelerator Laboratory—“SLAC”) is received directly or indirectly from the federal government. The largest federal sponsor, the Department of Health and Human Services, provided revenue of \$412 million in FY14 compared to \$414 million in the prior year, primarily through the National Institutes of Health. Most of these funds support research within the University’s School of Medicine.

The U.S. Department of Energy provided the majority of the \$369M in federal research support for SLAC in FY14, up 5% from FY13. Annual federal research support for the laboratory varies depending on the size and scope of construction in process. In FY14 SLAC received approximately \$80M for several projects: construction of the new Scientific User Support Building, the Research Support Office Building modernization, the Large Synoptic Survey Telescope (LSST camera) and the LCLS II project, an extension/upgrade of the Linac Coherent Light Source (LCLS), the revolutionary X-ray free-electron laser which has been operational since October of 2009. When complete in 2021,

**THE UNIVERSITY’S ENDOWMENT**

The University’s endowment is a collection of gift funds and reserves which are set aside and invested to support the University’s teaching and research missions. At August 31, 2014, the endowment totaled \$21.4 billion and represented approximately 73% of the University’s net assets. The endowment, which includes endowed lands, is comprised of pure endowment funds, term endowment funds and funds functioning as endowment.

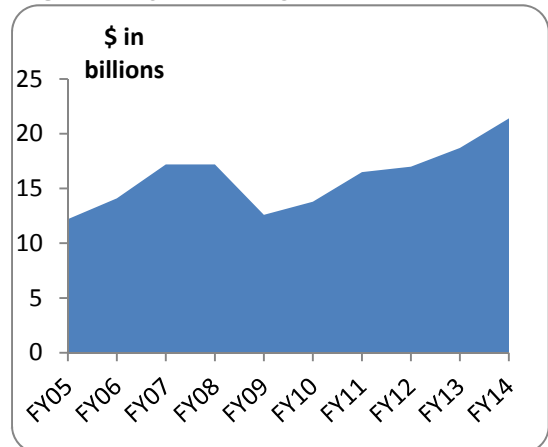
Gifts and pledge payments, investment returns, and other invested funds added \$3.7 billion to the endowment in FY14.

Annual payout to operations from the endowment--\$985 million in FY14--continues to be a significant source of operating revenue for the University, covering approximately 23% of expenses in FY14.

The University’s endowment provides funding annually for a wide variety of important purposes. As shown in Figure 2, a significant portion of the endowment (approximately 80%) is restricted as to purpose.

Approximately 29% funds instruction and research activities, 23% goes to student aid, 19% covers faculty salaries and support, 22% is unrestricted and the remainder is split between library support and other purposes.

**UNIVERSITY ENDOWMENT BY YEAR**



LCLS II will provide additional capacity for X-ray science research.

In addition to payment for the direct costs of performing research, the University receives an amount from sponsors for facilities and administrative costs, known as indirect costs. This amount covers costs related to facilities, utilities and administrative costs incurred in connection with sponsored research. For FY14, the federal and non-federal indirect cost recovery increased slightly to \$227 million.

**Health Care Services**

FY14 health care services revenue represented 15% of University operating revenues, increasing \$74 million to \$698 million. School of Medicine faculty serve as physicians for the Hospitals. Clinical revenue is billed and collected by the Hospitals, and a portion is remitted to the University as payment for these physician services. In addition, the Hospitals pay the University for other essential services such as medical direction, telecommunication, legal and internal audit services. Health care services revenues of \$670 million represent the net value of services provided by the University to the Hospitals; these amounts are eliminated in consolidation.

**Current Year Gifts in Support of Operations and Net Assets Released from Restrictions**

Current year gifts in support of operations increased 18% to \$212 million in FY14 due to several significant gifts. Net assets released from restrictions increased 12% to \$137 million.

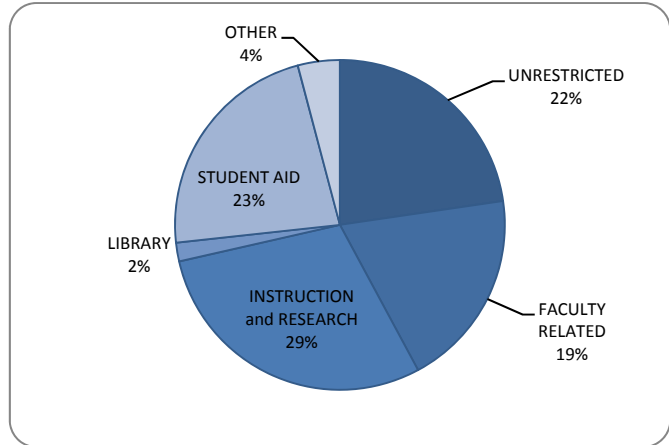
**Total Investment Income Distributed for Operations**

The University distributes investment income for use in operations according to policies approved by the Board. Total investment income distributed for operations represented 26% of University revenue in FY14, the second highest source of operating revenue for the University.

- Endowment income distributed for operations increased 7% to \$985 million in FY14. This includes payout from the University’s Merged Pool (MP) based on the Board-approved formula and income received from real estate investments outside of the MP and other invested assets. The

endowment payout as a percentage of the beginning endowment value was 5.3% for FY14 and 5.4% for FY13.

**FIGURE 2  
ENDOWMENT PAYOUT BY PURPOSE**



- Expendable funds pools and other investment income distributed for operations was \$181 million in FY14, compared to \$84 million in FY13. This category primarily includes the payout to operations from the Expendable Funds Pool (EFP) and the Endowment Income Funds Pool (EIFP), the principal investment vehicles for the University’s expendable funds.
- The EFP policy provides a variable payout to certain funds that support operations based on the prior year’s investment returns. Positive returns in both FY13 and FY12 resulted in the payouts to these funds over the past two years. Higher returns in FY13 over FY12 contributed to the increased payout in FY14. See *Note 6* to the FY14 Consolidated Financial Statements.
- The EIFP holds previously distributed but unspent endowment payouts. These amounts are invested in highly liquid instruments in order to preserve the principal balance. Earnings on these investments are distributed to the fund holders. See *Note 6* to the FY14 Consolidated Financial Statements.

## OPERATING EXPENSES

Total expenses increased \$319 million, or 8%, to \$4.3 billion in FY14. Salaries and benefits comprised 62% of the University's total expenses; depreciation expense was 7% and other operating expenses represented 31%.

- Salaries and benefits increased 6% in FY14 to \$2.7 billion. The increase resulted from a combination of salary programs designed to maintain Stanford's competitive position, higher benefit costs, and increases in headcount to support new programs, particularly within the School of Medicine.
- Depreciation expense increased by 7% to \$311 million in FY14 from \$292 million in FY13. The increase in this category resulted from buildings recently placed in service as described in the Capital Projects section below.
- Other operating expenses increased by 12% to \$1.3 billion in FY14 due to additional expenses incurred to support new and existing housing, recreational facilities and infrastructure, and new programs and facilities, particularly within the School of Medicine and SLAC.

## FINANCIAL POSITION

The University's *Statements of Financial Position* reflect strong donor support, excellent investment returns and positive operating results over the past four years. Total University assets increased \$3.7 billion in FY14 to end the year at \$35.2 billion. Total University liabilities increased slightly from \$5.8 billion to \$6.0 billion.

### Cash and Assets Limited as to Use

The University regularly monitors liquidity required to meet its operating needs and other contractual commitments. At the same time, the University strives to maximize the investment of its available funds. At August 31, 2014, the University's cash and cash equivalents was \$630 million, a decrease of \$154 million compared to the prior year. Assets limited as to use to fund construction expenditures increased \$135 million as a result of the issuance of tax-exempt bonds during FY14. In addition, there were \$1.7 billion in cash and cash equivalents in the University's investments. See *Note 5* to the FY14 Consolidated Financial Statements.

## Investments

University investments at August 31, 2014 were \$27.8 billion, an increase of \$3.1 billion or 13% over FY13.

There are three primary categories of investments:

- \$23.0 billion held in the MP (discussed above under FY14 Financial Highlights).
- Over \$3 billion of real estate investments on Stanford's endowed lands which have been designated for the production of income by the Board, and other real estate investments. In FY2014, these properties generated \$85M in income, net of expenses and appreciated \$481 million in value. In recent years, the value of these properties has benefited from strong dynamics in the local real estate market including rising investor demand for real estate; high office, hotel and apartment occupancy rates; increased office market rents; and strong retail sales.
- The remaining investments are specifically invested for a variety of purposes, including donor wishes.

## Capital Projects

The University continues to invest heavily in its physical facilities to support key academic initiatives, housing and infrastructure. During FY14, the University invested \$662 million in capital projects, bringing gross plant facilities before accumulated depreciation to \$8.2 billion. Plant facilities, net of accumulated depreciation, increased \$351 million to \$4.6 billion.

During FY14, construction was completed on the Shriram Center for Bioengineering and Chemical Engineering, the Donald Kennedy Graduate Residences, the Anderson Collection building and significant portions of the Stanford Energy System Innovations (SESI) project, including the electrical substation and the majority of the steam-to-hot water piping and building conversions. Completion and activation of the central energy facility is scheduled to occur in the spring of 2015.

SESI demonstrates Stanford's commitment to and investment in environmental sustainability and a major University initiative to reduce energy and water use, apply stringent environmental standards

to all new buildings, encourage sustainable living, conserve natural resources and decrease waste. As part of Stanford's commitment to make the arts integral to a Stanford education, a new arts district is taking shape. Anchored by the Cantor Arts Center, the Memorial Auditorium, the Stanford Art Gallery, the Frost Amphitheater, and the Bing Concert Hall (which opened in 2013), the newest additions include the Anderson Collection at Stanford (which opened to the public in September 2014) and the McMurtry Art and Art History Building (scheduled to open in 2015).

### **Debt**

The University's debt policy governs the amount and type of debt Stanford may incur and is designed to preserve debt capacity, financial flexibility and access to capital markets at competitive rates. A combination of fixed and variable rate debt, of varying maturities, is used to fund academic facilities, residential housing and dining facilities, real estate investment projects, faculty and staff mortgage loans and other infrastructure projects.

During FY14, the University issued \$553 million in taxable and tax-exempt debt to finance various facilities and infrastructure, including additional portions of the SESI project, to refinance certain tax-exempt bonds and commercial paper notes, and to achieve savings in interest costs. The debt was issued with yields-to-maturity ranging from 1.75%-3.63% on tax-exempt bonds with maturities of 7 and 31 years and 4.25% on taxable bonds with a maturity of 40 years. The University paid down \$350 million of its 2009 taxable debt upon maturity.

Total debt increased \$166 million to \$3.3 billion as of August 31, 2014. During FY14, Standard and Poor's, Moody's and Fitch affirmed the University's debt ratings in the highest rating categories for short and long-term debt.

### **Unrestricted Net Assets**

In total, unrestricted net assets of the University increased \$2.0 billion to \$15.5 billion, with \$214 million resulting from operating activities. The most significant components of non-operating changes in unrestricted net assets in FY14 were the \$1.6 billion increase in realized and unrealized

investment gains and \$168 million from the release of restrictions on capital and other gifts previously included in temporarily restricted net assets.

### **Temporarily Restricted Net Assets**

Temporarily restricted net assets increased \$1.2 billion to \$7.8 billion in FY14. An increase in realized and unrealized investment gains of \$1.1 billion, and new temporarily restricted gifts and pledges of \$373 million were the major factors in this result. The results were partially offset by \$168 million in transfers relating to capital assets placed in service and other gifts released from their restrictions and by \$137 million released for operating activities.

### **Permanently Restricted Net Assets**

Permanently restricted net assets increased \$284 million to \$5.9 billion during FY14. The increase was driven by \$154 million in new gifts and pledges and a \$64 million increase in realized and unrealized investment gains.

### **Hospitals**

The financial results and financial position of Stanford Health Care, formerly named Stanford Hospital and Clinics and its respective entities (SHC), and Lucile Salter Packard Children's Hospital at Stanford and its respective entities (LPCH), are combined in the FY14 Consolidated Financial Statements under the "Hospitals" column. The University is the sole member of each of the Hospitals. The University's School of Medicine and its clinical faculty, together with SHC and LPCH, comprise and are known in the marketplace as Stanford Medicine.

In FY11, the Hospitals received local government approval to rebuild and expand their principal facilities. Construction is now well underway and the facilities are expected to be completed in 2017. These improvements will assure that the Hospitals have adequate inpatient capacity in modern, technologically-advanced and patient-centered facilities, and meet state-mandated earthquake safety standards. The total estimated cost, inclusive of contingencies, is approximately \$2.0 billion for SHC and \$1.2 billion for LPCH.

To improve and expand their services, the Hospitals have established community-based ambulatory



clinic organizations—SHC's University HealthCare Alliance (UHA) and LPCH's Packard Children's Health Alliance (PCHA)—that support Stanford Medicine's mission to deliver quality care to the community and conduct research and education. Working collaboratively with the Hospitals and School of Medicine faculty, these organizations have acquired multi-specialty practices in outlying communities to form a network of coordinated care throughout the Bay Area.

The Hospitals continue to participate in the California Hospital Quality Assurance Fee (QAF) Program and the Hospital Fee Program. These programs are designed to provide supplemental payments to certain hospitals and support the State's effort to maintain health care coverage for children.

The following discussion summarizes the individual financial results of SHC and LPCH as shown in the FY14 Consolidated Financial Statements.

### **STANFORD HEALTH CARE**

SHC generated solid operating results in FY14, resulting in income from operations of \$278 million compared to \$253 million in FY13. SHC's positive operating results were due in part to strong volume, improved throughput, cost containment initiatives and growth in the number of new facilities and faculty physicians performing clinical services. Net assets grew by \$432 million, or 19%, to \$2.7 billion mainly due to the favorable results from operations, investment returns and fundraising commitments for the new Stanford Hospital.

In October 2014, Stanford Hospital and Clinics was renamed Stanford Health Care to reflect the range and focus of its organization and commitment to healing patients. SHC encapsulates the entire health system including: Stanford Hospital; Stanford Clinics; Stanford specialty centers such as the cancer, heart and neuroscience health centers; UHA medical groups; virtual care and patient navigation offerings; and the Stanford Health Care Alliance health plan.

In September 2014, ValleyCare Health System (VCHS) and SHC signed an affiliation agreement. VCHS has provided not-for-profit health care to the Tri-Valley and surrounding communities since 1961. VCHS offers a wide range of health care services at three Bay Area medical facilities in Alameda County. Closing of the affiliation is subject to various approvals including regulatory approvals.

### **Operating Results**

Operating revenues increased by 10.5% to \$3.0 billion. Net patient service revenue less doubtful accounts (including capitation/premium revenue) increased \$272 million or 10% from FY13 to \$2.9 billion and represented 97% of operating revenues. Inpatient and outpatient, which represented 47% and 53% of net patient revenues (including capitation/premium revenue), respectively, grew significantly due to overall strong volume growth and physician recruitments, including both Stanford faculty and UHA. Revenues from the QAF and Hospital Fee Programs contributed \$10 million and \$50 million to the FY14 and FY13 total operating revenues, respectively.

Operating expenses, including salaries and benefits, were up 10.5% to \$2.7 billion in FY14, including expenses related to the QAF and Hospital Fee Programs of \$8 million and \$29 million in FY14 and FY13, respectively. Salaries and benefits increased in response to growth in patient volumes (including UHA) and to maintain SHC's position in the competitive market for health care professionals.

Physicians' services and support increased 13% to \$482 million. This category includes all payments to the University for services provided by the School of Medicine for its clinical services. Other operating expenses were up by 9% to \$905 million as a result of costs related to increased patient activity (including UHA), enhanced IT infrastructure, and other SHC initiatives.

### **Statement of Financial Position (Balance Sheet)**

SHC's *Statement of Financial Position* reflected continued investments in the facilities and systems required to remain at the forefront of

medicine and to be the provider of choice for complex care in the communities it serves. Gross property and equipment increased \$359 million to \$2.5 billion during FY14. As of August 31, 2014, capital spending from inception on the new Stanford Hospital was \$556 million, inclusive of \$52 million of capitalized interest. Unrestricted cash and investments were \$2.0 billion at the end of FY14, an increase of \$238 million.

### **Other SHC Highlights**

Costs of charity care and uncompensated costs including those related to services provided to patients under Medi-Cal and Medicare in excess of reimbursement, were \$491 million in FY14, up 20% from FY13.

UHA collaborates with Stanford Medicine and community physicians to provide primary and specialty clinical services throughout the Bay Area. UHA consists of five medical groups comprising over 200 physicians and providers, a management services organization, and an independent practice association of approximately 1,600 physicians.

### **LUCILE SALTER PACKARD CHILDREN'S HOSPITAL AT STANFORD**

FY14 was a year of significant accomplishments and strong operating results for LPCH. Enterprise-wide implementation of a new information system, Epic, which provides electronic medical records and end-to-end revenue capture, billing and collection, was completed. The physician network continued to grow with the addition of six medical practices and 17 providers. At four locations throughout the San Francisco Bay Area, LPCH also opened two new ambulatory care centers and acquired two new outpatient facilities, for which construction design is underway. LPCH's hospital expansion construction continued. In FY14, LPCH issued \$200 million in fixed and variable rate tax-exempt debt as part of the overall funding plan for the hospital expansion construction.

### **Operating Results**

LPCH, together with Packard Children's Health Alliance (PCHA), the Packard Medical Group and the School of Medicine Pediatric and Obstetrics Faculty Practice Organization, comprise and are known in

the marketplace as Stanford Children's Health. However, the legal entity reported in these financial statements, known as LPCH, includes only the operations of LPCH and PCHA.

Operating revenues for LPCH increased by \$47 million or 4% in FY14, excluding revenues from the QAF and Hospital Fee Programs. Revenues from those Programs contributed \$15 million and \$83 million to the FY14 and FY13 total operating revenues, respectively.

Operating expenses increased by 10% in FY14, excluding expenses related to the QAF and Hospital Fee Programs of \$5 million and \$24 million for FY14 and FY13, respectively. The majority of the increase in expenses was caused by costs related to the strategic investments noted previously, including such items as training and depreciation for Epic, increased salaries and benefits and higher supply costs due in part to the mix of patients, and increased payments to the University for purchased services, including physician services.

As a result, LPCH generated income from operations of \$43 million in FY14 compared to \$147 million in FY13, including net revenue from the QAF and Hospital Fee Programs. Net assets at August 31, 2014 were \$1.9 billion, reflecting an increase of \$187 million over FY13. These results reflect solid operating results, positive investment performance and strong donor support.

### **Statement of Financial Position (Balance Sheet)**

LPCH's *Statement of Financial Position* reflects significant donor contributions and investments in the facilities and systems required to continue to provide the highest quality children's hospital services to the community it serves. Gross property and equipment increased \$272 million during FY14, including \$118 million for construction of LPCH's portion of hospital construction.

### **Other LPCH Highlights**

LPCH's community benefits, including services to patients under Medi-Cal and other publicly sponsored programs that reimburse at amounts less than the cost of services, were \$203 million

in FY14 compared with \$169 million in FY13. The increase was primarily due to more Medi-Cal patients in relation to the total hospital patients and higher Medi-Cal charges in relation to applicable costs. These amounts also include investments LPCH makes in improving the health of the children through a range of community-based programs.

### Looking Forward

Stanford's strong financial position, together with renewed facilities and continued investment in our physical infrastructure, provide a solid foundation as we look to the future. The generous support of our donors and commitment of the Stanford community have been essential to building our capabilities.

Each of Stanford's principal revenue sources faces challenges looking forward:

The health care system is undergoing substantial change as a result of the Affordable Care Act, consolidation of major health care providers, and increased focus by Medicare and large employers on accountable care. Although Stanford Medicine has achieved outstanding financial performance over the past few years, our future success may be challenged due to these changes. In addition, the new Stanford hospitals scheduled to open in 2017

will significantly increase fixed costs for SHC and LPCH.

We expect Federal funding for sponsored research to decline in the future on an inflation-adjusted basis. Today, this funding supports graduate student education, postdoctoral scholar training, state-of-the-art facilities, and, most importantly, much of the research that has made Silicon Valley and the United States an innovation powerhouse. Stanford is seeking to replace declining Federal funding with non-Federal sponsors and philanthropy, but our historic volume of research will be challenging to sustain.

Investment markets are inherently volatile, and Stanford has adopted a philosophy aimed at maximizing long-term returns with a high tolerance for short-term volatility. As a result, the downturn we experienced in 2008-09 could readily happen again. Although the United States economy is performing well, the global economy continues to be unsettled and a dramatic reversal of recent investment gains could occur at any time.

Stanford addresses these risks and situations proactively, always mindful of the end goal of preserving our mission and the institution for future generations.



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Daniel J. Morissette  
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Dana Haering  
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Lucile Salter Packard Children's Hospital at Stanford

## SELECTED FINANCIAL AND OTHER DATA

Fiscal Years Ended August 31

	2014	2013	2012	2011	2010
	(dollars in millions)				
<b>CONSOLIDATED STATEMENT OF ACTIVITIES HIGHLIGHTS:</b>					
Total operating revenues	\$ 7,924	\$ 7,359	\$ 6,814	\$ 6,289	\$ 5,707
Student income (A)	534	511	481	458	436
Sponsored research support	1,266	1,233	1,234	1,247	1,143
Health care services	3,942	3,734	3,245	2,902	2,542
Total operating expenses	7,389	6,794	6,298	5,774	5,345
Change in net assets from operating activities	535	565	516	515	362
Other changes in net assets	3,582	2,441	1,043	3,194	1,131
Net change in total net assets	\$ 4,117	\$ 3,006	\$ 1,559	\$ 3,709	\$ 1,493
<b>CONSOLIDATED STATEMENT OF FINANCIAL POSITION HIGHLIGHTS:</b>					
University					
Investments at fair value	\$ 27,829	\$ 24,703	\$ 22,247	\$ 21,189	\$ 17,804
Plant facilities, net of accumulated depreciation	4,559	4,208	3,826	3,674	3,584
Notes and bonds payable	3,265	3,098	2,709	2,727	2,816
Total assets	35,227	31,540	28,981	27,698	24,553
Total liabilities	6,006	5,817	5,476	5,143	5,118
Total net assets	29,221	25,723	23,505	22,555	19,435
Hospitals					
Investments at fair value	2,635	2,271	1,899	1,796	1,359
Plant facilities, net of accumulated depreciation	2,273	1,787	1,494	1,333	1,283
Notes and bonds payable	1,874	1,684	1,700	983	992
Total assets	7,319	6,448	5,803	4,283	3,658
Total liabilities	2,741	2,489	2,633	1,722	1,686
Total net assets	4,578	3,959	3,170	2,561	1,972
<b>OTHER UNIVERSITY FINANCIAL DATA AND METRICS:</b>					
Total endowment at year end	\$ 21,446	\$ 18,689	\$ 17,036	\$ 16,503	\$ 13,851
Endowment payout in support of operations	985	921	871	785	855
As a % of beginning of year endowment	5.3%	5.4%	5.3%	5.7%	6.8%
As a % of total expenses	23.0%	23.2%	23.1%	22.4%	25.9%
Total gifts (B)	928	932	1,035	709	599
<b>STUDENTS:</b>					
ENROLLMENT: (C)					
Undergraduate	7,018	6,980	6,999	6,927	6,887
Graduate (D)	9,118	8,980	8,958	8,883	8,870
DEGREES CONFERRED:					
Bachelor degrees	1,651	1,661	1,715	1,670	1,671
Advanced degrees	3,292	3,365	3,305	3,199	3,046
<b>FACULTY:</b>					
Total Professoriate	2,043	1,995	1,934	1,903	1,910
ANNUAL UNDERGRADUATE TUITION RATE (IN DOLLARS)	\$ 42,690	\$ 41,250	\$ 40,050	\$ 38,700	\$ 37,380

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

(B) As reported by the Office of Development. Includes SHC gifts (See Note 14).

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

(D) Enrollment for 2010 - 2013 revised to include Master of Liberal Arts online program.

## MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS

The University is the sole member of Stanford Health Care (formerly known as Stanford Hospital and Clinics) and Lucile Packard Children's Hospital at Stanford (collectively, the "Hospitals"); however, each of the Hospitals has its own separate management with responsibility for its own financial reporting.

Management of the University and the Hospitals is responsible for the integrity and reliability of their respective portions of these financial statements. The University oversees the process of consolidating the Hospitals' information into the consolidated financial statements. Management of each entity represents that, with respect to its financial information, the consolidated financial statements in this annual report have been prepared in conformity with accounting principles generally accepted in the United States of America.

In accumulating and controlling financial data, management of the University and the Hospitals maintains separate systems of internal accounting controls. Management of the respective entities believes that effective internal controls have been designed, implemented and maintained to provide reasonable assurance that assets are protected and that transactions and events are recorded properly. All internal control systems, however, no matter how well designed, have inherent limitations and can provide only reasonable assurance that their objectives are met.

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

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



Randall S. Livingston  
Vice President for Business Affairs  
and Chief Financial Officer  
Stanford University



M. Suzanne Calandra  
Senior Associate Vice President for Finance  
Stanford University



Daniel J. Morissette  
Chief Financial Officer  
Stanford Health Care



Dana Haering  
Chief Financial Officer  
Lucile Salter Packard Children's Hospital at Stanford



## Independent Auditor's Report

To the Board of Trustees of the  
Leland Stanford Junior University

We have audited the accompanying consolidated financial statements of the Leland Stanford Junior University ("Stanford University" or the "University") and its subsidiaries, which comprise the consolidated statements of financial position as of August 31, 2014 and 2013, and the related consolidated statements of activities and cash flows for the years then ended.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the University's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Leland Stanford Junior University and its subsidiaries at August 31, 2014 and 2013, and the results of their activities and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

December 10, 2014

# CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

At August 31, 2014 and 2013 (in thousands of dollars)

	2014			2013
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
<b>ASSETS</b>				
Cash and cash equivalents	\$ 630,214	\$ 641,812	\$ 1,272,026	\$ 1,421,683
Assets limited as to use	300,566	751,066	1,051,632	896,182
Accounts receivable, net	454,990	698,519	1,153,509	1,008,338
Receivables (payables) from SHC and LPCH, net	85,909	(85,909)	-	-
Prepaid expenses and other assets	67,869	151,360	219,229	199,108
Pledges receivable, net	711,795	254,032	965,827	961,734
Student loans receivable, net	81,441	-	81,441	78,437
Faculty and staff mortgages and other loans receivable, net	507,187	-	507,187	453,330
Investments at fair value, including securities pledged or on loan of \$155,758 and \$55,355 for 2014 and 2013, respectively	27,828,590	2,634,974	30,463,564	26,974,475
Plant facilities, net of accumulated depreciation	4,558,913	2,273,399	6,832,312	5,994,616
Works of art and special collections	-	-	-	-
<b>TOTAL ASSETS</b>	<b>\$ 35,227,474</b>	<b>\$ 7,319,253</b>	<b>\$ 42,546,727</b>	<b>\$ 37,987,903</b>
<b>LIABILITIES AND NET ASSETS</b>				
<b>LIABILITIES:</b>				
Accounts payable and accrued expenses	\$ 644,821	\$ 750,246	\$ 1,395,067	\$ 1,332,137
Accrued pension and post retirement benefit cost	566,236	117,339	683,575	669,585
Pending trades of securities	232,893	-	232,893	405,748
Liabilities under security lending agreements	191,011	-	191,011	84,048
Deferred rental and other income	616,575	-	616,575	584,067
Income beneficiary share of split interest agreements	436,166	-	436,166	394,195
Notes and bonds payable	3,264,636	1,873,873	5,138,509	4,782,478
U.S. government refundable loan funds	53,999	-	53,999	54,019
<b>TOTAL LIABILITIES</b>	<b>6,006,337</b>	<b>2,741,458</b>	<b>8,747,795</b>	<b>8,306,277</b>
<b>NET ASSETS:</b>				
Unrestricted	15,467,689	3,451,013	18,918,702	16,429,137
Temporarily restricted	7,844,164	915,748	8,759,912	7,419,222
Permanently restricted	5,909,284	211,034	6,120,318	5,833,267
<b>TOTAL NET ASSETS</b>	<b>29,221,137</b>	<b>4,577,795</b>	<b>33,798,932</b>	<b>29,681,626</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 35,227,474</b>	<b>\$ 7,319,253</b>	<b>\$ 42,546,727</b>	<b>\$ 37,987,903</b>

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

# CONSOLIDATED STATEMENTS OF ACTIVITIES

For the years ended August 31, 2014 and 2013 (in thousands of dollars)

	2014			2013
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
<b>UNRESTRICTED NET ASSETS</b>				
OPERATING REVENUES:				
Student income:				
Undergraduate programs	\$ 317,401	\$ -	\$ 317,401	\$ 311,027
Graduate programs	313,824	-	313,824	297,042
Room and board	151,313	-	151,313	144,887
Student financial aid	(248,848)	-	(248,848)	(241,512)
<b>TOTAL STUDENT INCOME</b>	<b>533,690</b>	<b>-</b>	<b>533,690</b>	<b>511,444</b>
Sponsored research support:				
Direct costs - University	669,670	-	669,670	657,296
Direct costs - SLAC National Accelerator Laboratory	369,317	-	369,317	350,406
Indirect costs	227,160	-	227,160	225,500
<b>TOTAL SPONSORED RESEARCH SUPPORT</b>	<b>1,266,147</b>	<b>-</b>	<b>1,266,147</b>	<b>1,233,202</b>
Health care services:				
Patient care, net	-	3,914,973	3,914,973	3,710,326
Physicians' services and support - SHC and LPCH, net	670,023	(670,023)	-	-
Physicians' services and support - other facilities, net	27,482	-	27,482	23,250
<b>TOTAL HEALTH CARE SERVICES</b>	<b>697,505</b>	<b>3,244,950</b>	<b>3,942,455</b>	<b>3,733,576</b>
<b>CURRENT YEAR GIFTS IN SUPPORT OF OPERATIONS</b>	<b>211,841</b>	<b>678</b>	<b>212,519</b>	<b>185,145</b>
Net assets released from restrictions:				
Payments received on pledges	98,630	1,556	100,186	81,781
Prior year gifts released from donor restrictions	38,063	8,148	46,211	45,231
<b>TOTAL NET ASSETS RELEASED FROM RESTRICTIONS</b>	<b>136,693</b>	<b>9,704</b>	<b>146,397</b>	<b>127,012</b>
Investment income distributed for operations:				
Endowment	985,215	14,551	999,766	934,303
Expendable funds pools and other investment income	180,895	735	181,630	84,458
<b>TOTAL INVESTMENT INCOME DISTRIBUTED FOR OPERATIONS</b>	<b>1,166,110</b>	<b>15,286</b>	<b>1,181,396</b>	<b>1,018,761</b>
<b>SPECIAL PROGRAM FEES AND OTHER INCOME</b>	<b>493,446</b>	<b>148,096</b>	<b>641,542</b>	<b>549,428</b>
<b>TOTAL OPERATING REVENUES</b>	<b>4,505,432</b>	<b>3,418,714</b>	<b>7,924,146</b>	<b>7,358,568</b>
OPERATING EXPENSES:				
Salaries and benefits	2,659,610	1,689,502	4,349,112	4,029,022
Depreciation	310,958	148,185	459,143	425,585
Other operating expenses	1,321,272	1,259,750	2,581,022	2,339,137
<b>TOTAL OPERATING EXPENSES</b>	<b>4,291,840</b>	<b>3,097,437</b>	<b>7,389,277</b>	<b>6,793,744</b>
<b>CHANGE IN NET ASSETS FROM OPERATING ACTIVITIES</b>	<b>\$ 213,592</b>	<b>\$ 321,277</b>	<b>\$ 534,869</b>	<b>\$ 564,824</b>

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



## CONSOLIDATED STATEMENTS OF ACTIVITIES, Continued

*For the years ended August 31, 2014 and 2013 (in thousands of dollars)*

	2014			2013
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
<b>UNRESTRICTED NET ASSETS (continued)</b>				
<b>CHANGE IN NET ASSETS FROM OPERATING ACTIVITIES</b>	<b>\$ 213,592</b>	<b>\$ 321,277</b>	<b>\$ 534,869</b>	<b>\$ 564,824</b>
NON-OPERATING ACTIVITIES:				
Increase in reinvested gains	1,561,670	288,009	1,849,679	1,077,779
Donor advised funds, net	29,314	-	29,314	1,930
Current year gifts not included in operations	17,673	-	17,673	2,902
Equity and fund transfers from Hospitals, net	69,018	(69,018)	-	-
Capital and other gifts released from restrictions	167,626	380	168,006	201,483
Pension and other post employment benefit related changes other than net periodic benefit expense	11,952	5,725	17,677	178,080
Transfer to permanently restricted net assets, net	(41,232)	-	(41,232)	(37,010)
Transfer to temporarily restricted net assets, net	(41,028)	-	(41,028)	(19,621)
Swap interest and change in value of swap agreements	(12,072)	(37,532)	(49,604)	120,610
Other	5,765	(1,554)	4,211	(185)
<b>NET CHANGE IN UNRESTRICTED NET ASSETS</b>	<b>1,982,278</b>	<b>507,287</b>	<b>2,489,565</b>	<b>2,090,792</b>
<b>TEMPORARILY RESTRICTED NET ASSETS</b>				
Gifts and pledges, net	372,875	88,179	461,054	441,719
Increase in reinvested gains	1,083,505	44,460	1,127,965	558,697
Change in value of split interest agreements, net	18,470	212	18,682	1,438
Net assets released to operations	(136,693)	(25,668)	(162,361)	(146,327)
Capital and other gifts released to unrestricted net assets	(167,626)	(380)	(168,006)	(201,483)
Gift transfers to Hospitals, net	(2,575)	2,575	-	-
Transfer from unrestricted net assets, net	41,028	-	41,028	19,621
Transfer from permanently restricted net assets, net	25,483	-	25,483	4,744
Other	(3,058)	(97)	(3,155)	(2,149)
<b>NET CHANGE IN TEMPORARILY RESTRICTED NET ASSETS</b>	<b>1,231,409</b>	<b>109,281</b>	<b>1,340,690</b>	<b>676,260</b>
<b>PERMANENTLY RESTRICTED NET ASSETS</b>				
Gifts and pledges, net	154,068	764	154,832	164,860
Increase in reinvested gains	64,256	-	64,256	17,261
Change in value of split interest agreements, net	50,276	1,938	52,214	24,987
Transfer from unrestricted net assets, net	41,232	-	41,232	37,010
Transfer to temporarily restricted net assets, net	(25,483)	-	(25,483)	(4,744)
<b>NET CHANGE IN PERMANENTLY RESTRICTED NET ASSETS</b>	<b>284,349</b>	<b>2,702</b>	<b>287,051</b>	<b>239,374</b>
<b>NET CHANGE IN TOTAL NET ASSETS</b>	<b>3,498,036</b>	<b>619,270</b>	<b>4,117,306</b>	<b>3,006,426</b>
Total net assets, beginning of year	25,723,101	3,958,525	29,681,626	26,675,200
<b>TOTAL NET ASSETS, END OF YEAR</b>	<b>\$ 29,221,137</b>	<b>\$ 4,577,795</b>	<b>\$ 33,798,932</b>	<b>\$ 29,681,626</b>

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

# CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended August 31, 2014 and 2013 (in thousands of dollars)

	2014			2013
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>				
Change in net assets	\$ 3,498,036	\$ 619,270	\$ 4,117,306	\$ 3,006,426
Adjustments to reconcile change in net assets to net cash provided by (used for) operating activities:				
Depreciation	310,958	148,185	459,143	425,585
Amortization, loss on disposal of fixed assets and other adjustments	6,272	(2,537)	3,735	12,149
Net gains on investments and security agreements	(3,667,658)	(264,103)	(3,931,761)	(2,365,886)
Net losses (gains) on derivatives	8,616	-	8,616	(34,407)
Changes in split interest agreements	34,672	(2,150)	32,522	27,024
Investment income for restricted purposes	(29,526)	(25,693)	(55,219)	(27,246)
Gifts restricted for long-term investments	(247,716)	(68,508)	(316,224)	(295,605)
Equity and fund transfers from Hospitals	(66,443)	66,443	-	-
Gifts of securities and properties	(11,372)	-	(11,372)	(50,025)
Premiums received from bond issuance	97,359	8,382	105,741	113,731
Changes in operating assets and liabilities:				
Accounts receivable and receivables from SHC and LPCH, net	(12,865)	(42,827)	(55,692)	(49,276)
Pledges receivable	(107,032)	-	(107,032)	(12,999)
Prepaid expenses and other assets	(3,698)	(15,331)	(19,029)	(14,728)
Accounts payable and accrued expenses	17,588	61,857	79,445	(64,911)
Accrued pension and post retirement benefit costs	23,312	(9,322)	13,990	(133,960)
Deferred rental and other income	32,508	-	32,508	27,339
Other	-	(3,780)	(3,780)	(3,126)
<b>NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES</b>	<b>(116,989)</b>	<b>469,886</b>	<b>352,897</b>	<b>560,085</b>
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>				
Land, building and equipment purchases	(696,511)	(620,333)	(1,316,844)	(1,032,377)
Student, faculty and other loans:				
New loans made	(118,134)	-	(118,134)	(70,684)
Principal collected	56,084	-	56,084	70,077
Increase in assets limited as to use	(135,328)	(20,117)	(155,445)	(167,858)
Purchases of investments	(25,113,421)	(151,650)	(25,265,071)	(20,252,633)
Sales and maturities of investments	25,418,479	104,460	25,522,939	19,892,351
<b>NET CASH USED FOR INVESTING ACTIVITIES</b>	<b>(588,831)</b>	<b>(687,640)</b>	<b>(1,276,471)</b>	<b>(1,561,124)</b>
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>				
Gifts and reinvested income for restricted purposes	312,701	94,782	407,483	477,155
Equity and fund transfers from Hospitals	56,453	(56,453)	-	-
Proceeds from borrowing	623,127	200,000	823,127	496,719
Bond issuance costs and interest rate swaps	(2,423)	(1,284)	(3,707)	(2,229)
Repayment of notes and bonds payable	(545,210)	(14,910)	(560,120)	(226,856)
Increase (decrease) in liabilities under security lending agreements	106,963	-	106,963	(57,151)
Other	(20)	191	171	236
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>551,591</b>	<b>222,326</b>	<b>773,917</b>	<b>687,874</b>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(154,229)</b>	<b>4,572</b>	<b>(149,657)</b>	<b>(313,165)</b>
Cash and cash equivalents, beginning of year	784,443	637,240	1,421,683	1,734,848
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ 630,214</b>	<b>\$ 641,812</b>	<b>\$ 1,272,026</b>	<b>\$ 1,421,683</b>
SUPPLEMENTAL DATA:				
Interest paid, net of capitalized interest	\$ 111,210	\$ 58,701	\$ 169,911	\$ 201,632
Cash collateral received under security lending agreements	\$ 163,449	\$ -	\$ 163,449	\$ 57,810
Increase (decrease) in payables for plant facilities	\$ (34,797)	\$ 14,416	\$ (20,381)	\$ 67,389

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 1. Basis of Presentation and Significant Accounting Policies

### **BASIS OF PRESENTATION**

The consolidated financial statements include the accounts of Stanford University (the “University”), Stanford Health Care (SHC), formerly known as Stanford Hospital and Clinics, as well as Lucile Salter Packard Children’s Hospital at Stanford (LPCH) and other majority-owned or controlled entities of these organizations. All significant inter-entity transactions and balances have been eliminated upon consolidation. Certain prior year amounts have been reclassified to conform to the current year’s presentation. These reclassifications had no impact on the change in net assets or total net assets.

### **University**

The University is a private, not-for-profit educational institution, founded in 1885 by Senator Leland and Mrs. Jane Stanford in memory of their son, Leland Stanford Jr. A Board of Trustees (the “Board”) governs the University. The University category presented in the consolidated financial statements comprises all of the accounts of the University, including its institutes and research centers, and the Stanford Management Company.

SLAC National Accelerator Laboratory (SLAC) is a federally funded research and development center owned by the Department of Energy (DoE). The University manages and operates SLAC for the DoE under a management and operating contract; accordingly, the revenues and expenditures of SLAC are included in the University’s *Statements of Activities*, but SLAC’s assets and liabilities are not included in the University’s *Statements of Financial Position*. SLAC employees are University employees and participate in the University’s employee benefit programs. The University holds some receivables from the DoE substantially related to reimbursement for employee compensation and benefits.

### **Hospitals**

SHC and LPCH are California not-for-profit public benefit corporations. The University is the sole member of each of these entities. SHC and LPCH support the mission of medical education and clinical research of the University’s School of Medicine (SoM). Collectively, these entities comprise Stanford Medicine. They operate two licensed acute care and specialty hospitals on the Stanford campus and numerous physician clinics on the campus, in community settings and in association with regional hospitals in the San Francisco Bay Area and elsewhere in California. The University has partnered with SHC and LPCH, respectively, to establish physician practice management organizations to support Stanford Medicine’s mission of delivering quality care to the community and conducting research and education.

The “Hospitals” category presented in the consolidated financial statements comprises all of the accounts of SHC, LPCH, the University HealthCare Alliance and Packard Children’s Health Alliance physician practice management organizations, and a captive insurance company which SHC and LPCH jointly control. For purposes of presentation of the Hospitals’ balance sheets, statements of operations and changes in net assets and statements of cash flows in these consolidated financial statements, conforming reclassifications have been made to the Hospitals’ revenues, expenses, investment income and inter-entity receivables and payables consistent with categories in these consolidated financial statements.

## **TAX STATUS**

The University and the Hospitals are exempt from federal and state income taxes to the extent provided by Section 501(c)(3) of the Internal Revenue Code and equivalent state provisions, except with regard to unrelated business income which is taxed at corporate income tax rates.

In accordance with the guidance on accounting for uncertainty in income taxes, management regularly evaluates its tax positions and does not believe the University or Hospitals have any uncertain tax positions that require disclosure or adjustment to the consolidated financial statements. The University and Hospitals are subject to routine audits by taxing jurisdictions. The University and Hospitals believe they are no longer subject to income tax examinations for fiscal years prior to August 31, 2010.

## **BASIS OF ACCOUNTING**

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

For financial reporting purposes, net assets and revenues, expenses, gains and losses are classified into one of three categories - unrestricted, temporarily restricted or permanently restricted.

### **Unrestricted Net Assets**

Unrestricted net assets are expendable resources which are not subject to donor-imposed restrictions. Unrestricted net assets include funds designated for operations, net investment in plant facilities, certain investment and endowment gains and funds functioning as endowment. These net assets may be designated by the University or the Hospitals for specific purposes under internal operating and administrative arrangements or be subject to contractual agreements with external parties. Donor-restricted contributions that relate to the University's or the Hospitals' core activities and are received and expended or deemed expended based on the nature of donors' restrictions are classified as unrestricted. All expenses are recorded as a reduction of unrestricted net assets.

The operating activities of the University and the Hospitals include the revenues earned and expenses incurred in the current year to support the University's core activities of teaching and research or the Hospitals' patient care, teaching and research missions. The non-operating activities of the University and Hospitals include increases in reinvested gains, current year gifts not included in operations, capital and other gifts released from restrictions, pension and other post employment benefit related changes other than net periodic benefit expense and certain other non-operating activities.

Transfers from unrestricted net assets to temporarily restricted net assets and permanently restricted net assets are primarily the result of donor redesignations or matching funds that are added to donor gift funds which then take on the same restrictions as the donor gift.

### **Temporarily Restricted Net Assets**

Temporarily restricted net assets include gifts and pledges that are subject to donor-imposed restrictions that expire with the passage of time, payment of pledges or specific actions to be undertaken by the University or the Hospitals, which are then released and reclassified to unrestricted net assets. In addition, appreciation and income on certain donor-restricted endowment funds are classified as temporarily restricted net assets until authorized for spending (see *Notes 12 and 13*). Donor-restricted resources intended for capital projects are initially recorded as temporarily restricted and released from their temporary restrictions and reclassified as unrestricted net assets when the asset is placed in service.

Also included in this category is the University's net equity in split interest agreements that are expendable at maturity.

### **Permanently Restricted Net Assets**

Permanently restricted net assets consist primarily of endowment, annuity and life income funds which are subject to donor-imposed restrictions requiring that the principal be invested in perpetuity. Permanently restricted net assets may also include funds reclassified from other classes of net assets as a result of donor-imposed stipulations, the University's net equity in split interest agreements that are not expendable at maturity and net assets which by donor stipulation must be made available in perpetuity for specific purposes.

### **CASH AND CASH EQUIVALENTS**

Cash and cash equivalents included in the *Statements of Financial Position* consist of U.S. Treasury bills, commercial paper, certificates of deposit, money market funds and all other short-term investments with original maturities of 90 days or less at the time of purchase. These amounts are carried at cost, which approximates fair value. Cash and cash equivalents that are held for investment purposes are classified as investments (see *Note 5*).

### **ASSETS LIMITED AS TO USE**

Assets limited as to use include accounts of the University that solely hold proceeds of tax-exempt bonds issued for the benefit of the University and limited by the terms of indentures to use for qualified University capital projects. Assets limited as to use also include trustee-held accounts holding proceeds of tax-exempt bonds issued for the benefit of the Hospitals and limited by the terms of indentures to use for qualified Hospital capital projects. Assets limited as to use consist of cash and cash equivalents and short-term investments, recorded at cost, which approximates fair value.

### **ACCOUNTS AND LOANS RECEIVABLE**

Accounts and loans receivable are carried at cost, less an allowance for doubtful accounts.

### **PLEDGES RECEIVABLE**

Unconditional promises to give are included in the consolidated financial statements as pledges receivable and are classified as temporarily restricted or permanently restricted, depending upon donor stipulations. Pledges recognized on or after September 1, 2008 are recorded at an applicable risk-adjusted discount rate commensurate with the duration of the donor's payment plan. Pledges recognized in periods prior to September 1, 2008 were recorded at a discount based on the U.S. Treasury rate. 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.

### **INVESTMENTS**

Investments are recorded at fair value. Gains and losses (realized and unrealized) on investments are recognized in the *Statements of Activities* (see *Note 5*).

The investment portfolio may be exposed to various risks, including, but not limited to, interest rate, market, sovereign, concentration, counterparty, liquidity and credit risk. Fair value reporting requires management to make estimates and assumptions about the effects of matters that are inherently uncertain. Estimates developed using methods such as discounted cash flow are subjective, requiring significant judgments such as the amount and timing of future cash flows and the selection of appropriate discount rates that reflects market and credit risks. Management of the University and the Hospitals regularly assess these risks through established policies and procedures. Actual results could differ from these estimates and such differences could have a material impact on the consolidated financial statements.

**PLANT FACILITIES**

Plant facilities are recorded at cost or, for donated assets, at fair value at the date of donation. Interest expense for construction financing, net of income earned on unspent proceeds, is capitalized as a cost of construction. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

The useful lives used in calculating depreciation for the years ended August 31, 2014 and 2013 are as follows:

	UNIVERSITY	HOSPITALS
Land improvements	10-25 years	10-25 years
Buildings and building improvements	4-50 years	7-40 years
Furniture, fixtures and equipment	3-10 years	3-20 years
Utilities	5-40 years	N/A

**WORKS OF ART AND SPECIAL COLLECTIONS**

Works of art, historical treasures, literary works and artifacts, which are preserved and protected for educational, research and public exhibition purposes, are not capitalized. Donations of such collections are not recorded for financial statement purposes. Purchases of collection items are recorded as operating expenses in the period in which they are acquired. Proceeds from sales of such items are used to acquire other items for the collections.

**DONATED ASSETS**

Donated assets, other than works of art and special collections as discussed above, are recorded at fair value at the date of donation. Undeveloped land, including land acquired under the original endowment from Senator Leland and Mrs. Jane Stanford, is reported at fair value at the date of acquisition. Under the terms of the original founding grant, a significant portion of University land may not be sold.

**DONOR ADVISED FUNDS**

The University receives gifts from donors under donor advised fund (DAF) agreements. These funds are owned and controlled by the University and are separately identified by donor. A significant portion of the gift must be designated to the University. At August 31, 2014 and 2013, approximately \$321.3 million and \$268.1 million, respectively, of DAFs may be used to support other approved charities; the donors have advisory privileges with respect to the distribution of these funds.

Current year gifts under the DAF agreements are included in the *Statements of Activities* as “donor advised funds, net” at the full amount of the gift. Transfers of funds to other charitable organizations are included in the *Statements of Activities* as a reduction to “donor advised funds, net” at the time the transfer is made.

### **SPLIT INTEREST AGREEMENTS**

Split interest agreements consist of arrangements with donors where the University and the Hospitals have an interest in assets held by the trustee and receive benefits that are shared with other beneficiaries. Split interest agreements where the University and the Hospitals are not the trustee are recorded in the "assets held by other trustees" category of "investments" in the *Statements of Financial Position* as described in *Note 5*.

The assets held under split interest agreements where the University is the trustee were \$773.6 million and \$679.7 million at August 31, 2014 and 2013, respectively, and were recorded in various categories in "investments"; the discounted present value of any income beneficiary interest is reported as "income beneficiary share of split interest agreements" in the *Statements of Financial Position*. The discount rates used, which range from 1% to 6%, are established in the year the gift was received and are based on tables established by the Internal Revenue Service.

During fiscal years 2014 and 2013, the discounted present value of new gifts subject to split interest agreements where the University is the trustee, net of the income beneficiary share, were \$17.9 million and \$21.2 million, respectively, and were included in "gifts and pledges, net" in the *Statements of Activities*. Actuarial gains or losses are included in "change in value of split interest agreements, net" in the *Statements of Activities*.

Funds subject to donor-imposed restrictions requiring that the principal be invested in perpetuity are classified as "permanently restricted net assets" in the *Statements of Financial Position*; all others are classified as "temporarily restricted net assets" until the expiration of the donor-imposed restrictions, at which point they will be classified as "unrestricted net assets."

### **SELF-INSURANCE**

The University self-insures at varying levels for unemployment, disability, workers' compensation, property losses, certain health care plans and general and professional liability losses. The Hospitals self-insure at varying levels for health care plans, workers' compensation and, through their captive insurance company, for professional liability losses. Third-party insurance is purchased to cover liabilities above the self-insurance limits. Estimates of retained exposures are accrued.

### **INTEREST RATE EXCHANGE AGREEMENTS**

The University and the Hospitals have entered into several interest rate exchange agreements to reduce the effect of interest rate fluctuation on their variable rate revenue bonds and notes. Current accounting guidance for derivatives and hedges requires entities to recognize all derivative instruments at fair value. The University and the Hospitals do not designate and qualify their derivatives for hedge accounting; accordingly, any changes in the fair value (i.e. gains or losses) flow directly to the *Statements of Activities* in "swap interest and change in value of swap agreements". The settlements (net cash payments less receipts) under the interest rate exchange agreements are recorded in the *Statements of Activities* in "swap interest and change in value of swap agreements" for the University and in "other operating expenses" for the Hospitals.

The University has entered into interest rate swaps to reduce the effect of interest rate fluctuations of certain investment positions (see *Note 7*).

### **STUDENT INCOME**

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

## **PATIENT CARE AND OTHER SERVICES**

### **Health Care Services**

The Hospitals derive a majority of patient care revenues from contractual agreements with Medicare, Medi-Cal and other third-party payers. Payments under these agreements and programs are based on a variety of payment models. "Patient care, net" is reported in the *Statements of Activities* at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive audit adjustments under reimbursement agreements with third-party payers and bad debts. Retroactive adjustments are estimated and recorded in the period the related services are rendered and adjusted in future periods, as final settlements are determined. Contracts, laws and regulations governing the Medicare and Medi-Cal programs are complex and subject to interpretation. As a result, it is reasonably possible that recorded estimates may change by a material amount in the near term. The Hospitals provision for doubtful accounts of \$153.5 million and \$123.5 million, respectively, for the years ended August 31, 2014 and 2013, is based upon management's assessment of expected net collections considering historical experience and other collection indicators.

The University has entered into various operating agreements with the Hospitals for the professional services of SoM faculty members, and for non-physician services such as telecommunications, facilities, and other services.

### **Charity Care**

The Hospitals provide care to patients who meet certain criteria under their charity care policies without charge or at amounts less than their established rates. The Hospitals do not record revenue for amounts determined to qualify as charity care.

The estimated cost of providing charity care was \$17.4 million and \$20.4 million for the years ended August 31, 2014 and 2013, respectively. This cost is estimated by calculating a ratio of total costs to gross patient service charges at established rates, and then multiplying that ratio by gross uncompensated patient service charges at established rates associated with providing care to charity patients. The Hospitals received \$684 thousand and \$652 thousand during the years ended August 31, 2014 and 2013, respectively, from contributions that were restricted for the care of indigent patients.

The Hospitals also provide services to other patients under the Medicare, Medi-Cal and other publicly sponsored programs, which reimburse at amounts less than the cost of the services provided to the recipients. Estimated costs in excess of reimbursements for the Medicare, Medi-Cal and other publicly sponsored programs for the years ended August 31, 2014 and 2013 were \$676.8 million and \$557.3 million, respectively.

### **Provider Fee**

The State of California enacted legislation in 2009 through 2014 which established a Hospital Quality Assurance Fee (QAF) Program and a Hospital Fee Program. These programs imposed a provider fee on certain California general acute care hospitals that, combined with federal matching funds, would be used to provide supplemental payments to certain hospitals and support the State's effort to maintain health care coverage for children. Certain rates under these programs are pending approval from the Centers for Medicare & Medicaid Services.

For the years ended August 31, 2014 and 2013, the Hospitals recorded \$12.9 million and \$52.6 million, respectively, in "other operating expenses" and recognized \$24.1 million and \$133.0 million, respectively, in "patient care, net" revenue under these programs.



## RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board (FASB) issued an update to the Accounting Standards Codification (ASC) to improve consistency of revenue recognition practices across industries for economically similar transactions. The core principle is that an entity recognizes revenue for goods or services to customers in an amount that reflects the consideration it expects to receive in return. The guidance is effective for periods beginning after December 15, 2016. The University and Hospitals are currently evaluating the impact that this guidance will have on its consolidated financial statements.

In October 2012, the FASB issued an update to the ASC to improve consistency in the classification of cash receipts from the sale of certain donated financial assets, such as securities, in the statement of cash flows. This guidance requires an entity to classify such cash receipts consistently with cash donations received if those receipts were from the sale of donated financial assets that have no entity-imposed limitations for sale and were converted nearly immediately into cash. The guidance is effective for periods beginning after June 15, 2013. The University and Hospitals adopted this guidance in fiscal year 2014 and applied it retroactively. Accordingly, consolidated cash receipts from the sale of donated financial assets of \$128.7 million and \$80.7 million were classified in the operating and financing sections, respectively, in the *Statement of Cash Flows* for the year ended August 31, 2014. For fiscal year 2013, \$158.9 million of consolidated cash receipts were reclassified from the investing section to the operating section (\$52.8 million) and financing section (\$106.1 million) in the *Statement of Cash Flows*.

In December 2011, the FASB issued an update to the ASC which expanded the required disclosures about offsetting and related arrangements of an entity's financial assets and liabilities. The disclosures are intended to provide additional information to assist financial statement users in understanding the effect of those arrangements on the entity's financial position. This guidance is effective for annual periods beginning after January 1, 2013. The University and Hospitals have adopted this guidance for the year ended August 31, 2014 (see *Notes 5 and 7*).

## 2. Accounts Receivable

Accounts receivable, net of bad debt allowances, at August 31, 2014 and 2013, in thousands of dollars, are as follows:

	2014			2013
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
U.S. government sponsors	\$ 82,388	\$ -	\$ 82,388	\$ 77,613
Non-federal sponsors and programs	41,034	1,581	42,615	75,624
Pending trades of securities	272,243	-	272,243	194,331
Accrued interest on investments	13,059	-	13,059	8,659
Student	6,055	-	6,055	6,808
Patient and third-party payers	-	799,694	799,694	704,409
Other	42,317	33,736	76,053	58,112
	457,096	835,011	1,292,107	1,125,556
Less bad debt allowances	(2,106)	(136,492)	(138,598)	(117,218)
<b>ACCOUNTS RECEIVABLE, NET</b>	<b>\$ 454,990</b>	<b>\$ 698,519</b>	<b>\$ 1,153,509</b>	<b>\$ 1,008,338</b>

Amounts due from Blue Cross and Blue Shield represent 21% and 12%, and 23% and 17%, of the Hospitals' net patient accounts receivable, at August 31, 2014 and 2013, respectively. Each Hospital's management does not believe significant credit risks exist with these payers.

## 3. Pledges Receivable

Pledges are recorded at applicable risk-adjusted discount rates, ranging from 1.1% to 6.0% for the University and Hospitals, commensurate with the duration of the donor's payment plan. At August 31, 2014 and 2013, pledges receivable, net of discounts and allowances, in thousands of dollars, are as follows:

	2014			2013
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
One year or less	\$ 133,942	\$ 24,937	\$ 158,879	\$ 159,049
Between one year and five years	654,628	231,441	886,069	854,453
More than five years	75,315	25,348	100,663	166,342
	863,885	281,726	1,145,611	1,179,844
Less discounts and allowances	(152,090)	(27,694)	(179,784)	(218,110)
<b>PLEDGES RECEIVABLE, NET</b>	<b>\$ 711,795</b>	<b>\$ 254,032</b>	<b>\$ 965,827</b>	<b>\$ 961,734</b>

Conditional pledges for the University, which depend on the occurrence of a specified future and uncertain event, were \$14.4 million and \$9.0 million at August 31, 2014 and 2013, respectively. The Hospitals had conditional pledges of \$62.6 million and \$119.6 million at August 31, 2014 and 2013, respectively. The majority of these conditional pledges are related to construction or time defined milestones related to the Medical Center Renewal Project. Lucile Packard Foundation for Children's Health is the primary community fundraising agent for LPCH and the pediatric faculty and programs at the University's SoM.

## 4. Loans Receivable

The University's loans receivable consist primarily of student loans receivable and faculty and staff mortgages. Management regularly assesses the adequacy of the allowance for credit losses of its loans by performing ongoing evaluations, including such factors as the differing economic risks associated with each loan category, the financial condition of specific borrowers, the economic environment in which the borrowers operate, the level of delinquent loans and the value of any collateral.

### STUDENT LOANS RECEIVABLE

Student loans receivable consist of institutional and federally-sponsored loans due from both current and former students. Student loans and allowance for student loan losses at August 31, 2014 and 2013, in thousands of dollars, are as follows:

	2014	2013
Institutional loans	\$ 22,687	\$ 20,144
Federally-sponsored loans	59,465	58,838
	82,152	78,982
Less allowance for student loan losses	(711)	(545)
<b>STUDENT LOANS RECEIVABLE, NET</b>	<b>\$ 81,441</b>	<b>\$ 78,437</b>

Institutional loans are funded by donor funds restricted for student loan purposes and University funds made available to meet demonstrated need in excess of all other sources of student loan borrowings.

Federally-sponsored loans are funded primarily by advances to the University primarily under the Federal Perkins Loan Program (the "Program"). Loans to students under the Program are subject to mandatory interest rates and significant restrictions, and loans issued under the Program can be assigned to the federal government in certain non-repayment situations. In these situations, the federal portion of the loan balance is guaranteed.

Amounts received under the Program are ultimately refundable to the federal government in the event the University no longer participates in the Program, and accordingly, have been reported as an obligation in the *Statements of Financial Position* as "U.S. government refundable loan funds".

### FACULTY AND STAFF MORTGAGES

In a program to attract and retain excellent faculty and senior staff, the University provides home mortgage financing assistance, primarily in the form of subordinated loans. Notes receivable amounting to \$504.6 million and \$450.6 million at August 31, 2014 and 2013, respectively, from University faculty and staff are included in "faculty and staff mortgages and other loans receivable, net" in the *Statements of Financial Position*. These loans and mortgages are collateralized by deeds of trust on properties concentrated in the region surrounding the University. Management has determined that no allowance is necessary.

## 5. Investments

Investments held by the University and the Hospitals are measured and recorded at fair value. The valuation methodology, investment categories, fair value hierarchy, certain investment activities and related commitments for fiscal years 2014 and 2013 are discussed below.

Investments held by the University and the Hospitals at August 31, 2014 and 2013, in thousands of dollars, are as follows:

	2014			2013
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
Cash and cash equivalents	\$ 1,693,240	\$ 61,785	\$ 1,755,025	\$ 1,386,414
Collateral held for securities loaned	163,449	-	163,449	57,810
Public equities	7,118,193	23,891	7,142,084	5,659,192
Derivatives	14,922	-	14,922	5,942
Fixed income	1,436,008	228,014	1,664,022	1,323,161
Real estate	5,926,195	-	5,926,195	5,337,236
Natural resources	2,010,161	-	2,010,161	1,796,786
Private equities	6,057,505	-	6,057,505	5,361,599
Absolute return	5,304,605	-	5,304,605	5,579,275
Assets held by other trustees	185,102	17,028	202,130	187,463
Other	217,640	5,826	223,466	279,597
	30,127,020	336,544	30,463,564	26,974,475
Hospital funds invested in the University's Merged Pool	(2,298,430)	2,298,430	-	-
<b>INVESTMENTS AT FAIR VALUE</b>	<b>\$ 27,828,590</b>	<b>\$ 2,634,974</b>	<b>\$ 30,463,564</b>	<b>\$ 26,974,475</b>

### VALUATION METHODOLOGY

To the extent available, the University's investments are recorded at fair value based on quoted prices in active markets on a trade-date basis. The University's investments that are listed on any U.S. or non-U.S. recognized exchanges are valued based on readily available market quotations. When such inputs do not exist, fair value measurements are based on the best available information and usually require a degree of judgment. For alternative investments, which are principally limited partnership investments in private equity, real estate, natural resources and hedge funds, the value is primarily based on the Net Asset Value (NAV) of the underlying investments. The NAV is reported by the external investment managers, including general partners, in accordance with their policies as described in their respective financial statements and offering memoranda. The most recent NAV reported is adjusted for capital calls, distributions and significant known valuation changes, if any, of its related portfolio through August 31, 2014 and 2013, respectively. These investments are generally less liquid than other investments, and the value reported may differ from the values that would have been reported had a ready market for these investments existed.

The University exercises due diligence in assessing the policies, procedures, and controls implemented by its external investment managers and believes the University's proportionate share of the carrying amount of these alternative investments is a reasonable estimate of fair value. Such due diligence procedures include, but are not limited to, ongoing communication, on-site visits, and review of information from the external investment managers as well as review of performance. In conjunction with these procedures, estimated fair value is determined by consideration of a wide range of factors, such as market conditions, redemption terms and restrictions, and risks inherent in the inputs of the external investment managers' valuation.

For alternative investments which are direct investments, the University considers various factors to estimate fair value, such as the timing of the transaction, the market in which the company operates, comparable transactions, company performance and projections as well as discounted cash flow analysis. The selection of an appropriate valuation technique may be affected by the availability and general reliability of relevant inputs. In some cases, one valuation technique may provide the best indication of fair value while in other circumstances, multiple valuation techniques may be appropriate. Furthermore, the University may review the investment's underlying portfolio as well as engage external appraisers, depending on the nature of the investment.

## **INVESTMENT CATEGORIES**

Investments are categorized by asset class and valued as described below:

**Cash and cash equivalents** categorized as investments include money market funds, overnight receivables on repurchase agreements and restricted cash. Overnight receivables on repurchase agreements are valued based on cost, which approximates fair value. Money market funds are valued based on reported unit values. Restricted cash includes collateral provided to or received from counterparties related to investment-related derivative contracts (see *Note 7*).

**Collateral held for securities loaned** is generally received in the form of cash and cash equivalents and is reinvested for income in cash equivalent vehicles. These investments are recorded at cost, which approximates fair value (see *Note 9*).

**Public equities** are investments valued based on quoted market prices (and exchange rates, if applicable) on the last trading date of the principal market on or before August 31. They include investments that are directly held as well as commingled funds which invest in publicly traded equities. The fair values of public equities held through alternative investments are calculated by the respective external investment managers as described under *Valuation Methodology* above.

**Derivatives** are used by the University to manage its exposure to certain risks relating to ongoing business and investment operations. Derivatives such as forward currency contracts, options, interest rate swaps and credit default swaps (CDS) are valued using models based on market verifiable inputs, or by using independent broker quotes.

**Fixed income** investments are valued by independent pricing sources, broker dealers or pricing models that factor in, where applicable, recently executed transactions, interest rates, bond or credit default spreads and volatility. They include investments that are actively traded fixed income securities or mutual funds.

**Real estate** represents directly owned real estate and other real estate interests held through limited partnerships. The fair value of real estate directly owned by the University, including the Stanford Shopping Center and the Stanford Research Park, is based primarily on discounted cash flows, using estimates from the asset manager or external investment managers, corroborated by appraisals and market data, if available. The fair value of real estate held through limited partnerships is based on NAV as reported by the external investment managers and is adjusted as described under *Valuation Methodology* above.

**Natural resources** are mostly held in commodity and energy related investments, which are valued on the basis of a combination of models, including appraisals, discounted cash flows and commodity price factors. The fair value of these types of alternative investments is based on NAV as reported by the external investment managers and is adjusted as described under *Valuation Methodology* above.

**Private equities** are investments primarily in venture capital and leveraged buyout strategies. Distributions from these investments are received through liquidation of the underlying asset. The fair value of these types of alternative investments is based on the NAV reported by the external investment managers and is adjusted as described under *Valuation Methodology* above.

**Absolute return** investments are typically commingled funds that employ multiple strategies to produce positive returns, regardless of the direction of the financial markets. The fair value of these types of alternative investments is valued based on NAV as reported by the external investment managers and is adjusted as described under *Valuation Methodology* above.

**Assets held by other trustees** generally represent the University's and the Hospitals' residual interest in split interest agreements where the University or the Hospitals are not the trustee. The residual (or beneficial) interest represents the present value of the future distributions expected to be received over the term of the agreement, which approximates fair value, and the assets are based on estimates provided by trustees.

### **FAIR VALUE HIERARCHY**

U.S. GAAP defines fair value as the price received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants. Current guidance establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Inputs are used in applying the various valuation techniques and take into account the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, liquidity statistics, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. In contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument. Valuation techniques used under U.S. GAAP must maximize the use of observable inputs to the extent available.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

**Level 1** – Investments whose values are based on quoted market prices in active markets for identical assets or liabilities are classified as Level 1. Level 1 investments include active listed equities and certain short term fixed income securities. Such investments are valued based upon the closing price quoted on the last trading date on or before the reporting date on the principal market, without adjustment.

Exchange-traded derivatives such as options, futures contracts and warrants using observable inputs such as the last reportable sale price or the most recent bid price are typically classified as Level 1 (see *Note 7*).

**Level 2** – Investments that trade in markets that are not actively traded, but are valued based on quoted market prices, dealer quotations, or alternative pricing sources for similar assets or liabilities are classified as Level 2. These investments include certain U.S. government and sovereign obligations, government agency obligations, investment grade corporate bonds and certain limited marketability securities.

Privately negotiated over-the-counter (OTC) derivatives such as forward currency contracts, CDS, total return swaps, and interest rate swaps are typically classified as Level 2 (see *Note 7*). In instances where quotations received from counterparties or valuation models are used, the value of an OTC derivative depends upon the contractual terms of the instrument as well as the availability and reliability of

observable inputs. Such inputs include market prices for reference securities, yield curves, and credit curves.

**Level 3** – Investments classified as Level 3 have significant unobservable inputs, as they trade infrequently or not at all. The inputs into the determination of fair value of these investments are based upon the best information in the circumstance and may require significant management judgment. These investments primarily consist of the University's alternative investments and are classified as Level 3 as the inputs are not observable. Certain alternative investments may be reclassified to Level 2 when the University has the ability to redeem them at NAV in the near term without significant restrictions on redemption.

The following tables summarize the University's and the Hospitals' investments and other assets within the fair value hierarchy and asset categories at August 31, 2014 and 2013, in thousands of dollars:

	AS OF			
	AUGUST 31, 2014	LEVEL 1	LEVEL 2	LEVEL 3
<b>UNIVERSITY*</b>				
Cash and cash equivalents	\$ 1,693,240	\$ 1,646,141	\$ 47,099	\$ -
Collateral held for securities loaned	163,449	-	163,449	-
Public equities	7,118,193	3,009,485	1,160,289	2,948,419
Derivatives	14,922	(45)	14,967	-
Fixed income	1,436,008	837,535	594,513	3,960
Real estate	5,926,195	144,450	49,554	5,732,191
Natural resources	2,010,161	157,691	-	1,852,470
Private equities	6,057,505	17,569	-	6,039,936
Absolute return	5,304,605	-	2,242,156	3,062,449
Assets held by other trustees	185,102	-	-	185,102
Other	217,640	493	-	217,147
<b>TOTAL</b>	<b>30,127,020</b>	<b>5,813,319</b>	<b>4,272,027</b>	<b>20,041,674</b>
<b>HOSPITALS</b>				
Cash and cash equivalents	61,785	56,826	4,959	-
Public equities	23,891	23,891	-	-
Fixed income	228,014	68,830	159,184	-
Assets held by other trustees	17,028	-	-	17,028
Other	5,826	-	-	5,826
<b>TOTAL</b>	<b>336,544</b>	<b>149,547</b>	<b>164,143</b>	<b>22,854</b>
<b>CONSOLIDATED TOTAL</b>	<b>\$ 30,463,564</b>	<b>\$ 5,962,866</b>	<b>\$ 4,436,170</b>	<b>\$ 20,064,528</b>

\* Amounts include the Hospitals' cross investment in the University's investment pools of \$2.3 billion.

	AS OF			
	AUGUST 31, 2013	LEVEL 1	LEVEL 2	LEVEL 3
<b>UNIVERSITY*</b>				
Cash and cash equivalents	\$ 1,303,199	\$ 1,225,411	\$ 77,788	\$ -
Collateral held for securities loaned	57,810	-	57,810	-
Public equities	5,545,012	2,545,284	1,166,840	1,832,888
Derivatives	5,942	4,677	1,265	-
Fixed income	1,273,525	691,323	582,202	-
Real estate	5,337,236	66,910	-	5,270,326
Natural resources	1,796,786	249,617	-	1,547,169
Private equities	5,361,599	4,139	-	5,357,460
Absolute return	5,579,275	166,121	2,236,941	3,176,213
Assets held by other trustees	172,605	-	-	172,605
Other	279,597	804	103	278,690
<b>TOTAL</b>	<b>26,712,586</b>	<b>4,954,286</b>	<b>4,122,949</b>	<b>17,635,351</b>
<b>HOSPITALS</b>				
Cash and cash equivalents	83,215	78,607	4,608	-
Public equities	114,180	67,407	46,773	-
Fixed income	49,636	-	49,636	-
Assets held by other trustees	14,858	-	-	14,858
<b>TOTAL</b>	<b>261,889</b>	<b>146,014</b>	<b>101,017</b>	<b>14,858</b>
<b>CONSOLIDATED TOTAL</b>	<b>\$ 26,974,475</b>	<b>\$ 5,100,300</b>	<b>\$ 4,223,966</b>	<b>\$ 17,650,209</b>

\* Amounts include the Hospitals' cross investment in the University's investment pools of \$2.0 billion.

The University manages the majority of the Hospitals' investments, including the Hospitals' investment in the Merged Pool (MP), with a combined fair value of \$2.3 billion and \$2.0 billion at August 31, 2014 and 2013, respectively.



## SUMMARY OF LEVEL 3 INVESTMENT ACTIVITIES AND TRANSFERS

The following tables present the activities for Level 3 investments for the years ended August 31, 2014 and 2013, in thousands of dollars:

FAIR VALUE MEASUREMENTS USING SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)	BEGINNING BALANCE AS OF SEPTEMBER 1, 2013	PURCHASES	SALES AND MATURITIES	NET REALIZED AND UNREALIZED GAINS (LOSSES)	TRANSFERS IN	TRANSFERS OUT	ENDING BALANCE AS OF AUGUST 31, 2014
<b>UNIVERSITY*</b>							
Public equities	\$ 1,832,888	\$ 596,883	\$ (125,266)	\$ 417,400	\$ 354,641	\$ (128,127)	\$ 2,948,419
Fixed income	-	3,990	-	(30)	-	-	3,960
Real estate	5,270,326	383,085	(622,261)	743,756	-	(42,715)	5,732,191
Natural resources	1,547,169	453,478	(435,136)	286,959	-	-	1,852,470
Private equities	5,357,460	599,357	(1,164,518)	1,247,637	-	-	6,039,936
Absolute return	3,176,213	241,530	(595,390)	253,090	-	(12,994)	3,062,449
Assets held by other trustees	172,605	-	-	12,497	-	-	185,102
Other	278,690	204,457	(278,335)	18,112	-	(5,777)	217,147
<b>TOTAL</b>	<b>17,635,351</b>	<b>2,482,780</b>	<b>(3,220,906)</b>	<b>2,979,421</b>	<b>354,641</b>	<b>(189,613)</b>	<b>20,041,674</b>
<b>HOSPITALS</b>							
Assets held by other trustees	14,858	-	-	2,170	-	-	17,028
Other	-	5,826	-	-	-	-	5,826
<b>TOTAL</b>	<b>14,858</b>	<b>5,826</b>	<b>-</b>	<b>2,170</b>	<b>-</b>	<b>-</b>	<b>22,854</b>
<b>CONSOLIDATED TOTAL</b>	<b>\$ 17,650,209</b>	<b>\$ 2,488,606</b>	<b>\$ (3,220,906)</b>	<b>\$ 2,981,591</b>	<b>\$ 354,641</b>	<b>\$ (189,613)</b>	<b>\$ 20,064,528</b>

\* Amounts include the Hospitals' cross investment in the University's investment pools.

FAIR VALUE MEASUREMENTS USING SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)	BEGINNING BALANCE AS OF SEPTEMBER 1, 2012	PURCHASES	SALES AND MATURITIES	NET REALIZED AND UNREALIZED GAINS	TRANSFERS IN	TRANSFERS OUT	ENDING BALANCE AS OF AUGUST 31, 2013
<b>UNIVERSITY*</b>							
Public equities	\$ 2,105,804	\$ 245,686	\$ (195,168)	\$ 303,566	\$ 13,183	\$ (640,183)	\$ 1,832,888
Real estate	4,988,534	444,838	(556,464)	403,383	-	(9,965)	5,270,326
Natural resources	1,406,981	268,981	(236,580)	100,212	9,965	(2,390)	1,547,169
Private equities	5,163,154	608,796	(775,787)	533,168	-	(171,871)	5,357,460
Absolute return	3,210,949	249,629	(590,059)	441,710	87,030	(223,046)	3,176,213
Assets held by other trustees	154,462	8,485	(9,363)	19,021	-	-	172,605
Other	204,045	44,393	(324,178)	354,430	-	-	278,690
<b>TOTAL</b>	<b>17,233,929</b>	<b>1,870,808</b>	<b>(2,687,599)</b>	<b>2,155,490</b>	<b>110,178</b>	<b>(1,047,455)</b>	<b>17,635,351</b>
<b>HOSPITALS</b>							
Assets held by other trustees	13,604	-	-	1,254	-	-	14,858
<b>TOTAL</b>	<b>13,604</b>	<b>-</b>	<b>-</b>	<b>1,254</b>	<b>-</b>	<b>-</b>	<b>14,858</b>
<b>CONSOLIDATED TOTAL</b>	<b>\$ 17,247,533</b>	<b>\$ 1,870,808</b>	<b>\$ (2,687,599)</b>	<b>\$ 2,156,744</b>	<b>\$ 110,178</b>	<b>\$ (1,047,455)</b>	<b>\$ 17,650,209</b>

\* Amounts include the Hospitals' cross investment in the University's investment pools.

Net realized and unrealized gains (losses) in the tables above are included in the *Statements of Activities* primarily as "increase in reinvested gains" by level of restriction. For the years ended August 31, 2014 and 2013, the change in unrealized gains (losses) for Level 3 investments still held at August 31, 2014 and 2013 was \$2.7 billion and \$1.8 billion, respectively.

Transfers in (out) include investments which have been reclassified to Level 2 as the University has the ability to redeem these at NAV in the near term. Transfers in (out) also include situations where observable inputs have changed, such as when Level 3 investments make distributions from an underlying asset with a fair value based on quoted market prices. All transfer amounts are based on the fair value at the beginning of the fiscal year. There were no transfers between Level 1 and Level 2 during the years ended August 31, 2014 and 2013.

### LEVEL 3 INVESTMENT VALUATION TECHNIQUES AND SIGNIFICANT UNOBSERVABLE INPUTS

The following table summarizes the significant unobservable inputs and valuation methodologies for Level 3 investments as of August 31, 2014 and 2013.

For each investment category and respective valuation technique, the range of the significant unobservable input is dependent on the nature and characteristics of the investment. The input range and weighted average values may vary at each balance sheet date.

INVESTMENT CATEGORIES	FAIR VALUE <sup>1</sup>	VALUATION TECHNIQUE	SIGNIFICANT UNOBSERVABLE INPUTS	RANGE		IMPACT TO VALUATION FROM AN INCREASE IN INPUT <sup>2</sup>
				MIN.	MAX	
<b>2014</b>						
Real estate	\$ 3,484,984	Discounted cash flow	Discount rate	4.0%	11.0%	Decrease
			Capitalization rate	5.0%	9.0%	Decrease
Natural resources	127,077	Market comparables	Weights ascribed to market comparables	20.0%	50.0%	N/A
Other	217,147	Market comparables	Recent transactions	N/A	N/A	N/A
<b>TOTAL AMOUNT WITH SIGNIFICANT UNOBSERVABLE INPUTS</b>		<b>3,829,208</b>				
<b>2013</b>						
Real estate	2,984,011	Discounted cash flow	Discount rate	5.8%	14.0%	Decrease
			Capitalization rate	5.0%	8.0%	Decrease
Natural resources	78,285	Market comparables	Weights ascribed to market comparables	20.0%	60.0%	N/A
Other	278,690	Market comparables	Recent transactions	N/A	N/A	N/A
<b>TOTAL AMOUNT WITH SIGNIFICANT UNOBSERVABLE INPUTS</b>		<b>\$ 3,340,986</b>				

<sup>1</sup> Level 3 investments assets of \$16.2 billion and \$14.3 billion at August 31, 2014 and 2013, respectively, were excluded from the above quantitative disclosure as their fair value was primarily based on the NAV reported by external investment managers as described in the Valuation Methodology section above.

<sup>2</sup> Unless otherwise noted, this column represents the directional change in the fair value of the Level 3 investments that would result from an increase to the corresponding unobservable input. A decrease to the unobservable input would have the opposite effect. Significant increases and decreases in these unobservable inputs in isolation could result in significantly higher or lower fair value measurements.

## INVESTMENT-RELATED COMMITMENTS

The University is obligated under certain alternative investment agreements to advance additional funding up to specified levels over a period of several years. The following table presents significant terms of such agreements for all related alternative investments at August 31, 2014, in thousands of dollars:

ASSET CLASS	FAIR VALUE	UNFUNDED COMMITMENT	REMAINING LIFE (YEARS)	REDEMPTION TERMS AND RESTRICTIONS
Public equities	\$ 4,105,972	\$ 145,502	0 to 5	Generally, lock-up provisions ranging from 0 to 5 years. After initial lock up expires, redemptions are available on a rolling basis and require 3 to 180 days prior notification.
Real estate	2,011,107	944,653	0 to 13	Not eligible for redemption
Natural resources	1,842,172	1,208,016	0 to 15	Not eligible for redemption
Private equities	6,039,932	1,815,518	0 to 16	Not eligible for redemption
Absolute return	5,304,605	1,110,148	0 to 7	Generally, lock-up provisions ranging from 0 to 6 years. After initial lock up expires, redemptions are available on a rolling basis and require 2 to 180 days prior notification.
<b>TOTAL</b>	<b>\$19,303,788</b>	<b>\$ 5,223,837</b>		

## OFFSETS TO INVESTMENT-RELATED ASSETS AND LIABILITIES

Financial instruments with off-balance sheet risk such as derivatives, securities lending agreements, and repurchase agreements (“repo”) are subject to counterparty credit risk. The University seeks to control this risk in various ways, such as entering into transactions with quality counterparties, establishing and monitoring credit limits, and requiring collateral in certain situations.

For certain derivatives, a master netting arrangement allows the counterparty to net applicable collateral held on behalf of the University against applicable liabilities or payment obligations of the University to the counterparty. These arrangements also allow the counterparty to net any of its applicable liabilities or payment obligations to the University against any collateral previously received.

The University may also enter into repo or reverse repo arrangements. When the University enters into a repo, it “sells” securities to a broker-dealer or financial institution, and agrees to purchase such securities for a predetermined price, including interest, from the broker-dealer or financial institution. Conversely, when the University enters into a reverse repo, it “buys” securities from a broker-dealer or financial institution, and agrees to sell such securities for a predetermined price, including interest, subject to the obligation of the broker-dealer or financial institution.

For financial statement purposes, the University nets investment-related derivative assets and liabilities on the *Statements of Financial Position*. For disclosure purposes, the University does not offset assets and liabilities relating to the financial and derivative instruments that are subject to an enforceable master netting arrangement or similar agreement, or that meet the right of setoff criteria in the accounting guidance. The potential effect of offset and related arrangements associated with these financial and derivative instruments as of August 31, 2014 and 2013, in thousands of dollars, is presented in the following table:

	AS PRESENTED IN CONSOLIDATED STATEMENTS OF FINANCIAL POSITION			GROSS AMOUNTS NOT OFFSET IN CONSOLIDATED STATEMENTS OF FINANCIAL POSITION		
	GROSS AMOUNTS OF ASSETS AND LIABILITIES	GROSS AMOUNTS OFFSET	NET AMOUNTS OF ASSETS AND LIABILITIES	FINANCIAL INSTRUMENTS <sup>4</sup>	CASH COLLATERAL RECEIVED (PLEGGED) <sup>4</sup>	NET AMOUNT
<b>2014</b>						
Assets:						
Derivatives <sup>1</sup>	\$ 46,522	\$ (31,600)	\$ 14,922	\$ -	\$ 14,922	\$ -
Reverse repurchase agreements <sup>2</sup>	-	-	-	-	-	-
<b>TOTAL</b>	<b>46,522</b>	<b>(31,600)</b>	<b>14,922</b>	<b>-</b>	<b>14,922</b>	<b>-</b>
Liabilities:						
Derivatives <sup>1</sup>	31,600	(31,600)	-	-	-	-
Securities lending <sup>3</sup>	163,449	-	163,449	163,449	-	-
<b>TOTAL</b>	<b>195,049</b>	<b>(31,600)</b>	<b>163,449</b>	<b>163,449</b>	<b>-</b>	<b>-</b>
<b>2013</b>						
Assets:						
Derivatives <sup>1</sup>	19,254	(13,312)	5,942	-	-	5,942
Reverse repurchase agreements <sup>2</sup>	82,900	-	82,900	-	-	82,900
<b>TOTAL</b>	<b>102,154</b>	<b>(13,312)</b>	<b>88,842</b>	<b>-</b>	<b>-</b>	<b>88,842</b>
Liabilities:						
Derivatives <sup>1</sup>	13,312	(13,312)	-	-	-	-
Securities lending <sup>3</sup>	57,810	-	57,810	57,810	-	-
<b>TOTAL</b>	<b>\$ 71,122</b>	<b>\$ (13,312)</b>	<b>\$ 57,810</b>	<b>\$ 57,810</b>	<b>\$ -</b>	<b>\$ -</b>

<sup>1</sup> Gross derivative assets less gross derivative liabilities are presented as “derivatives” in the investment table above.

<sup>2</sup> Reverse repurchase agreements are included in “Cash and cash equivalents” in the investment table above.

<sup>3</sup> Refer to Note 9 for details.

<sup>4</sup> These amounts are limited to the derivative asset balance and accordingly, do not include any excess collateral received.

## INVESTMENT RETURNS

Total investment returns for the years ended August 31, 2014 and 2013, in thousands of dollars, are as follows:

	2014			2013
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
Investment income	\$ 312,167	\$ 17,940	\$ 330,107	\$ 309,476
Net realized and unrealized gains	3,671,302	331,965	4,003,267	2,426,165
<b>TOTAL INVESTMENT RETURNS</b>	<b>3,983,469</b>	<b>349,905</b>	<b>4,333,374</b>	<b>2,735,641</b>
<i>Reconciliation to Statements of Activities:</i>				
Total investment income distributed for operations	\$ 1,166,110	\$ 15,286	\$ 1,181,396	\$ 1,018,761
Increase in reinvested gains - unrestricted	1,561,670	288,009	1,849,679	1,077,779
Increase in reinvested gains - temporarily restricted	1,083,505	44,460	1,127,965	558,697
Change in value of split interest agreements, net - temporarily restricted	18,470	212	18,682	1,438
Increase in reinvested gains - permanently restricted	64,256	-	64,256	17,261
Change in value of split interest agreements, net - permanently restricted	50,276	1,938	52,214	24,987
Adjusted for:				
Returns on split interest agreements paid to beneficiaries - temporarily restricted	12,323	-	12,323	11,031
Returns on split interest agreements paid to beneficiaries - permanently restricted	26,859	-	26,859	25,687
<b>TOTAL INVESTMENT RETURNS</b>	<b>\$ 3,983,469</b>	<b>\$ 349,905</b>	<b>\$ 4,333,374</b>	<b>\$ 2,735,641</b>

Investment returns are net of investment management expenses, including both external management fees and internal University investment-related salaries, benefits and operating expenses, and the portion of interest expense and amortization related to the April 2009 bond issuance held for liquidity purposes (see *Note 10*).

## FUTURE MINIMUM RENTAL INCOME

As part of its investment portfolio, the University holds certain investment properties that it leases to third parties. Future minimum rental income due from the Stanford Shopping Center, the Stanford Research Park and other properties under non-cancelable leases in effect with tenants at August 31, 2014, in thousands of dollars, is as follows:

YEAR ENDING AUGUST 31	FUTURE MINIMUM RENTAL INCOME
2015	\$ 93,639
2016	91,114
2017	87,249
2018	78,276
2019	73,952
Thereafter	1,648,022
<b>TOTAL</b>	<b>\$ 2,072,252</b>

## 6. Investment Pools

The University's investments are held in various investment pools or in specific investments to comply with donor requirements as indicated in the following table, at August 31, 2014 and 2013, in thousands of dollars:

	2014	2013
<b>UNIVERSITY</b>		
Merged Pool	\$ 25,330,910	\$ 22,600,862
Expendable Funds Pool	3,259,707	3,181,451
Endowment Income Funds Pool	360,867	342,622
Other investment pools	99,710	86,525
Specific investments	4,696,400	4,025,199
	<u>33,747,594</u>	<u>30,236,659</u>
Less:		
Amounts included in "cash and cash equivalents" in the <i>Statements of Financial Position</i>	(460,888)	(450,202)
Funds cross-invested in investment pools	(3,154,731)	(3,069,263)
Hospital funds invested in the University's investment pools	(2,303,385)	(2,013,787)
<b>TOTAL</b>	<b><u>27,828,590</u></b>	<b><u>24,703,407</u></b>
<b>HOSPITALS</b>		
Investments	2,634,974	2,271,068
<b>TOTAL</b>	<b><u>2,634,974</u></b>	<b><u>2,271,068</u></b>
<b>CONSOLIDATED TOTAL</b>	<b><u>\$ 30,463,564</u></b>	<b><u>\$ 26,974,475</u></b>

The MP is the primary investment pool in which endowment (see *Note 12*) and other long-term funds are invested. The MP is invested with the objective of optimizing long-term total return while maintaining an appropriate level of risk for the University. It is a unitized investment pool in which the fund holders purchase investments and withdraw funds based on a monthly share value.

The Expendable Funds Pool (EFP) and Endowment Income Funds Pool (EIFP) are the principal investment vehicles for the University's expendable funds. A substantial portion of the EFP is cross-invested in the MP; the remainder is included in "cash and cash equivalents" in the *Statements of Financial Position*. The EIFP holds income previously distributed to holders of permanently restricted endowment funds that has not yet been expended. The EIFP is invested in highly liquid instruments and is included in the *Statements of Financial Position* as "cash and cash equivalents".

The Board has established a policy for the distribution of the investment returns of the EFP. The difference between the actual return of this investment pool and the approved payout is deposited in, or withdrawn from, funds functioning as endowment (FFE) (see *Note 12*). For the years ended August 31, 2014 and 2013, the results of the EFP, in thousands of dollars, are as follows:

	2014	2013
Total investment return of the EFP	\$ 494,121	\$ 336,148
Less distributions to fund holders and operations	(126,473)	(60,927)
<b>AMOUNTS ADDED TO FFE</b>	<b><u>\$ 367,648</u></b>	<b><u>\$ 275,221</u></b>

## 7. Derivatives

The University, directly or through external investment managers on the University's behalf, utilizes various strategies to reduce investment and credit risks, to serve as a temporary surrogate for investment in stocks and bonds, to manage interest rate exposure on the University's debt, and/or to manage specific exposure to foreign currencies. Futures, options and other derivative instruments are used to adjust elements of investment exposures to various securities, sectors, markets and currencies without actually taking a position in the underlying asset or basket of assets. Interest rate swaps are used to manage interest rate risk. With respect to foreign currencies, the University utilizes forward contracts and foreign currency options to manage exchange rate risk.

### INVESTMENT-RELATED DERIVATIVES

The following table presents amounts for investment-related derivatives, including the notional amount, the fair values at August 31, 2014 and 2013, and gains and losses for the years ended August 31, 2014 and 2013, in thousands of dollars:

	AS OF AUGUST 31, 2014			YEAR ENDED AUGUST 31, 2014
	NOTIONAL AMOUNT <sup>1</sup>	GROSS DERIVATIVE ASSETS <sup>2</sup>	GROSS DERIVATIVE LIABILITIES <sup>2</sup>	REALIZED AND UNREALIZED GAINS (LOSSES) <sup>3</sup>
Interest-rate contracts	\$ 3,623,678	\$ 31,942	\$ 21,618	\$ (12,255)
Foreign exchange contracts	705,701	6,697	1,957	17,440
Equity contracts	1,605,379	6,409	7,836	(17,138)
Credit contracts	77,345	1,474	189	199
<b>TOTAL</b>	<b>\$ 6,012,103</b>	<b>\$ 46,522</b>	<b>\$ 31,600</b>	<b>\$ (11,754)</b>

	AS OF AUGUST 31, 2013			YEAR ENDED AUGUST 31, 2013
	NOTIONAL AMOUNT <sup>1</sup>	GROSS DERIVATIVE ASSETS <sup>2</sup>	GROSS DERIVATIVE LIABILITIES <sup>2</sup>	REALIZED AND UNREALIZED GAINS (LOSSES) <sup>3</sup>
Interest-rate contracts	\$ 1,644,761	\$ 9,394	\$ 8,950	\$ 3,164
Foreign exchange contracts	371,433	4,546	3,483	26,521
Equity contracts	283,100	4,677	-	40,652
Credit contracts	149,454	637	879	(2,820)
<b>TOTAL</b>	<b>\$ 2,448,748</b>	<b>\$ 19,254</b>	<b>\$ 13,312</b>	<b>\$ 67,517</b>

<sup>1</sup> The notional amount is representative of the volume and activity of the respective derivative type during the years ended August 31, 2014 and 2013.

<sup>2</sup> Gross derivative assets less gross derivative liabilities of \$14.9 million and \$5.9 million as of August 31, 2014 and 2013, respectively, are presented as "derivatives" on the investment table in Note 5.

<sup>3</sup> Gains (losses) on derivatives are included in the Statements of Activities as "increase in reinvested gains" in "non-operating activities".

## Credit Default Swaps

Credit contracts in the previous table consist of both the purchases and sales of CDS. CDS are contracts under which counterparties are provided protection against the risk of default on a set of debt obligations issued by specific companies (or group of companies combined in an index). The buyer of the CDS will make payment to the seller and in return receive payment if the underlying instrument goes into default or is triggered by some other credit event. The University's CDS transactions include both single name entities as well as index CDS. Under the index CDS, the credit events that would trigger settlement of the CDS and require the University to remit payment are generally bankruptcy and failure to pay.

The table below summarizes certain information regarding the sale of CDS at August 31, 2014 and 2013, in thousands of dollars:

CREDIT RATINGS OF THE REFERENCE OBLIGATION <sup>2</sup>	MAXIMUM POTENTIAL PAYOUT (NOTIONAL AMOUNT <sup>1</sup> ) / YEARS TO MATURITY			FAIR VALUE ASSET/ (LIABILITY)
	LESS THAN 3	OVER 3	TOTAL	
<b>2014</b>				
Single name credit default swaps:				
A- to AA+	\$ 6,900	\$ 26,200	\$ 33,100	\$ 431
BBB- to BBB+	575	30,474	31,049	599
Total single name credit default swaps	7,475	56,674	64,149	1,030
Index credit default swaps <sup>3</sup>	-	4,900	4,900	(14)
<b>TOTAL CREDIT DEFAULT SWAPS SOLD</b>	<b>\$ 7,475</b>	<b>\$ 61,574</b>	<b>\$ 69,049</b>	<b>\$ 1,016</b>
<b>2013</b>				
Single name credit default swaps:				
A- to AA+	\$ 7,900	\$ 1,500	\$ 9,400	\$ 188
BBB- to BBB+	300	5,512	5,812	(431)
Total single name credit default swaps	8,200	7,012	15,212	(243)
Index credit default swaps <sup>3</sup>	-	500	500	(2)
<b>TOTAL CREDIT DEFAULT SWAPS SOLD</b>	<b>\$ 8,200</b>	<b>\$ 7,512</b>	<b>\$ 15,712</b>	<b>\$ (245)</b>

<sup>1</sup> The notional amount is representative of the volume and activity of the respective derivative type during the years ended August 31, 2014 and 2013.

<sup>2</sup> The credit rating is according to Standard & Poor's and represents the current performance risk of the swap.

<sup>3</sup> Index credit default swaps are linked to a basket of credit derivatives that include entities that have a Standard & Poor's rating of BBB- or higher.



## DEBT-RELATED DERIVATIVES

The University and SHC use interest rate exchange agreements to manage the interest rate exposure of their debt portfolios. Under the terms of the current agreements, the entities pay a fixed interest rate, determined at inception, and receive a variable rate on the underlying notional principal amount. Generally, the exchange agreements require mutual posting of collateral by the University and SHC and the counterparties if the termination values exceed a predetermined threshold dollar amount.

At August 31, 2014, the University had interest rate exchange agreements related to \$97.0 million of the outstanding balance of the CEFA Series S bonds in variable rate mode (see *Note 10*). The agreements, which have a weighted average interest rate of 3.68%, expire November 1, 2039. The notional amount and the fair value of the exchange agreements are included in the table below. Collateral posted with various counterparties was \$11.0 million at August 31, 2014 and 2013, and is included in the *Statements of Financial Position*. In addition, the University issued an irrevocable standby letter of credit of \$15.0 million to support collateral requirements at August 31, 2014 and 2013 (see *Note 10*). In December 2012, the University terminated certain interest rate exchange agreements and recognized a loss of \$13.0 million in "non-operating activities" in the *Statements of Activities* for the year ended August 31, 2013.

At August 31, 2014, SHC had interest rate exchange agreements expiring through November 2051 (see *Note 11*). The agreements require SHC to pay fixed interest rates to the counterparties varying from 3.37% to 4.08% in exchange for variable rate payments from the counterparties based on a percentage of the One Month London Interbank Offered Rate (LIBOR). The notional amount and the fair value of the exchange agreements are included in the table below. There was no collateral required to be posted with counterparties at August 31, 2014 and 2013. In February 2014, SHC terminated certain interest rate exchange agreements and recognized a loss of \$71 thousand in "non-operating activities" in the *Statements of Activities* for the year ended August 31, 2014.

The following table presents amounts for debt-related derivatives including the notional amount, the fair values at August 31, 2014 and 2013, and gains and losses for the years ended August 31, 2014 and 2013, in thousands of dollars:

	AS OF AUGUST 31, 2014		YEAR ENDED AUGUST 31, 2014	AS OF AUGUST 31, 2013		YEAR ENDED AUGUST 31, 2013
	NOTIONAL AMOUNT <sup>1</sup>	GROSS DERIVATIVE LIABILITIES <sup>2</sup>	REALIZED AND UNREALIZED LOSSES <sup>3</sup>	NOTIONAL AMOUNT <sup>1</sup>	GROSS DERIVATIVE LIABILITIES <sup>2</sup>	REALIZED AND UNREALIZED GAINS <sup>3</sup>
Debt-related interest- rate contracts:						
University	\$ 97,000	\$ 30,457	\$ (8,617)	\$ 97,000	\$ 21,840	\$ 34,407
Hospitals	577,200	155,984	(37,532)	746,100	133,255	102,928
<b>TOTAL</b>	<b>\$ 674,200</b>	<b>\$ 186,441</b>	<b>\$ (46,149)</b>	<b>\$ 843,100</b>	<b>\$ 155,095</b>	<b>\$ 137,335</b>

<sup>1</sup> The notional amount is representative of the volume and activity of the respective derivative type during the years ended August 31, 2014 and 2013.

<sup>2</sup> Fair value is measured using Level 2 inputs as defined in Note 5. Amounts are included in the *Statements of Financial Position* in "accounts payable and accrued expenses" and discussed more fully in Notes 10 and 11.

<sup>3</sup> Gains (losses) on derivatives are included in the *Statements of Activities* as "swap interest and change in value of swap agreements" in "non-operating activities".

## 8. Plant Facilities

Plant facilities, net of accumulated depreciation, at August 31, 2014 and 2013, in thousands of dollars, are as follows:

	2014			2013
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
Land and improvements	\$ 503,521	\$ 119,075	\$ 622,596	\$ 602,222
Buildings and building improvements	5,148,947	1,429,522	6,578,469	5,925,451
Furniture, fixtures and equipment	1,531,679	1,096,230	2,627,909	2,424,358
Utilities	483,272	-	483,272	382,102
Construction in progress	486,935	1,072,877	1,559,812	1,323,225
	8,154,354	3,717,704	11,872,058	10,657,358
Less accumulated depreciation	(3,595,441)	(1,444,305)	(5,039,746)	(4,662,742)
<b>PLANT FACILITIES, NET OF ACCUMULATED DEPRECIATION</b>	<b>\$ 4,558,913</b>	<b>\$ 2,273,399</b>	<b>\$ 6,832,312</b>	<b>\$ 5,994,616</b>

At August 31, 2014, \$1.4 billion and \$841.3 million of fully depreciated plant facilities were still in use by the University and the Hospitals, respectively, and were included in plant facilities and accumulated depreciation.

## 9. Liabilities Under Security Lending Agreements

The University receives short-term U.S. government obligations or cash and cash equivalents as collateral deposits for certain securities loaned temporarily to brokers. It is the University's policy to require receipt of collateral on securities lending contracts and repurchase agreements equal to a minimum of 102% of the fair market value of the security loaned. In addition, the University is party to certain forward sale and purchase agreements. At August 31, 2014 and 2013, these amounts, in thousands of dollars, are as follows:

	2014	2013
Collateral deposits for certain securities loaned temporarily to brokers <sup>1, 2</sup>	\$ 163,449	\$ 57,810
Forward sale and purchase agreements <sup>1</sup>	27,562	26,238
<b>LIABILITIES UNDER SECURITY LENDING AGREEMENTS</b>	<b>\$ 191,011</b>	<b>\$ 84,048</b>

<sup>1</sup> The corresponding investments are included as "investments" in the Statements of Financial Position (see Note 5).

<sup>2</sup> The estimated fair value of securities loaned to brokers at August 31, 2014 and 2013 was \$155.8 million and \$55.4 million, respectively.

## 10. University Notes and Bonds Payable

Notes and bonds payable for the University at August 31, 2014 and 2013, in thousands of dollars, are as follows:

	YEAR OF MATURITY	INTEREST RATE * 2014/2013	OUTSTANDING PRINCIPAL	
			2014	2013
<b>Tax-exempt:</b>				
CEFA Fixed Rate Revenue Bonds:				
Series S	2039	5.00%	\$ 30,210	\$ 30,210
Series T	2014-2039	4.00% - 5.00%	188,900	361,310
Series U	2021-2045	5.00% - 5.25%	996,855	593,760
CEFA Variable Rate Revenue Bonds and Notes:				
Series L	2015-2022	0.03%/0.06%	83,818	83,818
Series S	2039-2050	0.10%-0.13%/0.17%-0.20%	141,200	141,200
Commercial Paper	2015	0.06%/0.08%	50,994	72,070
<b>Taxable:</b>				
Fixed Rate Notes and Bonds:				
Stanford University Bonds	2024	6.88%	150,000	150,000
Medium Term Note	2026	7.65%	50,000	50,000
Stanford University Series 2009A	2014-2019	3.63% - 4.75%	650,000	1,000,000
Stanford University Series 2012A	2042	4.01%	143,235	143,235
Stanford University Series 2013A	2044	3.56%	150,115	150,115
Stanford University Series 2014A	2054	4.25%	150,000	-
Other	2014-2015	Various	67,364	68,347
Variable Rate Notes:				
Commercial Paper	2015	0.15%/0.13%	140,715	70,656
University notes and bonds payable			2,993,406	2,914,721
Unamortized original issue premiums/discounts, net			271,230	183,712
<b>TOTAL</b>			<b>\$ 3,264,636</b>	<b>\$ 3,098,433</b>

\*Exclusive of interest rate exchange agreements (see Note 7).

At August 31, 2014 and 2013, the fair value of these debt instruments was approximately \$3.5 billion and \$3.1 billion, respectively. All bonds held at August 31, 2014 and 2013 are considered to be Level 2 fair value measurements.

The University borrows at tax-exempt rates through the California Educational Facilities Authority (CEFA). CEFA debt is a general unsecured obligation of the University. Although CEFA is the issuer, the University is responsible for the repayment of the tax-exempt debt. The University's long-term ratings of AAA/Aaa/AAA were affirmed in April 2014 by Standard & Poor's, Moody's Investors Service and Fitch Ratings, respectively.

In May 2014, CEFA Series U-5 bonds were issued in the amount of \$124.1 million plus an original issue premium of \$26.3 million. The bonds bear interest at a rate of 5.00% and mature on May 1, 2021. Proceeds were used to (1) refinance commercial paper notes which were previously used to refinance CEFA Series T-4 bonds which matured in March 2014; (2) finance facilities and infrastructure; and (3) pay bond issuance costs.

In May 2014, CEFA Series U-6 bonds were issued in the amount of \$279.0 million plus an original issue premium of \$71.0 million. The bonds bear interest at a rate of 5.00% and mature on May 1, 2045. Proceeds were used to (1) refinance commercial paper notes; and (2) finance facilities and infrastructure.

In May 2014, the University issued taxable fixed rate Series 2014 bonds in the amount of \$150.0 million plus an original issue discount of \$27 thousand. The bonds bear interest at a rate of 4.249% and mature on May 1, 2054. Proceeds were used to (1) refinance commercial paper notes; and (2) finance facilities and infrastructure.

In May 2014, the taxable Series 2009A (first tranche) in the amount of \$350.0 million matured and was paid off.

In May 2013, CEFA Series U-3 bonds were issued in the amount of \$261.4 million plus an original issue premium of \$90.4 million. The bonds bear interest at a rate of 5.00% and mature on June 1, 2043. Proceeds were used to (1) refinance commercial paper notes; (2) finance facilities and infrastructure; and (3) pay bond issuance costs.

In May 2013, CEFA Series U-4 bonds were issued in the amount of \$39.2 million plus an original issue premium of \$13.6 million. The bonds bear interest at a rate of 5.00% and mature on June 1, 2043. Proceeds were used to (1) legally defease \$51.3 million of CEFA Series P bonds; and (2) pay bond issuance costs.

In May 2013, CEFA Series S-2 bonds of \$40.0M were converted from a commercial paper rate mode to a fixed rate bond issued in the amount of \$30.2 million plus an original issue premium of \$9.8 million. The bonds bear interest at a rate of 5.00% and mature on November 1, 2039.

In May 2013, the University issued taxable fixed rate Series 2013 bonds in the amount of \$150.1 million. The bonds bear interest at a rate of 3.563% and mature on June 1, 2044. Proceeds were used to (1) refinance commercial paper notes; (2) finance facilities and infrastructure; and (3) pay bond issuance costs.

In December 2010, the University entered into a \$50.0 million line of credit agreement to issue irrevocable standby letters of credit to support various collateral posting obligations. At August 31, 2014, irrevocable standby letters of credit of \$36.5 million were outstanding in the following amounts and for the following respective purposes: (1) \$15.0 million to support collateral requirements under certain interest rate exchange agreements discussed in *Note 7*; and (2) \$21.5 million to serve as security for workers' compensation deductible insurance arrangements. No amounts have been drawn on these letters of credit at August 31, 2014.

Stanford holds controlling interests in several investment entities which were consolidated in the financial statements in fiscal years 2014 and 2013. At August 31, 2014 and 2013, taxable debt included \$66.8 million and \$67.8 million, respectively, of debt where Stanford is ultimately liable for principal should the investees default.

The University's taxable and tax-exempt commercial paper facilities and related information at August 31, 2014 and 2013, in thousands of dollars, are as follows:

COMMERCIAL PAPER	POTENTIAL BORROWINGS	OUTSTANDING BALANCE AT AUGUST 31	WEIGHTED AVERAGE DAYS TO MATURITY	WEIGHTED AVERAGE EFFECTIVE INTEREST RATE
<b>2014</b>				
Taxable	\$ 500,000	\$ 140,715	34.6	0.14%
Tax-exempt	\$ 300,000	\$ 50,994	49.6	0.07%
<b>2013</b>				
Taxable	\$ 500,000	\$ 70,656	93.1	0.22%
Tax-exempt	\$ 300,000	\$ 72,070	65.0	0.13%

The University had \$225.0 million of revenue bonds in variable rate mode outstanding in addition to commercial paper notes at August 31, 2014. CEFA Series L bonds bear interest at a weekly rate and CEFA Series S bonds bear interest at a commercial paper municipal rate and are outstanding for various interest periods of 270 days or less. In the event the University receives notice of any optional tender of these bonds, or if the bonds become subject to mandatory tender, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, the University will have a current obligation to purchase the bonds tendered. The University has identified several sources of funding including cash, money market funds, U.S. treasury securities and agencies' discount notes to provide for the full and timely purchase price of any bonds tendered in the event of a failed remarketing.

The University's interest expense, which includes amortized bond issuance costs and amortized bond premium or discount, in thousands of dollars, is as follows:

	2014	2013
Interest expense, gross	\$ 109,360	\$ 101,016
Less:		
Interest income earned on unspent proceeds	(198)	(253)
Interest capitalized as a cost of construction	(8,324)	(3,845)
Interest expense on Series 2009A bonds which is classified as an investment expense	(29,602)	(31,665)
<b>Interest expense, net</b>	<b>\$ 71,236</b>	<b>\$ 65,253</b>

The University uses interest rate exchange agreements to manage the interest rate exposure of its debt portfolio. Net payments on interest rate exchange agreements, which are included in "swap interest and change in value of swap agreements" in the *Statements of Activities*, were \$3.5 million and \$16.7 million for the years ended August 31, 2014 and 2013, respectively, including the loss on the termination of certain interest rate exchange agreements in 2013 (see *Note 7*).

At August 31, 2014, scheduled principal payments on notes and bonds, in thousands of dollars, are as follows:

YEAR ENDING AUGUST 31	PRINCIPAL PAYMENTS
2015 Commercial paper	\$ 191,709
2015 Variable debt subject to remarketing	225,018
2015 Other	1,334
2016	315,550
2017	-
2018	-
2019	400,000
Thereafter	1,859,795
<b>TOTAL</b>	<b>\$ 2,993,406</b>

## 11. Hospitals Notes and Bonds Payable

Notes, bonds and capital lease obligations for the Hospitals at August 31, 2014 and 2013, in thousands of dollars, are as follows:

	YEAR OF MATURITY	INTEREST RATE* 2014/2013	OUTSTANDING PRINCIPAL	
			2014	2013
<b>SHC:</b>				
CHFFA Fixed Rate Revenue Bonds:				
2008 Series A-1	2040	2.25%-5.15%	\$ 68,785	\$ 69,485
2008 Series A-2	2040	1.00%-5.25%	101,750	102,775
2008 Series A-3	2040	1.00%-5.50%	82,240	83,065
2010 Series A	2031	4.00%-5.75%	135,305	140,200
2010 Series B	2036	4.50%-5.75%	146,710	146,710
2012 Series A	2051	5.00%	340,000	340,000
2012 Series B	2023	2.00%-5.00%	58,520	63,555
Promissory Note	2014	7.03%	-	174
CHFFA Variable Rate Revenue Bonds:				
2008 Series B	2045	0.08%/0.11%	168,200	168,200
2012 Series C	2051	0.13%/0.14%	60,000	60,000
2012 Series D	2051	0.71%/0.74%	100,000	100,000
<b>LPCH:</b>				
CHFFA Fixed Rate Revenue Bonds:				
2008 Series A	2027-2033	1.45%	30,340	30,340
2008 Series B	2027-2033	1.45%	30,340	30,340
2008 Series C	2015-2023	1.45%	32,770	32,770
2012 Series A	2044-2051	5.00%	200,000	200,000
2012 Series B	2015-2027	4.00%/3.00%	46,815	49,015
2014 Series A	2025-2043	5.00%	100,000	-
CHFFA Variable Rate Revenue Bonds:				
2014 Series B	2034-2043	0.51%	100,000	-
Hospitals notes, bonds and capital lease obligations			1,801,775	1,616,629
Unamortized original issue premiums/discounts, net			72,098	67,416
<b>TOTAL</b>			<b>\$ 1,873,873</b>	<b>\$ 1,684,045</b>

\*Exclusive of interest rate exchange agreements (see Note 7).

At August 31, 2014 and 2013, the fair value of these debt instruments was approximately \$2.0 billion and \$1.6 billion, respectively. All bonds held at August 31, 2014 and 2013 are considered to be Level 2 fair value measurements.

The Hospitals borrow at tax-exempt rates through the California Health Facilities Financing Authority (CHFFA). CHFFA debt is a general obligation of the Hospitals. Payments of principal and interest on the Hospitals' bonds are collateralized by a pledge of the revenues of the respective hospitals. Although CHFFA is the issuer, the Hospitals are responsible for the repayment of the tax-exempt debt. The University is not an obligor or guarantor with respect to any obligations of SHC or LPCH, nor are SHC or LPCH obligors or guarantors with respect to obligations of the University.

SHC and LPCH are each party to separate master trust indentures that include, among other requirements, limitations on the incurrence of additional indebtedness, liens on property, restrictions on disposition or transfer of assets and compliance with certain financial ratios. Subject to applicable no-call provisions, the Hospitals may cause the redemption of the bonds, in whole or in part, prior to the stated maturities.

## **SHC**

At August 31, 2014, SHC had \$328.2 million revenue bonds in variable rate mode outstanding. The 2008 Series B-1 bonds bear interest at a weekly rate, and bondholders have the option to tender their bonds on a weekly basis. The 2008 Series B-2 bonds bear interest at the commercial paper rate for each commercial paper period of 270 days or less. Bondholders in commercial paper mode have the option to tender their bonds only at the end of the commercial paper rate period.

The 2012 Series C bonds are in a windows weekly floating index mode and cannot be tendered for 180 days after a 30 day notice and remarketing period. The 2012 Series D bonds are also in a floating index mode with monthly interest rate resets. The 2012 Series D bonds are not subject to remarketing or tender until May 23, 2019.

In the event SHC receives notice of any optional tender of the 2008 Series B-1 bonds or the 2012 Series C bonds, or if any bonds become subject to mandatory tender, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, SHC will have a current obligation to purchase the bonds tendered. SHC maintains sufficient liquidity to provide for the full and timely purchase price of any bonds tendered in the event of a failed remarketing.

At August 31, 2014, SHC had irrevocable standby letters of credit in the aggregate amount of \$26.8 million posted with certain beneficiaries in the following amounts and for the following respective purposes: (i) \$16.7 million to serve as security for the workers' compensation self-insurance arrangement and (ii) \$10.1 million to serve as security deposits for certain construction projects being undertaken by SHC including the Renewal Project. No amounts have been drawn on these letters of credit at August 31, 2014 and 2013.

## **LPCH**

In May 2014, CHFFA, on behalf of LPCH, issued 2014 Series A bonds and 2014 Series B bonds in the aggregate principal amount of \$200.0 million. Proceeds of the 2014 bonds will be used to finance a portion of the Renewal Project and to pay a portion of bond issuance costs. The 2014 Series A bonds were issued as fixed rate bonds with interest rates ranging from 4-5% over the life of the bonds. The 2014 Series B bonds were issued in a floating index mode with monthly interest rate resets. The 2014 Series B bonds are not subject to remarketing or tender until May 8, 2024.

At August 31, 2014, LPCH had irrevocable standby letters of credit in the aggregate amount of \$13.8 million posted with certain beneficiaries in the following amounts and for the following respective purposes: (i) \$7.2 million to serve as security for the workers' compensation self-insurance arrangement and (ii) \$6.6 million to serve as security deposits for certain construction projects being undertaken by LPCH including the Renewal Project. No amounts have been drawn on these letters of credit at August 31, 2014 and 2013.

## INTEREST

The Hospitals' interest expense, which includes settlements under the interest rate exchange agreements, amortized bond issuance costs and amortized bond premium or discount, in thousands of dollars, is as follows:

	2014	2013
Interest expense, gross, excluding settlements under the interest rate exchange agreements	\$ 60,623	\$ 59,614
Settlements under the interest rate exchange agreements	16,982	19,674
Less:		
Interest capitalized as a cost of construction	(21,648)	(19,074)
<b>Interest expense, net</b>	<b>\$ 55,957</b>	<b>\$ 60,214</b>

## PRINCIPAL PAYMENTS

At August 31, 2014, scheduled principal payments on notes, bonds and capital lease obligations, in thousands of dollars, are as follows:

YEAR ENDING AUGUST 31	PRINCIPAL PAYMENTS
2015 Variable debt subject to remarketing	\$ 228,200
2015 Other	17,075
2016	18,930
2017	19,065
2018	19,395
2019	20,720
Thereafter	1,478,390
<b>TOTAL</b>	<b>\$ 1,801,775</b>



## 12. University Endowment

The University classifies a substantial portion of its financial resources as endowment, which is invested to generate income to support operating and strategic initiatives. The endowment, which includes endowed lands, is comprised of pure endowment funds, term endowment funds, and funds functioning as endowment (FFE). Depending on the nature of the donor's stipulation, these resources are recorded as permanently restricted, temporarily restricted or unrestricted net assets. 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. Accordingly, term endowments are classified as temporarily restricted net assets. FFE are University resources designated by the Board as endowment and are invested for long-term appreciation and current income. These assets, however, remain available and may be spent at the Board's discretion. Accordingly, FFE are recorded as unrestricted net assets.

The University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment and (b) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are authorized for expenditure. In the absence of donor stipulations or law to the contrary, net unrealized losses on permanently restricted endowment funds first reduce related appreciation on temporarily restricted net assets and then on unrestricted net assets, as needed, until the fair value of the fund equals or exceeds historic value. The aggregate amount by which fair value was below historic value was \$4.9 million and \$20.3 million at August 31, 2014 and 2013, respectively.

Endowment funds by net asset classification at August 31, 2014 and 2013, in thousands of dollars, are as follows:

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
<b>2014</b>				
Donor-restricted endowment funds	\$ (4,882)	\$ 6,574,426	\$ 5,465,939	\$ 12,035,483
Funds functioning as endowment	9,410,523	-	-	9,410,523
<b>TOTAL ENDOWMENT FUNDS</b>	<b>\$ 9,405,641</b>	<b>\$ 6,574,426</b>	<b>\$ 5,465,939</b>	<b>\$ 21,446,006</b>
<b>2013</b>				
Donor-restricted endowment funds	\$ (20,278)	\$ 5,528,171	\$ 5,174,848	\$ 10,682,741
Funds functioning as endowment	8,006,127	-	-	8,006,127
<b>TOTAL ENDOWMENT FUNDS</b>	<b>\$ 7,985,849</b>	<b>\$ 5,528,171</b>	<b>\$ 5,174,848</b>	<b>\$ 18,688,868</b>

Most of the University's endowment is invested in the MP. The return objective for the MP is to generate optimal long-term total return while maintaining an appropriate level of risk for the University. Investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). Portfolio asset allocation targets as well as expected risk, return and correlation among the asset classes are reevaluated annually by Stanford Management Company.

Approximately 12% of the endowment is invested in real estate on Stanford's lands, including the Stanford Research Park. This portion of the endowment includes the present value of ground leases, and rental properties that have been developed on Stanford lands. The net operating income from these properties is distributed each year for University operations.

Through the combination of investment strategy and payout policy, the University is striving to provide a reasonably consistent payout from endowment to support operations, while preserving the purchasing power of the endowment adjusted for inflation.

The Board approves the amounts to be paid out annually from endowment funds invested in the MP. Consistent with the Uniform Prudent Management of Institutional Funds Act, when determining the appropriate payout the Board considers the purposes of the University and the endowment, the duration and preservation of the endowment, general economic conditions, the possible effect of inflation or deflation, the expected return from income and the appreciation of investments, other resources of the University, and the University's investment policy.

The current Board approved targeted spending rate is 5.5%. The sources of payout are earned income on endowment assets (interest, dividends, rents and royalties), realized capital gains and FFE, as needed and as available.

Changes in the University's endowment, excluding pledges, for the years ended August 31, 2014 and 2013, in thousands of dollars, are as follows:

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
<b>2014</b>				
Endowment, beginning of year	\$ 7,985,849	\$ 5,528,171	\$ 5,174,848	\$ 18,688,868
Investment returns:				
Earned income	228,278	-	-	228,278
Unrealized and realized gains	1,758,273	1,037,250	58,934	2,854,457
Total investment returns	1,986,551	1,037,250	58,934	3,082,735
Amounts distributed for operations	(985,215)	-	-	(985,215)
Gifts, transfers and other changes in endowment:				
Current year gifts and pledge payments	17,673	8,025	163,700	189,398
Transfers of prior year gifts	5,557	-	24,724	30,281
EFP funds invested in the endowment	367,648	-	-	367,648
Other funds invested in the endowment, net	27,578	980	43,733	72,291
Total gifts, transfers and other changes in endowment	418,456	9,005	232,157	659,618
Total net increase in endowment	1,419,792	1,046,255	291,091	2,757,138
<b>ENDOWMENT, END OF YEAR</b>	<b>\$ 9,405,641</b>	<b>\$ 6,574,426</b>	<b>\$ 5,465,939</b>	<b>\$ 21,446,006</b>
<b>2013</b>				
Endowment, beginning of year	\$ 7,067,439	\$ 5,016,796	\$ 4,951,569	\$ 17,035,804
Investment returns:				
Earned income	232,016	-	-	232,016
Unrealized and realized gains	729,859	1,006,324	17,099	1,753,282
Total investment returns	961,875	1,006,324	17,099	1,985,298
Amounts distributed for operations	(413,429)	(507,243)	-	(920,672)
Gifts, transfers and other changes in endowment:				
Current year gifts and pledge payments	2,902	2,441	165,232	170,575
Transfers of prior year gifts	3,732	354	28,002	32,088
EFP funds invested in the endowment	275,221	-	-	275,221
Other funds invested in the endowment, net	88,109	9,499	12,946	110,554
Total gifts, transfers and other changes in endowment	369,964	12,294	206,180	588,438
Total net increase in endowment	918,410	511,375	223,279	1,653,064
<b>ENDOWMENT, END OF YEAR</b>	<b>\$ 7,985,849</b>	<b>\$ 5,528,171</b>	<b>\$ 5,174,848</b>	<b>\$ 18,688,868</b>

### 13. Hospitals Endowments

The endowments of SHC and LPCH are intended to generate investment income to support their current operating and strategic initiatives. The following table summarizes each hospital's share of the Hospitals endowments at August 31, 2014 and 2013, in thousands of dollars:

	2014	2013
LPCH	\$ 308,872	\$ 280,799
SHC	17,985	16,133
<b>TOTAL ENDOWMENT FUNDS</b>	<b>\$ 326,857</b>	<b>\$ 296,932</b>

The Hospitals invest the majority of their endowments in the University's MP. Their endowments are subject to the same investment and spending strategies that the University employs as described in *Note 12*. The Hospitals' Boards of Directors have approved payout policies which provide for annual amounts to be distributed for current use. "Amounts distributed for operations" in the table below represents the Hospitals' current year endowment payout spent for designated purposes during fiscal years 2014 and 2013.

The Hospitals classify as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment and (b) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are authorized for expenditure. In the absence of donor stipulations or law to the contrary, net unrealized losses on permanently restricted endowment funds first reduce related appreciation on temporarily restricted net assets and then on unrestricted net assets, as needed, until the fair value of the fund equals or exceeds historic value. The aggregate amount by which fair value was below historic value was approximately \$0 and \$12 thousand at August 31, 2014 and 2013, respectively.

Changes in Hospitals endowments, for the years ended August 31, 2014 and 2013, in thousands of dollars, are as follows:

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
<b>2014</b>				
Endowments, beginning of year	\$ (12)	\$ 88,612	\$ 208,332	\$ 296,932
Investment returns:				
Earned income	-	14,957	-	14,957
Unrealized and realized gains	12	27,579	1,938	29,529
Total investment returns	12	42,536	1,938	44,486
Amounts distributed for operations	-	(14,551)	-	(14,551)
Gifts and pledge payments	-	-	744	744
Other	-	(774)	20	(754)
Total net increase in endowments	12	27,211	2,702	29,925
<b>ENDOWMENTS, END OF YEAR</b>	<b>\$ -</b>	<b>\$ 115,823</b>	<b>\$ 211,034</b>	<b>\$ 326,857</b>
<b>2013</b>				
Endowments, beginning of year	\$ (216)	\$ 74,081	\$ 207,350	\$ 281,215
Investment returns:				
Earned income	-	14,694	-	14,694
Unrealized and realized gains	204	14,812	1,364	16,380
Total investment returns	204	29,506	1,364	31,074
Amounts distributed for operations	-	(13,631)	-	(13,631)
Gifts and pledge payments	-	-	1,185	1,185
Other	-	(1,344)	(1,567)	(2,911)
Total net increase in endowments	204	14,531	982	15,717
<b>ENDOWMENTS, END OF YEAR</b>	<b>\$ (12)</b>	<b>\$ 88,612</b>	<b>\$ 208,332</b>	<b>\$ 296,932</b>

All of the Hospitals endowments are classified as donor-restricted.

## 14. University Gifts and Pledges

The University's Office of Development (OOD) reports total gifts based on contributions received in cash or property during the fiscal year. Gifts and pledges reported for financial statement purposes are recorded on the accrual basis. The following summarizes gifts and pledges reported for the years ended August 31, 2014 and 2013, per the *Statements of Activities* reconciled to the cash basis reported by OOD, in thousands of dollars:

	2014	2013
Current year gifts in support of operations	\$ 211,841	\$ 180,071
Donor advised funds, net	29,314	1,930
Current year gifts not included in operations	17,673	2,902
Temporarily restricted gifts and pledges, net	372,875	345,526
Permanently restricted gifts and pledges, net	154,068	164,102
<b>TOTAL PER STATEMENTS OF ACTIVITIES</b>	<b>785,771</b>	<b>694,531</b>
Adjustments to arrive at gift total as reported by OOD:		
New pledges	(368,759)	(247,611)
Payments made on pledges	269,958	282,948
Pledge discounts and other adjustments	31,842	27,225
Donor advised funds not designated for Stanford	(12,003)	10,669
Non-cash gifts	11,683	2,962
Non-government grants, recorded as sponsored research support when earned	110,535	85,098
SHC gifts	87,425	73,673
Other	12,007	2,072
<b>TOTAL AS REPORTED BY OOD</b>	<b>\$ 928,459</b>	<b>\$ 931,567</b>

## 15. Functional Expenses

Expenses for the years ended August 31, 2014 and 2013 are categorized on a functional basis as follows, in thousands of dollars:

	2014			2013
	UNIVERSITY	HOSPITALS	CONSOLIDATED	CONSOLIDATED
Instruction and departmental research	\$ 1,492,360	\$ -	\$ 1,492,360	\$ 1,400,573
Organized research - direct costs	1,075,577	-	1,075,577	1,040,952
Patient services	-	2,753,321	2,753,321	2,593,116
Auxiliary activities	896,359	-	896,359	790,917
Administration and general	353,680	322,453	676,133	538,030
Student services	188,268	-	188,268	167,551
Libraries	160,182	-	160,182	148,334
Development	82,678	21,663	104,341	90,744
SLAC construction	42,736	-	42,736	23,527
<b>TOTAL EXPENSES</b>	<b>\$ 4,291,840</b>	<b>\$ 3,097,437</b>	<b>\$ 7,389,277</b>	<b>\$ 6,793,744</b>

Depreciation, interest, operations and maintenance expenses are allocated to program and supporting activities, except for SLAC construction. Auxiliary activities include housing and dining services, intercollegiate athletics, Stanford Alumni Association, patient care provided by the SoM faculty, and other activities.

## 16. University Retirement Plans

The University provides retirement benefits through both contributory and noncontributory retirement plans for substantially all of its employees.

### **DEFINED CONTRIBUTION PLAN**

The University offers a defined contribution plan to eligible faculty and staff through the *Stanford Contributory Retirement Plan* (SCRCP). University and participant contributions are primarily invested in annuities and mutual funds. University contributions under the SCRCP, which are vested immediately to participants, were approximately \$129.0 million and \$117.6 million for the years ended August 31, 2014 and 2013, respectively.

### **DEFINED BENEFIT PLANS**

The University provides retirement and postretirement medical and other benefits through three defined benefit plans: the *Staff Retirement Annuity Plan*, the *Faculty Retirement Incentive Program*, and the *Postretirement Benefit Plan* (the "Plans"). The obligations for the Plans, net of plan assets, are recorded in the *Statements of Financial Position* as "accrued pension and post retirement benefit cost". These are described more fully below.

#### **Staff Retirement Annuity Plan**

Retirement benefits for certain employees are provided through the *Staff Retirement Annuity Plan* (SRAP), a noncontributory plan. While the SRAP is closed to new participants, certain employees continue to accrue benefits. The University's policy is to fund pension costs in accordance with the Employee Retirement Income Security Act (ERISA)'s requirements.

#### **Faculty Retirement Incentive Program**

The University also provides a retirement incentive bonus for eligible faculty through the University *Faculty Retirement Incentive Program* (FRIP). The University's faculty may become eligible for the FRIP program if they commit to retire within a designated window of time. At August 31, 2014 and 2013, there were no program assets. The University funds benefit payouts as they are incurred.

#### **Postretirement Benefit Plan**

The University also provides certain health care benefits for retired employees through its *Postretirement Benefit Plan* (PRBP). The University's employees and their covered dependents may become eligible for the PRBP upon the employee's retirement. Retiree health plans are paid for, in part, by retiree contributions, which are adjusted annually. Health benefits provided and the gross premiums charged (before University subsidies) to retirees under age 65 are the same as those provided to active employees. The University subsidy varies depending on whether the retiree is covered under the grandfathered design or the defined dollar benefit design. Medicare supplement options are provided for retirees over age 65.

The change in the Plans' assets, the related change in benefit obligations and the amounts recognized in the financial statements, in thousands of dollars, are as follows:

	STAFF RETIREMENT ANNUITY PLAN (SRAP)	FACULTY RETIREMENT INCENTIVE PROGRAM (FRIP)	POST RETIREMENT BENEFIT PLAN (PRBP)	TOTAL
<b>2014</b>				
<b>Change in plan assets:</b>				
Fair value of plan assets, beginning of year	\$ 276,536	\$ -	\$ 170,537	\$ 447,073
Actual return on plan assets	49,934	-	29,678	79,612
Employer contributions	-	3,694	18,373	22,067
Plan participants' contributions	-	-	9,146	9,146
Benefits and plan expenses paid	(25,156)	(3,694)	(24,625) *	(53,475)
<b>FAIR VALUE OF PLAN ASSETS, END OF YEAR</b>	<b>301,314</b>	<b>-</b>	<b>203,109</b>	<b>504,423</b>
<b>Change in projected benefit obligation:</b>				
Benefit obligation, beginning of year	310,424	175,558	504,015	989,997
Service cost	3,253	10,827	15,577	29,657
Interest cost	12,798	7,373	23,606	43,777
Plan participants' contributions	-	-	9,146	9,146
Actuarial loss	14,846	7,532	29,179	51,557
Benefits and plan expenses paid	(25,156)	(3,694)	(24,625) *	(53,475)
<b>BENEFIT OBLIGATION, END OF YEAR</b>	<b>316,165</b>	<b>197,596</b>	<b>556,898</b>	<b>1,070,659</b>
<b>NET LIABILITY RECOGNIZED IN THE STATEMENTS OF FINANCIAL POSITION</b>	<b>\$ (14,851)</b>	<b>\$ (197,596)</b>	<b>\$ (353,789)</b>	<b>\$(566,236)</b>

\* Net of Medicare subsidy

<b>2013</b>				
<b>Change in plan assets:</b>				
Fair value of plan assets, beginning of year	\$ 290,257	\$ -	\$ 149,798	\$ 440,055
Actual return on plan assets	5,082	-	18,216	23,298
Employer contributions	4,720	3,995	18,323	27,038
Plan participants' contributions	-	-	7,298	7,298
Benefits and plan expenses paid	(23,523)	(3,995)	(23,098) *	(50,616)
<b>FAIR VALUE OF PLAN ASSETS, END OF YEAR</b>	<b>276,536</b>	<b>-</b>	<b>170,537</b>	<b>447,073</b>
<b>Change in projected benefit obligation:</b>				
Benefit obligation, beginning of year	349,126	179,669	560,578	1,089,373
Service cost	3,831	11,734	18,349	33,914
Interest cost	11,256	5,867	20,861	37,984
Plan participants' contributions	-	-	7,298	7,298
Actuarial gain	(30,266)	(17,717)	(79,973)	(127,956)
Benefits and plan expenses paid	(23,523)	(3,995)	(23,098) *	(50,616)
<b>BENEFIT OBLIGATION, END OF YEAR</b>	<b>310,424</b>	<b>175,558</b>	<b>504,015</b>	<b>989,997</b>
<b>NET LIABILITY RECOGNIZED IN THE STATEMENTS OF FINANCIAL POSITION</b>	<b>\$ (33,888)</b>	<b>\$ (175,558)</b>	<b>\$ (333,478)</b>	<b>\$(542,924)</b>

\* Net of Medicare subsidy

The accumulated benefit obligation for the SRAP was \$313.9 million and \$307.8 million at August 31, 2014 and 2013, respectively.

Net periodic benefit expense and non-operating activities related to the Plans for the years ended August 31, 2014 and 2013, in thousands of dollars, includes the following components:

	STAFF RETIREMENT ANNUITY PLAN (SRAP)	FACULTY RETIREMENT INCENTIVE PROGRAM (FRIP)	POST RETIREMENT BENEFIT PLAN (PRBP)	TOTAL
<b>2014</b>				
Service cost	\$ 3,253	\$ 10,827	\$ 15,577	\$ 29,657
Interest cost	12,798	7,373	23,606	43,777
Expected return on plan assets	(18,389)	-	(11,938)	(30,327)
Amortization of:				
Prior service cost	540	-	2,545	3,085
Actuarial loss	349	5,679	5,111	11,139
<b>NET PERIODIC BENEFIT EXPENSE (INCOME)</b>	<b>(1,449)</b>	<b>23,879</b>	<b>34,901</b>	<b>57,331</b>
Net actuarial gain during period	(16,699)	7,532	11,439	2,272
Amortization of:				
Prior service cost	(540)	-	(2,545)	(3,085)
Actuarial loss	(349)	(5,679)	(5,111)	(11,139)
<b>TOTAL AMOUNTS RECOGNIZED IN NON-OPERATING ACTIVITIES</b>	<b>(17,588)</b>	<b>1,853</b>	<b>3,783</b>	<b>(11,952)</b>
<b>TOTAL AMOUNT RECOGNIZED IN NET PERIODIC BENEFIT EXPENSE AND NON-OPERATING ACTIVITIES</b>	<b>\$ (19,037)</b>	<b>\$ 25,732</b>	<b>\$ 38,684</b>	<b>\$ 45,379</b>
<b>2013</b>				
Service cost	\$ 3,831	\$ 11,734	\$ 18,349	\$ 33,914
Interest cost	11,256	5,867	20,861	37,984
Expected return on plan assets	(19,478)	-	(10,530)	(30,008)
Amortization of:				
Prior service cost	540	-	2,569	3,109
Actuarial loss	2,970	7,464	11,165	21,599
<b>NET PERIODIC BENEFIT EXPENSE (INCOME)</b>	<b>(881)</b>	<b>25,065</b>	<b>42,414</b>	<b>66,598</b>
Net actuarial gain during period	(15,870)	(17,717)	(87,632)	(121,219)
Amortization of:				
Prior service cost	(540)	-	(2,569)	(3,109)
Actuarial loss	(2,970)	(7,464)	(11,165)	(21,599)
<b>TOTAL AMOUNTS RECOGNIZED IN NON-OPERATING ACTIVITIES</b>	<b>(19,380)</b>	<b>(25,181)</b>	<b>(101,366)</b>	<b>(145,927)</b>
<b>TOTAL AMOUNT RECOGNIZED IN NET PERIODIC BENEFIT EXPENSE AND NON-OPERATING ACTIVITIES</b>	<b>\$ (20,261)</b>	<b>\$ (116)</b>	<b>\$ (58,952)</b>	<b>\$ (79,329)</b>



Cumulative amounts recognized in non-operating activities, but not yet recognized in net periodic benefit expense in the *Statements of Activities*, are presented in the following table for the years ended August 31, 2014 and 2013, in thousands of dollars:

	STAFF RETIREMENT ANNUITY PLAN (SRAP)	FACULTY RETIREMENT INCENTIVE PROGRAM (FRIP)	POST RETIREMENT BENEFIT PLAN (PRBP)	TOTAL
<b>2014</b>				
Prior service cost	\$ 314	\$ -	\$ 3,394	\$ 3,708
Net actuarial loss	21,838	98,690	135,025	255,553
<b>ACCUMULATED PLAN BENEFIT COSTS NOT YET RECOGNIZED IN NET PERIODIC BENEFIT EXPENSE</b>				
	<b>\$ 22,152</b>	<b>\$ 98,690</b>	<b>\$ 138,419</b>	<b>\$ 259,261</b>
<b>2013</b>				
Prior service cost	\$ 854	\$ -	\$ 5,939	\$ 6,793
Net actuarial loss	38,886	96,837	128,697	264,420
<b>ACCUMULATED PLAN BENEFIT COSTS NOT YET RECOGNIZED IN NET PERIODIC BENEFIT EXPENSE</b>				
	<b>\$ 39,740</b>	<b>\$ 96,837</b>	<b>\$ 134,636</b>	<b>\$ 271,213</b>

The prior service costs and net actuarial loss expected to be amortized from non-operating activities to net periodic benefit expense in fiscal year 2015, in thousands of dollars, are as follows:

	STAFF RETIREMENT ANNUITY PLAN (SRAP)	FACULTY RETIREMENT INCENTIVE PROGRAM (FRIP)	POST RETIREMENT BENEFIT PLAN (PRBP)	Total
Prior service cost	\$ 277	\$ -	\$ 2,545	\$ 2,822
Net actuarial loss	\$ -	\$ 5,570	\$ 5,192	\$ 10,762

### ACTUARIAL ASSUMPTIONS

The weighted average assumptions used to determine the benefit obligations and net periodic benefit cost for the Plans are shown below:

	STAFF RETIREMENT ANNUITY PLAN (SRAP)		FACULTY RETIREMENT INCENTIVE PROGRAM (FRIP)		POST RETIREMENT BENEFIT PLAN (PRBP)	
	2014	2013	2014	2013	2014	2013
<b>BENEFIT OBLIGATIONS</b>						
Discount rate	3.64%	4.31%	3.59%	4.30%	4.10%	4.77%
Covered payroll growth rate	3.00%	3.50%	4.45%	4.41%	N/A	N/A
<b>NET PERIODIC BENEFIT COST</b>						
Discount rate	4.31%	3.36%	4.30%	3.33%	4.77%	3.78%
Expected returns on plan assets	7.00%	7.00%	N/A	N/A	7.00%	7.00%
Covered payroll growth rate	3.50%	3.54%	4.41%	4.42%	N/A	N/A

The expected long-term rate of return on asset assumptions for both the SRAP and PRBP plans is 7%. Expected returns on plan assets, a component of net periodic benefit expense (income), represent the long-term return on plan assets based on the calculated market-related value of plan assets. These rates of return are developed using an arithmetic average and are tested for reasonableness against historical returns, and the future expectations for returns in each asset class, as well as the target asset allocation of the portfolios. The use of expected long-term returns on plan assets may result in income that is greater or less than the actual returns of those plan assets in any given year. Over time, however, the expected long-term returns are designed to approximate the actual long-term returns, and therefore result in a pattern of income and cost recognition that more closely matches the pattern of the services provided by the employees. Differences between actual and expected returns are recognized as a component of non-operating activities and amortized as a component of net periodic benefit expense (income) over the service life expectancy of the plan participants, depending on the plan, provided such amounts exceed the accounting standards threshold.

To determine the accumulated PRBP obligation at August 31, 2014, a 7.25% annual rate of increase in the per capita costs of covered health care was assumed for calendar year 2014, declining gradually to 4.75% by 2024 and remaining at this rate thereafter. Health care cost trend rate assumptions 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 PRBP obligation by \$99.5 million and the aggregate annual service and interest cost by \$8.3 million. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated PRBP obligation by \$78.4 million and the aggregate annual service and interest cost by \$6.3 million.

#### EXPECTED CONTRIBUTIONS

The University expects to contribute \$9.5 million to the FRIP and does not expect to contribute to the SRAP or PRBP during the year ending August 31, 2015.

#### EXPECTED BENEFIT PAYMENTS

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

YEAR ENDING AUGUST 31	STAFF RETIREMENT ANNUITY PLAN (SRAP)	FACULTY RETIREMENT INCENTIVE PROGRAM (FRIP)	POST RETIREMENT BENEFIT PLAN (PRBP)	
			EXCLUDING MEDICARE SUBSIDY	EXPECTED MEDICARE PART D SUBSIDY
2015	\$ 27,784	\$ 9,488	\$ 17,661	\$ 2,921
2016	23,774	12,457	18,782	3,209
2017	23,547	14,875	20,143	3,501
2018	23,375	15,007	21,599	3,810
2019	22,925	15,483	23,013	4,146
2020 - 2024	106,949	82,940	137,695	26,566

### INVESTMENT STRATEGY

The University's Retirement Program Investment Committee, acting in a fiduciary capacity, has established formal investment policies for the assets associated with the University's funded plans (SRAP and PRBP). The investment strategy of the plans is to preserve and enhance the value of the plans' assets within acceptable levels of risk. Investments in the plans are diversified among asset classes, striving to achieve an optimal balance between risk and return, and income and capital appreciation. Because the liabilities of each of the plans are long-term, the investment horizon is primarily long-term, with adequate liquidity to meet short-term benefit payment obligations.

### CONCENTRATION OF RISK

The University manages a variety of risks, including market, credit, and liquidity risks, across its plan assets. Concentration of risk is defined as an undiversified exposure to one of the above-mentioned risks that increases the exposure of the loss of plan assets unnecessarily. Risk is minimized by predominately investing in broadly diversified index funds for public equities and fixed income. As of August 31, 2014, the University did not have concentrations of risk in any single entity, counterparty, sector, industry or country.

### PLAN ASSET ALLOCATIONS

Actual allocations and weighted-average target allocations by asset category at August 31, 2014 are as follows:

ASSET CATEGORY	STAFF RETIREMENT ANNUITY PLAN (SRAP)		POST RETIREMENT BENEFIT PLAN (PRBP)	
	ACTUAL	TARGET	ACTUAL	TARGET
<b>2014</b>				
Cash and cash equivalents	<1%	0%	0%	0%
Public equities	40%	45%	75%	75%
Fixed income	60%	55%	25%	25%
Private equities	<1%	<1%	0%	0%
<b>TOTAL PORTFOLIO</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

## FAIR VALUE OF PLAN ASSETS

Current U.S GAAP defines a hierarchy of valuation inputs for the determination of the fair value of plan assets as described in *Note 5*. The plan assets measured at fair value at August 31, 2014 and 2013, in thousands of dollars, are as follows:

	AS OF AUGUST 31, 2014	LEVEL 1	LEVEL 2	LEVEL 3
SRAP:				
Cash and cash equivalents	\$ 1,308	\$ 1,308	\$ -	\$ -
Public equities	119,908	119,908	-	-
Fixed income	179,842	176,061	3,781	-
Private equities	256	-	-	256
<b>TOTAL</b>	<b>301,314</b>	<b>297,277</b>	<b>3,781</b>	<b>256</b>
PRBP:				
Public equities	152,150	152,150	-	-
Fixed income	50,959	50,959	-	-
<b>TOTAL</b>	<b>203,109</b>	<b>203,109</b>	<b>-</b>	<b>-</b>
<b>TOTAL FAIR VALUE OF PLAN ASSETS</b>	<b>\$ 504,423</b>	<b>\$ 500,386</b>	<b>\$ 3,781</b>	<b>\$ 256</b>

	AS OF AUGUST 31, 2013	LEVEL 1	LEVEL 2	LEVEL 3
SRAP:				
Cash and cash equivalents	\$ 1,156	\$ 1,156	\$ -	\$ -
Public equities	119,714	119,714	-	-
Fixed income	155,379	151,511	3,868	-
Private equities	287	-	-	287
<b>TOTAL</b>	<b>276,536</b>	<b>272,381</b>	<b>3,868</b>	<b>287</b>
PRBP:				
Public equities	127,182	127,182	-	-
Fixed income	43,355	43,355	-	-
<b>TOTAL</b>	<b>170,537</b>	<b>170,537</b>	<b>-</b>	<b>-</b>
<b>TOTAL FAIR VALUE OF PLAN ASSETS</b>	<b>\$ 447,073</b>	<b>\$ 442,918</b>	<b>\$ 3,868</b>	<b>\$ 287</b>

## 17. Hospitals Retirement Plans

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

### **DEFINED CONTRIBUTION PLAN**

Employer contributions to the defined contribution retirement plan are based on a percentage of participant annual compensation. Employer contributions to this plan amounted to approximately \$81.3 million and \$71.6 million for the years ended August 31, 2014 and 2013, respectively.

### **DEFINED BENEFIT PLANS**

Certain employees of the Hospitals are covered by the *Staff Pension Plan* (the "Pension Plan"), a noncontributory, defined benefit pension plan. Benefits of certain prior employees of LPCH are covered by a frozen defined benefit plan. Benefits are based on years of service and the employee's compensation. Contributions to the plans are based on actuarially determined amounts sufficient to meet the benefits to be paid to plan participants.

### **POST RETIREMENT MEDICAL BENEFIT PLAN**

The Hospitals currently provide health insurance coverage for certain retired employees through its *Post Retirement Medical Benefit Plan* (PRMB). The Hospitals' employees and their covered dependents may become eligible for the PRMB upon the employee's retirement as early as age 55, with years of service as defined by specific criteria. Retiree health plans are paid, in part, by retiree contributions, which are adjusted annually. The Hospitals provide a subsidy which varies depending on whether the retiree is covered under the grandfathered design or the defined dollar benefit design. A Medicare supplement option is provided for retirees over age 65. The obligation for these benefits has been recorded in the *Statements of Financial Position* as "accrued pension and post retirement benefit cost".

The change in Pension Plan and PRMB plans' assets, the related change in benefit obligations and the amounts recognized in the financial statements, in thousands of dollars, are as follows:

	STAFF PENSION PLAN	POST RETIREMENT MEDICAL BENEFIT PLAN (PRMB)	TOTAL
<b>2014</b>			
<b>Change in plan assets:</b>			
Fair value of plan assets, beginning of year	\$ 187,527	\$ -	\$ 187,527
Actual return on plan assets	37,820	-	37,820
Employer contributions	6,020	4,703	10,723
Plan participants' contributions	-	1,237	1,237
Benefits and plan expenses paid	(10,939)	(5,940)	(16,879)
<b>FAIR VALUE OF PLAN ASSETS, END OF YEAR</b>	<b>220,428</b>	<b>-</b>	<b>220,428</b>
<b>Change in projected benefit obligation:</b>			
Benefit obligation, beginning of year	231,342	82,846	314,188
Service cost	2,324	1,839	4,163
Interest cost	10,330	3,507	13,837
Plan participants' contributions	-	1,237	1,237
Actuarial loss	20,094	1,127	21,221
Benefits and plan expenses paid	(10,939)	(5,940)	(16,879)
<b>BENEFIT OBLIGATION, END OF YEAR</b>	<b>253,151</b>	<b>84,616</b>	<b>337,767</b>
<b>NET LIABILITY RECOGNIZED IN THE STATEMENTS OF FINANCIAL POSITION</b>	<b>\$ (32,723)</b>	<b>\$ (84,616)</b>	<b>\$ (117,339)</b>
<b>2013</b>			
<b>Change in plan assets:</b>			
Fair value of plan assets, beginning of year	\$ 190,704	\$ -	\$ 190,704
Actual return on plan assets	3,772	-	3,772
Employer contributions	3,986	5,163	9,149
Plan participants' contributions	-	1,859	1,859
Benefits and plan expenses paid	(10,935)	(7,022)	(17,957)
<b>FAIR VALUE OF PLAN ASSETS, END OF YEAR</b>	<b>187,527</b>	<b>-</b>	<b>187,527</b>
<b>Change in projected benefit obligation:</b>			
Benefit obligation, beginning of year	257,781	87,150	344,931
Service cost	2,708	2,075	4,783
Interest cost	9,117	2,911	12,028
Plan participants' contributions	-	1,859	1,859
Actuarial gain	(27,329)	(5,751)	(33,080)
Benefits and plan expenses paid	(10,935)	(7,022)	(17,957)
Plan amendments	-	1,624	1,624
<b>BENEFIT OBLIGATION, END OF YEAR</b>	<b>231,342</b>	<b>82,846</b>	<b>314,188</b>
<b>NET LIABILITY RECOGNIZED IN THE STATEMENTS OF FINANCIAL POSITION</b>	<b>\$ (43,815)</b>	<b>\$ (82,846)</b>	<b>\$ (126,661)</b>

The accumulated benefit obligation for the Pension Plan was \$250.7 million and \$228.7 million at August 31, 2014 and 2013, respectively.

Net periodic benefit expense and non-operating activities related to the plans for the years ended August 31, 2014 and 2013, in thousands of dollars, includes the following components:

	STAFF PENSION PLAN	POST RETIREMENT MEDICAL BENEFIT PLAN (PRMB)	TOTAL
<b>2014</b>			
Service cost	\$ 2,324	\$ 1,839	\$ 4,163
Interest cost	10,330	3,507	13,837
Expected return on plan assets	(13,471)	-	(13,471)
Amortization of:			
Prior service cost	-	815	815
Actuarial loss (gain)	2,245	(463)	1,782
<b>NET PERIODIC BENEFIT EXPENSE</b>	<b>1,428</b>	<b>5,698</b>	<b>7,126</b>
Net actuarial (gain) loss during period	(4,255)	1,127	(3,128)
Amortization of:			
Prior service cost	-	(815)	(815)
Actuarial (loss) gain	(2,245)	463	(1,782)
<b>TOTAL AMOUNTS RECOGNIZED IN NON-OPERATING ACTIVITIES</b>	<b>(6,500)</b>	<b>775</b>	<b>(5,725)</b>
<b>TOTAL AMOUNT RECOGNIZED IN NET PERIODIC BENEFIT EXPENSE AND NON- OPERATING ACTIVITIES</b>	<b>\$ (5,072)</b>	<b>\$ 6,473</b>	<b>\$ 1,401</b>
<b>2013</b>			
Service cost	\$ 2,708	\$ 2,075	\$ 4,783
Interest cost	9,117	2,911	12,028
Expected return on plan assets	(13,993)	-	(13,993)
Amortization of:			
Prior service cost	-	312	312
Actuarial loss (gain)	10,677	(71)	10,606
<b>NET PERIODIC BENEFIT EXPENSE</b>	<b>8,509</b>	<b>5,227</b>	<b>13,736</b>
Prior service cost during period	-	1,624	1,624
Net actuarial gain during period	(17,108)	(5,751)	(22,859)
Amortization of:			
Prior service cost	-	(312)	(312)
Actuarial (loss) gain	(10,677)	71	(10,606)
<b>TOTAL AMOUNTS RECOGNIZED IN NON-OPERATING ACTIVITIES</b>	<b>(27,785)</b>	<b>(4,368)</b>	<b>(32,153)</b>
<b>TOTAL AMOUNT RECOGNIZED IN NET PERIODIC BENEFIT EXPENSE AND NON- OPERATING ACTIVITIES</b>	<b>\$ (19,276)</b>	<b>\$ 859</b>	<b>\$ (18,417)</b>

Cumulative amounts recognized in non-operating activities, but not yet recognized in net periodic benefit expense in the *Statements of Activities*, are presented in the following table for the years ended August 31, 2014 and 2013, in thousands of dollars:

	STAFF PENSION PLAN	POST RETIREMENT MEDICAL BENEFIT PLAN (PRMB)	TOTAL
<b>2014</b>			
Prior service cost	\$ -	\$ 3,401	\$ 3,401
Net actuarial loss (gain)	66,817	(5,054)	61,763
<b>ACCUMULATED PLAN BENEFIT COSTS NOT YET RECOGNIZED IN NET PERIODIC BENEFIT EXPENSE</b>			
	<b>\$ 66,817</b>	<b>\$ (1,653)</b>	<b>\$ 65,164</b>
<b>2013</b>			
Prior service cost	\$ -	\$ 4,216	\$ 4,216
Net actuarial loss (gain)	73,317	(6,644)	66,673
<b>ACCUMULATED PLAN BENEFIT COSTS NOT YET RECOGNIZED IN NET PERIODIC BENEFIT EXPENSE</b>			
	<b>\$ 73,317</b>	<b>\$ (2,428)</b>	<b>\$ 70,889</b>

The prior service cost and net actuarial loss expected to be amortized from non-operating activities to net periodic benefit expense in fiscal year 2015, in thousands of dollars, are as follows:

	STAFF PENSION PLAN	POST RETIREMENT MEDICAL BENEFIT PLAN (PRMB)	TOTAL
Prior service cost	\$ -	\$ 815	\$ 815
Net actuarial loss (gain)	\$ 2,631	\$ (338)	\$ 2,293

### ACTUARIAL ASSUMPTIONS

The weighted average assumptions used to determine the benefit obligations and net periodic benefit cost for the Pension Plan and PRMB are shown below:

	STAFF PENSION PLAN		POST RETIREMENT MEDICAL BENEFIT PLAN (PRMB)	
	2014	2013	2014	2013
<b>BENEFIT OBLIGATIONS</b>				
Discount rate	3.66% - 3.84%	4.37% - 4.59%	3.65%	4.37%
Covered payroll growth rate	3.00%	3.00%	N/A	N/A
<b>NET PERIODIC BENEFIT COST</b>				
Discount rate	4.37% - 4.59%	3.42% - 3.62%	4.37%	3.43%
Expected return on plan assets	6.25% - 7.50%	6.25% - 8.00%	N/A	N/A
Covered payroll growth rate	3.00%	5.50%	N/A	N/A

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



To determine the accumulated PRMB obligation at August 31, 2014, a 7.25% annual rate of increase in the per capita cost of covered health care was assumed for calendar year 2014, declining gradually to 4.75% by 2024 and remaining at this rate thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated PRMB obligation by \$2.4 million and the aggregate annual service and interest cost by \$156 thousand. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated PRMB obligation by \$2.3 million and the aggregate annual service and interest cost by \$144 thousand.

### EXPECTED CONTRIBUTIONS

The Hospitals expect to contribute \$0 to their Pension Plan and \$4.4 million to their PRMB during the fiscal year ending August 31, 2015.

### EXPECTED BENEFIT PAYMENTS

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

YEAR ENDING AUGUST 31	STAFF PENSION PLAN	POST RETIREMENT MEDICAL BENEFIT PLAN (PRMB)	
		EXCLUDING MEDICARE SUBSIDY	EXPECTED MEDICARE PART D SUBSIDY
2015	\$ 13,164	\$ 5,464	\$ 314
2016	13,741	5,685	310
2017	14,222	5,918	304
2018	14,661	6,158	297
2019	15,046	6,418	287
2020 - 2024	78,427	34,573	1,249

### INVESTMENT STRATEGY

The Hospitals' investment strategy for the Pension Plan is to maximize the total rate of return (income and appreciation) within the limits of prudent risk taking and Section 404 of the ERISA. The funds are diversified across asset classes to achieve an optimal balance between risk and return and between income and capital appreciation. Many of the pension liabilities are long-term. The investment horizon is also long-term; however, the investment plan also ensures adequate near-term liquidity to meet benefit payments.

### CONCENTRATION OF RISK

The Hospitals manage a variety of risks, including market, credit, and liquidity risks, across its plan assets. Concentration of risk is defined as an undiversified exposure to one of the above-mentioned risks that increases the exposure of the loss of plan assets unnecessarily. Risk is minimized by diversifying the Hospitals' exposure to such risks across a variety of instruments, markets, and counterparties. As of August 31, 2014, the Hospitals did not have concentrations of risk in any single entity, counterparty, sector, industry or country.

## PLAN ASSETS

The Hospitals' investment policy is to invest in assets that result in a favorable long-term rate of return from a diversified portfolio. Actual allocations and weighted-average target allocations by asset category for the Pension Plan at August 31, 2014 are as follows:

ASSET CATEGORY	ACTUAL	TARGET
<b>2014</b>		
Cash and cash equivalents	<1%	0%
Public equities	49%	50%
Fixed income	51%	50%
<b>TOTAL PORTFOLIO</b>	<b>100%</b>	<b>100%</b>

## FAIR VALUE OF PLAN ASSETS

Current U.S. GAAP defines a hierarchy of valuation inputs for the determination of the fair value of plan assets as described in *Note 5*. The Pension Plan assets measured at fair value at August 31, 2014 and 2013, are all categorized as Level 1 investments and are as follows, in thousands of dollars:

	2014	2013
Cash and cash equivalents	\$ 962	\$ 1,128
Public equities	107,628	97,661
Fixed income	111,838	88,738
<b>TOTAL FAIR VALUE OF PENSION PLAN ASSETS</b>	<b>\$ 220,428</b>	<b>\$ 187,527</b>

## 18. Operating Leases

The University and the Hospitals lease certain equipment and facilities under operating leases expiring at various dates. Total rental expense under these leases for the years ended August 31, 2014 and 2013 was \$45.3 million and \$37.8 million, respectively, for the University and \$80.5 million and \$76.7 million, respectively, for the Hospitals.

Net minimum future operating lease payments and related present value, assuming a 4.8% discount rate for periods subsequent to August 31, 2014, in thousands of dollars, are as follows:

YEAR ENDING AUGUST 31	MINIMUM LEASE PAYMENTS		PRESENT VALUE OF MINIMUM LEASE PAYMENTS	
	UNIVERSITY	HOSPITALS	UNIVERSITY	HOSPITALS
2015	\$ 29,432	\$ 67,622	\$ 28,084	\$ 64,525
2016	20,703	61,424	18,850	55,926
2017	19,883	59,866	17,274	52,011
2018	19,547	55,382	16,205	45,912
2019	15,622	51,145	12,357	40,457
Thereafter	80,799	122,808	43,250	69,967
<b>TOTAL</b>	<b>\$ 185,986</b>	<b>\$ 418,247</b>	<b>\$ 136,020</b>	<b>\$ 328,798</b>

## 19. Related Party Transactions

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

## 20. 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 RESEARCH**

The University conducts substantial research for the federal government pursuant to contracts and grants from federal agencies and departments. The University records reimbursements of direct and indirect costs (facilities and administrative costs) from grants and contracts as operating revenues. The Office of Naval Research is the University's cognizant federal agency for determining indirect cost rates charged to federally sponsored agreements. It is supported by the Defense Contract Audit Agency, which has the responsibility for auditing direct and indirect charges under those agreements. Costs recovered by the University in support of sponsored research are subject to audit and adjustment. Fringe benefit costs for the fiscal years ended August 31, 2007 to 2014 are still subject to audit. The University does not anticipate that any adjustments will be material to the consolidated financial statements.

### **HEALTH CARE**

Cost reports filed under the Medicare program for services based upon cost reimbursement are subject to audit. The estimated amounts due to or from the program are reviewed and adjusted annually based upon the status of such audits and subsequent appeals. Differences between final settlements and amounts accrued in previous years are reported as adjustments to "patient care, net" revenue in the year the examination is substantially completed. Medicare cost reports have been audited by the Medicare fiscal intermediary through August 31, 2005 for SHC and August 31, 2012 for LPCH.

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 to regulatory actions unknown or unasserted at this time. Government activity with respect to investigations and allegations concerning possible violations by health care providers of regulations could result in the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. The Hospitals are subject to similar regulatory reviews, and while such reviews may result in repayments and/or civil remedies that could have a material effect on the Hospitals' financial results of operations in a given period, each Hospital's management believes that such repayments and/or civil remedies would not have a material effect on its financial position.

### **INFORMATION SECURITY AND PRIVACY**

As with many medical centers and universities across the country, information security and privacy is a growing risk area based on developments in the law and expanding mobile technology practices. The University and the Hospitals have policies, procedures, and training in place to safeguard protected information, but select incidents have occurred in the past and may occur in the future involving potential or actual disclosure of such information (including, for example, certain identifiable information relating to patients or research participants). In most cases, there has been no evidence of unauthorized access to, or use/disclosure of, such information, yet laws may require reporting to potentially affected individuals and federal and state governmental agencies. Governmental agencies have the authority to investigate and request further information about an incident or safeguards, to cite the University or Hospitals for a deficiency or regulatory violation, and/or require payment of fines, corrective action, or both. California law also allows a private right to sue for a breach of medical information. The cost of such possible consequences has not been material to date to the University or the Hospitals, and management does not believe that any future consequences of these incidents will be material to the consolidated financial statements.

## **LABOR AGREEMENTS**

Approximately 10% of the University's, 34% of SHC's and 42% of LPCH's employees are covered under union contract arrangements and are, therefore, subject to labor stoppages when contracts expire. There are currently no expired contracts under these union contract arrangements. The University's agreements with the Stanford Deputy Sheriffs' Association and the Service Employees International Union (SEIU) will expire in 2015 and 2019, respectively. The Hospitals' agreements with SEIU and the Committee for Recognition of Nursing Achievement (CRONA) will expire in 2017 and 2016, respectively.

## **GUARANTEES AND INDEMNIFICATIONS**

The University and the Hospitals enter into indemnification agreements with third parties in the normal course of business. The impact of these agreements, individually or in the aggregate, is not expected to be material to the consolidated financial statements. As a result, no liabilities related to guarantees and indemnifications have been recorded at August 31, 2014.

## **LITIGATION**

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

## **MEDICAL CENTER RENEWAL PROJECT**

In July 2011, the University and Hospitals obtained local approval for a Renewal Project to rebuild SHC and expand LPCH to assure adequate capacity and provide modern, technologically-advanced hospital facilities. The Renewal Project also includes replacement of outdated laboratory facilities at the Stanford SoM and remodeling of Hoover Pavilion.

California's Hospital Seismic Safety Act requires licensed acute care functions to be conducted only in facilities that meet specified seismic safety standards which have varying deadlines. The Renewal Project as approved is also designed to meet these standards and deadlines.

SHC's and LPCH's share of the estimated total cost of the Renewal Project is \$2 billion and \$1.2 billion, respectively. The source of funding for the Renewal Project includes operating surpluses, gifts, government grants, and bond proceeds. Through August 2014, the Hospitals have recorded \$913.8 million in construction in progress related to this project. Based on current estimated schedules, management currently projects that the Renewal Project construction will be complete in 2017.

## **CONTRACTUAL COMMITMENTS**

At August 31, 2014, the University had contractual obligations of approximately \$278.5 million in connection with major construction projects. Remaining expenditures on construction in progress are estimated to be \$631.3 million, which will be financed with certain unexpended plant funds, gifts and debt. Commitments on contracts for the construction and remodeling of Hospital facilities were approximately \$1.3 billion at August 31, 2014. As described in *Note 5*, the University is obligated under certain alternative investment agreements to advance additional funding up to specified levels over a period of years.

## 21. Subsequent Events

The University and the Hospitals have evaluated subsequent events for the period from August 31, 2014 through December 10, 2014, the date the consolidated financial statements were available to be issued.

In September 2014, ValleyCare Health System (VCHS) and SHC entered into an affiliation agreement under which SHC will become the sole corporate member of VCHS. VCHS operates inpatient and other health care facilities at three Bay Area locations in Alameda County, California. The closing of the affiliation is subject to various approvals including regulatory approvals.

# Stanford Management Company

## 2014 Annual Report

The Stanford Management Company (SMC) was established in 1991 to manage Stanford's financial assets. SMC is a division of the University with oversight by a Board of Directors appointed by the University Board of Trustees. The SMC Board consists of investment professionals, the University president, the University chief financial officer, members of the Board of Trustees, and the SMC chief executive officer. The Board approves SMC asset allocation targets, oversees the hiring of external asset managers, evaluates the performance of SMC investments and professionals, and oversees management of significant portions of endowment, trust assets and expendable funds for the University and the Hospitals.

The majority of the University's endowment assets are invested through the Merged Pool (MP), which is a diversified portfolio of actively managed financial assets valued at approximately \$25.0 billion as of June 30, 2014. To facilitate the comparison of returns with other endowments and foundations, MP performance measurements were calculated on the 12 months ending June 30, 2014. The following discussion of endowment performance relates solely to investments in the MP. The MP realized a 16.8% investment gain for the 12 months ending June 30, 2014. Over the past 10 years, the MP achieved an annualized rate of return of 9.9%, growing from \$10 billion to \$25 billion.

The MP portfolio is constructed on a foundation of modern portfolio theory and strategic asset allocation. The portfolio is designed to optimize long-term returns, create consistent annual payouts to the University's operating budget and preserve purchasing power for future generations of Stanford faculty and students.

SMC, with assistance from its Board of Directors, actively manages the MP, primarily through selecting third-party managers to deploy the MP's capital. Stanford University's brand and SMC's reputation as a stable long-term source of capital enable SMC to gain access to the best third-party managers in the world. Within each business unit, we endeavor to place capital with a diversified set of managers across geographies and investment strategies. SMC also seeks to add value through effective risk management, tactical portfolio rebalancing and opportunistic investment tilts.

## STANFORD MP ASSET ALLOCATION

Given the perpetual nature of the University, SMC's investment horizon is long-term. Our objective is to generate maximum total returns for an appropriate level of risk. SMC and the Board regularly reevaluate portfolio asset allocation targets, as well as expected risks, returns and correlations across business units. In addition, SMC reviews positioning relative to long-term policy targets on an ongoing basis and adjusts the portfolio in the context of current market conditions and relative opportunities. The strategic asset allocation targets for the MP as of June 30, 2014 are listed below:

### LONG-TERM POLICY TARGETS

Business Unit	Long-Term Policy Target
Public Equity	25%
Private Equity	23%
Absolute Return	22%
Natural Resources	12%
Real Estate	8%
Fixed Income	10%

### STANFORD MP PERFORMANCE COMPARED TO INFLATION

The table below outlines annualized returns for various periods ending June 30, 2014.

Business Unit	One-Year	Three-Year	Five-Year	Ten-Year
Nominal Endowment Return	16.8%	9.8%	13.1%	9.9%
GDP Deflator	1.6%	1.6%	1.6%	2.0%
Real Endowment Return	15.2%	8.2%	11.5%	7.9%



## STANFORD MP PERFORMANCE COMPARED TO BENCHMARKS

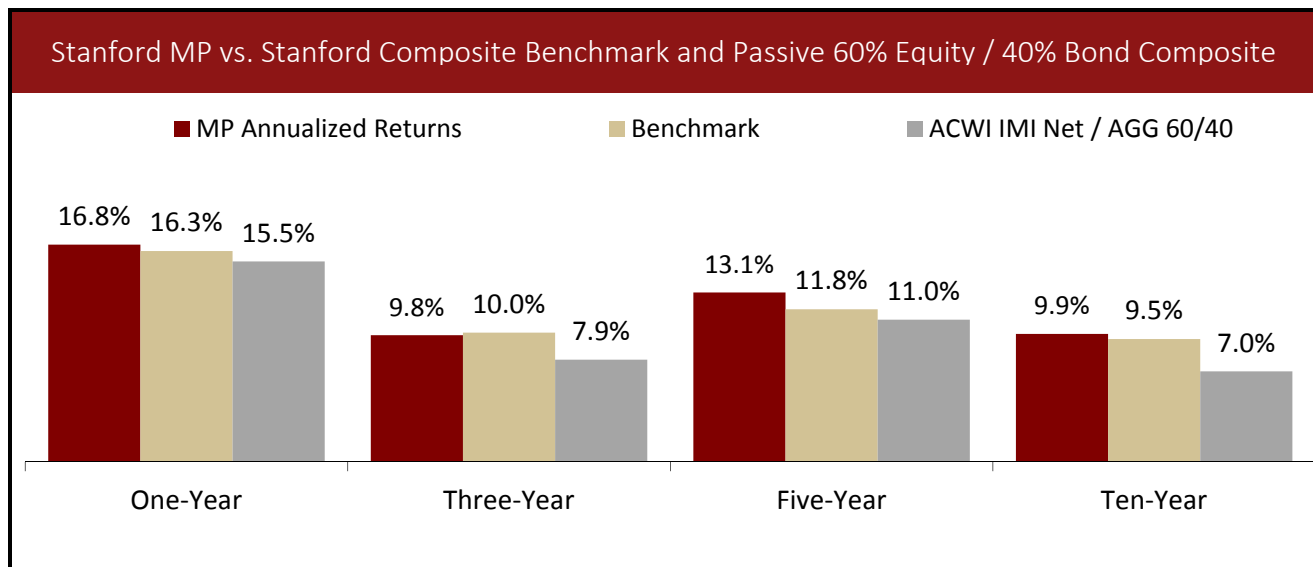
SMC reviews overall MP performance against the composite benchmark return, which represents a blend of the benchmark returns for each business unit weighted by the strategic allocations above. The relative one-year performance of the MP versus the benchmark was 0.5%.

In the 12 months ending June 30, 2014, the Merged Pool (MP) gained 16.8%, continuing a strong recovery since the market bottom in 2009. During the same period, the MSCI ACWI IMI Net Index returned 23.4%, the Barclays Aggregate returned 4.4%, and a 60/40 equity/fixed income mix would have returned 15.5%. Our performance was consistent with our long-term strategic asset allocation which gives us significant exposure to rising markets, while maintaining flexibility and optionality in the case of market volatility.

Diverging global macroeconomic conditions and policy responses have driven returns across the portfolio over the past year. The US economic recovery continues and the S&P 500 returned 24.6% over the year ending June 30, 2014. Economic growth has been weaker in Europe and Japan, but expectations of further stimulus have supported equity markets. Sovereign bond yields across Developed Markets remain low and credit spreads tight. US rates are expected to gradually increase, but how and when the Fed exits this period of unconventional monetary policy is a key question facing the economy and markets.

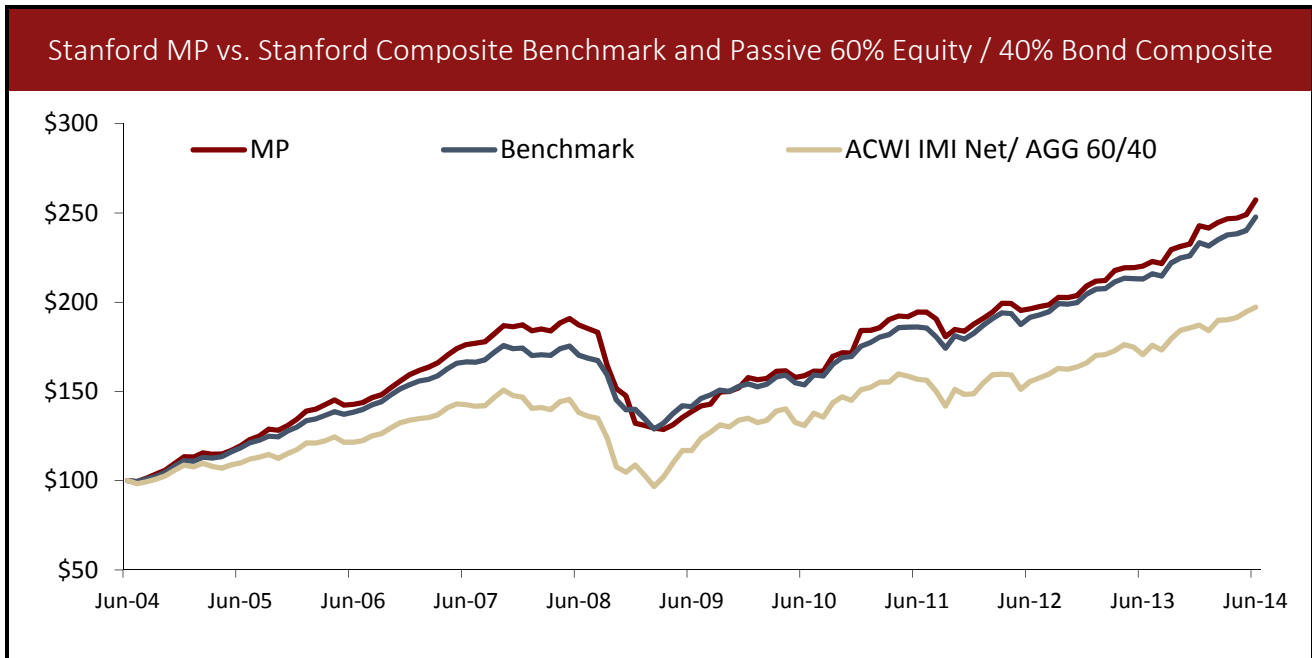
The MP is fully invested across a range of diversified assets and positioned close to policy allocation. The majority of our exposure is through external managers and complemented by direct positions to express more intentional global asset tilts and idiosyncratic opportunities. Within our asset allocation, we are actively positioning to drive alpha and maximize absolute and relative returns over the market cycle. In the table below, actual performance, net of management fees, is compared to the composite benchmark along with a 60% equity / 40% bond portfolio for periods ended June 30, 2014.

## STANFORD MP VS. STANFORD COMPOSITE BENCHMARK



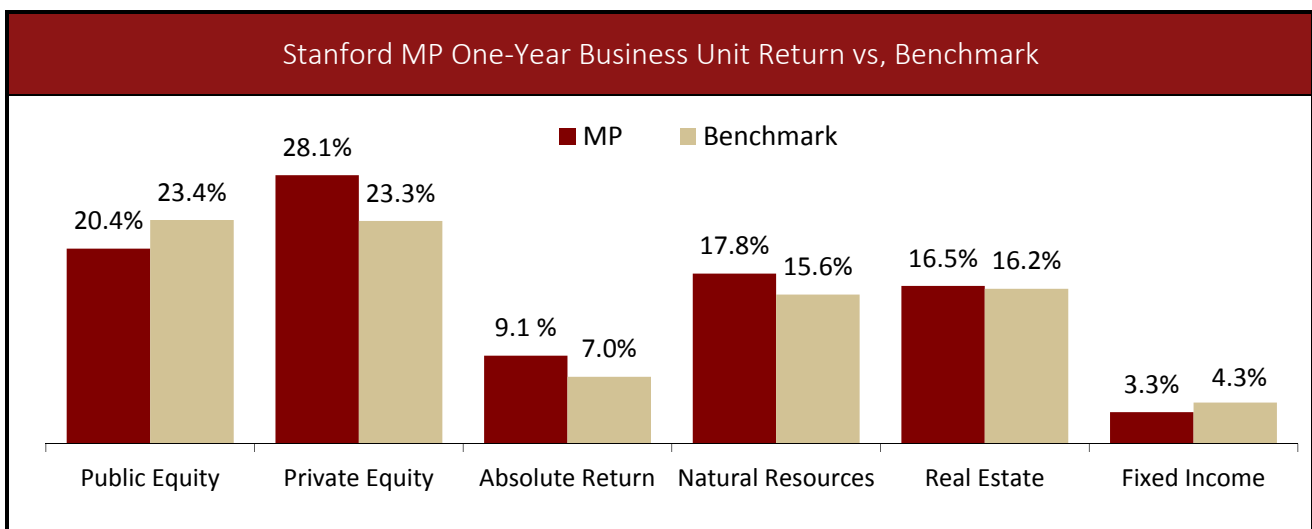
## STANFORD MP VS. STANFORD COMPOSITE BENCHMARK AND PASSIVE 60% EQUITY / 40% BOND COMPOSITE

SMC's effectiveness in implementing its investment strategies through top-level manager selection has resulted in consistent and long-term outperformance versus relevant benchmarks. The cumulative return chart below compares the growth of \$100 in Stanford's MP, a composite benchmark portfolio, and a 60% equity / 40% bond portfolio over the past 10 years:

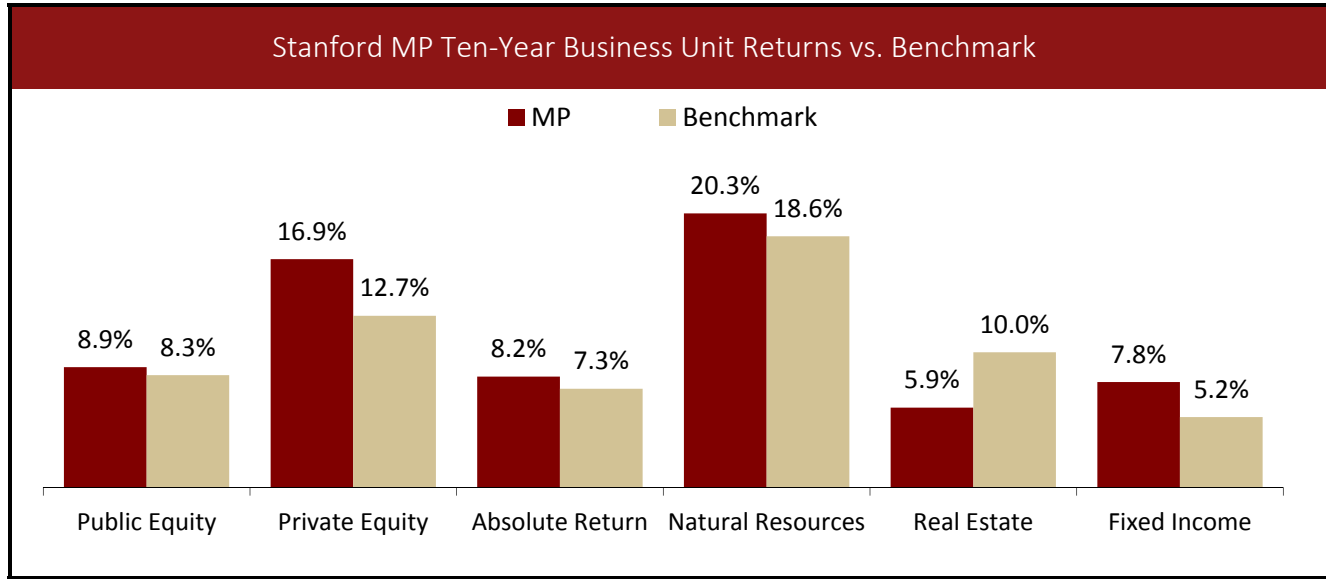


## INDIVIDUAL BUSINESS UNIT PERFORMANCE

SMC evaluates investment manager performance by comparing manager returns to respective SMC Board approved benchmarks. The performance of individual business units for the 12 months ended June 30, 2014, relative to each business unit benchmark, is illustrated in the graph below:



## STANFORD MP TEN-YEAR BUSINESS UNIT RETURNS VS. BENCHMARK



The endowment provides valuable resources to support the University's mission through funding financial aid, faculty research, and innovative programs. Over the past ten years, the MP has grown from \$10 billion to \$25 billion through strong investment returns and the generous support of alumni and friends. SMC is committed to building on past success to further improve our investment performance and enhance the University's mission of educating current students and future generations.

Finally, I have announced that I will leave my post in 2015. It has been a privilege and an honor to support this great university with its missions of teaching, research and service. I have decided that it is time to take my enthusiasm for business-building and find a new challenge, but I am mindful of the responsibility that comes with service to Stanford. Thus I want to provide ample time for a search to be conducted for a successor to lead the SMC team, of which I am very proud. I plan to remain CEO until my replacement can be appointed.

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