Section 1
Financial Overview

In this section we will review the details of the 2003/04 Consolidated Budget for Operations, discuss the impact of the Capital Budget on the Consolidated Budget, and present a projected Statement of Activities, which is presented in accordance with GAAP (Generally Accepted Accounting Principles).

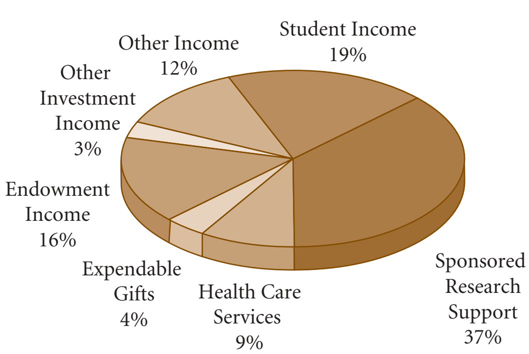
CONSOLIDATED BUDGET FOR OPERATIONS

The Consolidated Budget for Operations includes all non-capital revenues and expenses. It is based on forecasts from the schools and the administrative areas. These forecasts are then merged with the general funds budget forecast and adjusted by the University Budget Office for consistency. Unlike the Statement of Activities in the Annual Report, the Consolidated Budget for Operations is presented on a modified cash basis as opposed to an accrual basis, and it only shows those revenues and expenses available for current operations. It does not include plant funds, student loan funds, or endowment principal funds, although endowment income is reflected in this budget. The table on the next page shows the projected consolidated revenues and expenses for 2003/04. For comparison purposes, this table also shows the actual revenues and expenses for 2001/02 and both the budget and the year-end projections for the current fiscal year, 2002/03. In addition, definitions of key terms are provided on page 3.

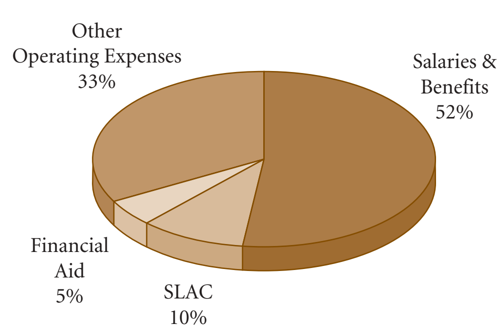
The 2003/04 Consolidated Budget for Operations shows total revenues of $2,422.6 million and expenses of $2,343.0 million, resulting in excess revenue over expense of $79.6 million. However, after estimated transfers, primarily to the plant division, the Consolidated Budget is projected to have a deficit of $19.0 million, or 0.8% of total expenses.

Total revenues in 2003/04 are projected to increase 3.8% over the expected 2002/03 levels. This growth is lower than the past several years due to continued sluggishness in investment returns, flat expectations for gift revenue, and flat revenue expectations in special program fees and other income that are affected by current economic conditions. Total expenses are expected to grow by 3.9% over the estimated year-end results for 2002/03. The constrained revenue forecast

2003/04 CONSOLIDATED REVENUES: $2,422.6M [1]



2003/04 CONSOLIDATED EXPENSES: $2,343.0M



[1] Net Revenues after Transfers: $2,324.0M

Projected Consolidated Budget For Operations, 2003/04

[in millions of dollars]

2001/02 Actuals	2002/03 Budget June 2002	2002/03 Projected Yr-End Acts		General Funds	Designated	Designated Clinics	Restricted	Grants and Contracts	Auxiliary Activities	Total Current Funds
			Revenues and Other Additions							
			Student Income:							
175.5	181.8	184.6	Undergraduate Programs	191.9						191.9
157.8	174.6	166.7	Graduate Programs	185.0						185.0
78.3	90.0	84.4	Room and Board						92.4	92.4
411.5	446.4	435.6	Total Student Income	376.9					92.4	469.3
			Sponsored Research Support:							
439.8	472.7	475.0	Direct Costs—University					505.9		505.9
227.8	219.9	230.0	Direct Costs—SLAC					223.0		223.0
134.0	135.1	145.1	Indirect Costs	156.7						156.7
801.6	827.7	850.1	Total Sponsored Research Support	156.7				728.9		885.6
195.8	187.9	208.1	Health Care Services	5.3	13.5	171.2			35.9	225.8
104.3	140.0	105.0	Expendable Gifts In Support of Operations	2.0			103.0			105.0
			Investment Income:							
377.8	403.6	382.1	Endowment Income	80.8			297.7			378.5
68.4	86.1	68.6	Other Investment Income	28.6	44.1		2.1			74.8
446.2	489.7	450.8	Total Investment Income	109.3	44.1		299.8			453.2
233.7	254.2	233.7	Special Program Fees and Other Income	23.9	115.8		(1.9)	0.3	95.7	233.7
39.8	50.0	50.0	Net Assets Released from Restrictions				50.0			50.0
2,232.9	2,395.9	2,333.4	Total Revenues	674.0	173.3	171.2	450.9	729.2	224.0	2,422.6
			Expenses							
1,084.0	1,133.4	1,169.1	Salaries and Benefits	341.1	109.7	147.2	209.9	264.5	160.5	1,233.0
227.8	219.9	230.0	SLAC					223.0		223.0
110.6	108.8	114.9	Financial Aid	22.7	1.2		90.8	8.9		123.6
704.4	780.8	740.6	Other Operating Expenses	242.3	117.3	14.9	114.2	231.6	43.2	763.5
2,126.8	2,242.9	2,254.6	Total Expenses	606.1	228.1	162.2	414.9	728.0	203.7	2,343.0
106.1	153.0	78.8	Revenues less Expenses	67.9	(54.8)	9.0	36.1	1.2	20.2	79.6
			Transfers							
(2.0)	(40.0)	(2.0)	Additions to Funds Functioning as Endowment		(5.0)		(2.9)		1.9	(6.0)
(85.0)	(67.1)	(103.0)	Transfer to Plant/Student Loan	(25.0)	(30.0)		(16.6)	(0.3)	(20.8)	(92.6)
2.7			Other Transfers	(40.0)	51.0	3.0	(14.0)			
(84.3)	(107.1)	(105.0)	Total Transfers	(65.0)	16.0	3.0	(33.4)	(0.3)	(18.9)	(98.6)
21.8	45.9	(26.2)	Revenues less Expenses and Transfers	2.9	(38.8)	12.0	2.6	0.9	1.3	(19.0)
			Beginning Operating Equity		302.3	4.0	516.7	31.7	27.2	882.0
			Ending Operating Equity	2.9	263.5	16.0	519.3	32.7	28.5	863.0

necessitated budget decisions that result in substantially slower growth in expense than in recent years.

In order to understand the different dimensions of the Stanford budget, in the following sections we will review the Consolidated Budget from three perspectives:

- By principal revenue and expense categories,
- By type of funding source (e.g., general funds, restricted funds, etc.), and
- By organizational unit.

The Consolidated Budget by Principal Revenue and Expense Categories

Revenues

Student Income

Increases in student charges are guided by a number of considerations. The most important are our programmatic needs, the affordability of a Stanford education, the effectiveness of our financial aid program, our market position, and price inflation in the local and national economies. Overall, student income is expected to increase by 7.7% in 2003/04.

Tuition – The general tuition rate increase for 2003/04, which was approved by the Trustees in February, is 5% for the second year in a row and is part of the overall strategy to prevent a shortfall in general funds. The increase applies to the undergraduate tuition rate, the general graduate rate, and the full-time tuition rates for graduate students in the Schools of Engineering, Medicine, and Law. The Graduate School of Business (GSB) will increase the rate for the MBA program by 8.9% in order to address the school's projected budget shortfall. As the GSB tuition rate sufficiently lags its peers, this increase will not jeopardize the school's pricing position.

Over the past few years, there has been a drop in both graduate student enrollment and the proportion of graduate students who are paying full-time tuition. These two factors combine to create decreases in graduate student tuition revenue. The practice of graduate students enrolling less than full-time is expected to continue. In particular, the School of Engineering feels that 8-10 units is an appropriate workload for master's students who are adjusting to the difficult courses in graduate school. Thus, while enrollment in the School of Engineering has remained flat over the past ten years,

KEY TERMS

General Funds: Unrestricted funds that can be used for any University purpose. The largest sources are tuition, unrestricted endowment, and indirect cost recovery.

Designated Funds: Funds that come to the university as unrestricted but are directed to particular schools and departments, or for specific purposes by management agreement.

Designated Clinics Funds: Funds associated with the clinical activities in the School of Medicine.

Restricted Funds: Includes expendable and endowed funds that can only be spent in accordance with donor restrictions.

Grants and Contracts: The direct component of sponsored research, both federal and non-federal; individual principal investigators control these funds.

Auxiliaries: Self-contained entities such as Residential and Dining Enterprises and Intercollegiate Athletics that generate income and charge directly for their services. These entities usually pay the university for central services provided.

Net Assets Released from Restrictions: Under Financial Accounting Standards Board (FASB) reporting standards, gifts and pledges that contain specific donor restrictions preventing their spending in the current fiscal year are classified as "temporarily restricted," and are not included in the Consolidated Budget for Operations. In the future, when the restrictions are released, these funds become available for use. At this time, these funds are considered "released from restrictions" and are included as part of the Consolidated Budget in the line Net Assets Released from Restrictions.

Financial Aid: Includes expenses for undergraduate and graduate student aid. Student stipends and tuition allowance are not considered to be financial aid and are classified as other operating expenses in the Consolidated Budget.

Formula Areas: Budget units whose allocations of general funds are predetermined by a formula agreed to by the Provost and the unit. Principal formula units include the Graduate School of Business, the School of Medicine, and the Hoover Institution.

the number of students paying part-time tuition has doubled, yielding a decrease in tuition revenue. The Board approved increasing the percentage of full time tuition charged to part-time graduate students. Historically, graduate students taking 8-10 units paid 62% of full tuition. The 8-10 unit rate will now be set at 65% of full tuition, which more accurately reflects the proportion of units taken by these students.

Another change in graduate tuition pricing is the terminal graduate registration (TGR) rate, for which students are eligible after completing 135 units of coursework. A comparative study with Stanford's peers reveals that Stanford's TGR rate is the lowest in the peer group. A higher TGR rate encourages timely completion of graduate degree programs, in addition to the revenue generated. As a result, this rate will be increased by 50% to $6,600 for four quarters.

Tuition revenue from undergraduate programs is expected to grow by 4%, a little less than the approved increase in tuition because we do not believe that the undergraduate student body will be quite as large next year. Conversely, graduate program revenue is expected to increase 11%, which includes the higher rate increases for the GSB and for part time graduate students. It also assumes additional master's students in the Schools of Engineering and Education.

Room and Board – In February, the Trustees approved a combined room and board rate increase of 4.25% for 2003/04. The room rate will increase by 5.7%, and the board rate by 2.75%. The 2003/04 recommended increases in room and board rates were developed under several operating principles: continuing an asset preservation program that will annually fund building infrastructure renewal; operating with a reserve-to-expense ratio of at least 2%; completing seismic and life safety projects as part of the Capital Improvement Plan; and implementing an operations budget reduction of approximately 5%. Overall room and board revenue will grow by 9.5% as a result of the reopening of the renovated Branner Hall and Kitchen and full occupancy of the Escondido Village studio apartments that opened in January, 2003.

Sponsored Research Support and Indirect Cost Recovery

The budget for sponsored research support is expected to be $885.6 million in 2003/04, or 37% of the total revenues projected in the Consolidated Budget for Operations. Included in this figure are the direct costs of externally supported grants and contracts ($505.9 million for university research and $223 million for SLAC), as well as reimbursement for the indirect costs ($156.7 million) incurred by the university in support of sponsored activities.

Federally sponsored research continues to grow moderately in the current year, and is expected to grow another 5% in 2003/04. Non-government grants are up over 40% in the Medical School and up more than 25% university-wide in the current year. Strong growth in this area is expected to continue into next year. Overall, we are budgeting a 6.5% increase in university direct costs.

Total direct costs for SLAC in 2003/04 are expected to decrease compared to 2002/03. Funding from the Department of Energy (DOE), which still provides almost all of the funding for SLAC, is expected to increase minimally. Funding from other sponsors, who provide less than 5% of SLAC's direct costs, is expected to decline substantially in 2003/04 with the completion of the joint NIH/DOE project SPEAR3. This project upgrades SPEAR, the existing synchrotron radiation source for the Stanford Synchrotron Radiation Laboratory (SSRL). After the completion of the SPEAR3 project in October 2003, the direct costs from other sponsors are expected to drop from the current level of about $15.7 million to $4.4 million in 2003/04.

Last year, the university negotiated predetermined indirect cost rates of 58% in the current year and 60% for 2003/04. The combination of a rate increase and increases in research volume will yield an 8% increase in indirect cost recovery over the projected year-end actuals.

Health Care Services

Health Care Services income is budgeted to be $225.8 million in 2003/04. This is an 8.5% increase over the projection for 2002/03. It includes $171.2 million paid to the Medical School by the Stanford Hospital and Clinics and Lucile Packard Children's Hospital related to physician services of its faculty. It also includes payments of $7.4 million by the Veteran's Administration Hospital and the Santa Clara Valley Medical Center. Other components are: $4.7 million of clinical revenue; $22.1 million of payments to the Medical School for rent, use of the library, blood products, and research support; and $2.9 million of overhead payments. The hospitals also pay the university for a number of non-Medical School expenses, including communications services, legal services, operations and maintenance, and utilities, totaling $18.1 million.

Expendable Gifts

Expendable gift income is expected to total $105 million in 2003/04. These gifts are immediately expendable for purposes specified by the donor. This amount does not include gifts to endowment principal, gifts for capital projects, gifts pending designation, or non-government grants. Gift receipts in support of current operations reached a high of $125.3 million in 2000/01. They totaled $104.3 million in 2001/02 and are projected to remain flat at $105 million in both the current year and in the 2003/04 budget.

Investment Income

Endowment Income – Endowment income in 2003/04 is expected to be $378.5 million, a 1.0% decrease over 2002/03. The payout rate in the current year is higher than the total return on the pool and will result in the market value of the endowment being down for the third year in a row. The expectation for a moderate level of gifts to endowment mitigates what otherwise would be a larger decline in endowment payout.

The estimate of endowment payout from the merged endowment pool is a product of a forecast of the endowment market value at the beginning of the coming budget year and a smoothed payout rate. Stanford uses a smoothing rule to dampen the impact on the budget of large annual fluctuations in the market value, thereby providing stability to budget planning. The smoothing rule sets the coming year's payout rate to be a weighted average of the current year's payout rate and the target rate. The smoothed payout rate trends up when the market declines, and it moves lower when the market value increases. Nonetheless, while the smoothing rule protects the budget from unmanageable swings in the market value, it cannot prevent a decline in payout when the market value experiences a sustained downturn as we have seen the past few years. The target payout rate is 5.05%, and the smoothed payout rate projected for 2003/04 is 5.24%.

Total endowment income includes payout from funds invested in the merged endowment pools as well as specifically invested endowments and rental income from the Stanford Research Park and other endowed lands. Total income is also impacted by new gifts to endowment. In 1999/00, Stanford received a record $242 million in gifts to endowment principal, up from $96 million in 1998/99. Unfortunately, we have not been able to sustain the 1999/00 gift level. We received $158 million in new gifts to endowment in 2000/01 and $134 million in 2001/02. We expect to raise $175 million in the current year and again in 2003/04.

Of the total endowment income, only $80.8 million, or 21.4%, is unrestricted. The unrestricted endowment income includes payout from unrestricted merged endowment funds and all of the income generated from Stanford endowed lands. This amount is expected to decline 5.4% from the projected revenue of $85.4 million in 2002/03 for several reasons. First, the unrestricted merged endowment funds are subject to the same payout as restricted funds and will suffer from the recent declines in the market value. Second this decline is exacerbated by the withdrawal of over $50 million in unrestricted funds functioning as endowment necessary to buffer the shortfall in the expendable funds pool (EFP) returns in each of the last two years. Finally, rental income from Stanford's endowed lands is expected to be lower due to the continued slump in the local economy.

Other Investment Income – Other investment income consists primarily of the payout on the expendable funds pool, the investment pool for non-endowment funds. The expendable funds pool is comprised of the university's general operating funds, non-government grants, unspent endowment income funds, expendable gifts and designated funds belonging to various schools and departments, as well as student loan funds, plant funds, and other short-term funds. This pool of funds represents a significant component of university investment capital, with a current average funds balance of $1.3 billion.

Other investment income is budgeted to increase 9% to $74.8 million in 2003/04. This sizable increase is due to two factors. The first is the assumption that total return on the investments of the EFP will be 4.5%, compared to the zero return expected in the current year. Second, the guaranteed payout rate received by general funds will increase in 2003/04 from 4% to 4.5% in accordance with the revised EFP payout policy proposed for adoption by the Trustees at the June 2003 Board meeting. Under the revised policy, the EFP will be invested approximately 87.5% in the Merged Endowment Pool and 12.5% in money market instruments. Unspent endowment income funds will be invested in a segregated, but merged investment pool, 100 percent of which will be invested in money market instruments.

Special Program Fees and Other Income

This category includes the revenues of several different types of activities. The first is a variety of special programs such as patent and royalty income, conferences and symposiums, fees from the executive education programs in the Graduate School of Business and the Stanford Center for Professional Development, and revenues from corporate affiliates, mostly in the Schools of Earth Sciences and Engineering.

A major component of this category is the revenue from auxiliary activities, excluding student room and board fees. This category includes revenues from conference activity, concessions, and other operating income in Residential and Dining Enterprises (R&DE), athletic event ticket sales and television income, HighWire Press, the University Press, Stanford West Apartments, and several other smaller auxiliaries.

Overall, special program fees and other income are budgeted in 2003/04 to be unchanged from the projected year-end level of $233.7 million. Revenue from these activities has been affected by the overall economic conditions. In addition, patent royalties are expected to decline due to the expiration of several patents.

Net Assets Released from Restrictions

This represents the portion of funds previously classified as temporarily restricted that will become available for spending as specific restrictions are satisfied. These include pending gifts whose designation has been determined. In 2003/04, we anticipate that schools and departments will be able to use $50 million of gifts received in previous years that had been classified as temporarily restricted. Temporarily restricted funds are university gifts and pledges that contain specific donor-imposed restrictions preventing their spending in the fiscal year in which they are received. Until they are released from restrictions, they are not included in the Consolidated Budget for Operations.

Expenses

Salaries and Benefits

Salaries – One of the actions the university took in response to the overall constraints on the budget was to implement a freeze on merit increases for both faculty and staff salaries for fiscal year 2003/04. Forgoing increases to base continuing pay for the university's 8,700 faculty and staff members will reduce salary expense in the Consolidated Budget by $24 million, a reduction of $8 million in general funds. The decision to hold salaries flat for a year was made in the hopes of minimizing staff layoffs. The freeze in salaries does not apply to bargaining unit employees. Wages of Stanford workers who are covered by bargaining unit agreements are negotiated separately between the university and labor unions. A new contract with United Stanford Workers will be negotiated during the summer of 2003.

Stanford compares favorably to its competitors in terms of current salary levels and comprehensive benefits for both faculty and staff. Given the state of the local economy, it is doubtful that a one-year freeze on Stanford base pay will significantly impact the university's competitive market position.

While no increases to base pay are authorized, the salary program for 2003/04 does include central funding of 1.5% for one-time performance bonuses and incentives, as well as targeted funding for specific job classifications that lag the market by ten percent or more. Central funding for non-base performance bonus and incentive programs increases from 0.5% last year and highlights the growing importance of variable pay as a component of Stanford's salary program. In addition, units may use up to 1% of their salary base from local funds, if available, for additional performance bonuses and incentives. These program components provide flexibility to recognize top performers and to address documented market lags. While there will be no general merit program in 2003/04, individuals who are promoted will receive normal base salary increases commensurate with the change in their responsibilities and position.

Salaries for research and teaching assistants are budgeted to increase by 3%.

Fringe Benefits – All four of Stanford's fringe benefits rates will increase from 2002/03 to 2003/04 by significant increments. The increases are due in large part to the continuing growth in the cost of employee and retiree health care benefits. In addition, many other benefits programs, including all insurance plans, will be more costly.

Total costs in the benefits pool are budgeted to increase 21% from negotiated 2002/03 costs, a significantly faster growth than the modest increase expected in the salary and wage base. As a result, the total rate for benefits-eligible employees is budgeted to go up by

4.2 points, from 24.8% to 29.0%. Insurance plans will account for 2.0 points of that increase. The largest share will come from health insurance for active employees (1.0 point) and for retirees (0.3 points). Dental insurance (0.3 points), life insurance (0.2 points), long-term disability (0.2 points) and workers' compensation (0.1 point) will also contribute to the increase.

Retirement programs comprise 0.5 points of the year-to-year budget increase, due primarily to the additional costs related to the transfer of most bargaining unit employees from the defined-benefit Stanford Retirement Annuity Plan to the defined-contribution Stanford Contributory Retirement Plan.

Miscellaneous plans in total will be 0.4 points higher in 2003/04 than in 2002/03. The two main contributors are severance (0.3 points) and staff development (0.2 points), with small reductions in several other programs slightly offsetting those increases.

The largest point change in a single line item comes not from a current year program cost, but from the carry-forward from earlier years. In 2000/01, the negotiated fringe benefit rate was slightly higher than actual costs, so the over-recovery of about $4 million became a credit (reduction) to the rate in 2002/03. By contrast, total costs for regular benefits-eligible employees were under-recovered in 2001/02 by about $18 million, so the entire amount would normally become a part of the cost pool in 2003/04. However, including the entire amount would raise the regular fringe rate so high that the university plans to spread the cost out over three years. Even with that effort to ameliorate the effect of the carry-forward, the difference from 2002/03 to 2003/04 is 1.1 point on the rate.

The benefits rate for post-doctoral research affiliates will also increase in the coming year, from 14.8% to 18.7%. This is due in large part to rising medical costs as discussed above. The post-doctoral pool is also affected by a swing from a credit carry-forward that reduces the total rate in 2002/03 to a debit carry-forward that increases the rate in 2003/04. The rate for contingent (casual or temporary) employees will rise from 8.1% to 9.1%, due almost entirely to the carry-forward due to the under recovery in 2001/02.

The rate for graduate teaching and research assistants, which was new to the pool in 2002/03, will increase more modestly, from 3.3% to 3.5%. This rate will continue to fund half the cost of Cardinal Care insurance for RAs and TAs with appointments of 25% or more, with a smaller contribution for appointments between 10% and 25%. Other student salaries, such as pay for part-time clerical work during the school year, are not charged for benefits, nor are the students holding those jobs eligible for the university contribution toward their Cardinal Care.

The negotiated 2002/03 and the proposed 2003/04 fringe benefits rates are as follows:

Fringe Benefits Rates

	2002/03 Negotiated Budget	2003/04 Proposed Rates
Regular Benefits-Eligible Employees	24.8%	29.0%
Post-Doctoral Research Affiliates	14.8%	18.7%
Casual/Temporary Employees	8.1%	9.1%
Graduate RAs and TAs	3.3%	3.5%
Other Students	0.0%	0.0%
Average Blended Rate	22.6%	26.4%
Tuition Grant Program Recovery Rate	1.2%	1.2%

The Tuition Grant Program (TGP) rate of 1.2% is charged separately against regular benefits-eligible salaries only and will be unchanged in 2003/04. In order to comply with federal government rules, all federal government sponsored accounts are exempted from the TGP charge. Academic service centers also are exempted.

Financial Aid

Stanford expects to spend a total of $123.6 million in student financial aid for undergraduate and graduate students, $22.7 million of which will come from general funds. As the table on the following page indicates, designated and restricted funds ($92.0 million) and grants and contracts ($8.9 million) will support the remainder. The total financial aid numbers are 7.5% above the projected total for 2002/03. This increase is consistent with an expected increase in the number of undergraduates receiving need-based aid due to a change in the overall financial profile of our student body as well as the 9.7% increase in the 8-10 unit rate for part time graduate students.

2003/04 Financial Aid and Other Graduate Student Support from Stanford Resources

[in millions of dollars]

Projected 2003 Year-End		General Funds	Designated and Restricted	Grants & Contracts	Total
	Student Financial Aid				
51.5	Undergraduate	15.5	39.6		55.1
12.0	Undergraduate Athletic		13.0		13.0
51.5	Graduate	7.2	39.4	8.9	55.5
115.0	Total	22.7	92.0	8.9	123.6
	Other Graduate Student Support				
64.0	Stipends	7.3	32.9	25.7	65.9
41.3	Tuition Allowance	25.7	4.7	15.0	45.3
92.5	RA and TA Salaries	11.4	26.0	57.9	95.3
197.8	Total	44.3	63.6	98.6	206.6
312.8	Total Student Support	67.0	155.6	107.5	330.2

Undergraduate Aid – This Budget Plan reflects Stanford's long-held commitment to need-blind admissions supported by a financial aid program that meets the demonstrated financial need of all admitted undergraduate students. We estimate that in 2003/04, Stanford students will receive $68.6 million in need-based scholarships, of which $55.1 million will be from Stanford resources. The remaining $13.5 million will come from government and outside awards. The following sources support Stanford's $55.1 million commitment:

- General funds will cover $15.5 million, the highest level of general funds support since 1995/96. The proportion of Stanford funded scholarship aid supported by general funds decreased to as low as $4.6 million in 2000/01 due to the success of Stanford's fundraising, the tremendous growth in investment income over this time period, and the extraordinary strength in the economy overall. However, with a changing undergraduate student body and the slowing of the economy, there has been a steady increase in the need for general funds.
- Restricted income will provide $28.8 million, and
- The Stanford Fund will provide $10.8 million.

Stanford restricted funding, including endowment income and The Stanford Fund, will contribute a little less than 58% of the total need-based scholarship budget, down from a high of 71% in 2000/01. While the Campaign for Undergraduate Education (CUE) has been very successful and has brought in many new restricted funds, many of the new endowment funds have not realized sufficient appreciation to make the full payout. This fact, together with the declining endowment market value, will result in endowment income supporting undergraduate scholarship remaining flat in the coming year. Athletic scholarships, none of which are need-based, will be awarded to undergraduate students in the amount of $13.0 million.

The table on the following page shows the detail of undergraduate need-based scholarship aid. There had been a steady decline in the number of students on aid between 1997/98 and 2001/02, consistent with a very strong economy during much of this period. However, with a weaker economy and with a changing undergraduate student body, the number of students on aid increased substantially in 2001/02. There was another large increase in the number of students on aid during the current fiscal year, and we expect to see an additional 110 students on aid in 2003/04. The additional students on aid will push up the expected cost of our need-based scholarship program by 6.7%. Appendix B (Schedules 6 and 7) includes supplemental information on undergraduate financial aid.

Graduate Aid – Stanford provides several kinds of financial support to graduate students totaling $262.1

Financial Aid Awarded to Undergraduates Who Receive Need-Based Scholarship Aid

[in millions of dollars]

Source of Aid	1998/99 Actual	1999/00 Actual	2000/01 Actual	2001/02 Actual	2002/03 Projected	2003/04 Budget
Restricted	19.0	20.2	25.9	26.5	28.1	28.8
Stanford Fund/Presidential funds	5.6	7.8	11.5	9.3	9.4	10.8
General Funds	12.4	7.9	4.6	10.3	14.0	15.5
Subtotal Stanford Funded Scholarship Aid	37.0	36.0	42.0	46.2	51.5	55.1
Govt. and Outside Awards	9.0	10.1	10.6	12.3	12.8	13.5
Total Undergraduate Scholarship Aid	46.0	46.0	52.6	58.5	64.3	68.6
General Funds as a Share of Total Aid	27%	17%	9%	18%	22%	23%
General Funds and Stanford Fund as a Share of Total Aid	39%	34%	31%	34%	36%	38%
Restricted funds as a Share of Total Aid	41%	44%	49%	45%	43.7%	41.9%
Number of Students	2,573	2,519	2,516	2,663	2,780	2,890

million in 2003/04. As the table on the previous page indicates, this includes the tuition component of fellowships in the amount of $55.5 million, which is reflected in the student financial aid line of the Consolidated Budget. It also includes funding, not shown in the student financial aid line of the budget, for stipends, tuition allowance, and research and teaching assistant (RA and TA) salaries of $206.6 million. Consistent with the presentation of Stanford's financial statements, tuition allowance (tuition benefits for RAs and TAs), and RA and TA salary expenses are in the Salaries and Benefits line, and the stipend amount is in the Other Operating Expense line of the Consolidated Budget for Operations on page 2.

The minimum rate for RA and TA salaries and stipends will increase by 3.0% in 2003/04; tuition allowance expense is expected to increase by 9.7%, the rate of increase for the 8-10 unit rate for graduate students.

Other Operating Expenses

This expense category includes all non-salary expenditures in the Consolidated Budget for Operations except financial aid, which is detailed separately above. The budget for these expenditures comprises one-third of the total expenses of the Consolidated Budget and is projected to increase by 3.1% to $763.5 million in 2003/04. The principal components include: materials and supplies ($138 million), administrative and professional services ($102 million), maintenance and utilities for campus buildings ($86 million), research subcontracts ($82 million), equipment purchases ($66 million), student stipends ($66 million), and travel ($32 million).

Maintenance and Utilities – Utilities costs continue to fluctuate. Although the unit cost of electricity is expected to remain flat in 2003/04, there is an increase in the budget for electricity that results from a 5% growth in consumption based on new buildings which will be activated next year. The unit cost of natural gas is undergoing significant fluctuation. The projected increase of 24% for 2003/04 offsets the 26% reduction in gas prices experienced in 2002/03, returning the prices close to 2001/02 levels. Again, overall consumption will be influenced by campus growth. Although a minor utility compared to electricity and natural gas, water prices are growing significantly. The San Francisco Public Utilities Commission staff is recommending a 25.7% increase in the wholesale price of domestic water, reflecting their continuing assessment of the need for increased maintenance on their aging delivery system.

Building maintenance budgets are increasing slightly as a result of the partial offset between increases for new buildings, and decreases resulting from significant budgets cuts. Facilities Operations budgets were cut

$2.5 million in 2002/03 and an additional $2.0 million for 2003/04. As a result, the absolute size of the budget is slightly higher, but resources per square foot are declining. Facilities Operations has identified service cuts in order to achieve the required budget reductions, but the appearance of the campus may suffer somewhat as a result of reduced services.

Debt Service – The 2003/04 internal debt service is projected to be $100 million, a $13.7 million increase over 2002/03. The university borrows funds from capital markets and uses the proceeds to fund capital projects and programs. These projects and programs are required to repay the funds plus interest over the life of the asset. These payments are known as internal debt service. Stanford is responsible for accumulating these funds for repayment to the external lenders. The rate charged to projects is calculated annually as a blended interest rate of all interest expense and bond issuance costs. The projected blended rate for 2003/04 is 5.65%.

The $100 million for total debt service is included in the Consolidated Budget for Operations in several fund types, depending on the specific uses of debt and consistent with the university annual financial statements format. Principal payments for academic projects are budgeted in the Transfer to Plant line and interest payments are budgeted in the Other Operating Expenses line.

Insurance Costs – Total expenses for property and general liability insurance programs are projected to be $13.8 million in 2003/04, up from $13.0 million in the current year. Both self-insurance and payment for external insurance premiums have increased in recent years, but external insurance premium costs are rising particularly rapidly, increasing from $2.7 million to $5.1 million over the two year period from 2001/02 to 2003/04.

The insurance industry's financial condition has been significantly weakened by the events of 9/11, the continuing weak economy, corporate scandals, and significant natural disasters. As a result, the insurance industry's capital has been depleted and their investment income is not sufficient to cover their extensive losses. All insurance customers, in both the academic and corporate sector, have seen a dramatic increase in rates for all purchased insurance, as well as forced reductions in coverage limits and increases in deductibles.

Stanford took steps in 2001/02 to review and modify its third party and self-insurance program to mitigate the effect on the budget of the increases in payments for external insurance premiums. We have taken preventative measures to reduce claims, improved our management of existing claims and settlements, increased our self-insurance coverage, and raised our deductibles and lowered coverage limits. However, 2002/03 third party insurance premiums still increased by 40% for liability and 67% for property insurance, and an additional increase of 20% for liability and 30% for property is projected for 2003/04. The reserves for self-insurance claims in 2003/04 are projected to remain relatively flat to current year projections. The workers compensation insurance program was modified to include a self-insurance component, which reduced the upfront costs. However, the required reserves for claims and additional compensation benefits required by the state have increased, thus offsetting and exceeding the upfront cost savings.

Administrative Systems – This Budget Plan includes $12.7 million for administrative systems replacement and infrastructure using marketplace solutions. The budgeted amount includes expenses for the final phase of the Oracle financial systems, enhancements to the PeopleSoft human resources system, creation of an enterprise data warehouse, and a variety of small projects necessary to complete the migration off of the mainframe. While the funding for these projects comes from a variety of sources in the Consolidated Budget, including general funds, Presidential funds, and university debt, the expenses are not reflected in the Consolidated Budget for Operations, but rather in the infrastructure section of the Capital Budget.

Transfers

Several adjustments and transfers are made to reflect accurately the net income available for operations.

- Additions to Endowed Equity: This line represents the net of transfers of unspent revenues from designated and restricted funds to funds functioning as endowment (FFE) and withdrawals from these endowment reserves. We expect a total of $6.0 million will be transferred to FFE in 2003/04, which is up from the 2001/02 actual of $2.0 million.
- Transfer to Plant/Student Loan: The vast majority of these funds will move to the plant division to be used for capital projects and repayment of debt. The total transfer to plant projected for next year, $90.5

million, is down compared to an expected transfer of $100.9 million in 2002/03 due to the need to make an additional transfer in the current year that should have been made in 2001/02 We are budgeting $25.0 million in general funds for academic facilities renovation and debt principal repayments. The academic units are budgeting $35 million from designated and restricted funds for a variety of capital projects. Another significant amount will come out of the auxiliaries, primarily Residential and Dining Enterprises as they undertake another year in the Capital Improvement Plan. Additionally, $2.1 million is expected to move to the student loan division, an amount comparable to previous years.

- Other Transfers: These are transfers between fund types within the Consolidated Budget for Operations. They include the transfer of Stanford lands rental income to the housing reserve and to R&DE to support faculty and graduate housing subsidies, the transfer of general funds revenue to support programs in the Alumni Association and Athletics, and other similar transfers. Because these transfers are made between fund types within the current division, the net is zero.

THE CONSOLIDATED BUDGET BY FUND TYPE

General Funds Budget

The general funds budget is an important subset of the Consolidated Budget because these funds can be used for any university purpose. The main sources of general funds are student income, indirect cost recovery, unrestricted expendable gifts, unrestricted endowment income, and income from the expendable funds pool. Total general funds revenue is projected to be $674 million in 2003/04.

Several factors have adversely impacted the 2003/04 general funds budget. Declining endowment payout and expendable funds pool income, along with reduced rental income, have kept general funds revenue from growing sufficiently to meet the requirements of the university. In addition, the university has significant existing incremental commitments to the general funds budget and a need to continue to fund ongoing one-time programs and essential new activities. As a result, Stanford faced a $25 million general funds deficit at the start of the 2003/04 budget process.

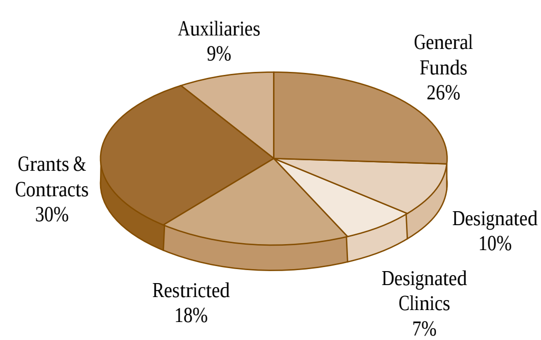
The university took several corrective actions to address the general funds shortfall, including increasing tuition above prior estimates, reassessing the Medical School's general funds formula, and freezing academic and staff salaries in 2003/04. While these actions improved the general funds bottom line by a total of about $19 million, the impact was offset by increased benefits costs and reductions in the projections of investment and rental income. The resulting projected deficit necessitated reductions to the general funds allocations to the units.

In response to a request by the Provost, the budget units proposed general funds cuts at 5%, 7.5% and 10% levels. On the heels of 5% budget reductions in 2002/03, units were doubly challenged to find budget solutions that would not adversely affect programs. In aggregate, the units presented hundreds of potential expense line item reductions, along with some revenue enhancements.

The Provost's Budget Group spent several months meeting with each budget unit, evaluating financial reports, fund balances, and proposed cuts. Unlike with last year's across the board reductions, the Budget Group made its decisions on a line-by-line basis. Throughout the process, a primary objective was to minimize the number of staff layoffs resulting from these cuts. The result of this comprehensive budget review was a $23.4 million decrease in general funds allocations and $2 million of central revenue enhancements.

A significant portion of the base budget cuts was necessary to fund $14.8 million of commitments made in prior years to cover critical incremental program initiatives, as well as to fund a handful of new base additions for 2003/04. The majority of prior base

2003/04 CONSOLIDATED EXPENSES BY FUND TYPE



SUMMARY OF 2003/04 GENERAL FUNDS REDUCTIONS AND ADDITIONS (EXCLUDING FORMULA UNITS)

[IN THOUSANDS OF DOLLARS]

	Reduction[1]	Central Revenue Enhancements[2]	Effective % GF Impact[3]	GF Commitments Prior[4]	GF Commitments New[5]	Total 2003/04 GF Allocation
School of Earth Sciences	228		7.5%	69	80	2,943
School of Education	476	216	7.1%		41	9,053
School of Engineering	1,367	1,377	7.1%		725	39,253
School of Humanities & Sciences	5,715		5.5%	874		98,651
School of Law	686		5.3%	123		12,461
Dean of Research	983		5.0%		286	20,336
Undergraduate Education	906		7.7%			10,804
Admissions & Financial Aid	250	180	5.5%	310	140	21,747
Stanford University Libraries	2,534		6.9%		275	34,234
Student Affairs	723	227	5.3%	72	140	17,322
Total Academic	13,868	2,000	6.1%	1,448	1,687	266,803
Office of the President & Provost	648		7.5%		250	8,232
Vice President for Public Affairs	387		7.6%			4,678
Business Affairs	1,749		4.6%	1,000	1,358	50,085
ITSS	2,418		6.3%		2,000	38,066
Development and Alumni Association	1,464		7.4%	1,360		19,795
Land & Buildings	1,944		5.6%			59,775
Other Administrative Units[6]	958		7.4%			11,921
Total Administrative	9,568		6.1%	2,360	3,608	192,552
Debt Service				6,406		29,412
O&M and Utilities on New Buildings				4,577		4,577
Central Obligations[7]						34,575
Total Other				10,983		68,564
Total All Units	23,436	2,000	6.1%	14,791	5,295	527,919

NOTES:

1 General funds allocation reductions.

2 Central general funds revenue enhancements accepted in lieu of further general funds reductions.

3 Reductions and central revenue enhancements as a percentage of applicable general funds base (excludes fixed costs such as financial aid, insurance, fire contract and utilities).

4 Previous incremental base allocations reflect commitments made prior to or separate from the 2003/04 budget process.

5 General funds allocation additions reflect commitments made during from the 2003/04 budget process, and are funds allocated for implementation of new ongoing academic or administrative programs, commencing in 2003/04.

6 Other administrative units includes general funds allocations for General Counsel, Procurement, SLAC, Athletics, Stanford University Press, and the Stanford Faculty Club.

7 Central obligations include tuition allowance, graduate student health insurance contribution, the systems reserve, and the university reserve.

commitments are for incremental debt and utilities and maintenance expenses related to capital projects. Debt service on capital projects is the largest component at $6.4 million. The general funds obligation for utilities and operations and maintenance expenses on new buildings is projected to be $4.6 million in 2003/04.

Not surprisingly, few new base general funds requests were granted for 2003/04. ITSS received allocations of $1.75 million for critical vendor software maintenance and $250,000 for e-commerce support. Some chronic one-time funding obligations were moved to general funds in 2003/04 to better reflect ongoing university costs, including $1.3 million for Office of Research Administration salaries and $250,000 for faculty development. The School of Engineering received $449,000 of additional funding for their new Bioengineering program and the Dean of Research was granted $286,000 to cover compliance costs. University Libraries received $275,000 toward the cost of continued development of CourseWork and the opening of the off-site library storage facility.

Academic units absorbed general funds reductions through a combination of continued belt tightening, service reductions, delays in planned purchases or program enhancements, improved efficiencies due to reorganization, enhanced revenues, and use of accumulated reserves. While drawing down reserves is not a viable long-term solution, many units will rely more heavily on fund balances to support operations in 2003/04 as they transition toward a more sustainable model going forward. Administrative support units, most of which have little flexibility with respect to revenue or reserves, relied primarily on restructuring and reducing the breadth or depth of services they provide.

In addition to expense reductions, some units were able to identify increased revenue opportunities. These came in two forms: revenues internal to the unit, and revenues that increase the central general funds pool. In the case of the latter, we recognized the additional revenue in lieu of requiring further general funds reductions.

The unit reductions are summarized below according to the strategies employed.

Central Revenue Enhancements – Both the School of Education and the School of Engineering will launch initiatives to increase the number of master's students by 13 and 63, respectively, which will increase central general funds tuition revenue for the university. Both schools will begin ramping up admissions in 2003/04, reaching their target student count by 2004/05. Incremental master's students will generate $1.6 million in general funds, net of school and university incremental administration costs. Admissions and Financial Aid will increase the undergraduate student application fee by $10, which will result in additional general funds revenue of about $180,000. In addition, Student Affairs will roll out several fee increases, including raising graduate application fees.

Local Revenue Enhancements – The School of Humanities and Sciences expects to generate more than $1 million of income from new endowed chairs. In addition, several units will either increase existing fees or institute new fees for services.

Restructured Funding Models – Several schools have restructured funding models so that school and department funds can be used to cover expenses formerly covered by general funds. An important example is the School of Humanities and Sciences' plan to fund student aid first with restricted funds before applying general funds. This will help the school to better utilize department fund balances while maintaining flexibility for the dean.

Service Reductions – Reductions in general funds allocations will result in the loss of some services in a variety of areas across campus. On the academic side, the Vice Provost for Undergraduate Education plans to reduce the scope of several programs, including research seminars, sophomore seminars, and sophomore college courses. Several of the schools' dean's offices will reduce staff, which will result in varying levels of reduced responsiveness to students and faculty. The Dean of Research plans to reduce Environmental Health and Safety staff. Staff hours in the libraries will be reduced, and a five percent cut in the library materials budget will result in a slightly smaller collection. Student Affairs will reduce the use of physician specialists at the Vaden Health Center two days a week in order to meet its reduction target.

Administrative units also plan to reduce the scope of some of their services. ITSS staff cuts will eliminate department technology assessments and academic research and development functions, as well as reduce property administration, training classes, technical consultants, and development of user software. There will also be a reduction in support to existing production systems. Office of Development staff cuts will result in some loss of university outreach. Land and Buildings will reduce the frequency of scheduled cleaning and maintenance and will perform fewer new studies. Business Affairs staff reductions will decrease the general responsiveness of central support units.

Organizational Restructuring – The School of Education will streamline the International Cooperative Education program and restructure the Administration & Policy Analysis master's program, both of which are not expected to impact programmatic integrity. The School of Engineering will eliminate the Scientific Computing and Computational Mathematics program.

Designated Funds Budget

Designated funds revenue is projected to be $344.5 million in 2003/04. Designated funds come into the university without any legal restriction as unrestricted revenues, but have been directed to particular units for specific purposes by management agreement. The schools, departments and programs, and individual faculty members control the majority of the funds in these budgets.

A major component of designated funds revenue comes from special program fees, including patents and royalties, corporate affiliate payments, and executive education programs. The other major component is $171.2 million for payments from the hospitals to the departments in the Medical School through the clinical practice. Another source of designated funds income is expendable funds pool payout on designated fund balances. Due to the current economic environment, the university anticipates only modest growth in the amount of income coming into designated funds.

Total expenses charged to designated funds are budgeted to be $390.3 million. Additionally, it is anticipated that $19 million of funds, primarily general funds, will be transferred into the designated funds budget. It is important to note that this is a net figure, with $35.0 million of designated funds (primarily existing fund balances) transferred to funds functioning as endowment and to cover plant projects. It is anticipated that $54.0 million of funds, primarily general funds and endowment income, will be transferred to designated funds. The $26.8 million designated funds deficit primarily represents a planned use of the university's substantial designated fund balances for capital projects and to offset the immediate impact of revenue reductions.

In the 2003/04 Consolidated Budget, two significant changes impact the designated funds budget:

Designated Funds, Clinical – To recognize more appropriately the sources of funding and align with other similar activities in the institution, the clinical activities of the School of Medicine will be recorded in designated funds. Prior to 2003/04, they have been budgeted and reported as an auxiliary activity. Designated-clinical funds include three components:

- The clinical practice at Stanford Hospital and Clinics and at Lucile Packard Children's Hospital, ($124.7 million),
- Service payments and academic clinical funding from SHC and LPCH ($46.5 million), and
- A transfer from the dean's office of $3.0 million to help fund a portion of the academic clinical fund that the hospitals are not funding in the next year.

Nearly 69% of the expenses are for faculty or physician salaries and benefits; another 22% are for staff expense. Non-salary expense in support of the physician's clinical activities totals almost $15 million, including the dean's tax of approximately $10.2 million.

An aggregate surplus of $12 million is projected in 2003/04 and reflects the combination of the surplus generated by a number of the clinical departments less the deficits generated by others. Thus, while some departments will see a net transfer to their executive funds at the end of the year, some departments will need to cover the deficits using their own reserves.

Significant progress has been made this year in working with the two hospitals to identify and begin to develop areas of strategic importance for all components of the Medical Center. A new funds flow approach, including the academic clinical fund, has been designed that attempts to more closely align the mission of the school with that of SHC and to support the school in a manner that is consistent, fair, and transparent. The school and LPCH expect to go through a similar process during this next year. This joint focus and development should help to strengthen the financial situation of all three entities as well as the clinical and teaching programs of the clinical departments.

Alumni Association – As with the clinical activities, in 2003/04 the activities of the Alumni Association will be represented in the designated funds budget. This will allow for consistent treatment of its activities with similar alumni relations activities in other parts of the university. Approximately $32 million of activity which previously has shown up as auxiliary activity, since the incorporation of the Stanford Alumni Association into the university in 1998/99, is reflected in the designated funds budget. Only the merchandising activities of the Alumni Association, approximately $1 million in revenue, remain as auxiliary activities.

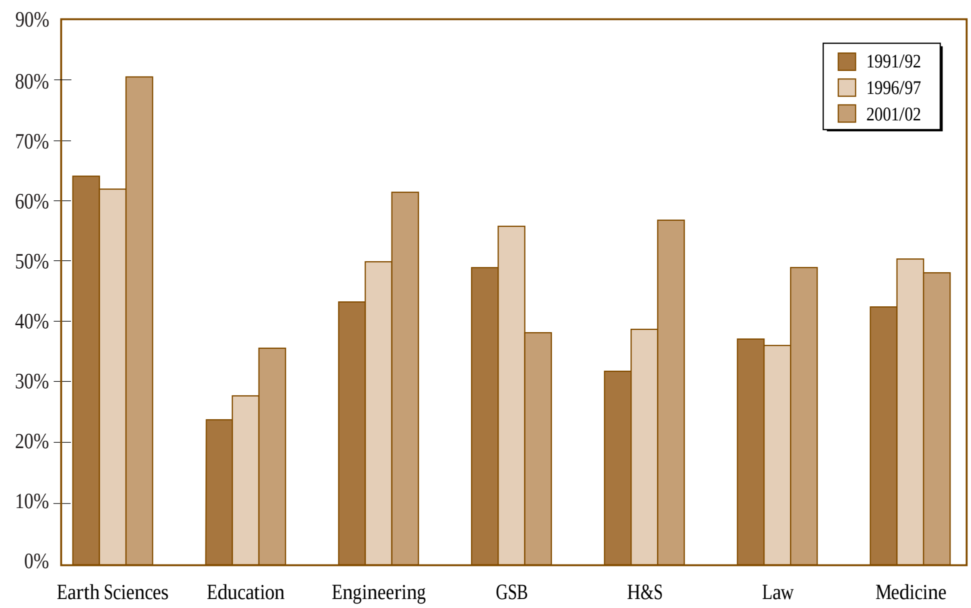
Restricted Funds Budget

Restricted funds represent income, transfers, and expense for both restricted expendable funds and restricted endowment income funds. Together, revenue for these funds is projected to be $450.9 million in 2003/04. Of this amount, $90.8 million will be used to cover financial aid, which in the financial statements shows as a deduction from student income. Of the $450.9 million total, $297.7 million is from endowment income, and $153.2 million is from expendable gifts, payments on prior pledges, and other sources of income, primarily expendable funds pool payout on existing fund balances. A total of $33.4 million of endowment income and expendable gift funds is expected to be transferred to other funds, including plant and designated funds. Total expenses are budgeted at $414.9 million, resulting in a net of $2.6 million.

The schools, which control nearly two-thirds of the university's total expendable (designated and restricted) fund balances, have historically generated more restricted revenue than can be spent in each year, resulting in significant growth in fund balances. Some of the annual revenue is not used because the terms of the funds are so restrictive as to preclude their use. Efforts continue to review and possibly ease the restrictiveness of some funds as well as to split some large endowed chair funds, which generate much more income than can be used to cover a single faculty member's salary and benefits, to allow them to support more than one faculty member.

It is regular practice to reserve designated and restricted revenue to pay for planned capital projects or other large purchases, to cover potential shortfalls in sponsored research funding, to supplement existing research funding, and to provide student support that cannot be met from other funding sources. Because of the significant revenue reductions in 2003/04, it is expected that units will tap into these accumulated fund balances to cover anticipated deficits. Given the continuing pressure on general funds, it is critical for the institution to find ways of utilizing accumulated restricted fund balances more effectively and to substitute the use of general funds with restricted funds. Schedule 17 in Appendix B shows the academic area fund balances by unit. The chart below shows expendable fund balances as a percentage of each school's net revenues over the past decade.

Expendable Fund Balances as a Percent of Net Revenues[1]



[1] This graph represents year-end balances in designated, expendable gift, and unspent endowment income funds.

Grants and Contracts Budget

The grants and contracts budget for 2003/04 of $728.9 million represents $505.9 million of direct sponsored activity under the oversight of individual faculty principal investigators and $223.0 million in direct costs for SLAC. The total includes $8.9 million of student aid. The university direct cost totals are formulated based upon the projected year-end results for 2002/03 and through consultations with individual research areas. Total university research volume is expected to grow by 6.5% in 2003/04. This growth rate, more moderate than in the past, reflects a projected slowdown in government research support, particularly by the National Institutes of Health. As well, the 2003/04 budget incorporates a decrease of over $7 million of direct expenditures related to Gravity Probe B, projected to launch in 2003/04 (most of these costs were subcontracted outside the university) and a decrease in NIH support for the SPEAR3 facility in SLAC.

Auxiliary Activities

Auxiliary operations are self-contained financial entities supporting the broader purposes of the university, generating significant amounts of revenue from non-university funding sources. As such, these organizations charge both internal and external clients/customers for their services and programs. They also pay the university for central services provided. Together the auxiliaries are projecting a surplus of $1.3 million in 2003/04, including net transfers of $18.9 million to other funds, primarily to reflect the retirement of debt principal by the auxiliaries and service centers. Additionally, we are projecting that the administrative service centers of the university (principally Communications Services and Utilities) will receive $20.0 million in reimbursement from the hospitals, recognized in the Consolidated Budget as an external revenue stream on the Health Care Services line.

The principal auxiliary activities of the university are the Athletics department, the Blood Center, HighWire Press, Residential and Dining Enterprises, the Stanford West/Welch Road Apartments, and the Stanford University Press. Two other entities, the Stanford Alumni Association and the Medical School clinical practice, previously were treated as auxiliary enterprises. As mentioned above, starting in 2003/04, however, these entities are incorporated into the other components of the Consolidated Budget to better reflect their alignment with similar academic and administrative activities occurring throughout the university. In addition, there are several other small auxiliary enterprises, such as the Residential Subdivisions, the Bing Nursery School, the Stanford-In-Washington and Overseas Studies campus residences, and the Schwab Residential Center. Detailed budgets may be found in Appendix A.

Athletics – Athletics is projecting a balanced consolidated budget in 2003/04. Operating income will grow by less than 2% from 2002/03, inclusive of a 7.5% reduction in university support. Due to a more favorable home schedule, there will be an increase in football gate receipts of about $200,000. Athletics also expects small increases in Golf Course, Summer Camp, and restricted funds income. After experiencing a sizeable increase last season due to the new CBS NCAA Basketball contract, income from the NCAA and Pacific 10 Conference will essentially remain flat in 2003/04.

With the exception of contractual commitments, Athletics will hold salaries flat in 2003/04, consistent with the university's salary plan, although total compensation will rise gradually due to the increase in the fringe benefits rate. The department will make budget reductions in several operational and marketing areas, although no reductions will be made to sport programs, physical education & recreation programs, or programs affecting the well-being of student-athletes.

The total number of full scholarships, for which commitments are made well in advance, increases from 299 in 2002/03 to 305 in 2003/04. Even with the success of Athletics' Campaign for Undergraduate Education fundraising, the slowed rate of endowment payout, combined with increased scholarships and tuition, room, and board costs, may cause 2003/04 financial aid expenses to exceed financial aid income. In that case, Athletics will draw upon its financial aid reserves to cover any resulting gap.

Blood Center – The Blood Center is projecting a balanced budget for 2003/04. The Blood Center continues to function as an auxiliary since it provides blood products and services to other medical and research facilities in the community as well as to the Stanford Hospital and Clinics and Lucile Packard Children's Hospital. The revenue budget for the Blood Center for 2003/04 is expected to total approximately $19.1 million and is anticipated to cover expense. Approximately 64% of the expense is related to salaries and benefits while the remainder is related to

Total Auxiliary Activities, 2003/04

[in millions of dollars]

	Revenues and Transfers	Expenses	Surplus/ (Deficit)
Athletics[1]	38.2	38.2	
Blood Center	19.1	19.1	
Highwire Press & Media Solutions	17.5	17.5	
Residential & Dining Enterprises	100.3	100.3	
Stanford West/Welch Road	14.9	12.7	2.2
University Press	5.7	6.9	(1.2)
Net Service Center Activity[2]	20.0	20.0	
Other	14.3	13.9	0.3
Total[3]	230.0	228.7	1.3

Notes:

1 Financial Aid activity is not included.

2 University Communications and Utilities services to the hospitals and other outside entities.

3 This table represents gross revenues and expenditures. When incorporated into the Consolidated Budget on page 2, interdepartmental transactions of $25 million have been netted out.

the other direct costs, including supplies, utilities, and operations of running the Center.

HighWire Press – HighWire Press is projecting a balanced budget after a transfer of $350,000 to support the operations of the Stanford University Libraries and Academic Information Resources area. HighWire will continue its industry-leading Internet publishing service for high quality, frequently cited, and prominent scholarly journals. By careful control of costs, use of more efficient software (most of it being developed in-house), and related efficiencies, HighWire will reduce its prices to client publishers. Several important new publishers and their titles are scheduled to become clients in 2003/04. With these process developments, HighWire will protect its client base against quasi-competitors offering loss-leader pricing, but this year it will not be able to provide a contribution to its capital or operating reserves.

Residential and Dining Enterprises – Residential and Dining Enterprises (R&DE) is projecting for 2003/04 total revenues of $110.4 million. R&DE will use $181,000 from their reserves in order to finance the debt associated with the Capital Improvement Program (CIP) for renovations of housing and dining facilities. 2003/04 is the 12th year of the $420 million, 19 year CIP plan. Major projects during 2003/04 include seismic retrofitting in Escondido Village and Florence Moore Hall.

Several enterprise-wide revenue enhancements have been identified to strengthen the bottom line. These enhancements include summer storage services for students and miscellaneous housing and dining initiatives. Additionally, R&DE will realize other increased revenues from the re-opening of the newly renovated Branner Hall residences and kitchen and the first full year of operations for both the SLAC Guest House and the Clark Center Restaurant and Café, which will be the largest retail operation on campus and is the latest in a series of new Stanford Dining enterprises, preceded by The Café at Arrillaga Alumni Center and Olives @ Building 160.

In addition to absorbing the higher than anticipated university costs associated with fringe benefits, debt service, and property and liability insurance, R&DE will replace the current housing assignment system that resides on the mainframe, and continue to build an asset preservation program which will annually fund building infrastructure renewal. These programs will be funded through modest room and board rate increases, operating budget expense reductions, as well as from the revenue enhancements noted above.

Stanford West/Welch Road Apartments – Due to softening in the local rental market, the Faculty/Staff Housing Office is planning a 5% reduction in rental rates for the Stanford West Apartments in an attempt to maintain occupancy at the current 95% level. Even so, Stanford West projects a surplus for 2003/04 of $2 million. There are no plans to adjust the rents at the Welch Road Apartments because they are currently below market and occupancy continues to run at about 98%. Welch Road projects a surplus of $150,000 for 2003/04. The surpluses for both of these auxiliaries will be added to capital reserves. With the addition of the 2003/04 surplus for Stanford West Apartments, there are plans for a major capital improvement program, installing air conditioning in the rental units. The university currently is using the capital reserves for the Welch Road Apartments to cover depreciation expenses of its various rental properties.

University Press – In 2003/04 the Stanford University Press will complete the third full year of its long range plan to publish works of outstanding scholarship while, at the same time, reducing its financial reliance on the university. In doing so, the Press is projecting a deficit of $1.2 million for 2003/04.

So far, the Press has managed to implement its long range plan within the confines of the investment program established by the university, but this has not been achieved without difficulty. Market conditions since the fall of 2001 have been very harsh for all publishers of serious works, and for scholarly presses in particular. The 2003/04 budget assumes that these conditions will continue, keeping wholesale, retail, and library sales fairly flat; hence, revenue expectations are conservative (4% growth), despite the planned publication of about 80 titles in the established humanities and Asian studies programs, and about 50 titles in the newer social science, law, and business programs. In order to maximize the return on this revenue, the Press will continue its program of cost management – a program that has significantly reduced both cost of goods sold and operating costs.

The Press enters the year with an outstanding program, a committed staff, new distribution and sales partners around the world, and with contracts for some 400 titles to be released over the next four to five years. Consequently, it is well positioned to weather the current storms in the marketplace and emerge stronger, when economic conditions improve, with a publishing program that reflects many of the academic strengths of Stanford University.

The Consolidated Budget by Organizational Unit

The table on page 19 shows the Consolidated Budget for Operations displayed by organizational unit. Detailed consolidated budgets by unit are found in Appendix A. A brief discussion of selected unit follows.

Graduate School of Business

The Graduate School of Business (GSB) projects a deficit of $1.3 million for 2003/04, reflecting a decrease in designated fund balances. For 2003/04, the GSB plans several revenue enhancements while keeping operating expenses relatively flat compared to the current year.

A concerted fundraising effort has begun to support faculty (especially junior faculty), to support the school's research centers, and to provide fellowship support for MBA and PhD Programs. At the same time, the GSB has increased tuition, increased rents at the Schwab Residential Center, and raised prices on most executive education programs.

Plans are underway to keep the operating budget flat, which includes absorbing large increases in benefits rates and investments in two new research initiatives. This will be achieved through adopting the 2003/04 salary program for faculty and staff, reductions to information technology infrastructure and web service projects, and targeted reductions to most department budgets. The school expects the budget for student services will be the least affected by these budget reductions. If successful, these actions will eliminate the school's operating deficit completely by 2004/05 while maintaining its position at the top of its peer institutions.

School of Earth Sciences

The School of Earth Sciences projects a deficit of $177,000 on revenues and transfers of $28.4 million. The deficit will be the result of increased reliance on school endowment and gift funds, coupled with a projected 2% reduction in endowment income. This will result in the use of school reserves to support 2003/04 expenses. The school is also projecting a smaller than average surplus in designated funds due to a weak economy and the decline in corporate affiliate programs. The school's consolidated budget is heavily dependent on non-general funds; for 2003/04 only 11% of total expenses are supported by general funds, although this is up from 9% for 2002/03. Endowment income (38.5%) and grants and contracts (30%) make up the bulk of the support for the school.

The school's budget reduction plan includes cuts in teaching support, departmental support, reduced funding for research faculty, and deferral of financial commitments such as increases in faculty salaries. Cautious investments will be made in the areas of scientific equipment, as well as faculty recruitment and start-up packages. With a significant number of faculty retirements on the horizon, the school anticipates a draw on both expendable and endowment reserves over the next few years to support new faculty start-up costs. School reserves intended to support these expenses have been built up for just such a purpose.

Projected Consolidated Budget for Operations by Unit, 2003/04

[in millions of dollars]

	Total Revenues and Transfers	Total Expenses	Surplus/ (Deficit)
Academic Units:			
Graduate School of Business[1,2]	91.1	92.3	(1.3)
School of Earth Sciences	28.4	28.6	(0.2)
School of Education	29.2	28.4	0.8
School of Engineering	200.6	195.2	5.4
Hoover Institution	31.9	31.9	
School of Humanities & Sciences[1]	236.2	243.8	(7.6)
School of Law	34.0	34.0	
School of Medicine[1,2]	724.5	756.5	(32.0)
Dean of Research	129.5	132.3	(2.8)
Undergraduate Education	18.7	20.8	(2.1)
Total Academic Units	1,524.1	1,563.8	(39.7)
Academic Support Units:			
Admissions (excluding financial aid)	6.0	6.0	
Stanford University Libraries	46.6	48.1	(1.5)
Student Affairs	27.5	28.0	(0.5)
Total Academic Support Units	80.1	82.1	(2.0)
Total Administrative	428.4	427.1	1.2
Auxiliary Activities	205.1	203.7	1.3
SLAC	223.0	223.0	
Indirect Cost Adjustment[3]	(156.7)	(156.7)	
Grand Total from Units	2,303.9	2,343.0	(39.1)
Other Anticipated Income[4]	20.1		20.1
Total Consolidated Budget	2,324.0	2,343.0	(19.0)

Notes:

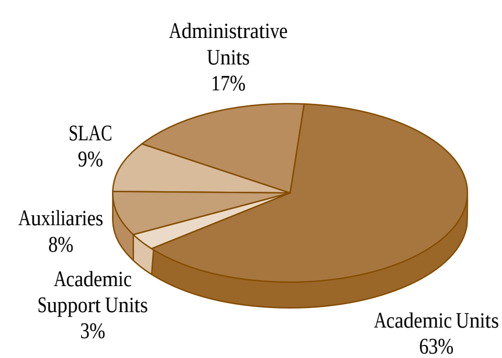
1 The budget lines for the School of Medicine, Graduate School of Business, and H&S do not include auxiliary revenues and expenses. These items are shown in the Auxiliary Activities line. These auxiliary operations include the Medical School Blood Center, the Schwab Center of the GSB, and Overseas Studies, Stanford In Washington, and Bing Nursery School in H&S. These auxiliary activities are shown in more detail in the schools' Consolidated Forecasts in Appendix A.

2 This budget reflects a direct allocation of tuition revenue in those units operating under a formula funding arrangement.

3 The academic unit budgets include both direct and indirect sponsored income and expenditures. Indirect cost funding passes through the schools and is transferred to the university as expenditures occur. At that point, indirect cost recovery becomes part of unrestricted income for the university. In order not to double count, indirect cost recovery of $156.7 million received by the schools is taken out in the "Indirect Cost Adjustment" line.

4 The $20.1 million shown in Other Anticipated Income is based on historical experience and reflects the expectation that the university will receive additional unrestricted and/or restricted income that cannot be specifically identified by unit at this time.

2003/04 Consolidated Expenses by Unit



School of Education

The School of Education projects a surplus of $786,000 on revenues and transfers of $29.2 million. The surplus results primarily from new expendable gift funds related to the John Gardner Center that will be spent over the coming years. Other surplus funds represent unused restricted endowment income funds. The school will increase revenues by increasing the number of master's students and by raising new restricted funds.

To meet budget reductions the school will restructure and streamline master's programs, modify the faculty administrative support model, restrict visiting faculty appointments, limit facilities projects, and reduce non-salary expenses.

School of Engineering

The School of Engineering projects a surplus of $5.4 million in 2003/04 on expected revenues of $201 million. Total revenue and expenses in non-sponsored areas will be approximately the same as in 2002/03. Grants and contracts are expected to grow by approximately $7 million from the 2002/03 projected total of $88 million, around 8%. Much of this growth reflects the addition this year of the Global Climate and Energy Project (G-CEP), an Independent Laboratory managed administratively by the School of Engineering.

The School of Engineering has approached its budget reductions with the goal of protecting the ability of its departments to effectively deliver their academic programs. As a result, most of the school's planned reductions are within the dean's office. Some positions have been trimmed or eliminated, general expenses have been reduced, and new charges will be made for currently free services. In addition, revenue-generating units have been challenged to increase the net support they provide to departments.

These plans, however, were not sufficient to meet the school's budget targets. As a result, Engineering proposed to increase its base master's enrollment by 63 students from the 2002/03 level. The model proposed by the School of Engineering provides support for the university's central services as well as support for the academic program delivered by engineering departments for these incremental students. The additional tuition revenue, net of central and local program support, will be used to meet the school's budget target.

Hoover Institution

Continued success in annual fundraising and sound management of expenditures has allowed the Hoover Institution to generate a series of annual budget surpluses over the past eight years and to build a reserve fund. The budget outlook for 2003/04 and the future calls for balanced budgets.

The Hoover Institution has participated in the university's program of cutbacks in general funds and has trimmed its budget accordingly. Although the Hoover Institution is on solid financial footing, it is cognizant of the uncertain economic situation the university and Hoover is facing. Consequently, Hoover has developed a contingency plan to reduce its annual base budget expenditures by $2 million over a two-year period—this represents a budget reduction of more than 6%. The cuts will be accomplished by a smooth reduction in staff through attrition and some curtailment of programs in all areas: research, library and archives, and communications and outreach.

School of Humanities & Sciences

The School of Humanities and Sciences (H&S) is projecting a $7.6 million deficit for 2003/04, reflecting operational funding problems and investments of accumulated fund balances in one-time facilities expenditures. The deficit, funded by H&S reserves, includes:

- Approximately $2 million of investments in critical information technology and basic infrastructure,
- Activation costs associated with the Clark Center and Lokey Laboratory totaling $1 million, and
- Renovations for faculty labs and department facilities using $2.5 million.

New models for funding operating budgets are currently being implemented, resulting in a more effective use of department-controlled funds and eliminating large accumulated balances during the next three years. Consequently, additional reserves will be available to the dean's office for this period to fund annual operating deficits, infrastructure and facilities needs. Longer-term, the school will have to move to a financial plan in equilibrium, eliminating annual deficits and strictly matching on-going expenditures with on-going funding sources.

Fiscal year 2003/04 will be the second year of new initiatives which implement financial management improvements in H&S and respond to university funding reductions. Planning for 2002/03 incorporated $4.2 million of base and one-time funding reductions, offset by some incremental base funding in targeted areas. For 2003/04, planning incorporates $5.7 million of additional base funding reductions. Efforts in both of these years have focused on maximizing the use of existing funding sources in order to preserve academic programming and the faculty recruitment plan, while making critical investments in infrastructure and facilities. Funding for certain discretionary expenditures will be reduced across the school while additional targeted cuts will be made in selected programs.

In addition to reduction and reallocation strategies, revenue enhancements have also been incorporated into financial projections. New endowed chairs matched by Hewlett gift funds are projected to add $1 million of revenue in 2003/04 with larger amounts in future years as pledges are paid. Significant amounts of additional gifts are projected to come into H&S from the Hewlett gift and matches, and from the CUE Campaign, but the timing will be over a longer period than previously reported.

School of Law

The Law School is projecting a small deficit of $30,000 for 2003/04. One-time surplus funds generated by cost savings and empty faculty billets will be used to continue renovations to the Crown Quad building and Law Library and replenish funds borrowed from funds functioning as endowment. Law will also continue drawing down expendable gifts that have been raised during past years to fund start-up programs and clinics.

To meet the budget reduction goal of $686,000 the Law School will eliminate its COO position, reduce the number of books and subscriptions purchased, reduce library staff, eliminate five positions in its external relations office, reduce the information technology staff, and decrease event spending. These reductions will be met mostly through attrition. The impact of these cuts will be felt throughout the Law School; services to students and faculty will be cut back. Using funds originally earmarked for program expenses such as conferences and research projects to cover visiting faculty and research leaves, now covered with unrestricted funds, will reduce the research efforts of Law School faculty.

School of Medicine

In 2003/04 the School of Medicine is projecting a $32 million deficit for the following reasons:

- Expenses are projected to increase 9.5% over the budget plan for 2003/03, while revenues are increasing only 4.9%.
- The net result of the new formula is a payment from the school to the Provost's Office of approximately $42.1 million in 2003/04, an increase of approximately $7.0 million from the methodology of the former formula.
- The school plans to transfer $5 million of designated funds to funds-functioning-as-endowment and an additional $15 million of designated funds to cover plant-related expenses.

This results in a planned use of expendable reserves held by the dean's office and by individual departments within the school of $11.2 million in 2003/04 to cover expenses and an additional $20.8 million to be transferred to endowment and to plant. As mentioned above, over the past year the school and the Provost's Office have revised the formula by which the school pays for the services provided by the central university. This is a significant factor in the unfavorable discrepancy between revenue and expenses.

The dean's office and departments have accumulated reserves to use for program and facilities development. The school has always anticipated drawing down a portion of its reserves at the appropriate time for strategic development and investment and is now planning to do so in 2003/04.

Revenue Growth – The increase in revenues, before transfers, over the 2002/03 Consolidated Budget Plan is 7.8%. As noted above, this slowing of revenue growth is related to:

- A decrease in endowment market value and yield resulting in a decrease in net payout,
- A decrease in gifts received thus far in 2002/03 leading to reduced expectations for new gift revenue in 2003/04, and
- A slower rate of growth of sponsored project activity, which has been quite rapid in recent years.

Year-end projections for 2002/03 show sponsored activities approximately 9.2% higher than year-end 2001/02, and the school's 2003/04 budget anticipates an increase of approximately 5.6%.

Expense Growth – The consolidated plan assumes that the school will recruit approximately 22 tenure line faculty and 16 incremental medical center line faculty during 2003/04. The expenses related to faculty recruitment, including program support and staff, are included in the Consolidated Budget Plan. The faculty and associated staff salary and benefits alone total approximately $17.5 million. This anticipated increase in faculty, when added to changes in compensation and in benefits rates, accounts for approximately $40.9 million or 61% of the total increase in expenses. The increased cost of benefits for both new and current faculty and staff of $18.8 million makes up approximately 46% of the increase in total salaries and benefits. Approximately $3 million is related to the tuition allowance for graduate students in the benefits total while almost $13 million is related to the increase in the cost of benefits for faculty and staff who are currently here.

Non-salary expenditures on sponsored projects, both direct and indirect, account for another $21.3 million or 32% of the anticipated increase in expenses in the 2003/04 budget. In addition, approximately $4.5 million or 6.7% in non-salary expenditures has been planned for investments in strategic initiatives and interdisciplinary program under development, the increase in the school's portion of Clark Center operating costs and to support the transition to the new operating budget algorithm in the school.

Transfers to Plant and Endowment – The 2003/04 budget continues to reflect the need to complete planned maintenance activities that had been deferred in anticipation of the renovation of the Main Medical Center building, which was canceled two years ago. It also reflects the need to fund the planning expenses for the more focused project that replaced that renovation, the Stanford Medicine Instruction and Learning Environment (SMILE). These two components make up about $6.5 million or approximately 42% of the transfers to plant. The remaining transfers to plant include an estimated $2.5 million to build out the laboratories in the Clark Center that will be occupied by School of Medicine faculty or the new joint Department of Bioengineering, as well as $2.0 million for ongoing planned maintenance, and approximately $4.5 million for other small, but essential projects. Transfers to endowment have been made in recent years by clinical departments with surpluses and basic science departments with accumulated reserves as a mechanism to earn some return on the funds while holding them for future investments in new faculty or programs. The school has implemented a new policy to encourage the development of departmental reserves for emergencies and for academic development. The emergency reserves will be held in the endowment and the projected transfers in 2003/04 reflect the creation of some of these emergency reserves as well as the ongoing transfers for those departments with surpluses or accumulated current reserves.

Dean of Research

The Office of the Vice Provost and Dean of Research and Graduate Policy projects a consolidated budget deficit of $2.8 million. About half of this deficit is related to endowment income funding shortfalls for the Stanford Graduate Fellowship (SGF) program. To address the funding problem, the Dean of Research has reserved $1 million for anticipated SGF need. In addition, the number of new fellowships to begin in 2003/04 will be reduced from 110 to 80. The remainder of the deficit is due to commitments that are spread over several years and the increasing need to use restricted fund reserves for on-going program support. The anticipated space launch of Gravity Probe B in 2003/04 should result in a significant decrease in total research expenditures, along with an equal decrease in recovered revenues.

Vice Provost for Undergraduate Education

The Vice Provost for Undergraduate Education (VPUE) projects a budget deficit for 2003/04 of just over $2 million, to be covered by existing fund balances. Drawing down these balances will limit flexibility to address future budget contingencies, which are anticipated as long as the endowment income shortfalls persist. In addition, by 2004/05 VPUE will have exhausted its largest expendable gift, which is forecast to support 11% of total expenditures in 2003/04. Offsetting this lost revenue in 2004/05 would fully expend remaining fund balances.

VPUE began implementing substantial undergraduate education initiatives in 1994/95. These initiatives have been supported through a combination of term funding sources, with the long-term goal of permanent funding through base general funds increments and new endowment gifts from the Campaign for Undergraduate Education (CUE). While base funding for VPUE has increased through CUE gifts and base general funds increments, a significant gap remains between the ongoing cost of the undergraduate programs and base permanent funding. This gap constitutes 37% of total forecasted 2003/04 expenditures.

The unpredictable revenue stream from CUE complicates closing this budget gap in 2003/04. Even though CUE donor pledge payments have exceeded earlier budget forecasts, actual incremental revenue from CUE gifts has fallen significantly short of forecasts because of the endowment performance and the resulting endowment income shortfalls. In 2003/04, 75% of the total market value of VPUE endowments is forecast to be invested in endowment funds subject to income shortfall, effectively halving the endowment payouts, decreasing anticipated revenue by $2.1 million. To offset the endowment income shortfalls, the VPUE budget plan increases the allocation of accumulated restricted fund balances, resulting in a projected fund balance decline of 25%.

As in 2002/03, VPUE proposes expenditure reductions from existing programs that exceed the mandated base general funds reduction of $906,000. These additional reductions permit VPUE to reallocate funds internally to support innovations which, though few in number, are important and substantive, affecting all undergraduates through investments in the writing and undergraduate research programs.

While the short-term financial context presents significant challenges, long-term forecasts project that, by the conclusion of CUE and the end of endowment income shortfalls, VPUE will achieve permanent endowment and general funds support for its consolidated budget.

Stanford University Libraries/Academic Information Resources

SUL/AIR is projecting a deficit of almost $1.5 million for 2003/04, using accumulated reserves to cover the shortfall. The budget for 2003/04 was reduced by about $2.5 million, or 7.5%, from 2002/03. This year's level of reduction means that there will be some staff layoffs, perhaps as many as 25. Taken with the last year's staff cuts of 17 people, the cumulative effects on service to faculty and students will be noticeable. For the most part, this round of staff cuts will be achieved without sacrificing the core expertise embedded in the bibliographic, processing, public services, conservation, and academic computing departments, although the community will experience reductions or slowdowns in all these services.

The Academic Technology Specialist program, which serves many departments and schools, will be reduced in scope. It is expected that such shifting of costs will result in reduced rates of adoption of CourseWork, the popular innovative course management system, despite its obvious values and efficiencies compared to more costly and less responsive commercial competitor systems. Spending in the area of equipment, maintenance, and services will be reduced concomitantly.

Vice Provost for Student Affairs

The Vice Provost for Student affairs (VPSA) projects a deficit of $479,000 for 2003/04, to be funded by existing reserves. The division's unrestricted reserves will be used again in 2003/04 to support staffing in Judicial Affairs and other initiatives. Multi-year expendable gifts from prior years will be used to support gift-related initiatives. During 2002/03, VPSA will draw down approximately $460,000 of designated fund balances to fund the lag in cash flow to Vaden Health Center following the restructuring of the student insurance program; initiatives in Judicial Affairs; the new Dean of Freshman and Transfer Students; and a portion of the division's return of general funds to the university. This reduction in designated fund balances will be partially offset by increases in endowment income fund balances due to professorship income that will be used over multiple years. To meet the general funds reduction goals for 2003/04, the division will increase several fees for graduate applicants and students, and will implement new fees for travel health advice and late registration changes. VPSA will also restructure positions, including reducing or eliminating several positions, reducing the annual addition to capital reserves for Tresidder, and cutting back non-salary expenses in several areas.

VPSA is largely funded by general funds, with most of the rest of the funding coming from revenues and fees related to student health, support from student room revenues for residential education programs, endowment income and gifts, and fees for such activities as new student orientation. The rate of inflation in medical costs currently exceeds the overall rate of inflation used to develop the budget, with the result that Vaden Health Center anticipates an operating budget deficit of approximately $80,000. The impact of this potential shortfall in funding on the financial condition of Vaden Health Center will be carefully monitored.

The 2003/04 consolidated budget includes $140,000 in increased base general funds to support programs in the six community centers. It replaces $150,000 of support provided as one-time funds for the past several years. This commitment of base funding sends a strong message to students, staff, faculty, and alumni that the university is committed to the centers, even in this difficult economic climate. One-time commitments to graduate student programs and staffing have been renewed for another year, as has support for an intensive summer orientation for Native American students.

Due to reductions in one-time funding, support for classrooms and classroom technology maintenance and renewal will be reduced significantly in 2003/04. If after next year the support for the classrooms and classroom technology cannot be increased to at least the previous levels, the number of classrooms equipped with technology will have to be reduced in order to adequately support the remaining classrooms.

Stanford Linear Accelerator Center

Total direct costs in 2003/04 for SLAC are expected to be lower than 2002/03, primarily because of the expected completion of the SPEAR3 project in October 2003; the budget for SLAC will be balanced. The SPEAR3 project, which upgrades SPEAR—the existing synchrotron radiation facility of the Stanford Synchotron Radiation Lab—is jointly funded by the Department of Energy (DOE) and the National Institutes for Health. SPEAR3 costs were about $16 million in 2001/02; they are expected to be $18 million in 2002/03 and $5 million (DOE only) in 2003/04. In 2003/04, other sponsored direct costs will return to the pre-SPEAR3 level.

SLAC projects the total salary expense to be level between 2002/03 and 2003/04, in part due to the university's salary freeze. The actual budget in 2002/03 for High Energy Physics (HEP) is $5 million less than for 2001/02, and much lower than what was requested. Therefore, in addition to cutbacks in all the HEP program elements in the current year, SLAC has to rely on three staff-related cost saving measures as well. A voluntary layoff program was initiated and 40 staff participated in the program; all staff funded by the HEP program will take four days leave without pay during the week of July 4th; and all HEP-funded staff will take vacation during 2002/03 equal to at least the vacation earned during that year.

SLAC's next big construction project will be funded by DOE. DOE still provides most of the funding for SLAC, although in recent years SLAC has been involved in interagency projects such as SPEAR3 and GLAST. Congress has recently approved the construction of the Linac Coherent Light Source (LCLS) project that will also utilize the linear accelerator at SLAC. LCLS will build the world's first x-ray free electron laser, a fourth generation x-ray light source. The total estimated cost for the project is $200 to $240 million and 2002/03 is the start of the design phase. In 2002/03, funding for design is $6 million, and in 2003/04 and 2004/05, $7.5 million and $20 million are expected respectively. Construction is expected in 2005/06 through 2007/08.

Stanford Alumni Association

The Stanford Alumni Association (SAA) is projecting a deficit of approximately $2 million for 2003/04. University funding in 2003/04 will decrease by approximately $900,000 compared to 2002/03. In addition, due to the uncertain political and economic environment, SAA is also projecting a large decrease in its net revenues generated from its travel/study programs. Consequently, SAA will decrease significantly the costs of both programs and staff to balance its budget with revenues of $32.7 million. Despite these program and staff cutbacks, SAA is confident that it will be able to maintain its focus in 2003/04 on its three main priorities: building Stanford's presence in the regions; integrating Stanford's alumni into the life of the university; and strengthening class identity.

Information Technology & Systems Support

ITSS has consolidated revenues of approximately $86 million, funded by both general funds and service centers. The general funds budget reduction for 2003/04 is approximately 9%, including one-time funding variances. ITSS will achieve these reductions primarily through staff reductions, many through attrition.

ITSS provides services such as Networking, Security, Help Desk and Academic Computing that are funded directly by general funds of about $14 million. In addition there are four major service centers:

- Communication Services (voice, video, and data communications) – $34 million,

- Computer Resources (desktop & server installation & maintenance) – $6 million,
- Instructional Programming (lecture, classroom and hands-on training) – $2 million, and
- Stanford Data Center (hosting, operations, and core administrative systems) – $30 million.

ITSS forecasts a deficit in 2003/04 in the Stanford Data Center that could well exceed $1 million. This deficit is caused by the need to operate both the legacy mainframe systems and the new administrative systems in parallel for about half the year, while at the same time trying to meet budget reductions. To meet those reductions, ITSS will eliminate services such as departmental technology assessments and academic R&D, as well as significantly reduce support for training, technology consulting, academic hardware, student dorm networks and support for enterprise administrative systems.

Land & Buildings

The Land & Buildings organization consists of the departments of Facilities Operations, Department of Capital Planning, Department of Project Management, University Architect/Planning Office, and Office of the Vice Provost. Overall, the unit is projecting a surplus of $650,000 in 2003/04. Half of the surplus results from endowment income in support of special campus houses that exceeds the annual operations of the houses. The excesses are reserved for major planned maintenance projects. The other half of the surplus is in the Department of Transportation and will be used along with existing reserves for the purchase of the fleet of Marguerite buses.

In 2003/04, Land & Buildings faces $1.9 million in budget cuts, resulting in reductions in maintenance services to the campus and reductions in funding for planning and conservation projects. In addition, staff in Land and Buildings will be reduced in both generally funded and service center-supported areas due to the slowing capital plan and the anticipated reduction in customer-funded work.

Approximately $2.25 million was funded for O&M and utilities associated with the completion of new buildings, including Lokey Lab, the Off-Site Library Collections facility, and Pasteur Parking Structure. Electricity prices have stabilized, but natural gas prices are expected to rise, causing increases in the steam rate. In addition, purchase prices for domestic water, lake water, and sewer are projected to increase. The Cogen contract was renegotiated (effective January 1, 2003) and is projected to save over $500,000 in 2003/04 due to a decrease in labor costs for plant operations and maintenance.

Stanford continues to preserve planned maintenance project funding for buildings. The university continues to survey the physical condition of buildings, including those that are slated for renovation/replacement in the Capital Plan but have uncertain funding. This will allow the department to prioritize the use of planned maintenance funding.

IMPACT OF THE CAPITAL BUDGET ON THE CONSOLIDATED BUDGET FOR OPERATIONS

The 2003/04 Capital Budget calls for $151.6 million in expenditures on capital projects. The impact of these expenditures on the Consolidated Budget for Operations is shown in two places. The first is $13.7 million in incremental internal debt service for those projects that will be coming on-line in 2003/04 or which had less than a full year of debt service incurred in 2002/03. Of this total, $6.4 million will be borne by the unrestricted (general funds and designated funds) portion of the Consolidated Budget. The second is $5.8 million for the incremental operations, maintenance, and utilities costs required to run those facilities, $4.6 million of which will be funded by general funds. The details of the Capital Budget for 2003/04 are included in Section 3 of this document.

PROJECTED STATEMENT OF ACTIVITIES

The table on page 27 compares the Consolidated Budget for Operations with the projected operating results section of the Statement of Activities. The Statement of Activities is analogous to a corporate income statement and is part of the audited annual financial statements, published in the Annual Report.

Stanford University, as a non-profit institution and a recipient of restricted donations, manages itself internally according to the principles of fund accounting. It manages its cash resources according to categories of funds, which distinguish different legal and management constraints. There are four divisions in the accounting system reflecting the different categories of funds: 1) the Current Division, which includes revenue to be used for ongoing operations — e.g., tuition revenue; 2) the Endowment Division, which incorporates all of Stanford's endowment funds; 3) the Plant Division, which includes all funds to be used for capital facilities purposes; and 4) the Student Loan Division, which includes those funds to be lent to students. The Consolidated Budget principally reflects planned activity in the Current Division and is shown on a modified cash basis. The Consolidated Budget also includes transfers to the other divisions of the accounting system. For example, a school may choose to transfer operating revenue to the Plant Division in anticipation of using those funds for a future capital project. Similarly, a department may decide to move unspent current funds to the Endowment Division, either to maximize the return on those funds or to build capital for a particular purpose.

In addition to its management accounting practices and donor imposed restrictions, Stanford also has external reporting requirements. The university prepares its annual financial statements in accordance with Generally Accepted Accounting Principles (GAAP) and includes revenue and expense accruals and other adjustments/reclassifications necessary to comply with GAAP.

The Consolidated Budget for Operations focuses on the operating revenues and expenses of the university by fund type and the use of funds to cover those operations. It also reports the transfer of operating funds for investment in funds functioning as endowment, for investment as student loan funds, and to be used to cover capital expenditures.

Converting the Consolidated Budget into the Statement of Activities

In order to relate the Consolidated Budget to the Statement of Activities, it is necessary to translate between the "fund accounting" presentation and the "GAAP" presentation. For example, the Consolidated Budget reports as expense the use of funds to acquire equipment. The Statement of Activities does not recognize this use of funds as an expense; rather, the capital equipment expenditure increases assets in the Statement of Financial Position (similar to a corporate balance sheet). The relevant expense that is recorded in the Statement of Activities is the annual depreciation charge of both newly acquired assets and all other assets capitalized by the institution. Additionally, the Statement of Activities incorporates the activities of other separate, wholly-owned entities.

The primary differences between the Statement of Activities and the Consolidated Budget are two-fold: first, as discussed above, the Statement of Activities is prepared on an accrual basis in conformity with GAAP while the Consolidated Budget is prepared on a modified cash basis. Second, the Statement of Activities also includes some reclassifications from expense to revenue and adds information for other wholly-owned entities which must be consolidated into the university's financial statements.

The following adjustments are made to the Consolidated Budget to conform the budget to the GAAP basis Statement of Activities format:

Adjustments from modified cash basis to accrual basis:

a) The Consolidated Budget projects that the schools will transfer over $98 million of current funds to other fund classifications, including plant ($90.5 million), student loans ($2.1 million), and funds functioning as endowment ($6.0 million). Fund transfers are not considered expenses for GAAP purposes.

b) The budget includes the projected current year's purchases of capital equipment as expense. For GAAP purposes, the cost of capital equipment is recorded as an asset on the Statement of Financial Position and recorded as depreciation expense ratably over the useful life of the asset. As a result, $66.2 million is subtracted from Consolidated Budget expenses. Effective September 1, 2003, the university will change the threshold above which equipment purchases are capitalized, from $1,500 to $5,000. Net of current year's depreciation expense, this change will result in approximately $13 million additional operating expense in the Statement of Activities.

c) The Statement of Activities includes current year's depreciation expense related to capital assets being depreciated over their useful lives. Depreciation expense includes capital equipment assets (b above) plus other capital assets, such as buildings and land improvements. This adjustment adds $195.0 million of expense.

Comparison of Consolidated Budget and Consolidated Statement of Activities for Unrestricted Net Assets, 2003/04

[in millions of dollars]

Statement of Activities 2001/02 Actuals	2002/03 June 2002 Budget	2002/03 Projected Year-End		Fiscal Year 2003/04 Projected Consolidated Budget	Adjustments	Projected Statement of Activities
			Revenues and Other Additions			
			Student Income:			
175.5	181.8	184.6	Undergraduate Programs	191.9		191.9
157.8	174.6	166.7	Graduate Programs	185.0		185.0
78.3	90.0	84.4	Room and Board	92.4		92.4
(106.7)	(108.8)	(114.9)	Student Financial Aid[e]		(123.6)	(123.6)
304.9	337.6	320.7	Total Student Income	469.3	(123.6)	345.7
			Sponsored Research Support:			
439.8	472.7	475.0	Direct Costs—University	505.9		505.9
227.8	219.9	230.0	Direct Costs—SLAC	223.0		223.0
134.0	135.1	145.1	Indirect Costs	156.7		156.7
801.6	827.7	850.1	Total Sponsored Research Support	885.6		885.6
182.8	187.9	191.2	Health Care Services[f]	225.8	(18.2)	207.6
104.3	140.0	105.0	Expendable Gifts In Support of Operations	105.0		105.0
			Investment Income:			
377.8	403.6	382.1	Endowment Income	378.5		378.5
69.4	86.1	68.6	Other Investment Income	74.8		74.8
447.2	489.7	450.8	Total Investment Income	453.2		453.2
238.8	254.2	238.8	Special Program Fees and Other Income[g]	233.7	5.1	238.8
39.8	50.0	50.0	Net Assets Released from Restrictions	50.0		50.0
2,119.4	**2,287.1**	**2,206.7**	**Total Revenues**	**2,422.6**	**(136.7)**	**2,285.9**
			Expenses			
1,104.5	1,133.4	1,192.8	Salaries and Benefits[d,g]	1,233.0	4.1	1,237.0
227.8	219.9	230.0	SLAC	223.0		223.0
			Capital Equipment Expense[b]	66.2	(66.2)	
175.6	194.8	186.0	Depreciation[c]		195.0	195.0
3.9			Financial Aid[e]	123.6	(123.6)	
624.7	688.4	647.1	Other Operating Expenses[f,g]	697.2	(16.4)	680.8
2,136.5	**2,236.5**	**2,255.9**	**Total Expenses**	**2,343.0**	**(7.2)**	**2,335.9**
(17.1)	**50.6**	**(49.2)**	**Revenues less Expenses**	**79.6**	**(129.6)**	**(50.0)**
			Transfers			
			Additions to Funds Functioning as Endowment[a]	(6.0)	6.0	
			Transfer to Plant/Student Loan[a]	(92.6)	92.6	
			Total Transfers	**(98.6)**	**98.6**	
(17.1)	**50.6**	**(49.2)**	**Excess of Revenues Over Expenses After Transfers**	**(19.0)**	**(31.0)**	**(50.0)**

d) The Statement of Activities includes accruals for certain benefits, including pension and post retirement benefits that are required by GAAP to be shown as expense in the period that the employee earns the benefit. The budget only includes actual cash payments made for pension and post-retirement and other benefits in the current period. Adjustments amounting to an additional $2.6 million in Benefits expense are made to the Consolidated Budget for Operations for these purposes.

Reclassifications or other modifications for consolidated reporting purposes:

e) Student financial aid is required by GAAP to be shown as a reduction from revenue. In the Consolidated Budget, financial aid is reported as an operating expense. Accordingly, $123.6 million of student financial aid expense is reclassified as a reduction of revenue.

f) For GAAP purposes, Health Care Services revenues received from the Hospitals are reported net of expenses that the Hospital reimburses to the university. The Consolidated Budget presents the revenues and expenses on a gross basis. This adjustment reclassifies $18.2 million from Other Operating Expenses to Health Care Services revenues.

g) Activities of the Sierra Camp LLC, are consolidated in the Statement of Activities, but are not included in the Consolidated Budget. This adjustment adds $5.1 million in Special Program Fees and Other Income revenue, $1.5 million in Salaries and Benefits expense, and $1.8 million in Other Operating Expenses.

In summary, the impact of these adjustments increases the projected $19 million Consolidated Budget deficit by an additional $31 million, bringing the projected deficit in the Statement of Activities to $50 million.