Section 1

Financial Overview

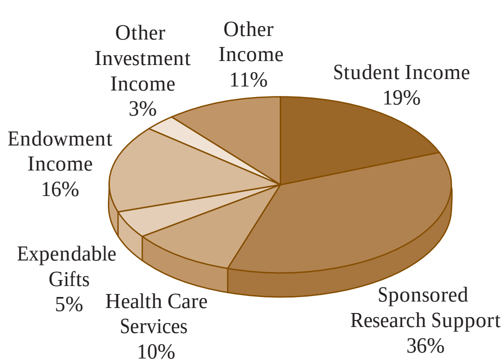
In this section we will review the details of the 2004/05 Consolidated Budget for Operations, discuss the impact of the Capital Budget on the Consolidated Budget, and present a projected Statement of Activities.

CONSOLIDATED BUDGET FOR OPERATIONS

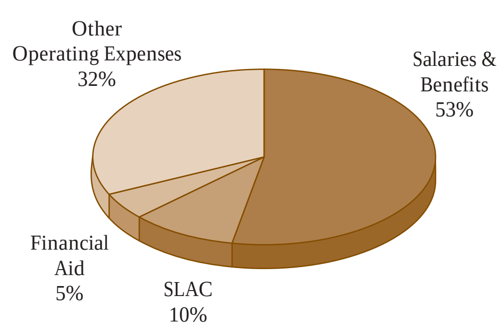
The Consolidated Budget for Operations provides a management oriented overview of all non-capital revenues and expenditures for Stanford University (excluding the hospitals) in the fiscal year. It is based on forecasts from the schools and the administrative areas. These forecasts are then merged with the general funds budget forecast and adjusted by the University Budget Office for consistency. The Consolidated Budget is shown on a modified cash basis and reflects the legal restrictions of fund accounting. Unlike the Statement of Activities in the Annual Report, which is presented in accordance with Generally Accepted Accounting Principles (GAAP), the Consolidated Budget for Operations more closely reflects the uses and movements of funds as managed internally by schools and departments. It reflects capital equipment expenditures (which reduce available fund balances) rather than reflecting only the current year's depreciation charge. Also, it reflects benefits as they are charged through the benefits rate burden rather than the actual payments to providers outside the university. The Consolidated Budget only shows those revenues and expenses available for current operations. It does not include plant funds, student loan funds, or endowment principal funds, although it does reflect endowment income. The table on the next page shows the projected consolidated revenues and expenses for 2004/05. For comparison purposes, this table also shows the actual revenues and expenses for 2002/03 and both the budget and the year-end projections for the current fiscal year, 2003/04. In addition, definitions of key terms are provided on page 3.

The 2004/05 Consolidated Budget for Operations shows total revenues of $2,655.1 million and expenses of $2,586.8 million, resulting in excess revenue over expense of $68.3 million. However, after estimated transfers, primarily to plant funds, the Consolidated Budget shows a slight surplus of $6.7 million.

2004/05 Consolidated Revenues: $2,655.1M [1]



2004/05 Consolidated Expenses: $2,586.8M



[1] Net Revenues after Transfers: $2,593.5M

PROJECTED CONSOLIDATED BUDGET FOR OPERATIONS, 2004/05

[IN MILLIONS OF DOLLARS]

2002/03 Actuals	2003/04 Budget June 2003	2003/04 Projected Actuals		General Funds	Designated	Restricted	Grants and Contracts	Auxiliary Activities	Total Consolidated Budget
			Revenues and Other Additions						
			Student Income:						
185.3	191.9	193.4	Undergraduate Programs	201.7					201.7
166.6	185.0	183.3	Graduate Programs	196.4					196.4
82.1	92.4	90.3	Room and Board					93.3	93.3
434.0	469.3	467.0	Total Student Income	398.1				93.3	491.4
			Sponsored Research Support:						
496.7	505.9	529.0	Direct Costs—University				546.1		546.1
219.7	223.0	228.0	Direct Costs—SLAC				260.0		260.0
143.9	156.7	159.0	Indirect Costs	158.7					158.7
860.3	885.6	916.0	Total Sponsored Research Support	158.7			806.1		964.8
227.6	225.8	249.6	Health Care Services	5.7	233.1			35.7	274.5
112.6	105.0	115.0	Expendable Gifts In Support of Operations	2.0		118.0			120.0
			Investment Income:						
391.1	378.5	404.2	Endowment Income	90.2		334.6			424.8
116.7	74.7	76.6	Other Investment Income	27.2	48.5	5.5	0.2	0.2	81.6
507.8	453.2	480.8	Total Investment Income	117.4	48.5	340.1	0.2	0.2	506.4
227.9	233.7	241.9	Special Program Fees and Other Income	23.8	115.8	(1.9)	0.3	110.0	248.0
54.2	50.0	50.0	Net Assets Released from Restrictions			50.0			50.0
2,424.4	2,422.6	2,520.3	Total Revenues	705.7	397.4	506.2	806.6	239.2	2,655.1
			Expenses						
1,175.0	1,233.0	1,282.0	Salaries and Benefits	375.9	303.7	219.8	292.8	168.9	1,361.1
219.7	223.0	228.0	SLAC				260.0		260.0
123.5	123.6	132.0	Financial Aid	29.6	1.5	100.8	10.0		141.9
723.3	801.4	798.2	Other Operating Expenses	255.2	136.0	116.7	244.7	71.2	823.8
2,241.5	2,381.0	2,440.2	Total Expenses	660.7	441.2	437.3	807.5	240.1	2,586.8
182.9	41.6	80.1	Revenues less Expenses	45.0	(43.8)	68.9	(0.9)	(0.9)	68.3
			Transfers						
(22.0)	(6.0)	(15.0)	Additions to Funds Functioning as Endowment		(5.0)	(10.0)			(15.0)
(91.4)	(54.6)	(46.6)	Transfer to Plant/Student Loan	(10.0)	(20.0)	(16.6)			(46.6)
			Other Transfers	(34.5)	54.5	(20.0)			
(113.4)	(60.6)	(61.6)	Total Transfers	(44.5)	29.5	(46.6)			(61.6)
69.5	(19.0)	18.5	Revenues less Expenses and Transfers	0.5	(14.3)	22.3	(0.9)	(0.9)	6.7
			Beginning Operating Equity	10.3	345.4	578.8	35.0	22.2	991.7
			Ending Operating Equity	10.8	331.1	601.1	34.1	21.3	998.4

Total revenues in 2004/05 are projected to increase 5.3% over the expected 2003/04 level. This growth is an improvement over the 4.0% increase from 2002/03 to projected 2003/04 level and is aided by a strong growth in the endowment market value. Total expenses are expected to grow by 6.0% over the estimated year-end results for 2003/04. The increase is driven by a normal salary program, a second year of substantial increases in benefits costs, and increased demand for financial aid.

To explain 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), 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 5.2% in 2004/05.

Tuition – The general tuition rate increase for 2004/05, which was approved by the Trustees in February, is 4.5%, the lowest rate of increase in five years. 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 and Law. The School of Medicine will increase its tuition by 4.6%, and the Graduate School of Business (GSB) will increase the rate for the MBA program by 4.8%. In addition, the terminal graduate registration (TGR) rate, for which students are eligible after completing 135 units of coursework, will be increased by 50%, concluding a two-year plan to bring Stanford's rate to a level comparable with those of its peers. A comparative study with Stanford's peers revealed that Stanford's TGR rate was the lowest in its peer group. A higher TGR rate encourages timely completion of graduate degree programs, in addition to generating revenue.

Tuition revenue from undergraduate programs is expected to grow by 4.3%, slightly less than the approved increase in tuition due to expected variations in enrollment. Conversely, graduate program revenue is expected to increase 7.1%, which includes the higher

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.

Restricted Funds: Includes expendable and endowment income 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 GAAP, 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. When the restrictions are released, these funds become available for use and are included as part of the Consolidated Budget on the line Net Assets Released from Restrictions. These funds include cash payments on pledges and funds transferred from pending funds to gift funds.

Financial Aid: Includes expenses for undergraduate and graduate student aid. Student stipends and tuition allowance are not considered to be financial aid and are included in other lines 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.

increases for the MBA program and the TGR rate, as well as the assumption of additional Masters student enrollment in the Schools of Engineering and Education.

Room and Board – In February, the Trustees approved a combined room and board rate increase of 4.7% for 2004/05. The room rate will increase by 6.1% and the board rate by 3.25%. The 2004/05 recommended increases in room and board rates were developed while taking into account numerous Residential and Dining Enterprises (R&DE) guiding principles and operational goals. These include sustaining operations with a reserve-to-expense ratio of at least 2.0%, continuing to build an asset renewal/preservation program that will annually fund building infrastructure projects and improvements, completing life safety and seismic projects as part of the ongoing capital improvement program, and ensuring that students receive extraordinary services that are provided in a fiscally responsible manner. Overall room and board revenuewill grow by only 3.3%, despite the larger approved increase in room and board rates. This is due primarily to a reduction in revenue associated with off-campus subsidies for graduate student housing as the need for these subsidies has decreased.

Sponsored Research Support and Indirect Cost Recovery

The budget for total sponsored research is expected to be $964.8 million in 2004/05, or 36% 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 ($546.1 million for university research and $260.0 million for SLAC), as well as reimbursement for the indirect costs ($158.7 million) incurred by the university in support of sponsored activities.

University direct costs are up approximately 6.5% in the current year and are expected to grow 5.2% in 2004/05. However, overall, we are budgeting only a 3.2% increase in university direct costs due to an expected loss in research dollars associated with the ramping down of the Gravity Probe B project.

Total direct costs for SLAC in 2004/05 are expected to increase substantially compared to 2003/04. Funding from the Department of Energy (DOE), which still provides almost all of the funding for SLAC, is expected to increase from $223 million in the current year to $251 million in 2004/05, including $54 million for the construction of the Linac Coherent Light Source (LCLS) project. LCLS will be the world's first x-ray free electron laser. Funding from other sponsors is also expected to increase in 2004/05 with the completion of the joint NIH/DOE project SPEAR3. Only funding for the High Energy Physics area of SLAC is expected to be lower in 2004/05.

The university is in the process of negotiating new predetermined indirect cost rates for 2004/05 and 2005/06. We expect the 2004/05 rate to be somewhat lower than the current year's rate of 60%. As a result, total indirect cost recovery in 2004/05 is expected to remain flat at $159 million.

Health Care Services

Health Care Services income is budgeted to be $274.5 million in 2004/05. This is a 10.0% increase over the projection for 2003/04. It includes $203.8 million paid to the Medical School by Stanford Hospital and Clinics and Lucile Packard Children's Hospital related to physician services of its faculty. It also includes payments of $13.0 million by the Veterans Administration Hospital and the Santa Clara Valley Medical Center. Other components include $4.7 million of clinical revenue and $24.4 million of payments to the Medical School for rent, use of the library, blood products, and research support. 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 $28.6 million.

Expendable Gifts

Expendable gift income is expected to total $120 million in 2004/05. Expendable gifts are those that are immediately available for purposes specified by the donor. They do 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 before falling off to $104.3 million in 2001/02. The estimate for 2004/05 represents a continued but moderate growth in new expendable gifts.

Investment Income

Endowment Income – Endowment income in 2004/05 is expected to be $424.8 million, a 5.1% increase over 2003/04. The merged endowment pool has enjoyed a strong gain in its market value over the past year as investment markets have improved along with the economy as a whole and is the driver for the strong increase in endowment income.

The estimate of endowment payout from the merged endowment pools 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 to be a weighted average of the current year's payout and the target rate. The smoothed payout rate trends up when the market declines and down when the market value increases. The target payout rate is 5.0%, and the smoothed payout rate projected for 2004/05 is 4.67%.

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 endowment 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. Gifts to endowment dropped substantially in 2000/01 but have been increasing in each subsequent year and are expected to reach a new high of $250 million in 2004/05.

Of the total endowment income, only $90.2 million, or 21.2%, 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 not expected to increase over the 2003/04 unrestricted endowment income. While the portion of unrestricted endowment income generated from the merged endowment pool is expected to be up 5.6%, the increase is offset by a comparable decrease in income from the Stanford lands.

Other Investment Income – Other investment income consists of four main sources: the payout on the expendable funds pool (EFP), income earned on unexpended endowment payout, income on the Stanford Housing Assistance Center portfolio, and investment income supporting the Stanford Management Company. The largest of these sources is the EFP, the investment pool for non-endowment funds. The EFP comprises the university's general operating funds, non-government grants, 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 fund balance of $1.1 billion. The EFP is invested approximately 87.5% in the merged endowment pool and 12.5% in money market instruments. An additional $200 million in unspent endowment payout, formerly invested in the EFP and now segregated in the endowment income funds pool (EIFP), is invested entirely in money market instruments.

Total other investment income is budgeted to increase 6.5% to $81.6 million in 2004/05. The amount from the EFP and the newly segregated EIFP is projected to increase 10.0% in 2004/05 as a result of a 2.0% assumed increase in the size of the pools as well as a doubling in the expected money market rate of return on the EIFP. Income on the Stanford Housing Assistance Center portfolio and investment income supporting the Stanford Management Company are projected to increase by an inflationary rate of 2.5%.

Special Program Fees and Other Income

This category includes the revenues from several different types of activities. The first is a variety of special programs such as technology licensing income, conference and symposium revenue, fees from the executive education programs in the Graduate School of Business and the Stanford Center for Professional Development, fees from travel/study programs, and revenues from corporate affiliates, mostly in the Schools of Earth Sciences and Engineering.

Another major component of this category is the revenue from auxiliary activities, excluding student room and board fees. This includes revenues from conference activity, concessions, rent, 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.

Total special program fees and other income are budgeted at $248.0 million in 2004/05, an inflationary increase of 2.5% over the expected level in 2003/04.

Net Assets Released from Restrictions

This represents the funds previously classified as temporarily restricted that will become available for spending as specific restrictions are satisfied. These include cash payments on pledges as well as pending gifts whose designation has been determined. In

2004/05, 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 being spent 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 – The 2004/05 Budget Plan includes a competitive merit salary program for faculty and staff following a freeze on merit increases for both groups in 2003/04. The program also provides special market adjustment funding for those faculty and staff groups that are below their relevant markets. The goal is to set faculty salaries at a level that will maintain Stanford's competitive position both nationally and internationally for the very best faculty. For staff, the salary program is designed to target salaries in the mid-range of the local employment market.

The recommendation for faculty salary increases is based on a review of data supporting particular recommendations from each school, internal comparisons, comparisons with peer institutions using data that are publicly available, and consideration of available resources. Based on this analysis, the general salary program increase in 2004/05 for faculty salaries is 3.5%. Added to this will be targeted increases to address equity and retention issues. Total academic salaries, which include faculty, lecturers, research and teaching assistants, and other academic salaries, are projected to grow by 6.0% in 2004/05, driven by the faculty salary program, a 6.5% increase in research and teaching assistant salaries, a 10% increase in clinical academic salaries, and modest headcount growth.

Staff salary expenditures are expected to increase by 4.5% as a result of our merit program and a slight increase in headcount. Fortunately, the freeze on increases to base salaries of non-bargaining unit employees in the current year did not adversely impact Stanford's market position. Faced with the same economic conditions, other employers with whom we compete for talented staff implemented similar cost control measures. The approved staff salary program for 2004/05 is expected to allow the university to maintain its desired position in the local market. The program authorizes base merit increases, targeted funding for specific job groups that lag the market by 10% or more, and non-base performance bonus/incentive programs equal to 1.5% of each unit's approved salary base. Taken together, the 2004/05 authorizations for central and local funding offer management substantial flexibility to reward top performers, to recognize differences in individual performance, and to address the documented cases where pay for specific jobs lags the overall market.

Fringe Benefits – Of Stanford's four fringe benefits rates, two will increase from 2003/04 to 2004/05, and two will decline. The rate for regular benefits-eligible employees, which covers most university employees and comprises most of Stanford's benefits costs, will rise by 1.5 percentage points, from 29.0% of applicable salaries in 2003/04 to 30.5% in 2004/05.

The increase in the regular benefits-eligible rate is mainly due to two factors: the continuing rise in health care costs (which will contribute 0.4 points to the increase), and the carry-forward created by Stanford's under-recovery of costs in 2001/02 and 2002/03 (0.7 points). Retirement programs (0.3 points), unemployment insurance (0.3 points), and workers' compensation (0.2 points) will also contribute to the increase, partially offset by reductions in miscellaneous programs such as staff development and severance.

Overall, the cost of insurance programs is expected to increase by 10.0%. Health insurance premiums are continuing to increase at double-digit rates, both for current employees and for retirees, despite the university's efforts to control costs through plan design and negotiation with providers. The cost of medical insurance for current employees is expected to increase 15.4%, but, as Schedule 13 illustrates, the costs of the retiree medical plan charged to the benefits rate are expected to decline by nearly 10%, due to an adjustment in the accounting treatment of Stanford's liability. Other insurance programs, including workers' compensation, unemployment, and group life, will need to be funded in 2004/05 after many years in which the earnings of the university's self-insurance reserves were sufficient to pay the claims costs, which were, therefore, not charged to the fringe benefits pool.

The increase in the cost of retirement programs from budgeted 2003/04 to proposed 2004/05 is due to the need to fund Stanford's defined-benefit plan (Stanford Retirement Annuity Plan) for the first time in several years.

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. Total costs for regular benefits-eligible employees were under-recovered in 2001/02 by about $18 million. Ordinarily, the entire amount would become a part of the cost pool to be recovered in 2003/04. However, given the magnitude of the carry-forward, the university decided to spread the cost out over three years, from 2003/04 through 2005/06. The under-recovery in 2002/03 was even higher, at $22.4 million, and is also being spread over three years, from 2004/05 through 2006/07. The result is that the carry-forward amount in the regular benefits-eligible pool will be about $7 million higher in 2004/05 than it is in 2003/04, adding 0.7 points to the regular benefits-eligible rate.

The benefits rate for postdoctoral research affiliates will also increase in the coming year, from 18.7% to 19.1%. This is due in large part to rising medical costs, as discussed above. The rate for contingent (casual or temporary) employees will decline from 9.1% to 8.9%, due to a reduction in the carry-forward from prior years.

The rate for graduate teaching and research assistants, a new category to the pool in 2002/03, will decline slightly, from 3.5% to 3.4%. 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.

Total costs in the benefits pool are budgeted to increase 7.2% from negotiated 2003/04 costs.

The negotiated 2003/04 and the provisional 2004/05 fringe benefits rates are as follows:

Fringe Benefits Rates

	2003/04 Negotiated Budget	2004/05 Provisional Rates
Regular Benefits-Eligible Employees	29.0%	30.5%
Postdoctoral Research Affiliates	18.7%	19.1%
Casual/Temporary Employees	9.1%	8.9%
Graduate RAs and TAs	3.5%	3.4%
Other Students	0.0%	0.0%
Average Blended Rate	26.4%	27.6%
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 2004/05. 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 $141.9 million on student financial aid for undergraduate and graduate students, $29.6 million of which will come from general funds. As the table on the following page indicates, designated and restricted funds ($102.3 million) and grants and contracts ($10.0 million) will support the remainder. The total financial aid numbers are 7.5% above the projected total for 2003/04. 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 and the expected increase in graduate student enrollment.

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 2004/05, Stanford students will receive $75.2 million in need-based scholarships, of which $61.8 million will be from Stanford resources. The remaining $13.4 million will come from government and outside awards. The following sources support Stanford's $61.8 million commitment:

- General funds will cover $20.1 million, an increase of 36.8% over 2003/04 and the highest level of general funds support ever. This sizeable jump in general funds support, which provides for all unmet need, is due to a combination of the increase in the student budget, another expected jump in the number of students on aid, and the failure of other sources of financial aid support to keep pace with the overall growth in total aggregate need. Stanford-funded scholarship aid supported by general funds decreased to $4.6 million in 2000/01 due to the success of Stanford's fundraising, the tremendous growth in investment returns in the late 1990s, and the extraordinary strength in the economy overall. At that time, the number of students on aid had dropped to a low of 2,516. In 2004/05, 2,990 students are projected to receive need-based scholarship aid.

2004/05 Financial Aid and Other Graduate Student Support from Stanford Resources[1]

[in millions of dollars]

Projected 2004 Year-End		General Funds	Designated and Restricted	Grants & Contracts	Total
	Student Financial Aid				
56.0	Undergraduate	20.1	41.7		61.8
13.1	Undergraduate Athletic		14.1		14.1
62.9	Graduate	9.5	46.5	10.0	66.0
132.0	Total	29.6	102.3	10.0	141.9
	Other Graduate Student Support				
63.5	Stipends	7.4	33.7	26.2	67.3
43.8	Tuition Allowance	26.0	4.7	15.0	45.7
66.2	RA and TA Salaries	8.7	19.5	42.3	70.5
173.5	Total	42.1	57.9	83.5	183.5
305.5	Total Student Support	71.7	160.2	93.5	325.4

[1] Excludes postdoctoral salaries

This dramatic increase in the number of students on aid is the result of the decline in the economy and an increasingly diverse undergraduate student population. Record numbers of all minority groups are enrolled in 2003/04 and together represent 48.9% of the total undergraduate student body.

- Restricted income will provide $32.3 million, and
- The Stanford Fund will provide $9.4 million.

Stanford restricted funding, including endowment income and the Stanford Fund, will contribute a little more than 55% 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, the overall need for financial aid has grown substantially faster than the available restricted funds. Nonetheless, we are anticipating that income from both existing and new gifts to endowment will increase 6.3% after a sluggish year in 2003/04.

Athletic scholarships, which are not need-based, will be awarded to undergraduate students in the amount of $14.1 million, an increase that reflects the cost of tuition and nine new scholarships.

The table on the following page shows the detail of undergraduate need-based scholarship aid. 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 expected to total $249.5 million in 2004/05. As the table above indicates, this includes the tuition component of fellowships in the amount of $66.0 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 $183.5 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 Expenses line of the Consolidated Budget for Operations on page 2.

The minimum rate for RA and TA salaries and stipends will increase by 6.5% in 2004/05; tuition allowance expense is expected to increase by 4.5%, the rate of increase for general graduate tuition.

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. These budget expenditures make up one-third of the total expenses of the Consolidated Budget and are projected to increase by 3.2% to $823.8 million in 2004/05. The principal components include materials

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

[in millions of dollars]

Source of Aid	1999/00 Actual	2000/01 Actual	2001/02 Actual	2002/03 Actual	2003/04 Projected	2004/2005 Budget
Restricted	20.2	25.9	26.5	29.1	30.5	32.3
Stanford Fund/Presidential funds	7.8	11.5	9.3	9.5	10.8	9.4
General Funds	7.9	4.6	10.4	13.5	14.7	20.1
Subtotal Stanford Funded Scholarship Aid	35.9	42.0	46.2	52.1	56.0	61.8
Govt. and Outside Awards	10.1	10.6	12.3	12.4	13.8	13.4
Total Undergraduate Scholarship Aid	46.0	52.6	58.6	64.5	69.8	75.2
General Funds as a Share of Total Aid	17%	9%	18%	21%	21%	27%
General Funds and Stanford Fund as a Share of Total Aid	34%	31%	34%	36%	37%	39%
Restricted Funds as a Share of Total Aid	44%	49%	45%	45%	44%	43%
Number of Students	2,519	2,516	2,663	2,803	2,930	2,990

and supplies ($170 million), administrative and professional services ($114 million), maintenance and utilities for campus buildings ($113 million), internal debt service ($113 million), research subcontracts ($74 million), equipment purchases ($63 million), student stipends ($67 million), and travel ($30 million).

Utilities and Maintenance – The total cost of utilities in 2004/05 is expected to be virtually unchanged from the current year cost of $61 million, despite considerable fluctuations in the component utility prices. In the second part of 2003/04, electricity prices decreased nearly 20% due to PG&E's implementation of the approved settlement agreement plan to resolve its Chapter 11 bankruptcy case. While PG&E is not our primary supplier, the COGEN contract is structured to rise and fall with PG&E rates. These savings will continue into 2004/05 and will offset increases in the costs of other utilities. The price of natural gas is projected to increase about 9% over the 2003/04 budget. Although minor utilities compared to electricity and natural gas, domestic water (Hetch Hetchy) and lake water (Santa Clara Valley Water District well tax) prices are projected to increase 9% and 8%, respectively, and sewer expenses from the City of Palo Alto are projected to increase 7%. Overall utility consumption is expected to increase modestly with very few new structures coming on line in 2004/05.

Maintenance and repair costs are budgeted at $52 million in 2004/05. Since the Loma Prieta earthquake, Stanford has made significant investments in renovation and new construction. During this period we have largely rebuilt the campus and have substantially avoided the accumulation of deferred maintenance. To preserve this strong position we have analyzed the ongoing costs of renewing facilities and have begun to provide incremental funds for that purpose. Next year's budget includes an increment of $1 million in general funds for planned maintenance, the first of what will likely be additional incremental allocations over the next several years.

Debt Service – The 2004/05 internal debt service is projected to be $112.5 million, a $2.4 million increase over 2003/04. The university borrows from capital markets and uses the proceeds to fund capital projects and programs. These projects and programs are required to repay the principal and premium, if any, plus interest over the estimated useful 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 2004/05 is 5.4%.

Administrative Systems – This Budget Plan includes $42.6 million for one-time project costs for new administrative systems, plans for upgrades and enhancements to existing administrative systems, and ongoing production support costs for these systems. For the past several years, Stanford has been engaged in a significant effort to replace its administrative systems and to upgrade the infrastructure supporting both academic and administrative computing. While the lion's share of new development projects will be finished with the completion of the Oracle financial systems implementation, there is $19.1 million budgeted for systems development and infrastructure in the 2004/05 budget, a decrease from the $24 million in the current year. Now that most of the large enterprise-wide system implementations are complete, most of next year's systems cost will be expensed, funded from a variety of sources in the Consolidated Budget, including general funds, Presidential funds, and university debt. $6.8 million will be capitalized and is carried in the infrastructure section of the Capital Budget in 2004/05.

Transfers

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

- Additions to Funds Functioning as Endowment: This line represents the net of transfers from designated and restricted funds to funds functioning as endowment (FFE) and withdrawals from these endowment reserves. We expect a total of $15 million will be transferred to FFE in 2004/05, which is down from the 2002/03 actual of $22.0 million.

- Transfer to Plant/Student Loan: This line includes transfers of expendable funds to both plant funds and student loan funds. Of the total, $44.5 million is budgeted to be transferred to plant funds to be used for capital projects. We are budgeting $10.0 million in general funds for academic facilities renovation. Additionally, the academic units are budgeting $34.5 million from designated and restricted funds for a variety of capital projects. $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 Consolidated Budget for Operations, 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 endowment income, and income from the expendable funds pool. Every non-auxiliary unit receives general funds, which support both academic and administrative functions. Total general funds revenue is projected to be $706 million in 2004/05.

The past two budget cycles have been very taxing across the university. Due primarily to an unfavorable investment climate, general funds revenue has not grown sufficiently to meet the needs of a dynamic university. With only a moderate growth in general funds revenue, the university has had to rely, to a large extent, on budget reductions in order to fund new academic initiatives, debt service associated with university growth, and other university priorities.

In total, almost $40 million was cut from general funds allocations over the past two years in order to fund about $35 million of incremental activities. While units absorbed significant reductions during both years, the approach in 2003/04 was different from that in 2002/03. In 2002/03, the university made across-the-board reductions totaling $16 million, with each unit taking about a 4% cut. In 2003/04, units proposed specific cuts and $23 million of general funds was trimmed on a line-by-line basis.

At the outset of the 2004/05 budget process, the university once again faced a general funds deficit of roughly $15 million. This deficit was driven by the need to fund university priorities, including a competitive salary program, academic initiatives such as the new Bioengineering Department, and a renewal of administrative systems and facilities. However, after two years of general funds reductions, there was little fat left to be cut. Thus, the Provost looked toward university-wide structural changes that might yield general funds relief.

Study groups were formed to investigate potential savings from six primary areas:

- Application of the infrastructure charge,
- Income distribution from technology licensing,
- Unraveling of the layers of residential advising,

Summary of 2004/05 General Funds Reductions and Additions (Excludes Formula Units)

[in thousands of dollars]

	Total 2003/04 GF Allocation	Price & Salary Inflation	Reductions	% Reduction	Additions	% Addition	Total 2004/05 GF Allocation
School of Earth Sciences	2,943	72			80	2.7%	3,094
School of Education	9,053	444	50	0.5%	216	2.3%	9,663
School of Engineering	39,584	2,830			440	1.0%	42,854
School of Humanities and Sciences	98,559	4,474	1,000	1.0%	3,070	3.0%	105,103
School of Law	12,466	440					12,906
Dean of Research	22,608	889	760	3.2%	1,133	4.8%	23,870
Undergraduate Education	10,804	469	341	3.0%	250	2.2%	11,182
Office of Admission & Financial Aid	6,338	267	100	1.5%	127	1.9%	6,632
Stanford University Libraries	34,217	1,258	250	0.7%	950	2.7%	36,175
Student Affairs	17,182	728	451	2.5%	223	1.2%	17,682
Total - Academic	253,754	11,871	2,952	1.1%	6,489	2.4%	269,162
Office of the President & Provost	10,870	489	184	1.6%	294	2.6%	11,468
Vice President for Public Affairs	4,464	199	100	2.1%			4,563
Business Affairs[1]	37,887	1,765	615	1.6%	973	2.5%	40,010
ITSS	38,172	1,150	865	2.2%	1,101	2.8%	39,557
Development and Alumni Association	19,795	862	250	1.2%	1,510	7.3%	21,917
Land & Buildings[2]	34,049	1,423			1,192	3.4%	36,663
Other Administrative Units[3]	9,352	297	284	2.9%	270	2.8%	9,635
Total - Administrative	154,588	6,184	2,298	1.4%	5,340	3.3%	163,814
Undergraduate Scholarship Aid	15,626	4,474					20,100
Debt Service	29,912	(3,371)			246	0.9%	26,787
Central Obligations[4]	77,841	3,023			1,050	1.3%	81,914
Total - Other	123,379	4,126			1,296	1.0%	128,801
Total Non-Formula Units	531,721	22,181	5,250	0.9%	13,125	2.4%	561,777

Notes:

1 For this table, insurance and fire contract allocations have been moved to Central Obligations.

2 For this table, utilities allocations have been moved to Central Obligations.

3 Other Administrative Units includes general funds allocations for General Counsel, Procurement, SLAC, Athletics, Stanford University Press, and the Stanford Faculty Club.

4 Central obligations include tuition allowance, graduate student health insurance contribution, the systems reserve, and the university reserve. In addition, for this table, utilities, insurance and fire contract allocations have been included in this line.

- Review of university benefits,
- Evaluation of graduate student housing subsidies, and
- Examination of the delivery of human resources services.

The Provost's Budget Group, which comprises representatives from both faculty and administration, recognized that, though there is potential for future general funds savings in these areas, we were only able to find savings in off-campus student housing subsidies and in funding for the Office of Technology Licensing. We anticipate additional savings in the other areas in the future. Therefore, the Provost asked each budget unit to submit potential line-item reductions at increments of 3% and 5% of its general funds allocation.

Over the next several months, each budget unit met individually with the Budget Group to discuss strategic plans, fund balances, financial reports, and the potential impact of specific budget reductions. At the same time, the projected general funds deficit decreased markedly, due to a continued improvement in the investment outlook.

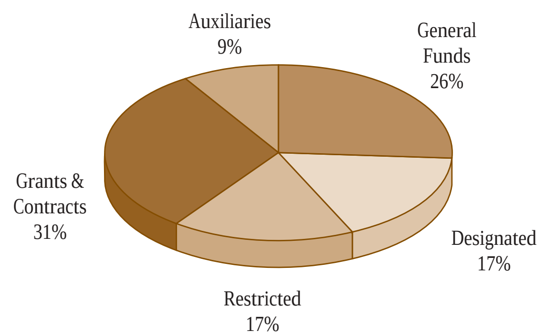
In fact, the budget forecast improved to the point that the Budget Group shifted from a budget reduction to a budget reallocation strategy. The cuts to the units were minimal (about 1% across the university). Through this process the university was able to achieve its top priorities of implementing a competitive salary program for both faculty and staff, providing start-up funds for the Bioengineering program, addressing the deficit in the School of Humanities and Sciences, and providing funds for systems and facilities renewal. Incremental funds were also allocated for a handful of pressing needs such as research compliance staffing and library acquisitions. General funds additions and cuts for individual units are shown in the table on page 11.

The general funds outlook for the university is brighter than it was just a year ago. However, it will take a strong effort on the part of staff and faculty to implement the university-wide structural changes necessary to ensure that general funds grow at a level sufficient to support the university's ongoing needs.

Designated Funds Budget

Designated income comes into the university as unrestricted revenues, but has been directed to particu-

2004/05 CONSOLIDATED EXPENSES BY FUND TYPE



lar units for specific purposes by management agreement. The main sources of designated income are special program fees such as technology licensing income, corporate affiliates payments, and executive education programs; payments from the hospitals to the departments in the Medical School through the clinical practice; and other investment income, including income generated by the Stanford housing portfolio and investment income supporting the Stanford Management Company. Also included in designated funds are most activities of the Stanford Alumni Association, including all of the income and expenses associated with the travel/study programs. Other designated funds include funds set aside for university-sponsored research and cost sharing. The schools, departments and programs, and individual faculty members control the majority of the funds in these budgets, but also included in this category are funds held by the university as reserves, such as self-insurance reserves.

Total designated income is expected to be $397.4 million in 2004/05, an increase of 7.1% over the 2003/04 year-end projection. This growth is fueled by an 11.8% projected growth in designated clinical revenue paid by the hospitals to the School of Medicine for physician services. The remaining designated funds are expected to grow about 2.8%. Additionally, we are projecting that $54.5 million, primarily general funds and endowment income, will be transferred to support the designated funds budget.

Total expenses charged to designated funds are budgeted to be $441.2 million. An additional $25.0 million of designated funds, primarily existing fund balances, is expected to be transferred to funds functioning as endowment and to cover plant projects. The $14.3 million designated funds deficit primarily represents a planned use of the university's substantial designated fund balances for capital projects.

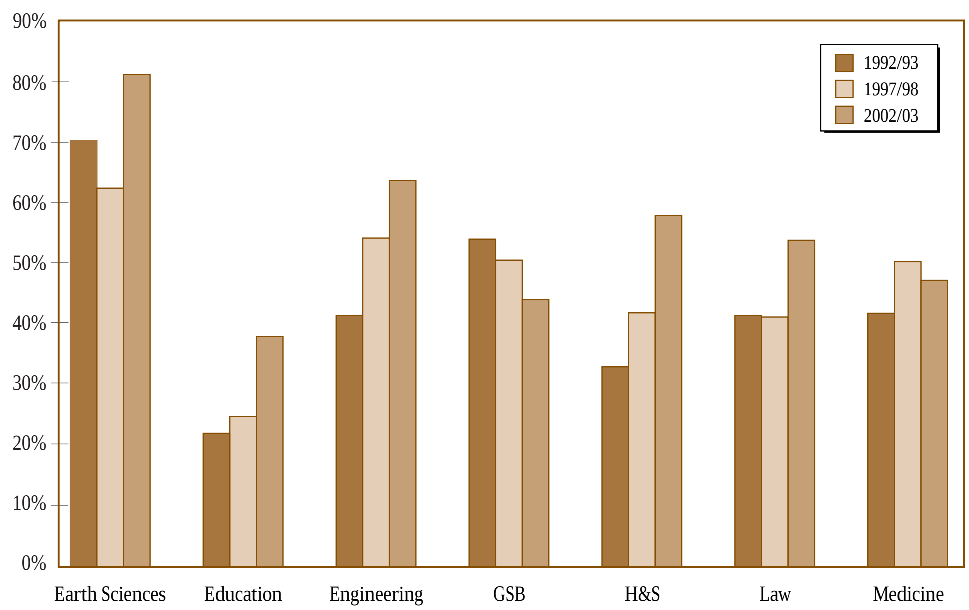
Restricted Funds Budget

The restricted funds budget represents income, expenditures, and transfers for both restricted expendable funds and restricted endowment income funds. Together, revenue from these sources is projected to be $506.2 million in 2004/05. Of this total, $334.6 million is from endowment income and the remaining $171.6 million is from expendable gifts, payments on prior pledges, and expendable funds pool payout on restricted fund balances. $437.3 million is budgeted to be spent from restricted funds for a variety of activities, including endowed professorships, fellowships, and general expense supporting research and teaching. $100.8 million of this amount will be used to cover financial aid. An additional $46.6 million in restricted funds is expected to be transferred to other fund types, including plant, endowment principal, and designated funds. Total restricted revenues less expenses and transfers net a projected surplus of $22.3 million, most of which will be added to the fund balances in the schools.

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 a given year, resulting in growth in fund balances. Some of the annual revenue is not used because the terms of the funds are so restrictive as to preclude its 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. 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 use restricted funds in place of general funds where possible. Schedule 17 in Appendix B shows the academic area fund balances by unit.

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 2004/05 of $806.6 million represents $546.1 million of direct sponsored activity under the oversight of individual faculty principal investigators and $260.0 million in direct costs for SLAC. The total includes $10.0 million of student aid. The university direct cost totals are formulated based upon the projected year-end results for 2003/04 and through consultations with individual research areas. Total university research volume is expected to grow by 3.2% in 2004/05. This growth rate, more moderate than in the past, reflects a significant reduction in research volume related to Gravity Probe B following its successful launch in April 2004. SLAC is projecting a 14.0% increase over its current year budget with the ramp up of its major construction project, the Linac Coherent Light Source.

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 deficit of $0.9 million in 2004/05.

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. 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.

Athletics – The Department of Athletics, Physical Education and Recreation (DAPER) projects a balanced consolidated budget in 2004/05. DAPER operating budget income will grow by 4% from 2003/04, due primarily to increased budgeted contributions of restricted funds to cover discretionary sport program spending. These contributions have occurred historically, but were not previously formalized in the budget. Other operating budget income areas remain basically flat. DAPER is budgeting a slight decrease in football gate receipts. Contractual income from the NCAA and Pacific 10 Conference will increase by 3%. After holding salaries flat in 2003/04, DAPER will have modest salary growth in 2004/05, consistent with the university's salary plan. Total compensation will rise further due to the increase in the university benefits rate. To adjust to a flat income base, DAPER will make budget reductions in several operational and marketing areas. Though new program growth will be quite modest, no reductions will be made to sport programs or programs affecting the well being of participants.

The total number of full scholarships will increase from 305 in 2003/04 to 314 in 2004/05. DAPER's Campaign for Undergraduate Education fundraising success, coupled with the rebound in endowment performance, will offset the cost of incremental scholarships, as well as higher tuition and room and board costs.

Blood Center – The Blood Center is projecting a balanced budget of $24 million for 2004/05. The Blood Center continues to function as an auxiliary because 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. Approximately 53% of budgeted expense is related to salaries and benefits while the remainder is related to the other direct costs, including supplies, utilities, and operations, of running the center.

HighWire Press – HighWire Press is projecting a deficit of $900,000 after its annual transfer to University Libraries and one-time expenses (funded from designated reserves) for the creation of a digital backset of the journals presently associated with HighWire. This digital backset will enhance customer retention and satisfaction and will include many, but not all, of the reading and searching features HighWire now offers. Major new growth beyond science and medicine titles is underway with the addition of 450 journals in the social sciences and the humanities. Price reductions in calendar 2004 have addressed customer concern, but have eliminated the ability to add to reserves; prices are now competitive. Significant development work is being done to largely automate the manual and repetitive work of content loading, and this will allow additional revenue growth through staff redeployment or attrition without added expense.

Residential and Dining Enterprises – Residential and Dining Enterprises (R&DE) is projecting a $437,000 deficit on revenues and transfers of $119.5 million in 2004/05. R&DE will use reserves to cover the shortfall.

Total Auxiliary and Net Service Center Activities, 2004/05

[in millions of dollars]

	Revenues and Transfers	Expenses	Surplus/ (Deficit)
Athletics[1]	40.3	40.3	
Blood Center	24.0	24.0	
HighWire Press & Media Solutions	18.8	19.7	(0.9)
Residential and Dining Enterprises	119.5	119.9	(0.4)
Stanford West/Welch Road	14.5	14.0	0.5
University Press	6.5	6.5	
Net Service Center Activity[2]	20.1	20.1	
Other	17.6	17.7	(0.1)
Total[3]	261.3	262.2	(0.9)

Notes:

1 Financial Aid activity and Camps are not included.

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

3 This Table represents gross revenues and expenditures. When incorporated into the Consolidated Budget on page 2, interdepartmental transactions of $22 million have been netted out.

Capital projects scheduled for 2004/05 include the first phase of the three-phase Roble Hall renovation to meet seismic, life safety, and other codes. Seismic improvement projects are also planned for two of the Row Houses, and there are plans to address code issues in Escondido Village.

2004/05 will be the first fiscal year that R&DE is able to benefit from 12 months of revenue generation from two of its latest enterprises: the SLAC Guest House, which is operated by Student Housing, and the Tresidder Union (including the Coffee House) food service operation that is run by Stanford Dining. Another new source of revenue is the "Just Like Home" laundry program, which is now included in the room rate. The laundry program was implemented in response to student requests and supports R&DE's objective of serving student needs.

As a result of university policy on the application of the pooled debt rate, R&DE will realize significant interest expense savings. However, these savings will be more than offset by several expense increases, including the continuing escalation of fringe benefits; the costs of new enterprises; Student Housing's implementation of a state-of-the-art facilities management system; and R&DE's responsibility for the operations, maintenance, and debt service of the new Graduate Community Center.

Combining these issues with the continuing initiatives to build an asset preservation program that funds building infrastructure renewal, and the near-term goal of stabilizing operations, presents R&DE with a challenging year.

Stanford West/Welch Road Apartments – Stanford West Apartments will be assuming the Below Market Rate (BMR) requirements for the Hyatt Classic Residences scheduled to open in 2004/05. By agreement with the City of Palo Alto, Stanford West will be required to increase the number of BMR units from 63 to 105 in 2004/05, and up to 156 units in 10 years. The addition of BMR units will cause a drop in revenue over time, so the project will need to bank its expected surplus to cover future years. The Welch Road Apartments expects a surplus of $150,000 for 2004/05. The surpluses for both of these auxiliaries are added to their capital reserves. The university currently is using the capital reserves for the Welch Road Apartments to cover depreciation expenses of various other rental properties.

University Press – Stanford University Press is forecasting total revenue and other income of $6.5 million with $4.6 million coming from book sales and $1.9 million from rights sales and other income sources. As in the previous four years, this income will be applied in proportional measure to sustaining the Press's list of humanities books, which constitute the majority of titles signed and published, and to underwriting the growth of the lists in the social sciences, law, and business.

Year-on-year sales growth will be less aggressive than the 14% anticipated this year, because the difficult trading conditions that have plagued university presses for the last three years are expected to intensify.

To ensure that its title output is maintained and that its new programs are properly funded, the Press will continue its program of cost control, reducing overhead by 10% over the current year, thereby reducing its cost base to pre-2001 levels.

At the same time, a general fund operating subsidy of $498,000 will continue to play a part in supporting the University Press as it strives to become a self-sustaining enterprise.

The Consolidated Budget by Organizational Unit

Graduate School of Business

The Graduate School of Business (GSB) projects a $1.3 million surplus budget for 2004/05, before contributions to building reserves. The school plans to offset increased expenses with higher tuition, aggressive fundraising, and continued growth in its executive education business. The GSB expects salary pressures and continued increases in benefits costs to add substantially to its costs.

Revenues are expected to grow 8% over the budget plan for 2003/04. A concerted fundraising effort has begun to support two new research centers (the Center for Leadership Development and Research and the Center for Global Business and the Economy), to support faculty (especially junior faculty), and to provide fellowship support for the MBA and Ph.D. Programs. At the same time, the GSB has increased degree tuition 4.8%, and it is targeting a modest increase in executive education revenues due to price increases and new programs.

School of Earth Sciences

The School of Earth Sciences projects a surplus of $1.1 million on revenues and transfers of $34.0 million. A plan to more than double expendable gifts revenue to $1.8 million, and a projected 5.6% increase in endowment payout, will provide for the surplus. Revenue from designated funds and affiliate programs is expected to be flat next year. The consolidation in the oil, gas, and mineral industries has resulted in fewer companies in these industries, and the remaining firms are competing for business. This affects the growth in membership in the affiliate programs.

The school's consolidated budget is heavily dependent on non-general funds; for 2004/05, general funds will make up 12.3% of total expenses, slightly down from 13.0% in 2003/04. Endowment income and grants and contracts together make up slightly more than two-thirds of the school's budget.

School expenses are projected to increase 11% in 2004/05. This anticipated growth reflects first steps in the implementation of the school's strategic plan, a base adjustment of faculty salaries that addresses some market and equity issues, fellowships for graduate students in the Interdisciplinary Program in the Environment and Resources (IPER), and various group and individual research activities in the school.

A significant number of Earth Sciences faculty are expected to retire over the next five years. The school expects to draw from expendable and endowment fund balances to recruit, provide start-up packages for, and renovate laboratories for new faculty. In addition, these fund balances will allow the Dean to provide seed money for new initiatives and centers of excellence. They will also serve as bridge funding during periods of weak economic performance.

School of Education

The School of Education projects a deficit of $1 million in 2004/05. The deficit primarily results from an unusually high beginning balance of non-federal sponsored project funds that is expected to decrease by over $2 million during the year. In 2002/03 and 2003/04 several large non-federal grants pre-funded multi-year projects.

Revenue Growth – Revenue is expected to increase only 3% over 2003/04.

- Unexpectedly high revenues in 2003/04 resulted from a special fundraising event sponsored by Bill Cosby, which brought in over $1 million.
- For the past several years over half of the expendable funds raised have been in support of the John Gardner Center for Youth and Their Communities.
- In 2003/04, the school experienced a decrease in revenue from federal sponsored project activities, and this is expected to continue in 2004/05. This slowdown in federal sponsored project activities results from two recent developments: (1) changing demographics of the faculty, resulting in a larger number of junior faculty, and (2) the movement of grants supporting School of Education faculty to the Stanford Center for Innovations in Learning (SCIL).
- If the school succeeds in raising funds to remodel the Old Bookstore, $2 million in pending funds can be directed to general school activities and revenue growth could increase as much as 9%. The remodeled building will house the school and community partnership programs.

Expense Growth – Expenses are expected to grow by 5%, primarily in non-federal sponsored project activities.

Projected Consolidated Budget for Operations by Unit, 2004/05

[in millions of dollars]

	Total Revenues and Transfers	Total Expenses	Surplus/ (Deficit)
Academic Units:			
Graduate School of Business[1,2]	98.7	97.4	1.3
School of Earth Sciences	34.0	32.9	1.1
School of Education	28.1	29.2	(1.0)
School of Engineering	209.6	204.8	4.7
Hoover Institution	33.7	33.7	
School of Humanities and Sciences[1]	269.8	280.4	(10.7)
School of Law	34.7	34.5	0.3
School of Medicine[1,2]	787.4	811.8	(24.4)
Dean of Research	177.5	176.3	1.3
Vice Provost for Undergraduate Education	22.1	24.0	(1.9)
Total Academic Units	1,695.6	1,725.0	(29.4)
Academic Support Units:			
Admissions (excluding financial aid)	6.7	6.7	
Stanford University Libraries	51.0	53.6	(2.5)
Student Affairs	25.2	25.3	(0.1)
Total Academic Support Units	82.9	85.5	(2.6)
Total Administrative	537.2	538.6	(1.4)
Total Auxiliary Activities	239.2	240.1	(0.9)
SLAC	260.0	260.0	
Internal Transaction Adjustment	(163.1)	(163.1)	
Indirect Cost Adjustment[3]	(158.7)	(158.7)	
Grand Total from Units	2,493.2	2,527.4	(34.2)
Central Accounts	74.2	59.4	14.8
Central Adjustment[4]	26.1		26.1
Total Consolidated Budget	2,593.5	2,586.8	6.7

Notes:

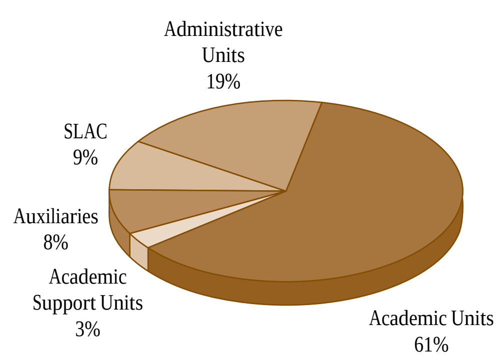
1 The budget lines for the School of Medicine, Graduate School of Business, and H&S do not include auxiliary revenues and expenses. These items are shown in the Auxiliary Activities line. These auxiliary operations include Medical School Blood Center, the Schwab Center of the GSB, and Overseas Studies, 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 $158.7 million received by the schools is taken out in the "Indirect Cost Adjustment" line.

4 The $26 million of revenue 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.

2004/05 Consolidated Expenses by Unit



- The operating budget will grow by 3.5%, primarily as a result of faculty and staff raises and increased benefit expenses. While the new Elementary Teacher Education Program will increase expenses, the school hopes to secure outside funding for a portion of these. Faculty searches for 2004/05 have not been finalized, and expenses could grow if the school succeeds in filling some open positions.
- Expendable gift expenses relate to two areas: (1) new fellowships which will be supported by funds secured from the Bill Cosby event, and (2) a growth in expenses related to the John Gardner Center.
- Non-federal sponsored project expenses will increase 10%, and federal expenses will stay flat or fall slightly

School of Engineering

The School of Engineering projects a surplus of $4.7 million in 2004/05 on expected revenues and transfers of $209.6 million, which reflects a 3% increase over 2003/04 projected year-end results.

The School of Engineering approached its budget reductions in 2003/04 with the goal of protecting the ability of its departments to effectively deliver their academic programs. Although these budget cuts have been sustainable, the school continues to be concerned with funding core academic activities along with new initiatives.

In lieu of additional 2003/04 budget cuts, the school proposed to increase its base Masters enrollment by 63 students from the 2002/03 level. The school was successful, enrolling 102 students, and plans have been put in place to continue with this increased enrollment. 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. Tuition revenue, net of central and local program support, will be used to meet the school's budget target.

Hoover Institution

Continued success in fundraising and sound management of expenditures have enabled the Hoover Institution to generate a series of annual budget surpluses over the past ten years and to build a reserve fund. The budget outlook for the future continues to call for balanced budgets.

Although the Institution is on solid financial footing, it continues to face an unsettled economic outlook. In response, the Institution has embarked on a contingency plan that will reduce Hoover's annual base budget expenditures by $2.5 million over a two-year period; this represents a budget reduction of 8%. While the cuts will be accomplished primarily in the research and communications area, contingency planning allows for opportunistic hiring to refresh and enhance the scholarly ranks of the Institution.

School of Humanities and Sciences

The School of Humanities and Sciences (H&S) projects a deficit of $10.7 million for 2004/05. H&S will continue with last year's strategy of using accumulated fund balances to maintain academic programming levels, strengthening the graduate aid program, and making investments in faculty hires, infrastructure, and facilities.

The school has increased the volume of faculty hiring to fill billets that have been vacant for a number of years. This initiative will result in $12 million of one-time recruitment expenses. The graduate aid program has been strengthened across the school in order to attract top students. Increased levels of student funding, including the addition of a fifth year of support, have increased graduate aid costs by $8 million per year. As a result of these and other investments, consolidated fund balances are projected to decrease by $10 million. Over the short term, these investments will create considerable strain on the school's finances, requiring the use of one-time funding sources for both one-time and ongoing costs.

Long-term projections show that H&S will move back to financial equilibrium through a combination of revenue enhancements and expenditure controls.

Increases in general funds over the next three years will provide immediate relief, and fundraising activities associated with the Hewlett gift will steadily increase endowment income streams. To manage and reduce expenditures, the school has launched initiatives to reorganize department and program administrative structures and increase grant and contract support of expenses. The Dean's Office is also examining the faculty hiring plan to slow searches and move some senior searches to the junior level.

School of Law

The Law School projects a small surplus of $253,000 on revenue and transfers of $34.7 million. Expenses will increase approximately 7% as the school begins rebuilding its tenure line faculty and addresses competitive faculty salary pressures from peer schools. The school has also begun building a clinical faculty and will continue to expand its clinical offerings. The Law School will continue drawing down expendable gifts that have been raised during past years to fund start-up programs and clinics.

School of Medicine

For 2004/05, the School of Medicine is projecting a $24.4 million deficit. Key components of this projection include the following:

- Expenses are projected to increase 5.6% over the projected 2003/04 actual results, while revenues are projected to increase only 4.0%.
- The school will lose $5.3 million in revenue from the change in the Board's investment and earnings policies for unused endowment income and expendable funds.
- The school will increase its investment in interdisciplinary programs, including Clark Center operations, Bio X, the Department of Bioengineering, the Stanford Institutes of Medicine, and the development of the Comprehensive Cancer Center.
- The school plans to transfer $5.0 million of designated funds to funds functioning as endowment, an additional $12.6 million to cover plant-related costs, and $2.3 million to the Department of Bioengineering for costs related to department operations and faculty recruitment.

$6.8 million of expendable reserves held by the Dean's Office and by individual departments will be used in 2004/05 to cover expenses, and an additional $17.6 million will be transferred to endowment and plant. The Dean's Office and the departments have accumulated reserves to use for program and facility development and will utilize the reserves wisely in their 2004/05 investments in carefully planned strategic initiatives.

Revenue Growth – Revenue is projected to increase 4.0% for 2004/05 over the projected 2003/04 year-end actual results. This projected revenue growth is lower than that of prior years due to the following factors:

- Changes in the Board of Trustees' policies for the investment of unused endowment income balances and the cap on the distribution of earnings on the expendable funds pool result in a projected loss of $5.3 million.
- A slower rate of growth in research activity is projected (3.8%) due to space constraints, the reductions in the growth of the NIH budget, and an anticipated slowdown in the recruitment of tenure line faculty.
- Modest increases in the level of new expendable gift revenue are projected for 2004/05, as a major focus of the school's 2004/05 development effort will be capital gifts, which are not part of the Consolidated Budget.

Income from clinical operations is projected to increase 11.8% in 2004/05 from the projected year-end results for 2003/04. The two major components of this income stream are the professional fees generated from patient care services and the service payments from the hospitals. As a result of the recruitment of incremental Medical Center line faculty and clinician educators, plus a projected increase in productivity of the current faculty, the school projects an increase in professional fee income of 12.0%. Service payments from the hospitals are projected to increase 11.2%. The largest component of the service payment increase is in program development funds to support the school's recruitment of new faculty for the hospitals' expansion of their centers of excellence.

Expense Growth – The school's budget plan assumes the recruitment of approximately nine incremental tenure line faculty and 22 incremental Medical Center line faculty in 2004/05. The expenses related to faculty recruitment, including program support and incremental staff, are included in the budget plan. This represents a slower growth in faculty than the average for the past three years. A number of factors have influenced this projection. All available space for faculty is assigned and fully utilized; the Provost has imposed a cap on the school's faculty billets; the departure rate of faculty is projected to increase as many reach retirement age; and unrestricted resources for expansion and faculty retention are limited.

Expenses are projected to increase 5.6%, or $44.2 million, in 2004/05 over the projected 2003/04 year-end results. The major components of this increase are:

- $8.2 million in expenses associated with the incremental tenure line and Medical Center line faculty,
- $13.3 million in increases in annual compensation for faculty and staff salaries,
- $9.6 million in increased costs of employee benefits for current faculty and staff,

- $6.0 million in increases in non-compensation expenditures on sponsored projects, both direct and indirect, and
- $3.9 million in increases in space-related costs.

Transfers to Plant, Endowment, and Other Entities – The school and individual departments will continue to transfer funds to endowment as a mechanism for earning additional return on the funds while holding them for future investments in new faculty and programs. The projected amount of these transfers is $5 million in 2004/05. The projected transfers to plant of $12.6 million represent the school's continued expenditure on planned maintenance projects plus smaller renovation projects and discretionary projects to accommodate changes in program and recruitment of faculty.

Dean of Research

The Vice Provost and Dean of Research and Graduate Policy budget relies heavily on restricted funds and sponsored research, which constitute more than 75% of total projected revenue. Affiliate, gift, and endowment income is expected to increase in 2004/05, as are associated expenditures. Due largely to expected endowment income, the Dean of Research budget anticipates a $1.3 million surplus in 2004/05. As long as the endowment pool share value remains high, programs supported by endowment income, such as the Stanford Graduate Fellowship Program, will be in good financial standing.

Sponsored research activity is expected to remain strong. Recent research activity includes the Gravity Probe B launch and announcement of a new seed research program at the Stanford Institute for the Environment (SIE). SIE is a new independent institute designed to serve as a coordinating organization for environmental research and education at Stanford. Faculty interest in the program has been extremely high: SIE received 39 proposals from 87 faculty members representing 29 university departments, including classics, music, pediatrics, chemistry, and geophysics.

VPUE

In 2004/05, the Vice Provost for Undergraduate Education (VPUE) projects a deficit of nearly $1.9 million to be covered by existing fund balances. This deficit was anticipated in the multi-year funding plan that permitted VPUE to begin implementing substantial undergraduate education initiatives in 1994/95. This plan called for a combination of one-time funding sources to support the new initiatives for the first several years, 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 permanent funding for VPUE has increased through CUE gifts and base general funds increments, a significant gap remains between the ongoing costs of the undergraduate programs and the permanent funding available to support them. The $1.9 million deficit constitutes 8% of total forecast 2004/05 expenditures, and closing it will expend 17% of accumulated fund balances.

The following factors contribute to the amount of the projected deficit in 2004/05:

- One-time support from the President's and Provost's offices is forecast to decrease from $2.5 million in 2003/04 to $570,000 in 2004/05, a decrease of 78%. As anticipated in the multi-year funding plan, this one-time support has decreased annually as offsetting CUE revenues became available. One-time support from the President and Provost is scheduled to end in 2004/05.
- By 2004/05, VPUE will have exhausted its single largest funding source, which supported 13% of 2003/04 consolidated expenditures and has provided over $15 million of support since 1994/95.
- VPUE is investing in new residential advising initiatives and in the new writing curriculum, requiring significant investments in classroom technology and oral communication infrastructure. To meet growing student and faculty demand, VPUE is also continuing the scheduled expansion of undergraduate research programs. Together these new investments have $1.2 million of projected expenses and are supported through $250,000 of incremental base general funds earmarked to support the new writing requirement, increased allocations from accumulated fund balances, and the reallocation of existing resources. As in the previous two fiscal years, VPUE proposes to support innovation though reallocation of existing resources, and accordingly is reducing expenditures by an additional $280,000 beyond the Provost's mandated general funds reduction of $341,000.
- The forecast deficit is mitigated by a substantial turnabout in forecast endowment income. In 2004/05, VPUE forecasts endowment income of $8.3

million, representing an increase of 118% from the $3.8 million of endowment income that was forecast in 2003/04. In 2003/04, 75% of the total market value of VPUE endowments was invested in endowment funds expected to be subject to income shortfall, effectively halving their endowment payout and decreasing total anticipated revenue by $2.1 million. In 2004/05, with improved endowment performance, only 9% of combined endowment market value is forecasted to be subject to shortfall. CUE donor pledges have exceeded forecasts, and anticipated gift receipts also contribute to increased projected endowment income.

With its many new endowment funds, VPUE remains vulnerable to substantial income fluctuations from endowment shortfalls that can result from comparatively small decreases in endowment market value. As a buffer against this market volatility, VPUE seeks to retain adequate reserves while simultaneously allocating from these reserves to fund annual deficits forecast through 2008/09, when incremental CUE income is forecast to close the funding gap.

Libraries

After two years of budget cutting, 2004/05 shows some improvement in the support from general funds and increased payout from endowments. Although Stanford University Libraries & Academic Information Resources (SUL/AIR) will remove $250,000 from the base expense budget, it will do so primarily by attrition and cost cutting in non-personnel areas. SUL/AIR continues to have about $2 million structural deficit, arising primarily from its inability to increase revenue for materials and supplies expenses in the 1990s, while its expenses, particularly for computers and related services, as well as for facilities and outsourcing, increased dramatically. SUL/AIR continues to use its diminishing fund balances to balance its budget, but there is now almost no reserve to apply to innovation, to the development of new systems and services, or to various minor capital projects.

Incremental allocations to the SUL/AIR 2004/05 base budget provide a course management system as a common good to the entire campus and increased funding for the operations at the new SAL3, the high-density storage facility in Livermore, California. Further, increases to the library materials budget are meant to account for the dramatic decrease in the value of the U.S. dollar against foreign currencies, in which SUL/AIR spends well over 50% of its collections budget. The library materials budget continues to be stretched by the addition of new programs of teaching and research at Stanford, without equivalent decreases in other programs.

One-time funding will be directed to continued development of a course management system to succeed CourseWork, to the Stanford Digital Repository (a managed care facility for digital intellectual property assets), and to the acquisition of the Samson Copenhagen Collection, a rare book collection important to Judaic and historical studies at Stanford.

While new support for the course management system is in place, that support will be limited to basic technology maintenance; it will not provide direct support to instructors for creating or converting content to include in an instantiation of CourseWork. Academic Computing staff will provide training for instructors and teaching assistants in the use of CourseWork and supporting applications, attempting to make them self-sufficient, rather than providing direct support course by course.

Vice Provost for Student Affairs

In 2004/05, the Vice Provost for Student Affairs will increase its use of fee revenues to support its operating budget. Unrestricted local reserves will be used to fund new and short-term initiatives, including those in residential and student programming and staff development. Multi-year expendable gifts from prior years will be used to support gift-related programs.

To meet the general funds reduction goals for 2004/05, the division will reduce funding for programming in several areas, restructure a limited number of positions, and, at least for this year, use fees to support a small portion of base expenses. It will also increase fees for applicants to many graduate programs and incoming students. New base funding has been added for positions in Judicial Affairs and classroom technology support, as well as to complete the support for a major reorganization following system implementation several years ago.

One-time commitments to graduate student programs and staffing were renewed, as were support for an intensive summer orientation for Native American students and support for technology and related equipment in classrooms.

Beginning late in 2003/04, the Office of the Dean of Freshmen and Transfer Students will work closely with Freshmen Advising and will report directly to VPUE, while continuing to collaborate with Student Affairs. The 2004/05 Consolidated Budgets for VPUE and Student Affairs reflect this change in reporting structure.

SLAC

The Department of Energy (DOE) still provides most of the funding for SLAC, although in recent years SLAC has been involved in various interagency projects such as SPEAR3 and GLAST. The Linac Coherent Light Source (LCLS), SLAC's next major construction project, will also be funded by the DOE. The project will utilize the last third of 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 about $270 million, and the project is currently in the design phase. It is scheduled to be operational in 2007/08. The projected costs for 2004/05 assume funding of $54 million for the LCLS program ($4 million for R&D, $20 million to continue design, and $30 million to initiate long-lead procurements), but this funding awaits Congressional action. Primarily because of the expected LCLS project funds, total direct costs for SLAC are expected to be significantly higher in 2004/05 than in 2003/04.

Although in the President's proposed 2004/05 budget for SLAC there is growth in the synchrotron radiation science area (LCLS, SPEAR3 operations, and other research programs), the High Energy Physics (HEP) request for SLAC was lower than in 2003/04. This reduction, although small, coincides with a significant expected rise in electrical power costs due to the expiration of a long-term favorable contract that the Western Area Power Administration (WAPA) has with Pacific Gas & Electric (PG&E). 2004/05 electrical power costs for SLAC are estimated at $16.4 million, an increase of about $7 million from 2003/04. SLAC is requesting a supplement of $12.5 million above the President's HEP request from DOE in order to maintain a reasonable but lean program.

Stanford Alumni Association

Stanford Alumni Association (SAA) is projecting a balanced budget for 2004/05. SAA anticipates a slight increase in funds and revenues from both internal and external sources. SAA anticipates a slow but steady recovery from many external revenue sources, and it will use the available resources to continue to build and maintain alumni relation activities.

SAA was able to balance its projected 2003/04 budget through dramatic reductions in both staffing and program expenses. Now, however, SAA management has determined that some of these reductions may have been too severe and risk adversely impacting the long-term commitment and involvement of alumni. Consequently, SAA is re-examining each of its program cuts, and is prepared to reallocate any available resources so as to achieve the greatest return on investment.

SAA is confident that it will be able to maintain its focus in 2004/05 on its four main strategic priorities: building Stanford's presence in the regions; integrating Stanford's alumni into the life of the university; strengthening class identity; and leveraging the power of communications.

Information Technology & Systems Support

For 2004/05, ITSS forecasts consolidated revenue of $86.5 million. This funding is divided approximately equally between general funds of $42.5 million and service center rate-based funds of $44 million. The 2004/05 general funds budget reflects a reduction of 2%, following two previous years of reductions at a deeper level.

General funds of $26.5 million are provided to staff, equip, and operate all principal university administrative systems; Financial (Oracle), Human Resource (PeopleSoft), and Student Administration (PeopleSoft) consume the majority of this funding.

$16 million of remaining general funds is dedicated to basic IT services that are utilized by all university client groups: faculty, staff, and students. These are services and/or infrastructures that are essential in nature to delivering and supporting technology: Networking, Backbone and Desktop Security, Help Desks, and the Campus Card program.

ITSS provides rate-based services through its four service centers:

- Communications Services (voice, video, and data communications) – $31 million,
- Stanford Data Center (hosting, operations) – $7 million,
- Computer Resource Center (desktop and server installation, and maintenance) – $5 million, and

- Technology Training (lecture, hands-on, classroom, and web-based training) – $1 million.

One of ITSS's major goals for 2004/05 is to reduce the cost of services to its clients. A rate reduction in telecommunications for local calling will eliminate approximately $1 million from rate-based services that will be passed on to clients in their local calling rates.

Other process improvements and technology options are being actively pursued to accomplish similar savings across a variety of services without sacrificing performance and client satisfaction.

Land and Buildings

The Land and Buildings organization is projecting a $476,000 surplus. Most of the surplus results from endowment income in support of special campus houses that exceeds the annual operations and maintenance of these houses and is reserved for major planned maintenance projects in the upcoming years. Similarly, a projected surplus in the Residential Subdivision auxiliary will be reserved for major infrastructure projects related to roads and pathways in the residential subdivision.

A recent study projecting future needs in planned maintenance projects showed that due to Stanford's significant investment in renovation and new construction since the Loma Prieta earthquake, many buildings will be entering their early planned maintenance cycles. The university has allocated an incremental $1 million of general funds to the existing $8 million for planned maintenance to address these needs.

Only a couple of new building and renovation projects will be completed in 2004/05. Therefore less than $200,000 has been allocated for incremental O&M and utilities. These costs are related to the construction of the EPGY building, the renovation of Building 500/510 (the Archaeology Center), and smaller infrastructure projects.

Utilities costs overall are relatively flat due to offsetting decreases and increases in the different utilities. Electricity prices decreased 20% as a result of PG&E's implementation of the approved settlement agreement plan to resolve its Chapter 11 case. Natural gas, domestic water, lake water, and sewer costs are projected to increase in the upcoming year.

Overall, the service centers are projecting a break-even between revenues and expenses, with a small increase in expenses due to the salary increases related to the university salary program, the Bargaining Unit contract, and the benefits rate increase.

Minimal rate increases are projected due to a combination of reduction in non-salary expenses, productivity improvements, and maintaining the level of customer-funded work. As always, the nature of service centers is such that unexpected changes in the Capital Plan and customer-funded work could cause the revenue streams to fluctuate, thereby affecting staff headcounts and service center rates.

IMPACT OF THE CAPITAL BUDGET ON THE CONSOLIDATED BUDGET FOR OPERATIONS

The 2004/05 Capital Budget calls for $168.9 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 $2.4 million in incremental internal debt service for those projects that will be coming on line in 2004/05 or for projects completing in 2003/04 that were operational for less that the entire fiscal year. Of this total, $278,803 will be borne by unrestricted funds (general funds and designated funds) and $2.1 million will be covered by the Auxiliaries and Service Centers. The second impact of the Capital Budget on the operations budget is $792,000 for incremental operations, maintenance, and utilities costs, primarily for the Lucas Center, Maples Pavilion renovation, and the Graduate Community Center.

PROJECTED STATEMENT OF ACTIVITIES

The table on page 25 compares the Consolidated Budget for Operations with the projected operating results section of the Statement of Activities. The Statement of Activities summarizes all changes in net assets during the year (both operating and non-operating). It has similarities to a corporate income statement. It is prepared in accordance with Generally Accepted Accounting Principles (GAAP) and is part of the audited annual financial statements published in the Annual Report.

Stanford University, as a not-for-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 are subject to different legal and management constraints.

There are four different types of funds:

1) Current Funds, which include revenue to be used for operating activities — e.g., tuition revenue, sponsored research support, endowment payout, and other investment income;

2) Endowment Principal Funds, which include all of Stanford's endowment funds;

3) Plant Funds, which include all funds to be used for capital facilities purposes, such as construction of new facilities or retirement of indebtedness;

4) Student Loan Funds, which include those funds to be lent to students.

The Consolidated Budget for Operations follows the principles of fund accounting, representing the sources and uses of current operating funds on a modified cash basis that more closely matches the way that the university is managed internally. It 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. For example, a school may choose to transfer operating revenue to be used to fund 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.

Stanford also has external reporting requirements in addition to its requirement to manage funds in accordance with donor-imposed restrictions. The university prepares its annual financial statements in accordance with GAAP.

CONVERTING THE CONSOLIDATED BUDGET INTO THE STATEMENT OF ACTIVITIES

To convert the Consolidated Budget to the Statement of Activities format, it is necessary to add revenue and expense reclassifications and adjustments to the numbers in the Consolidated Budget. For example, the Consolidated Budget reports as expense the use of funds to acquire equipment. The Statement of Activities records the acquisition of capital equipment as an increase in assets in the Statement of Financial Position (similar to a corporate balance sheet), with a corresponding annual amount of expense required to depreciate the cost of the capital equipment over its useful life in the Statement of Activities. Additionally, the Statement of Activities incorporates the activities of other separate, wholly owned entities, which are not accounted for in the Consolidated Budget.

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

a) Eliminate fund transfers. The Consolidated Budget includes transfers of $61.6 million of current funds to other fund classifications, including plant and student loans ($46.6 million) and funds functioning as endowment ($15 million). The Statement of Activities reflects operating results for all fund types, including plant, student loan, and funds functioning as endowment.

b) Record capital equipment purchases as assets on the Statement of Financial Position. The Consolidated Budget includes the projected current year's purchase of capital equipment as expense. For GAAP purposes, the cost of capital equipment is recorded as an increase in assets on the Statement of Financial Position and recorded as depreciation expense ratably over the useful life of the asset in the Statement of Activities. As a result, $63.6 million is subtracted from Consolidated Budget expenses. Effective September 1, 2003, the university changed the threshold above which equipment purchases are capitalized, from $1,500 to $5,000. Net of the current year's depreciation expense, this change is expected to result in approximately $20 million additional operating expense in the Statement of Activities.

c) Record depreciation expense for the current year's asset use. The Statement of Activities includes the 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 million of expense.

d) Accrue fringe benefit expenses. The Consolidated Budget reflects the fringe benefits cost as the amount of the fringe benefit rate charged on all salaries. It does not reflect the actual payments made by the university to external providers. Those costs may differ from the amount collected through the fringe benefits rate. In addition, the Statement

Comparison of Consolidated Budget and Statement of Activities, 2004/05
Unrestricted Net Assets

[in millions of dollars]

Statement of Activities				Fiscal Year 2004/05		
2002/03 Actuals	2003/04 June 2003 Budget	2003/04 Projected Year-End		Projected Consolidated Budget	Adjustments	Projected Statement of Activities
			Revenues and Other Additions			
			Student Income:			
185.3	191.9	193.4	Undergraduate Programs	201.7		201.7
166.6	185.0	183.3	Graduate Programs	196.4		196.4
82.1	92.4	90.3	Room and Board	93.3		93.3
(116.1)	(123.6)	(132.0)	Student Financial Aid[e]		(141.9)	(141.9)
317.8	345.7	335.0	Total Student Income	491.4	(141.9)	349.5
			Sponsored Research Support:			
496.7	505.9	529.0	Direct Costs—University	546.1		546.1
219.7	223.0	228.0	Direct Costs—SLAC	260.0		260.0
143.9	156.7	159.0	Indirect Costs	158.7		158.7
860.3	885.6	916.0	Total Sponsored Research Support	964.8		964.8
211.2	207.6	230.4	Health Care Services[f]	274.5	(19.2)	255.3
112.9	105.0	115.0	Expendable Gifts In Support of Operations	120.0		120.0
			Investment Income:			
391.4	378.5	404.2	Endowment Income	424.8		424.8
116.7	74.8	76.6	Other Investment Income	81.6		81.6
508.1	453.2	480.8	Total Investment Income	506.4		506.4
246.8	238.8	247.0	Special Program Fees and Other Income[g]	248.0	3.4	251.4
54.2	50.0	50.0	Net Assets Released from Restrictions	50.0		50.0
2,311.3	**2,285.9**	**2,374.2**	**Total Revenues**	**2,655.1**	**(157.7)**	**2,497.4**
			Expenses			
1,220.7	1,237.0	1,294.0	Salaries and Benefits[d,g]	1,361.1	(6.9)	1,354.2
219.7	223.0	228.0	SLAC	260.0		260.0
			Capital Equipment Expense[b]	63.6	(63.6)	
181.3	195.0	193.0	Depreciation[c]		195.0	195.0
			Financial Aid[e]	141.9	(141.9)	
644.1	680.8	673.4	Other Operating Expenses[f,g,h]	760.2	(69.0)	691.2
2,265.7	**2,335.9**	**2,388.4**	**Total Expenses**	**2,586.8**	**(86.4)**	**2,500.4**
45.6	**(50.0)**	**(14.2)**	**Revenues less Expenses**	**68.3**	**(71.3)**	**(3.0)**
			Transfers			
			Additions to Funds Functioning as Endowment[a]	(15.0)	15.0	
			Transfer to Plant/Student Loan[a]	(46.6)	46.6	
			Total Transfers	(61.6)	61.6	
45.6	**(50.0)**	**(14.2)**	**Excess of Revenues Over Expenses After Transfers**	**6.7**	**(9.7)**	**(3.0)**

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 includes actual cash payments made for pension and post-retirement and other benefits in the current period. For 2004/05, budgeted expenses are expected to exceed GAAP expenses by $8.6 million.

e) Reclassify financial aid. Student financial aid is required by GAAP to be shown as a reduction of revenue. In the Consolidated Budget, financial aid is reported as an operating expense. Accordingly, $141.9 million of student financial aid expense is reclassified as a reduction of revenue in the Statement of Activities.

f) Adjust Health Care Services. For GAAP purposes, Health Care Services revenues received from the hospitals are reported net of expenses that the hospitals reimburse to the university. The Consolidated Budget presents the revenues and expenses on a gross basis. This adjustment reclassifies $21.8 million from Other Operating Expenses to Health Care Services revenues. The Health Care Services revenue also has an offsetting adjustment of $2.6 million for income from the hospitals for capital-related projects, which are not included in the Consolidated Budget.

g) Include Sierra Camp LLC. Activities of the Sierra Camp, a wholly owned university entity, are consolidated in the Statement of Activities, but are not included in the Consolidated Budget. This adjustment adds $3.4 million in Special Program Fees and $1.7 million to each of Salaries and Benefits and Other Operating Expenses.

h) Adjust for difference in treatment of debt service. The Consolidated Budget reflects as Other Operating Expenses the use of unit funds to cover repayment of their respective debt service. This includes repayment of principal and interest expense computed at a pre-established pooled interest rate. The Statement of Activities treats as expense only the external interest accrued on the university's outstanding indebtedness. Repayment of principal is treated as a capital transaction (reduction of outstanding indebtedness when payment is made to our bondholders.) Therefore, Other Operating Expenses on a Consolidated Budget basis must be reduced by $48.9 million to reflect the difference in the treatment of principal repayment ($49.8 million) and the additional external interest expense ($0.9 million).

In summary, the impact of these adjustments decreases the Consolidated Budget's projected $6.7 million surplus by $9.7 million, resulting in a projected deficit of $3.0 million in the Statement of Activities.