

STANFORD UNIVERSITY

BUDGET PLAN 2014/15



EXECUTIVE SUMMARY

To The Board of Trustees:

Since recovering from the financial crisis, Stanford has approached the annual budgeting process cautiously. This year is no exception. While our overall financial condition is excellent, we remain concerned about the outlook for federal research and the increasing burden of compliance, information security, and privacy costs. These issues played a significant role in the budget process this year and constrained our capacity to invest in academic program expansion and enhancement. However, growth in other non-sponsored revenue sources, notably investment income, health care services revenue, and philanthropy, has provided the funding to address high priority needs, such as a competitive salary program for faculty and selective strategic investments in student services, research support, and facilities. We are confident that this budget will maintain Stanford's leadership across our many academic fields while positioning us well to take advantage of future opportunities.

This document presents Stanford's 2014/15 Budget Plan for Trustee approval. The Budget Plan has two parts. The first is the Consolidated Budget for Operations, which includes all of Stanford's anticipated operating revenue and expense for next year. The second is the Capital Budget, which is set in the context of a multi-year Capital Plan. The budgets for the Stanford Hospital and Clinics and the Lucile Packard Children's Hospital, both separate corporations, are not included in this Budget Plan, although they are included in the university's annual financial report.

Some highlights of the Budget Plan:

- The Consolidated Budget for Operations projects a surplus of \$160 million on \$5.1 billion of revenues, \$4.7 billion in expenditures, and \$219 million in transfers. We anticipate a revenue increase of 6.0% over the projected 2013/14 year-end results. This is principally due to a 9.5% growth in health care services and an 8.4% increase in investment income, moderated by a 2.7% growth in sponsored research (including SLAC). We are budgeting for a 5.6% increase in expense, driven by a 7.3% growth in compensation expenses. Other expenses are projected to increase by 3.2%.
- The Consolidated Budget includes \$1.25 billion in general funds, of which \$177 million flows to the Graduate School of Business, the School of Medicine, and the Continuing Studies and Summer Session Programs in accordance with previously agreed upon formulas. We anticipate a general funds surplus of \$25.6 million, a figure comparable to prior years and one that provides a necessary cushion against revenue fluctuation and gives us the flexibility to address one time needs throughout the year.
- This Budget Plan also presents the projected 2014/15 results in a format consistent with Generally Accepted Accounting Principles, as reported in the university's annual financial report. The projected Statement of Activities shows a \$147.8 million surplus.
- The Capital Budget calls for \$655.4 million in expenditures in 2014/15. These expenditures are in support of a Capital Plan whose projects, when fully completed, will require approximately \$2.8 billion in total project expenditures. Principal expenditures in 2014/15 will be directed toward:
 - ◆ \$110 million of work on the Stanford Energy System Innovations (SESI) project, leading to completion by April, 2015.
 - ◆ Completion of the McMurtry Art and Art History Building.

- ◆ Continued work on the California Avenue faculty housing project.
- ◆ Completion of the Roble Gym renovation and the expansion of the Manzanita undergraduate residential complex.
- ◆ Substantial work on the Science Teaching and Learning Center (Old Chemistry).

STRATEGIC CONTEXT

As we look ahead to 2014/15, Stanford will continue to operate from a position of great programmatic and financial strength. Our academic departments and research programs are among the very best in the world, and our financial profile has returned to its pre-recession levels. Despite this positive position, however, one of our largest revenue sources, the direct costs of sponsored research (excluding SLAC), is only expected to grow at 1.3% next year, continuing a trend in place since 2011. We have responded by directing up to \$5 million of the university reserve to be used by school deans in assisting faculty to bridge grant shortfalls, particularly to maintain support for graduate students when anticipated grants are delayed or not funded.

By contrast, the other revenue sources in the consolidated budget are growing, particularly investment income, which includes endowment payout and returns on the expendable funds pool. Health care services revenue (payments from the hospitals generated by faculty physicians in the Medical School) is also increasing substantially next year. The health care services revenue line is now the third largest in the consolidated budget, exceeding tuition revenue and nearly matching total tuition, room and board income. General funds (not itself a revenue line, but the unrestricted portion of each revenue line) are expected to grow at 5.3%, which will allow modest incremental allocations for the highest university needs.

The substantially improved economy has been a double-edged sword. On the revenue side, it has helped our investment performance and strengthened our philanthropic results. But on the expense side, it exerts pressure on compensation and local housing costs. Thankfully, we are able to maintain a very competitive faculty and staff salary program for 2014/15, and we continue to assist recruits who are dealing with the very challenging local housing market.

Some of this year's key budget decisions are:

Academic Initiatives

We funded many of the highest priority needs in the schools and academic programs. Among the incremental allocations were increased graduate student support in the Graduate School of Education, support for the Architectural Design program in the School of Engineering, operational resources for the Precourt Institute for Energy, increased support for shared scientific instrumentation and analytical facilities, and funds to maintain the purchasing power of the library materials budget.

Compliance, Privacy, and Security

We have made several significant allocations in the 2014/15 budget to meet continued increases in government regulatory compliance requirements and to enhance the university's computer security and privacy infrastructure.

Student Support

A high priority in this year's budget process was to provide funding for the Career Services Center. Under its new director, Farouk Dey, the Center is significantly expanding its offerings to provide all Stanford

students with a superior career counseling experience. (See sidebar on page 19.) In addition, we are providing substantially increased funding for teaching assistants in Engineering and Physics.

Facilities

The cost of maintaining and enhancing Stanford's physical plant is significant. We are budgeting \$245.8 million for operations, maintenance, and utilities on new and existing campus facilities in 2014/15, an increase of \$17.1 million. Much of the increase, \$6.4 million, is due to amortization costs associated with the new energy facility and will be charged through utility rates paid by the units.

FINANCIAL RESERVES

Stanford has three principal categories of financial reserves:

Expendable reserves - We project Stanford's expendable reserves will stand at \$4.1 billion at the end of 2014/15. Of that amount, \$2.9 billion is a combination of reserves, restricted and unrestricted expendable funds, and unspent restricted endowment payout. The remaining \$1.2 billion is split between plant funds (\$1.0 billion) and student loan and agency funds (\$260 million). These reserves consist of thousands of funds held across the university, largely controlled by individual faculty, departments, programs, and schools.

Tier I Buffer - We project the Tier I buffer will stand at \$1.3 billion by the end of 2014/15. The buffer's funds are generated by the investment returns on a subset of our expendable reserves. The money is invested as funds functioning as endowment, the payout from which supports the general funds component of the Consolidated Budget. The Tier I Buffer acts as a backstop to maintain the value of those expendable funds, which are invested in the merged pool.

Tier II Buffer - Our estimate of the Tier II buffer is \$1.0 billion by the end of 2014/15, which is close to its nominal value before the recession. Like the Tier I Buffer, this fund is generated from excess investment returns from expendable reserves, and is invested as funds functioning as endowment. The payout is used at the discretion of the president. (Further detail on the buffers may be found in Chapter 1 in the Other Investment Income section.)

CONSOLIDATED BUDGET FOR OPERATIONS

The table on the next page shows the main revenue and expense line items for 2014/15 and compares those numbers to our current projection of final results for 2013/14. Some highlights of both income and expense follow.

Revenue

Student Income - This figure is the sum of tuition and room and board income, and is expected to grow by 4.2%. Tuition income is projected to grow 3.5% over the projected 2013/14 actuals as the result of a 3.5% increase in the general undergraduate and graduate tuition rates and a slight growth in the number of professional school students. Room and board income is projected to increase 7.5%, due principally to the opening of the new Kennedy Graduate Residences.

University Sponsored Research - Given federal budget constraints, we expect the direct costs of university sponsored research (excluding SLAC) to grow by only 1.3%, while indirect cost recovery will increase by 2.1%. When SLAC is included, total sponsored research revenue is expected to increase to \$1,328 million, 2.6% over 2013/14 projected year-end results.

CONSOLIDATED BUDGET FOR OPERATIONS, 2014/15

[IN MILLIONS OF DOLLARS]

2012/13 ACTUALS	2013/14 BUDGET JUNE 2013	2013/14 PROJECTED ACTUALS		2014/15 CONSOLIDATED BUDGET	CHANGE FROM PROJECTED ACTUALS
Revenues					
753	779	786	Student Income	820	4.3%
882	899	902	University Sponsored Research	915	1.5%
351	452	392	SLAC	413	5.5%
715	700	745	Health Care Services	816	9.5%
358	290	295	Gifts and Net Assets Released from Restrictions	315	6.8%
1,040	1,176	1,172	Investment Income	1,270	8.4%
474	483	517	Special Program Fees and Other Income	551	6.5%
4,573	4,779	4,809	Total Revenue	5,100	6.0%
Expenses					
2,517	2,655	2,647	Compensation	2,840	7.3%
242	254	248	Financial Aid	256	3.3%
162	171	170	Debt Service	183	7.6%
1,239	1,384	1,405	Other Operating Expense	1,442	2.6%
4,160	4,465	4,469	Total Expense	4,721	5.6%
413	313	339	Operating Results	379	
(229)	(140)	(224)	Transfers	(219)	
184	173	115	Operating Results after Transfers	160	
2,403	2,423	2,587	Beginning Fund Balances	2,702	
2,587	2,596	2,702	Ending Fund Balances	2,862	

Health Care Services Income – Revenue from health care services is projected to increase by 9.5% in 2014/15. This revenue consists principally of payments from the hospitals to the School of Medicine for faculty physician services. This continues to be the fastest-growing revenue source in our budget, having increased at 12.1% annually over the past decade.

Expendable Gifts – We are budgeting a 6.8% increase in expendable gifts. Note that this figure does not include gifts to endowment or gifts for capital projects, which do not appear in the Consolidated Budget for Operations. Net assets released from restrictions — payments made on prior year pledges and prior year gifts released for current use — are included in this figure.

Investment Income – This category consists of income paid out to operations from the endowment (\$1,064.7 million) and from other investment income (\$205.0 million), the majority of which is payout from the expendable funds pool (EFP). Overall, investment income is expected to be up by 8.4% in 2014/15. Endowment payout is projected to increase by 8.2%, based on the Trustee-approved payout rate and our forecast of \$500 million in new gifts and additions to endowment. Other investment income is expected to be up by 9.3%. This increase is governed by the EFP policy, which uses the prior year's investment return to set most of the payout in the subsequent year. With current strong market performance, we project healthy returns this year.

Expense

Salaries and Benefits – We anticipate total compensation to increase 7.3% over 2013/14 year-end results. The increase is the result of our salary program, an increase in headcount, and a significant increase in benefits costs. Although no new benefits are being added, overall fringe benefits expense is expected to increase by 12%. This is driven by the salary program, anticipated staff growth, and increased health care costs.

Financial Aid – The costs for need-based financial aid, athletic aid, and graduate student aid will increase by 3.3%. This increase allows Stanford to maintain its generous need-based aid program for undergraduates, consistent with our tuition increase. It also reflects our assumption of a slight improvement in the financial circumstances of some of our families on need-based aid.

Other Operating Expenses – This substantial expense item is the amalgam of graduate stipends, operations and maintenance, utilities, capital equipment, materials and supplies, travel, library materials, subcontracts and professional services. These expenses are projected to grow at 2.6%.

School Initiatives

Stanford's principal academic units, the seven schools, will continue advancing their research and teaching missions with ambitious agendas for 2014/15. A few highlights of their plans are:

Graduate School of Business – As the business school moves into its fourth year of implementing the GSB2020 strategy, it plans to increase the number of doctoral students. It will also expand efforts to develop joint MBA degrees with other schools, and to integrate further the Management for Experienced Managers program (MSx) with the MBA program.

Earth Sciences – The school plans an expansion of master's and co-terminal programs in the upcoming year. It also plans to complete faculty searches in water/land management, end-to-end energy, and coastal ocean science.

Graduate School of Education – The school will continue its strategic focus on enhancing the role of technology in education, as well as on educating low-income students. There are two important searches underway, one for a faculty member specializing in education and poverty and another who will address the education of linguistic minorities.

Engineering – While Engineering transitions to a new dean in the year ahead, it will continue to expand initiatives in on-line learning; it will move the Stanford Data Sciences Initiative into its formative stage; and it will expand the implementation of a joint major model in which students will pursue integrated elements of both a computer science and a less closely related major.

Humanities and Sciences – The school is engaged in several collaborative initiatives with other units at Stanford, including the Institute for Chemical Biology; the Center for Computational, Evolutionary, and Human Genomics; and the Neuroscience Institute. Although these initiatives are unfolding with great promise, H&S continues to be concerned with the future of research funding, which is expected to be flat for the foreseeable future.

Law – As an innovative leader in legal education, the Law School will seek to enhance its Law and Policy Lab, as well as expand the exposure of its students to the practice of law in a global context.

Medicine – As Stanford's largest and fastest growing school, Medicine will accelerate its translational research by expanding its clinical trials infrastructure. Over the next several years the number of MD/PhD students will grow by 50%, and the newly formed Stanford Health Care Alliance will build on its successful launch into the local community.

GENERAL FUNDS BUDGET

A focal point of the budgeting process is the development of the general funds component of the Consolidated Budget. The \$1.25 billion in general funds can be used for any university purpose and supports many of the core academic and support functions of the university.

As shown in the chart below, the general funds budget will increase by \$70.7 million. About half will cover inflationary adjustments for salaries, benefits, non-salary costs, and the operating costs of existing facilities. Of the remainder, most will go to compliance, security, and necessary administrative activities. We continue to see the burden of such infrastructure and administrative costs increase, diminishing our capacity for academic program investment.

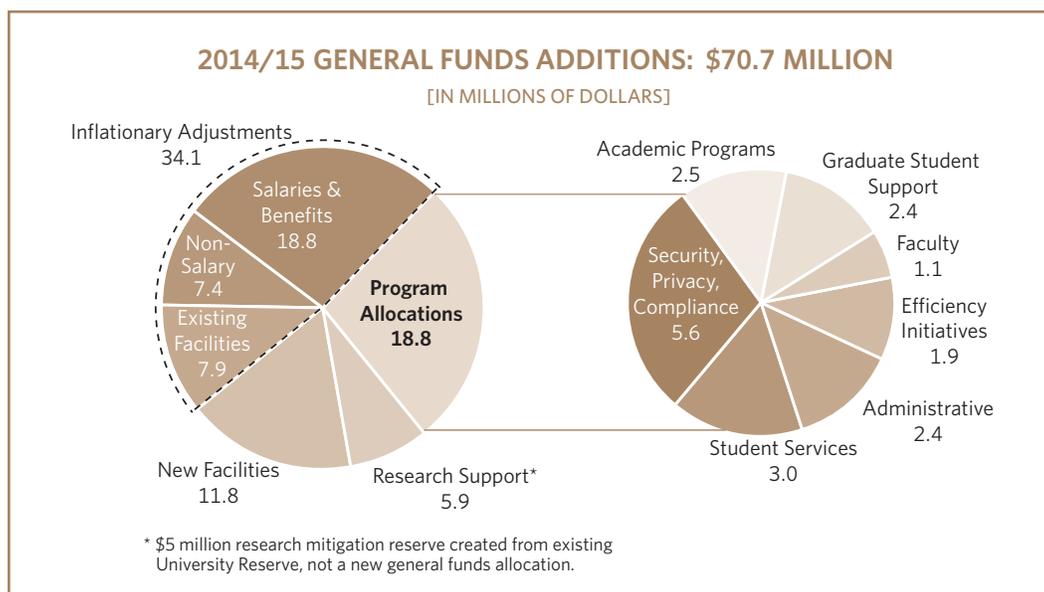
Some examples of incremental program support are:

Security, Privacy, Compliance - In light of recent attacks on our information systems, we are making a large investment to enhance security and infrastructure. We are also funding additional compliance requirements in information privacy, research activities, and federal Title IX compliance.

Graduate Student Support - In recent years, Engineering and Physics have experienced significant growth in undergraduate enrollments. To respond, we have allocated \$2.2 million to a central teaching assistant pool that will initially go to these two areas but can be shifted to other departments in the future as enrollment trends change.

Efficiency Initiatives - After the 2008 recession Stanford piloted a number of efficiency initiatives, including establishing an internal web services group, thereby saving on more costly external providers; centralizing human resources transactions; and increasing strategic sourcing initiatives in procurement. These trial initiatives have all proven to be effective, so we are providing on-going funding in this budget, subject to regular reviews.

The pie chart below reflects all of the general funds additions. After making the program additions described above we anticipate a general funds surplus of \$25.6 million.



CAPITAL BUDGET AND PLAN

The Capital Budget and three-year Capital Plan are based on a projection of the major capital projects that the university intends to pursue to further its academic mission. The three-year Capital Plan spans 2014/15 through 2016/17; the Capital Budget represents anticipated capital expenditures in the first year of the plan. The three-year plan includes projects that were initiated prior to 2014/15, as well as projects that will commence within the rolling three-year period through 2016/17. The Capital Budget and Capital Plan are subject to change based on funding availability, budget affordability, and evolving university priorities.

The 2014/15 Capital Budget is projected to be \$655.4 million. The major projects within the Capital Budget include infrastructure investments of \$253.9 million for the energy facility, Parking Structure 10, and various planned maintenance projects; \$197.2 million in academic and research projects, including the McMurtry Building, the Science Teaching and Learning Center (Old Chemistry), and the Bass Biology Research Building; and \$109.7 million in housing projects, comprising the California Avenue Faculty Homes, Business School Graduate Residences, and Manzanita Undergraduate Dorm.

The three-year Capital Plan includes \$2.8 billion in construction and infrastructure projects and programs. With the completion of the ambitious Science, Engineering, and Medicine Campus plan, strategic directions for capital planning at Stanford are changing. As we look ahead, new initiatives will shape our capital planning process. Most notably, we must address additional facility needs in the Biology/Chemistry/Computer Science precinct. We will be looking at different ways to address issues of transportation, parking, and circulation. The housing needs of students, faculty, and staff continue to be one of our highest strategic priorities, and several new facilities will be added to the campus in the coming years. Finally, Stanford will accelerate its efforts to move more non-academic and administrative functions to a satellite campus in Redwood City.

ACKNOWLEDGEMENTS

The budget plan is the product of a great deal of work on the part of managers and budget officers at every level of the university. I would like to begin by acknowledging the budget officers and leadership in the schools and administrative units for their efforts in support of the budget process. I am particularly grateful to the leadership of the schools for making a concerted effort to fund new initiatives first out of restricted, school-controlled funds, and only secondarily asking for general funds supplementation when these funds fall short.

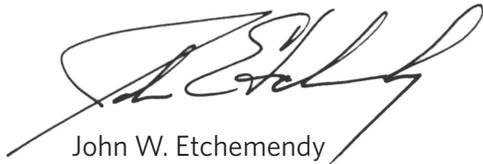
As always, I am extremely grateful to two hardworking advisory groups that assist me in formulating the general funds budget and capital plan. The University Budget Group consists of Margaret Brandeau, Adam Daniel, Harry Elam, Andrea Goldsmith, Patti Gumpert, Neil Hamilton, Rosemary Knight, Randy Livingston, Maureen McNichols, Kam Moler, Dana Shelley, Bob Simoni, Buzz Thompson and Tim Warner. This group met from late September through March, often twice a week, to review submissions and requests from the various budget units and to advise me on the final allocations of general funds. Kam Moler, the group's newest member, brought new insights about the needs of the physical sciences, as well as a thoughtful and analytical perspective that was greatly valued by the entire group. At the end of this year, Bob, Buzz and Maureen will be stepping down after many years of dedicated service. It is an understatement to say that I will sorely miss their wise and experienced counsel. Staff support for the Budget Group, and for the creation of this document, is provided by the budget office staff, consisting of Neil Hamilton, Andrew Harker, Betsy Lewis, Serena Rao, and Dana Shelley, under the able leadership of Tim Warner.

The Capital Planning Group consists of Jack Cleary, Megan Davis, Alise Johnson, Stephanie Kalfayan, David Lenox, Bob Reidy, Craig Tanaka, Bob Tatum and Tim Warner. Craig guides the capital planning process with remarkable efficiency, while Megan tracks all financial aspects of the plan and supervises the final write-up in Chapter 4 of this document.

REQUESTED APPROVAL AND ORGANIZATION OF THIS DOCUMENT

The budget plan provides a university-level perspective on Stanford's programmatic and financial plans for 2014/15. We seek approval of the planning directions, the principal assumptions, and the high-level supporting budgets contained herein. As the year unfolds, we will provide periodic variance reports on the progress of actual expenses against the budget. In addition, we will bring forward individual capital projects for approval under normal Board of Trustees guidelines.

This document contains four chapters and two appendices. Following the overview of budgeting at Stanford, Chapter 1 describes the financial elements of the plan, including details of the Consolidated Budget for Operations and the projected Statement of Activities for 2014/15. Chapter 2 addresses program directions in the academic areas of the university. Chapter 3 provides a similar view of the administrative and auxiliary units. Chapter 4 contains details on the Capital Budget for 2014/15 and the Capital Plan for 2014/15-2016/17. The appendices include budgets for the major academic units and supplementary financial information.



John W. Etchemendy
Provost
June 2014

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INTRODUCTION: BUDGETING AT STANFORD

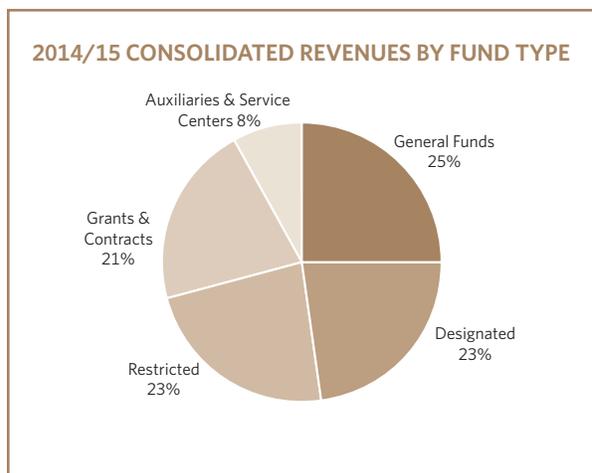
Budgeting at Stanford is a continuous process that takes place throughout the year and occurs at nearly every level within the university. The cycle starts with planning that considers programmatic needs and initiatives, continues with the establishment of cost drivers such as the approved salary program and fringe benefits rates, and is tempered by available funding sources. Stanford's "budget" is an amalgamation of thousands of smaller budgets, including everything from an individual faculty member's budget for a sponsored grant from the National Institutes of Health, to the budget for the Department of Psychology, to the budget for the School of Engineering, to the total of the Consolidated Budget for Operations. These budgets are created and managed by the areas that are governed by them, with oversight by the provost, the chief budget officer of the university. There are general principles and guidelines to which the budgets must adhere, but schools and other units are allowed tremendous freedom in the development and execution of their budgets.

Fund Accounting

Stanford's budgets are developed and managed according to the principles of fund accounting. Revenue is segregated into a variety of fund types, and the use of the revenue is governed by the restrictions of the fund. For example, each expendable gift is put into an individual fund, and the recipient must use the funds in accordance with the wishes of the donor. Gifts of endowment are also put into separate funds, but the corpus itself is not usually spent. An annual payout on the endowment fund is spent, and as with gift funds, only in accordance with the restrictions imposed by the donor. The segregation of each gift allows the university to ensure that the funds are spent appropriately and to report to donors on the activities that their funds support. Monies received from government agencies, foundations, or other outside sponsors are also deposited in separate, individual funds to ensure strict adherence to the terms of the grants and/or contracts that govern the use of the funds. Non-gift and non-sponsored research revenue also reside in funds, but this type of revenue may be commingled in a single fund. Departments may choose to combine unrestricted monies into separate funds for a particular program, for a capital project, or to create a reserve. Stanford's consolidated revenues by fund type are shown at the right.

Budget Management

So how does Stanford budget and manage its roughly 15,000 expendable funds (with balances) and more than 7,000 endowment funds? It goes without saying that the university uses a sophisticated financial accounting system to set up the individual funds, to record each financial transaction, and to track fund balances. But nearly all of the decision-making for the use of Stanford's funds is made at the local level, consistent with the decentralized and entrepreneurial spirit of the university. Unlike a



corporation, Stanford is closer to a collection of disparate, autonomous businesses with widely varying cost structures and resources. As such, each principal investigator is accountable for the responsible use of his/her grant funding, each gift recipient must ensure that the gift funds are used in accordance with the donor's wishes, and each school must fulfill the expectations for teaching and scholarship within its available resources. Schedule 21 in Appendix B shows expendable fund balances by academic unit and by level of control.

Budget Control

The primary control on local unit budgets at Stanford is available funding. Except for general oversight and policies governing the appropriate and prudent use of university funds, the central administration does not place additional limits on spending. For example, if a faculty member needs to hire a postdoctoral fellow to help carry out a particular research project, and if grant funding is secured to cover this expense, the university does not second-guess this decision. Conversely, two important budget matters are controlled centrally: faculty billets and space.

Because the majority of Stanford's funding is under the direct control of a faculty member, a department, or a school, these entities are able to support programs as long as they maintain a positive fund balance. This, however, does not mean that the programs must operate with a surplus during any particular fiscal year. In fact, a "deficit" is usually reflective of a planned use of prior year fund balances. A simple example of this is when a department receives a gift of \$5.0 million to be spent over five years. If the funds are spent evenly over the time period, the program will show a surplus of \$4.0 million in the first year and will generate an ending fund balance of \$4.0 million. In each of the next four years, this program will receive no revenue, will expend \$1.0 million dollars, and will thus generate an

annual deficit of \$1.0 million while drawing down the fund balance of the gift.

The Consolidated Budget for Operations, the aggregate of all of Stanford's smaller budgets, is therefore not centrally managed in the corporate sense. Nonetheless, a great deal of planning goes into the development of the individual unit budgets that aggregate into the Consolidated Budget of the university.

Development of the Consolidated Budget & the Role of General Funds

Another key element in the development of the units' budgets and the Consolidated Budget are university general funds, which are funds that can be used for any university purpose. General funds play a particularly important role in the overall budget, because they cover many expenses for which it is difficult to raise restricted funds, such as administration and campus maintenance. The main sources of general funds are tuition income, indirect cost recovery, unrestricted endowment income, and income from the expendable funds pool.

Each school and administrative unit receives general funds in support of both academic and administrative functions. The process for allocating general funds is controlled by the provost and aided by the Budget Group, which includes representation from both faculty and administration.

The critical elements of the process are a forecast of available general funds, a thorough review of each unit's programmatic plans and available local funding, and an assessment of central university obligations such as building maintenance and debt service. Balancing the needs and the resources is the ultimate goal of the Budget Group. The general funds allocation process is described in more depth in Chapter 1.