STANFORD UNIVERSITY

BUDGET PLAN 2016/17

EXECUTIVE SUMMARY

To The Board of Trustees:

As Stanford looks ahead to 2016/17 and a presidential transition, its reputational and financial positions are at their historic peaks. Record philanthropy and world recognized academic and research programs have placed us among the top few research universities in the world. Although we are in an enviable position, we have proceeded cautiously in developing the 2016/17 budget. The volatility of investment markets and the modest growth of federal research funding has led us to restrain the pace of budget growth compared to recent years. Our highest priorities in developing this budget have been: i) to maintain a competitive compensation and benefits program; ii) to enhance the affordability of a Stanford education; and iii) to invest very selectively in high priority university initiatives. We are confident this budget, though cautious, both furthers Stanford's programmatic objectives and maintains a strong underlying financial condition.

This document presents Stanford's 2016/17 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 Stanford Health Care and Lucile Packard Children's Hospital, both separate corporations, are not included in this Budget Plan, although they are incorporated into the university's annual financial report.

Highlights of the Budget Plan:

- The Consolidated Budget for Operations projects a surplus of $121 million on $5.9 billion of revenues, $5.6 billion in expenditures, and $166 million in transfers. We anticipate revenue to increase 2.6% over the projected 2015/16 year-end results. This modest increase is the result of a 9.5% reduction in investment income, moderated by a 19% increase in SLAC revenue and a 10.5% increase in health care services revenue. The increase in SLAC revenue is due to major construction activity anticipated next year. (Government accounting conventions require construction projects at SLAC to be expensed, rather than capitalized.) Excluding SLAC and health care services, we expect revenues to decline by 1.4%. Overall, we are budgeting for a 6.7% increase in expenses, driven by growth in total compensation and construction expenses at SLAC.
- The Consolidated Budget includes $1.3 billion in general funds, of which $202 million flows to the Graduate School of Business, the School of Medicine, and Continuing Studies in accordance with previously agreed upon formulas. We anticipate a general funds surplus of $12.2 million, a figure slightly lower than that in recent years but one that provides a necessary cushion against revenue fluctuation and allows us to address one-time needs throughout the year.
- This Budget Plan presents the projected 2016/17 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 an $8.6 million surplus.
- The Capital Budget calls for $1 billion in expenditures in 2016/17. These expenditures are in support of a Capital Plan whose projects, when fully completed, will total approximately $4.1 billion. Principal expenditures in 2016/17 will be directed toward:

- $161.8 million for Stanford in Redwood City, Phase 1. This is part of a multi-year project to build out an administrative campus in Redwood City at a total cost of $568.8 million.
- $152.6 million towards the Housing Acquisition Initiative.
- $138.3 million towards the $257 million ChEM-H and Stanford Neurosciences Institute building.
- $95.2 million toward the new Escondido Village graduate housing complex.

STRATEGIC CONTEXT

We approached the development of the 2016/17 budget focused particularly on the uncertainty around broader macro economic conditions. The sharp drop in the equity markets in January and early February, when many of our budget decisions were made, prompted a more cautious approach on revenue forecasts and budget allocations. In response, we decided to suspend the endowment payout smoothing rule for a year and to recommend holding payout on existing funds flat, at the current year's level, which the Trustees approved. We also made constrained general funds allocations, as described in detail below.

With no increase in endowment payout in 2016/17, schools and other units that rely on an increase in endowment payout had to make adjustments to cover their anticipated expense increases. Most units have built up expendable reserves from both unspent payout and operating surpluses during recent years of strong investment returns. Many units plan to dip into those reserves for 2016/17, and some units may cut expenses. Looking beyond 2016/17 and assuming historical growth rates in future endowment returns, endowment payout will grow only modestly in the coming years. It will likely be 2-3 years before payout growth will fully cover the anticipated growth in expense. Consequently, units may have to make cuts or find other sources of funding to offset anticipated expense growth in the years beyond 2016/17.

Growth in our two other significant revenue sources, sponsored research and health care services, continues to follow recent historical trends. Sponsored research across the university is projected to increase modestly, although significant growth (5.5%) is expected in the School of Medicine. Health care services income, which is dominated by the clinical revenue generated by Stanford Medicine faculty physicians, continues to grow at double-digit rates, with a 10.5% increase anticipated for 2016/17. This revenue item has now exceeded $1 billion and is our second largest revenue source. With the expansion of Stanford Medicine and its clinical activity around the region, health care services revenue has grown from 9% of the budget in 2001/02 to a projected 20% in 2016/17.

Finally, the cost of housing continues to be Stanford's greatest challenge. We are addressing it with several aggressive initiatives:

- The University Terrace Faculty Homes will open the first units in 2016/17, with the full 180-unit complex to be available by the end of calendar 2018.
- We will break ground in the fall 2016/17 on a 2400-bed graduate student housing complex in Escondido Village, a $937 million project.
- Stanford is buying homes and apartments in the area under the $500 million Housing Acquisition Initiative approved by the Trustees.
- We are pursuing a proposal with the city of Menlo Park for additional faculty and staff housing at 500 El Camino Real.
- Next year Stanford will provide approximately $22 million in subsidies for off campus apartments for graduate students.

While these initiatives will not address all of the housing needs of Stanford students, faculty, and staff, they are having a positive impact and will continue to improve the situation over time.

Our key budget decisions centered around three areas:

STRENGTHENING THE BASE BUDGET

Stanford's ongoing base budget supports the human and physical capital of the university: faculty, staff, students, facilities, and the underlying support required for each to fulfill research and teaching missions. Our budget also affirms Stanford's commitment to the values of diversity and sustainability. The budget process focused on each of these areas for 2016/17:

Faculty—We have budgeted a competitive faculty salary program, with targeted supplemental funding for selected faculty groups where our competitive salary position needs strengthening. The budget also continues to support our extensive housing assistance programs and laboratory start-up packages.

Staff—We have planned a staff salary program that maintains a competitive market position in a very strong local economy. Stanford also funds generous health insurance, retirement, tuition assistance, and leave programs, as well as the considerable offerings of the BeWell program. Nonetheless, we recognize the challenges staff face in an extremely expensive housing market, an issue on which we must continue to focus in the coming years.

Students—The base budget supports one of the most competitive and generous financial aid programs in American higher education for both undergraduate and graduate students. We provide an extensive array of student health, advising, and research support services. Our housing and dining programs offer accommodation to nearly all undergraduates and half of the graduate students. Until the major graduate housing project in Escondido Village is completed, we plan to continue our practice of providing substantial subsidies for off campus apartments for graduate students.

Facilities—Stanford is one of a very few universities with little deferred maintenance on its facilities. Plans are in place to address in the coming years the minimal amount that exists in the School of Medicine and in Residential & Dining Enterprises. Over many years we have built up funding for the "Investment in Plant" program, which reserves money for life-cycle building system maintenance and component replacement. The budget for 2016/17 continues this important practice.

Academic and Administrative Support—From highly sophisticated research labs to health and safety monitoring; from administrative systems to vast physical and digital library collections; and from HR administrative services to support for research conducted internationally, we provide extensive assistance to our faculty and students. There are also growing regulatory requirements around many of Stanford's activities. Some of these regulations are useful and justified, while others have become increasingly questionable and burdensome. But they all must be funded in the budget.

Diversity—Stanford's long-standing commitment to diversity is reflected in the base budget through our need-blind undergraduate financial aid program; through targeted graduate aid programs; through the Faculty Incentive Fund and Faculty Diversity Initiative; and through our extensive efforts to recruit and retain a diverse staff.

Sustainability—An important example of Stanford's commitment to energy conservation has been the launch of the new central energy facility. The efficiency of that facility, coupled with our ability to buy power under the state's Direct Access program, has markedly decreased our energy use and carbon footprint, while reducing the life cycle cost of the new energy facility.

INVESTING SELECTIVELY TO ENHANCE STANFORD'S PREEMINENCE

The 2016/17 budget allocates $15.0 million in incremental general funds to support a variety of academic and student support programs. One goal guiding these allocations was to provide base funding to underwrite high priority programs that were previously sustained with short-term funding. Of the $15.0 million, $4.8 million is allocated to such items. In addition, $5.6 million is dedicated to enhancing or extending existing programs, while the remaining $4.6 million is designated for truly new academic and support activities. These allocations range from summer fellowships for graduate students in the Graduate School of Education and additional student service staff in Engineering departments that have experienced large undergraduate enrollment growth, to operating funding for the new alumni and development relationship management system.

RESPONDING TO EMERGING INSTITUTIONAL NEEDS

An important commitment for 2016/17 is the university's support for the recommendations made by the Provost's Task Force on Sexual Assault Policies and Practices. This budget fully funds those programmatic and staffing recommendations with a base general funds allocation of $2.7 million. This is the largest incremental allocation of base general funds made in this year's budget. Another major commitment is the proposed graduate housing complex in Escondido Village. This $937 million project will provide a net increase of approximately 2,000 beds and expand the proportion of graduate students housed on campus to almost 70%. Funding for this massive project will come from debt (to be serviced by rents), gifts, and an equity contribution from university reserves.

FINANCIAL RESERVES

Stanford has three principal categories of financial reserves:

Expendable reserves—We project Stanford's expendable reserves will stand at $4.0 billion at the end of 2016/17. Of that amount, $3.4 billion is a combination of restricted and unrestricted expendable funds, and unspent restricted endowment payout. The remaining amount is split among plant funds, student loan, and agency funds. 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 $1.2 billion by the end of 2016/17. The Tier I Buffer comprises the university's unrestricted funds functioning as endowment, the payout from which supports the general funds component of the Consolidated Budget. The majority of the buffer's funds are generated by the investment returns on a subset of our expendable reserves. The Tier I Buffer acts as a backstop to maintain the face value of those expendable funds, which are invested in the merged pool.

Tier II Buffer—The Tier II Buffer is estimated to be $1.1 billion by the end of 2016/17, 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 from the Tier II buffer, however, 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 2016/17 and compares those numbers to our current projection of final results for 2015/16. 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 4.4%. Tuition income is projected to grow 3.7% over the projected 2015/16 actuals as the result of

CONSOLIDATED BUDGET FOR OPERATIONS, 2016/17

[IN MILLIONS OF DOLLARS]

2014/15 ACTUALS	2015/16 BUDGET JUNE 2015	2015/16 PROJECTED ACTUALS		2016/17 CONSOLIDATED BUDGET	CHANGE FROM PROJECTED ACTUALS
			Revenues		
824	849	858	Student Income	896	4.4%
959	957	1,016	University Sponsored Research	1,050	3.3%
430	508	497	SLAC Sponsored Research	591	18.9%
958	964	1,065	Health Care Services	1,177	10.5%
390	315	355	Gifts and Net Assets Released from Restrictions	350	−1.5%
1,288	1,395	1,418	Investment Income	1,284	−9.5%
516	514	523	Special Program Fees and Other Income	534	2.1%
5,366	**5,502**	**5,732**	**Total Revenue**	**5,881**	**2.6%**
			Expenses		
2,882	3,054	3,110	Compensation	3,323	6.8%
261	280	276	Financial Aid	286	3.8%
199	193	190	Debt Service	204	7.5%
1,525	1,615	1,668	Other Operating Expense	1,781	6.8%
4,866	**5,143**	**5,244**	**Total Expenses**	**5,594**	**6.7%**
500	**359**	**488**	**Operating Results**	**287**	
(242)	(231)	(219)	Transfers	(166)	
259	**128**	**269**	**Operating Results after Transfers**	**121**	
2,710	2,814	2,969	Beginning Fund Balances	3,238	
2,969	2,942	3,238	Ending Fund Balances	3,359	

a 3.5% increase in the undergraduate and graduate tuition rates and a slight growth in the number of students in the Graduate School of Business. Room and board income is projected to increase 7.3%, due to the 3.5% room and board rate increase, the opening of Highland Hall and the two new Lagunita dorms, and the expansion of off campus subsidized apartments for graduate students.

University Sponsored Research—Sponsored research revenues (excluding SLAC) are expected to grow by 3.3%, while indirect cost recovery will increase by 3.5%. Direct research in the School of Medicine will continue its strong growth, increasing at 5.7%, while non-Medical grant funding will be flat. SLAC's revenues are expected to increase by almost 19%, due to an expanded construction program. When SLAC is included, total sponsored research revenue is expected to increase by 8.4% over 2015/16 projected year-end results.

Health Care Services—Revenue from health care services is projected to increase by 10.5% in 2016/17. This revenue consists principally of payments from the hospitals to the School of Medicine for faculty physician services. Health care services revenue has been the fastest growing element of the Consolidated Budget over the last decade, with a compound annual growth rate of 11%. The 2016/17 growth is driven by continued expansion of Stanford Medicine's clinical activities throughout the region.

Expendable Gifts—We expect expendable gift revenue to be down slightly in 2016/17. Higher goals for gifts to capital projects and endowment are anticipated to depress expendable giving totals.

Investment Income—This category consists of income paid out to operations from the endowment ($1,178.1 million) and from other investment income ($105.6 million). Endowment payout is projected to increase by 2.5% in spite of the flat payout rate, due to new gifts and other additions to endowment. Other investment income is expected to be down by 60%. Overall, investment income is expected to be down by 9.5% in 2016/17. This significant reduction is governed by the EFP policy, which uses the prior year's investment return to set the payout in the subsequent year. We expect that the returns in 2015/16 will be barely positive.

EXPENSE

Compensation—We anticipate total compensation to increase 6.6% over 2015/16 year-end results. The increase is the result of our salary program, a 3.5% overall increase in headcount, and the targeted salary enhancements mentioned earlier.

Financial Aid—The costs for need-based financial aid, athletic aid, and graduate student aid will increase by 3.8%. This increase allows Stanford to maintain its generous need-based aid program for undergraduates, particularly for those families with incomes below $125,000. It also reflects a 4.5% increase in aid for graduate students, reflecting more generous graduate support in selected disciplines and a slight increase in the number of graduate students.

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 2.9% in 2016/17, exclusive of SLAC. SLAC's significant construction program pushes the growth rate to 6.8%.

SCHOOL INITIATIVES

Stanford's principal academic units, the seven schools, will continue advancing their research and teaching missions with ambitious agendas for 2016/17. A few highlights of their plans are:

Graduate School of Business (GSB)—The Business School continues to expand its global reach while strengthening its core programs and faculty on the Stanford campus. The GSB's Global Innovation Programs, the Stanford Institute for Innovation in Developing Economies, and the Global Development and Poverty Initiative, all seek to advance business development internationally with a particular focus on poverty and emerging economies. The faculty expansion plan initiated six years ago is nearly complete at 124 faculty members, compared to 106 in 2009/10.

Earth, Energy & Environmental Sciences (SE3)—The school has a set of major initiatives underway to accelerate its efforts in teaching, research, and solving problem posed by increased worldwide demand for energy, water, and food. There are plans for a new building, which the school hopes to bring forward for trustee approval in 2016/17.

Graduate School of Education (GSE)—The school has launched a three-tiered planning process designed to shape its agenda for the coming years, with emphasis on: i) internal operations and priorities; ii) engaging the GSE with the broader Stanford community; iii) developing a vision that will keep it at the forefront of education scholarship over the next decade. Initial results from that effort include a research and design agenda focusing on the intersection of equity, information technology, and education. Also, the school will launch a summer fellowship program to support doctoral students who historically have not received funding in the summer.

Engineering—The school completed a strategic direction-setting effort late last spring. Advancing the School of Engineering over the next decade will require 30 new faculty positions. The school also projects growth in staff and graduate students as those positions are filled. In the short run, Engineering faces continuing growth in undergraduate majors and higher enrollments across all course levels. Supplemental funding from university general funds for 2016/17 will help to address the need for increased teaching assistants and student services support.

Humanities and Sciences (H&S)—After several years of investments in faculty, programs, and facilities, the school is extremely strong, with most departments ranked in the top five nationally. In addition to the McMurtry Art and Art History building, opened in 2015/16, several new facilities will be integrated into H&S in the coming years: the Roble Gym renovation for the arts; the Bass Biology building; and the Science Teaching and Learning Center. Several H&S faculty will play leadership roles in university-wide initiatives, including ChEM-H and the Stanford Neurosciences Institute.

Law—Stanford Law School continues to strengthen its curriculum with the expansion of its Law and Policy Lab and an expanded focus on preparing students for global legal practice. Considerable attention is also being paid to the role of technology in legal practice and to specific skills training.

Medicine—The Medical School, with its hospital partners, continues to focus on advancing Precision Health, the next generation of patient care that is proactive, predictive, and directed at each individual. The school's research position remains strong with consistently higher funding per investigator than peer institutions. The Campaign for Stanford Medicine, which has already exceeded its $1 billion goal, has been particularly effective in raising funds for PhD students. These students now have their first four years of training covered, reducing dependence on funding from government sponsored research.

GENERAL FUNDS BUDGET

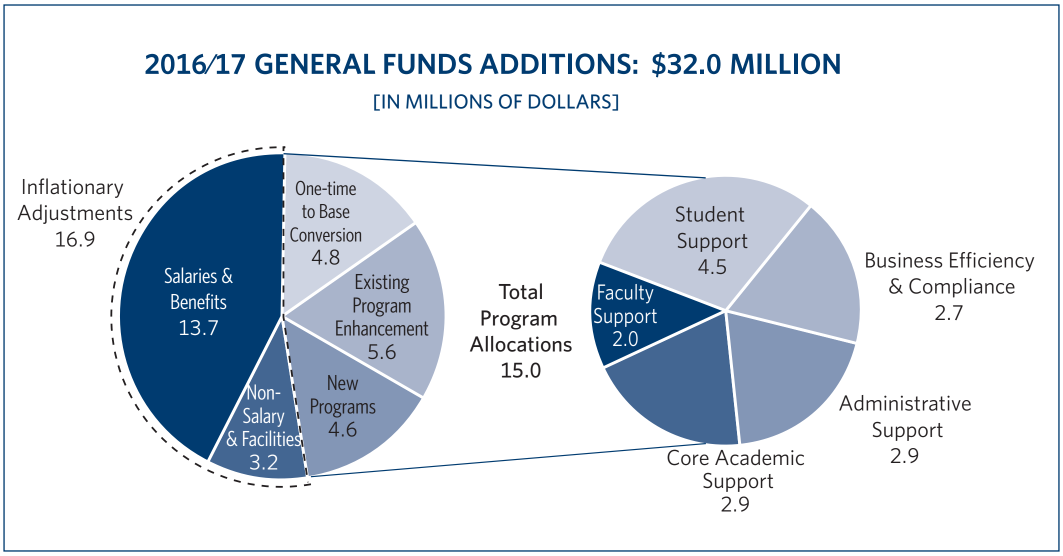
A focal point of the budgeting process is the development of the general funds component of the Consolidated Budget. The $1.3 billion in general funds can be used for any university purpose and sustain many of the core academic and support functions of the university.

As shown in the chart on the next page, base general funds allocations will increase by $32.0 million, the smallest increase since the 2009/10 recession. About half will cover increases in continuing costs for salaries, benefits, non-salary costs, and the operating costs of facilities. As noted earlier, the other half will be split equally among enhancing existing programs, converting certain one-time expenses to the continuing base budget, and funding new programs. These various items are further delineated in the following functional areas:

Student Support ($4.5 million)—The largest allocation ($2.7 million) will be for programs and staffing to respond to the recommendations of the Task Force on Sexual Assault Policies and Practices.

Faculty Support ($2.0 million)—We continued our investment in the Faculty Incentive Fund and the Faculty Development Initiative to encourage ongoing recruitment of under-represented minorities and women to the faculty. We allocated $1 million in two different schools to help recruit and retain faculty, as well as to address faculty salary equity concerns.

Core Academic Support ($2.9 million)—The general funds budget provides incremental support for a South Asian Studies library collection cataloger, as well as funding for digital humanities technical staff in the Center for Spatial and Textual Analysis and operational funding for the Stanford Research Computing Center.



Business Efficiency and Compliance ($2.7 million)—This category provides funding for enhanced efficiencies in procurement, for increased workload in Environmental Health and Safety, and for the new alumni and development system and the new university budget system.

Administration ($2.9 million)—This category adds administrative capacity in the new Vice Provost for Teaching and Learning unit, as well as additional staffing for fundraising for arts programs and interdisciplinary institutes.

The pie chart above reflects all of the general funds additions. After making these program additions we anticipate a general funds surplus of $12.2 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 2016/17 through 2018/19; 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 2016/17, as well as projects that will commence within the rolling three-year period through 2018/19. The Capital Budget and Capital Plan are subject to change based on funding availability, budget affordability, and evolving university priorities.

The 2016/17 Capital Budget is projected to be $1.0 billion. The major projects within the Capital Budget include $161.8 million in funding for Stanford in Redwood City, $152.6 million for the Housing Acquisition Initiative, $138.3 million for ChEM-H and the Stanford Neurosciences Institute, and $95.2 million for the first phase of work on the Escondido Village graduate housing complex.

The three-year Capital Plan includes $4.1 billion in construction and infrastructure projects and programs. The projects noted above, when fully completed over the multi-year period, comprise the bulk of the Plan. It also includes a number of smaller projects and several infrastructure programs.

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 thank 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, Judy Goldstein, Patti Gumport, Rosemary Knight, Jon Levin, Randy Livingston, Kam Moler, Serena Rao, Dana Shelley, George Triantis, 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. Support for the Budget Group, and for the creation of this document, is provided by the budget office staff, consisting of Kayte Bishop, Jacy Crapps, Neil Hamilton, Betsy Lewis, Mike Ling, Serena Rao, Mark Rickey, and Dana Shelley, under the able leadership of Tim Warner.

The Capital Planning Group consists of Jack Cleary, Megan Davis, Stephanie Kalfayan, David Lenox, Bob Reidy, Craig Tanaka, Bob Tatum and Tim Warner. Craig guides the capital planning process with remarkable efficiency, with excellent support from Howard Leung.

REQUESTED APPROVAL AND ORGANIZATION OF THIS DOCUMENT

The budget plan provides a university-level perspective on Stanford's programmatic and financial plans for 2016/17. 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 begins with an overview of budgeting at Stanford and a brief retrospective of the growth and change in Stanford's budget, followed by four chapters and two appendices. Chapter 1 describes the financial elements of the plan, including details of the Consolidated Budget for Operations and the projected Statement of Activities for 2016/17. 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 2016/17 and the Capital Plan for 2016/17–2018/19. The appendices include budgets for the major academic units and supplementary financial information.

Finally, we have also included several 'sidebar' pieces in the body of this document that focus on budgetary topics of particular interest this year: Stanford Energy Systems Innovations (p. 19); The Budgetary Response to the Recommendations of the Provost's Task Force on Sexual Assault (p. 23); Strategic Planning for Administration (p. 58); Graduate Housing (p. 74); and Capital Facilities Fund (p. 84).

John W. Etchemendy
Provost
June 2016

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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.

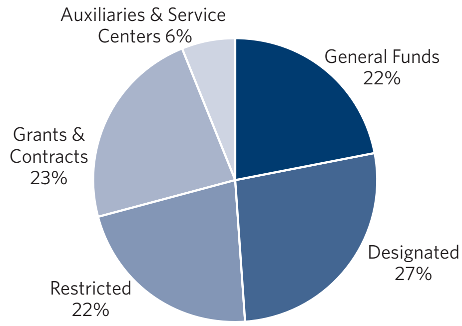
FUND ACCOUNTING

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

At the end of fiscal year 2014/15, Stanford had roughly 24,000 active expendable funds and more than 7,500 endowment funds. So how does Stanford budget and manage all these 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

2016/17 CONSOLIDATED REVENUES BY FUND TYPE



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 AND 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.

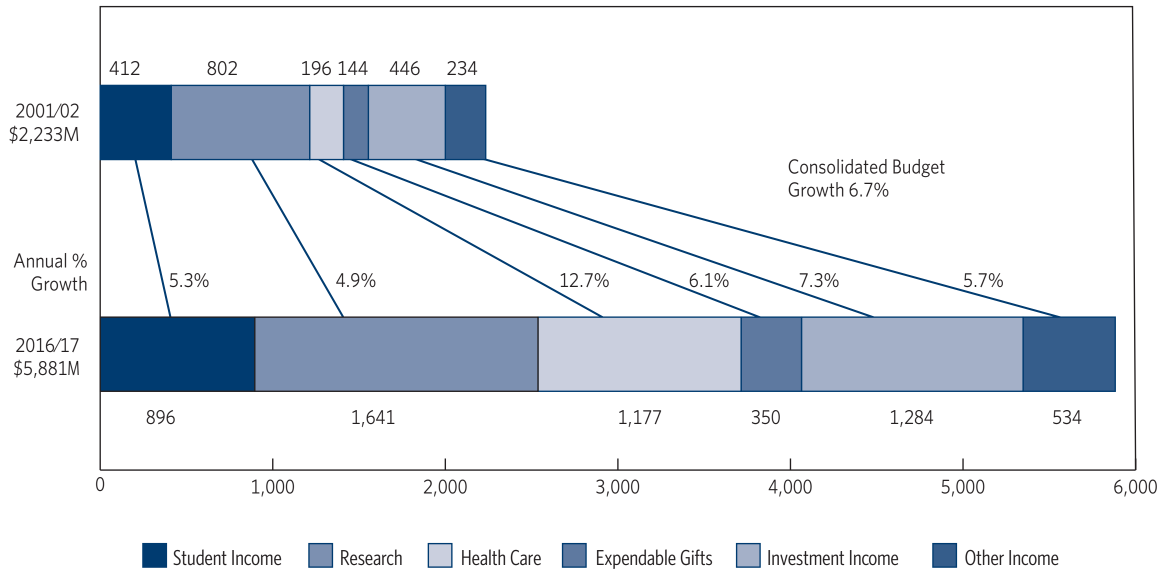
A RETROSPECTIVE OF STANFORD'S BUDGET, 2001/02 – 2016/17

Stanford has reached new heights under the leadership of President John Hennessy and Provost John Etchemendy. As a preamble to the last budget to be proposed by this administration, we take a brief look back at growth and change in Stanford's budget during this extraordinary period.

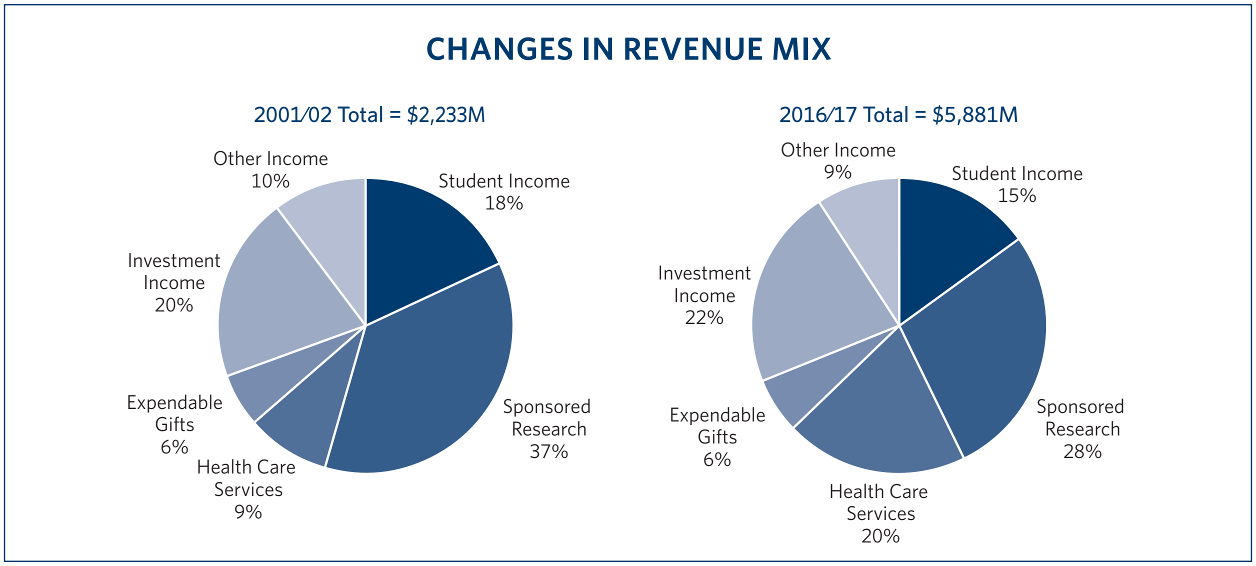
Stanford's Consolidated Budget for Operations grew about three-fold from 2001/02 to 2016/17. The fastest growing revenue source has been health care services, predominantly revenue from Stanford Health Care and Lucile Packard Children's Hospital that flows to the School of Medicine for faculty physician services. Investment income has also helped to propel growth at Stanford, with an average annual increase of 7.3%. This figure is particularly remarkable, considering the 26% drop in market value of the endowment in 2008/09. But the investment returns before and after the recession, combined with generous giving to endowment, has helped to keep endowment payout a significant force in Stanford's budgetary growth. Even the slowest growing revenue source, sponsored research, increased faster than general inflation. Most of the sponsored research growth occurred in the School of Medicine, while research in the rest of the university was essentially flat.

REVENUES BY LINE ITEM

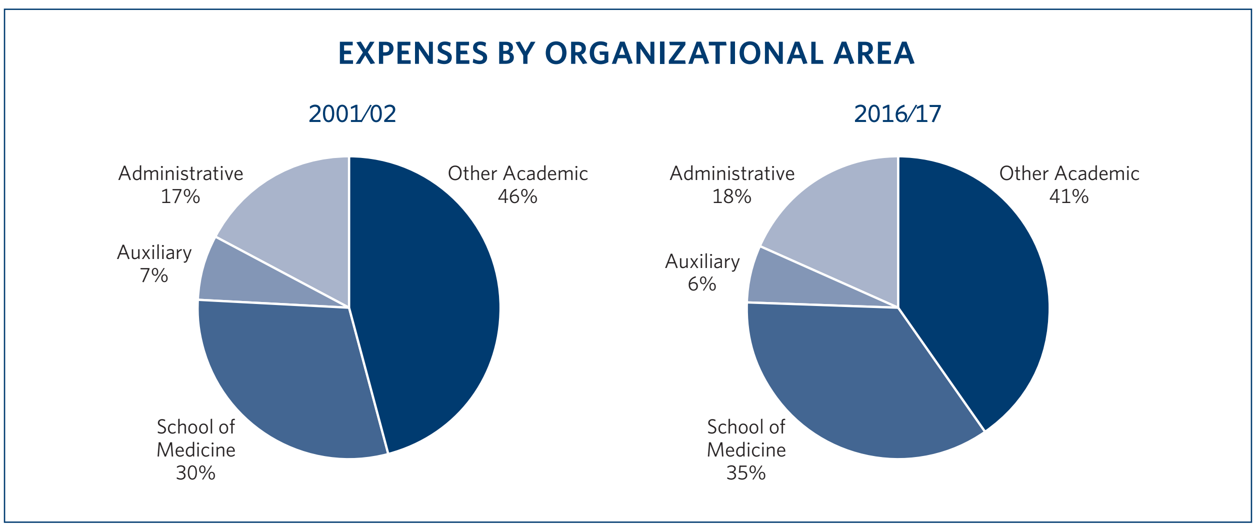
[IN MILLIONS OF NOMINAL DOLLARS]



The following chart shows that over the period there have been clear shifts in the revenue mix across the Consolidated Budget. The rapid growth in health care services has propelled that line item to 1/5 of Stanford's revenue. Due to the slow growth in federal sponsored research, the fraction of the budget comprised of sponsored research has been reduced.



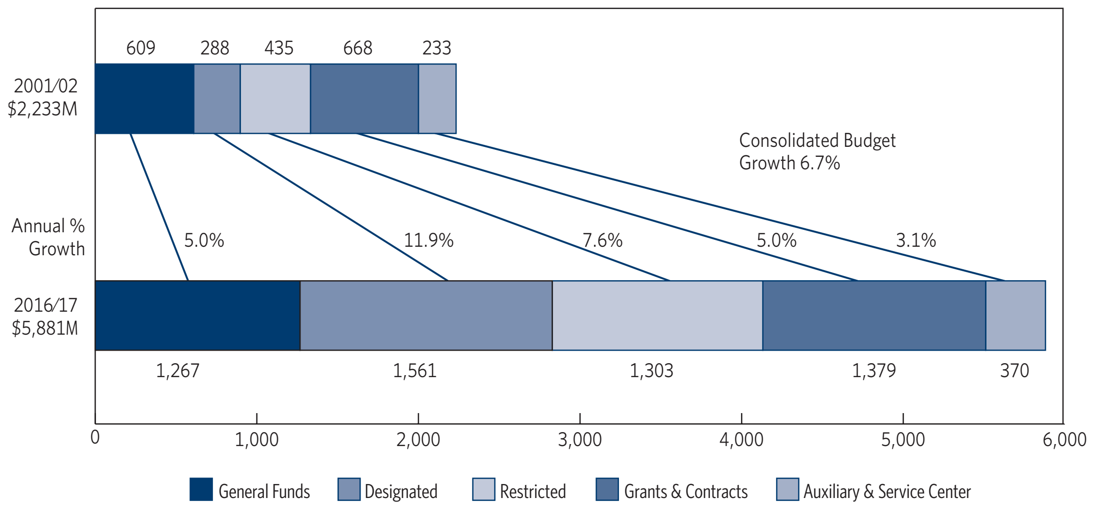
This chart highlights the growth in the School of Medicine since 2001/02. The growth has been fueled in part by research, but principally by growth in clinical activity associated with the expansion of Stanford Health Care and the Lucile Packard Children's Hospital.



The following chart reflects the growth of the different categories of funds—and the restrictions on those funds. The largest area of growth has been in designated funds. These are legally unrestricted funds that have been directed by Trustee or administration policy for a specific purpose. The growth in designated funds over John Hennessy's and John Etchemendy's tenure has been driven principally by increases in health care services. These funds flow into the university without restriction, but have been designated to the School of Medicine. Restricted funds have also seen strong growth during this period. Much of this growth has come as a result of record-breaking fundraising, in which gifts that are donor-directed are either expendable or are payout from restricted endowment funds. General funds averaged an annual growth of 5% over the period. This is significant given the recession of 2008-2009 and the resulting 25% reduction in endowment payout to general funds in 2009/10 and 2010/11. The much slower growth in auxiliary and service center activities reflects the recent sales of HighWire Press and the Stanford Blood Center.

BUDGET GROWTH BY FUND TYPE

[IN MILLIONS OF NOMINAL DOLLARS]



This has also been a remarkable period in Stanford's history with respect to facilities. The Capital Plan has generated $6.2 billion in construction, with particular focus on new and renovated facilities for medicine, science, engineering, the arts, athletics, and housing. Stanford may be unique among major research universities in that the campus has minimal deferred maintenance. This is because base budget funds have been built up so that the university is able to cover the cost of the replacement and renovation of building systems across the campus. Some deferred maintenance in the School of Medicine and in Residential & Dining Enterprises will be addressed in the coming years.

CAPITAL BUDGET BY PROGRAM CATEGORY