

Discussion of Financial Results

Fiscal year 2007 (FY07) was another year of outstanding operating results and significant growth for Stanford's consolidated net assets and Endowment. Consolidated net assets increased \$4.1 billion to end the year at \$24 billion. See Figure 1. The University's Endowment grew \$3.1 billion to \$17.2 billion as a result of strong investment performance and new gifts. See Figure 4. Stanford's consolidated operating revenues exceeded expenses by \$384 million in FY07 compared to \$299 million in fiscal year 2006 (FY06).

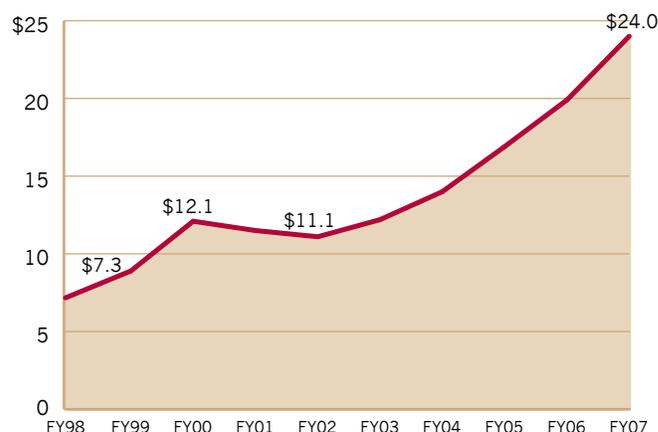
University

The University ended the year with a surplus from operations of \$250 million compared to \$141 million in FY06. Total revenues increased by 10% while expenses increased by 6%.

FY07 FINANCIAL HIGHLIGHTS

- > **Continued strong investment performance.** Total investment returns were \$3.6 billion, up from \$2.5 billion in FY06. See the report from the Stanford Management Company on page 53 for an in-depth analysis of University investment strategies and performance.
- > **Strong Support from Donors.** The University enjoyed another year of outstanding donor support in FY07 with over 109,000 gifts from 69,000 donors totaling \$853 million. Highlights included:
 - A \$52 million gift from the Virginia and D.K. Ludwig Fund to establish the Ludwig Center for Cancer Stem Cell Research and Medicine. The gift is part of a larger commitment to Stanford and five other academic centers to fund cancer research.
 - Gifts toward a \$75 million pledge made by alumni Jerry Yang and Akiko Yamazaki, which will be used for the Jerry Yang and Akiko Yamazaki Environment and Energy Building, for the Learning

FIGURE 1
CONSOLIDATED NET ASSETS (IN BILLIONS)



and Knowledge Center at the School of Medicine and for other purposes yet to be determined.

- Several large bequests, including \$27.5 million from the estate of alumna Susanna Atwell, which will be used to provide matching for annual gifts from young alumni; \$37.5 million from the estate of alumnus Ric Weiland, which will go toward various uses; and \$51 million from the estate of alumnus Dudley Chambers for scholarships, faculty salaries and general support in engineering and the natural sciences.

- A final payment of \$88.4 million on a \$300 million pledge by the William and Flora Hewlett Foundation to the School of Humanities and Sciences (H&S), used to match qualifying gifts to H&S and for top priorities within the school.

The majority of these gifts and pledges counted toward The Stanford Challenge which was launched in October 2006 with a goal of raising \$4.3 billion over five years for efforts aimed at seeking solutions to intractable global problems and educating a new generation of leaders for the complexities of today’s world. At the end of FY07, the campaign total stood at \$2.9 billion from nearly 300,000 gifts.

STATEMENT OF ACTIVITIES

The Statement of Activities details operating revenues and expenses and other non-operating changes in net assets during the year. University total net assets increased \$3.6 billion in FY07 compared with a \$2.7 billion increase in FY06. As in prior years, the increase resulted primarily from significant increases in the value of the University’s investments and new gifts and pledges.

Unrestricted Net Assets – Results of Operations

Operating activities include all revenues and expenses that support current year teaching and research efforts and other University priorities.

The components of the University’s \$3.2 billion in operating revenues are shown in Figure 2. Sponsored research support accounts for 34% of total operating

revenues, with an additional 22% resulting from investment income distributed for operations and 12% each from student income and health care services revenues. The University’s operating activities are summarized below:

- > Student income increased 5% to \$394 million in FY07, representing 12% of University operating revenues compared to 13% in the prior year. Revenues from undergraduate tuition increased by 7% and graduate tuition increased by 6%. The undergraduate student body grew by 70 students while the number of graduate students remained relatively flat. Offsetting tuition and room and board revenues is financial aid. Financial aid continues to be 28% of gross student income. Approximately 78% of undergraduate students and 75% of graduate students receive some form of financial aid.
- > Sponsored research support increased \$64 million, or 6%, to \$1.1 billion in FY07. Total SLAC revenue increased approximately \$48 million to \$346 million. Of the increase, \$30 million was due to increased Department of Energy funded construction activity. Sponsored research in the School of Medicine increased approximately \$18 million, or 5%, and the School of Engineering had an increase of \$4 million, or 4%, over FY06. Indirect cost recovery remained relatively flat at \$171 million in FY07.
- > Health care services revenues for the University increased \$50 million or 16% in FY07 to \$366 million and represented 12% of operating revenues.

Health care services revenues consist primarily of payments made by the Hospitals to the University, including \$335 million to the School of Medicine for faculty physicians’ services, the blood center and other essential services. An additional \$18 million includes other services provided by the School of Medicine and other University departments to the Hospitals, reduced by the value of certain services provided by the Hospitals to the School of Medicine and University. The increase is due primarily to higher professional services revenues being paid by the Hospitals to the School of Medicine. These amounts are eliminated in consolidation. Faculty physicians also generated \$13 million in revenues from services provided to external parties, including the Santa Clara Valley Medical Center and the Palo Alto Veterans Administration Hospital. See Figure 3.

FIGURE 2

FY07 UNIVERSITY OPERATING REVENUES (\$3.2 BILLION)

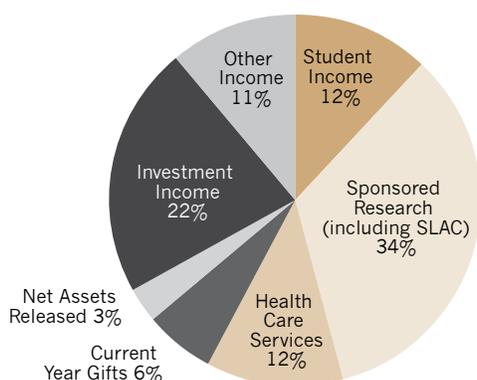
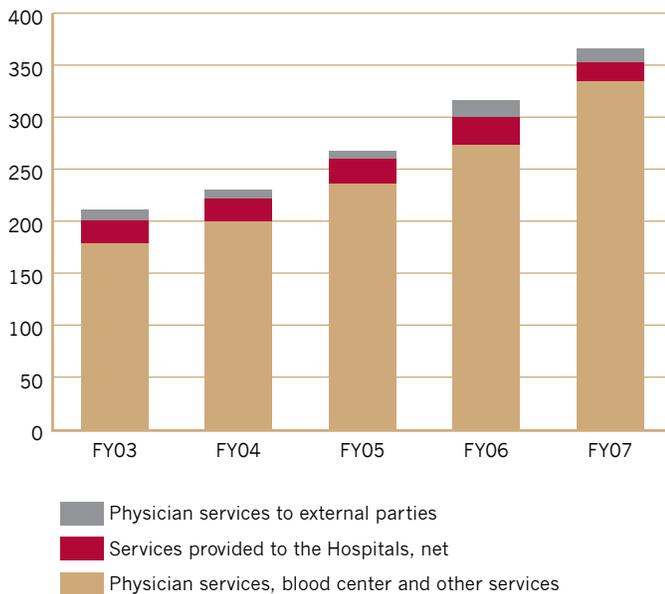


FIGURE 3
HEALTH CARE SERVICES REVENUES
(IN MILLIONS)



- > The increase in current year gifts is a reflection of the strong fundraising activities in FY07. Current year gifts in support of operations increased to \$198 million, up from \$168 million in FY06 due to several large estate gifts received in FY07. These gifts are immediately expendable for purposes described by the donor.
- > Net assets released from restrictions, which consist of payments on prior year pledges and prior year gifts released from donor restrictions, totaled \$96 million, relatively flat from \$94 million in FY06.
- > Total investment income included in operations represented 22% of University revenues.
- Endowment income distributed for operations was \$609 million in FY07, up from \$535 million in FY06. The University's Endowment (see insert) generates investment income that is used to support operating activities of the University. The largest component of endowment income is the payout from endowment funds invested in the University's Merged Pool (MP). In FY07, the MP payout was \$541 million, up from \$459 million in FY06. Over the last 10 years, the payout amount has grown appreciably due primarily to growth of endowment principal from continued strong investment returns, substantial new gifts and transfers of expendable funds into the endowment.

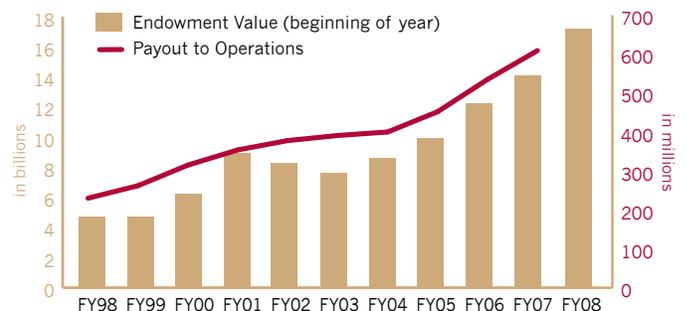
The University's Endowment

The University's Endowment is a collection of gift funds and reserves that are set aside and invested to support the University's teaching and research missions. At August 31, 2007, the Endowment totaled \$17.2 billion and represented approximately 78% of the University's net assets. The Endowment includes pure endowment funds, endowed lands, term endowment funds and funds functioning as endowment.

The increase in the Endowment of approximately \$3.1 billion in FY07, after payout to operations of \$609 million, resulted from \$3 billion of investment returns, \$361 million in new gifts and transfers of \$334 million of expendable funds into the Endowment. Payout to operations from the Endowment is a significant and increasing source of operating revenue for the University, covering approximately 21% of expenses in FY07 compared to 19% in FY06. Distributions in FY07 and FY06 were approximately 4.3% and 4.5%, respectively, of the beginning of year endowment value.

Also included in endowment income is rental income from ground leases of the University's endowed lands, including the Stanford Research Park. See Figure 4 for a comparison of payout to endowment value.

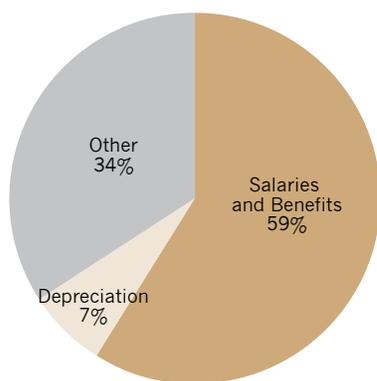
FIGURE 4
ENDOWMENT VALUE vs. PAYOUT TO OPERATIONS



- Other investment income was \$101 million in FY07 compared to \$74 million in FY06. This category includes the payout to operations from the Expendable Funds Pool (EFP), the Endowment Income Funds Pool (EIFP) and income from the faculty and staff mortgage loan program. The EFP payout policy seeks to achieve a stable payout to operations, while also providing that investment returns in excess of the payout be added to the Endowment. EIFP fund holders receive total return. The combined EFP and EIFP payout was approximately \$83 million in FY07, compared to \$57 million in FY06.
- > Special program fees and other income totaled \$333 million in FY07, a 4% increase over FY06. This revenue category consists of the external revenues generated by auxiliary enterprises and service centers, executive education, corporate affiliate programs, technology licensing and other programs. Also included are the operations of residential housing and dining (other than room and board revenues from students), catering services, revenues from the Stanford West Apartments and from intercollegiate athletic activities. Increases were due to increased ticket sales for events in the new stadium, increased executive and other program fees and new affiliates programs.

Total expenses increased \$170 million, or 6%, to \$2.9 billion in FY07. As depicted in Figure 5, salaries and benefits comprised approximately 59% of the University's total expenses, depreciation expense was 7% and other operating expenses represented approximately 34%.

FIGURE 5
FY07 UNIVERSITY OPERATING EXPENSES (\$2.9 BILLION)



- > Salaries and benefits increased 5% in FY07 to \$1.7 billion. Increases in salaries were a result of annual salary increases and increases in faculty and staff headcount. Benefits expense was up mostly due to increases in expenses related to the University's post retirement health plan.
- > Depreciation expense increased 2% to \$202 million in FY07 from \$198 million in FY06. During the year, a number of new projects, including the newly renovated Old Union complex, were placed in service.
- > Other operating expenses increased 10% to \$991 million from \$900 million in FY06. The majority of the increase is the result of the increased construction activities at SLAC and significant increases in materials and supplies.

Other Changes in Unrestricted Net Assets

In total, unrestricted net assets of the University increased \$3 billion, with the majority coming from investment returns. Total unrestricted investment gains were \$3.4 billion, of which \$609 million of endowment income and \$101 million of EFP and other investment income were distributed for operations. In years with strong investment performance, such as in the last few years, the University's investment returns on both the Endowment and the EFP exceed the amount of the predetermined payout to operations and the excess is transferred to the Endowment. In FY07, total investment return of the EFP was \$314 million, of which \$227 million was added to the Endowment.

Temporarily Restricted Net Assets

Temporarily restricted net assets increased \$100 million to \$1.1 billion in FY07. Included in this category are pledges that will become expendable upon payment, gifts pending designation by the donor, funds for which donor-imposed restrictions have not yet been met, including gifts for capital construction, and certain other purposes. The University recorded \$273 million of new temporarily restricted gifts and pledges in FY07, net of discounts and allowances. During the year, \$96 million of temporarily restricted net assets were released from their restrictions and utilized to fund operating activities. Another \$130 million of capital and other gifts for use by the University and Hospitals were released to unrestricted net assets related to capital assets placed in service during the year and other gifts which no longer carried donor restrictions. Finally, \$13 million of pending funds were moved into permanently restricted endowed funds, following donor instructions.

Permanently Restricted Net Assets

Permanently restricted net assets increased by \$498 million to \$4.4 billion during FY07. The principal value of these funds must be invested in perpetuity to generate endowment income to be used only for purposes designated by donors. The increase was due to the receipt of \$342 million in new gifts and pledges to the Endowment, net of discounts and allowances, and \$161 million in gains on investments held in the Endowment that were reinvested in accordance with the donor's instruction. In addition, \$42 million in funds previously designated as unrestricted or temporarily restricted net assets were transferred to permanently restricted net assets in order to satisfy matching gift conditions.

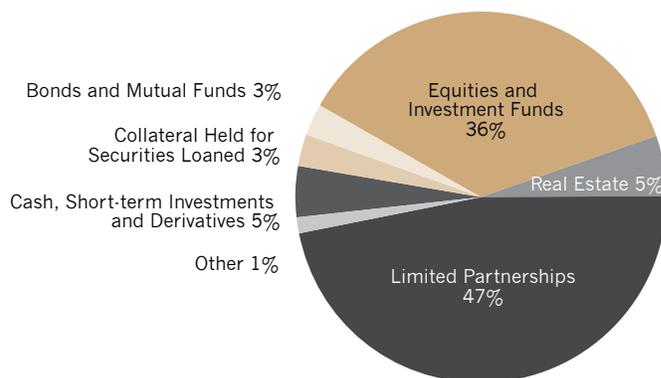
FINANCIAL POSITION

The University's Statement of Financial Position reflects continued strong investment returns, increased giving and solid operating results. Total University assets increased \$4.1 billion in FY07 to end the year at \$25.9 billion. Total University liabilities increased \$523 million to \$3.9 billion.

Highlights of the Statement of Financial Position are as follows:

- > Cash and cash equivalents increased \$86 million in FY07. The increase was due to cash received in connection with issuance of tax-exempt bonds that was held in highly liquid instruments at August 31, 2007.
- > Net pledges receivable were \$667 million at August 31, 2007, an increase of \$84 million over FY06. The University received a number of new pledges in FY07 in connection with The Stanford Challenge fundraising campaign. Valuation allowances were recorded for pledges that may not be collectible or where the pledge term may be extended.
- > The University provides home mortgage financing assistance as a means of attracting and retaining outstanding faculty and senior staff. Total notes outstanding under this program increased \$37 million to \$333 million in FY07.
- > Total investments increased by \$3.6 billion, or 21%, to \$21.2 billion. See Figure 6 for investment asset allocation at August 31.
- > Plant facilities, net of accumulated depreciation, increased \$159 million to \$2.7 billion in FY07. Net additions to plant facilities in FY07 totaled \$318 million, bringing gross plant facilities before accu-

FIGURE 6
INVESTMENT ALLOCATION AT AUGUST 31, 2007
(\$21.2 BILLION)



mulated depreciation to \$4.9 billion. Additions to the University's plant facilities in FY07 included the newly renovated Old Union complex, the seismic retrofit of Roble Hall and the renovation of off-campus buildings occupied by the School of Medicine.

- > Deferred rental income, consisting of prepaid rents on properties leased by the University, was \$393 million at August 31, 2007. These amounts are recognized as revenue ratably over the terms of the associated leases. The majority of the balance, \$306 million, relates to the Stanford Shopping Center 51-year ground lease which the University entered into in 2003.
- > Notes and bonds payable were \$1.5 billion at August 31, 2007, up \$185 million from FY06 due to the issuance of \$112 million of tax-exempt bonds and a \$60 million increase in commercial paper borrowing. The proceeds from the bond offering will be used to fund current and future capital projects. In June 2007, the University's Board of Trustees approved a \$2.4 billion, three year capital plan that includes funding for several new buildings and infrastructure projects. An important source of funding for these projects will be debt.

The University's debt policy governs the amount and type of debt Stanford may incur and is intended to preserve long-term debt capacity, financial flexibility and access to capital markets at competitive rates. The University uses a combination of fixed and variable rate debt to fund academic facilities, residential housing and dining facilities, faculty and staff mortgage loans and other projects.

Hospitals

The financial results and financial position of Stanford Hospital and Clinics (SHC) and the Lucile Packard Children's Hospital (LPCH) are combined in the consolidated financial statements under the "Hospitals" column. The University is the sole member of each of the Hospitals.

The Hospitals had a combined operating surplus of \$134 million, down 15% from \$158 million in FY06. At August 31, 2007, the Hospitals' net assets were \$2 billion versus \$1.5 billion at August 31, 2006, an increase of \$501 million, or 34%. The following discussion summarizes the individual financial results of SHC and LPCH as shown in the consolidated financial statements.

STANFORD HOSPITAL AND CLINICS

SHC continued to improve its financial position in FY07, generating income from operations of \$113 million, down 2% from \$115 million in FY06.

Prior to FY07, the University had assigned to SHC the right to all revenue related to pediatric and obstetric practices of the School of Medicine (SoM) faculty. Effective September 1, 2006, LPCH assumed the right to these revenues. In FY07, the pediatric and obstetric practices earned revenue of \$61 million. Payment for physicians' services related to these practices was \$48 million.

STATEMENT OF ACTIVITIES

Revenues, excluding pediatric and obstetric practice services, increased by 10% to \$1.6 billion.

- > Patient revenues increased by 10%, to \$1.5 billion.
 - Inpatient revenues, which make up 53% of the total, grew by 7% on continuing increases in patient volume. Despite significant capacity limitations, total patient days were up by 2%.
 - Outpatient revenues increased by 12%, accounting for 47% of the total.
- > Other income, which includes the results of the outreach laboratory and various related entities, was up by 10% to \$73 million.
- > Net assets released from restrictions were virtually unchanged from FY06 at \$4 million.

Expenses, excluding pediatric and obstetric practice services, increased by 11% to \$1.5 billion.

- > Salaries and benefits grew by 12% to \$665 million. The number of employees was up 6% in response to growth in patient volumes, while salaries were increased to maintain SHC's position in the competitive market for health care professionals.
- > Physicians' services and support increased by 13% from \$219 million to \$247 million. This category includes all payments to the University for services, the majority of which are payments to the School of Medicine for physician services.
- > Depreciation increased by 14% to \$45 million as a result of increases in capital assets.
- > Other operating expenses, including such categories as supplies, purchased and professional services, and bad debt expense, increased by 5% to \$492 million as a result of both higher patient volumes and prices.

Total net assets increased \$251 million to \$901 million.

- > Unrestricted net assets increased \$220 million to \$844 million. The increase was due to SHC's operating surplus of \$113 million and from an increase of \$112 million in investment income and gains.
- > Temporarily restricted net assets increased \$29 million to \$51 million.
- > Permanently restricted net assets increased \$2 million to \$6 million in FY07.

FINANCIAL POSITION

SHC's Statement of Financial Position reflects continued investments in the facilities and systems required to remain at the forefront of medicine and to be the provider of choice for complex care in the communities it serves.

SHC continued to strengthen its balance sheet to support the expansion of services to the community and to support the shared missions of the Hospital and the University School of Medicine.

- > Unrestricted cash and investments were \$875 million at the end of FY07, an increase of \$126 million. As a result, days cash on hand increased from 205 to 228.

- > Assets held by a trustee decreased by \$69 million to \$334 million. The decrease represents the expended proceeds of the 2006 bond issue, which were used to help fund the new outpatient facility, the clinical information system and other facilities and systems projects.
- > Property and equipment, net of depreciation, increased \$108 million to \$511 million during FY07. The largest elements of the increase were expenditures related to a new electronic clinical information system and continued investment in the Stanford Outpatient Center in Redwood City, which is being developed to expand the availability of outpatient care.
- > Outpatient visits increased by 17% over FY06, including a 5% increase in outpatient surgery visits, and resulted in increased net revenues of \$15 million, a 19% increase over the prior year.
- > LPCH's community benefits, including services to patients under Medi-Cal and other publicly sponsored programs that reimburse at amounts less than the cost of services provided to the recipients, were \$132 million in FY07 compared with \$105 million in FY06. LPCH also invests in improving the health of the children of San Mateo and Santa Clara counties through a range of community-based programs.

LUCILE PACKARD CHILDREN'S HOSPITAL

LPCH generated an excess of revenues over expenses from operations of \$21 million in FY07, down from \$43 million in FY06. Operating results were depressed by a number of factors in FY07 including ongoing increases in the number of Medi-Cal patients served, significant costs related to moving non-clinical operations out of LPCH for capacity reasons and costs related to installation of a new electronic medical record system.

Net assets increased \$250 million to \$1.1 billion at August 31, 2007. The increase in net assets stems principally from investment earnings of \$92 million and restricted contributions of \$160 million, which includes state funding of \$74 million for expansion of facilities.

Net patient revenues grew 20% to \$564 million. The unusually high step up in net patient revenue is related to LPCH absorbing the operations of the Pediatric Faculty Practice from SHC. Due to the structure of this arrangement, the ongoing net effect of this transfer on LPCH's net operating margin is immaterial.

Other financial highlights for LPCH:

- > Inpatient net revenues, which make up approximately 81% of total net patient revenues, grew by slightly less than 4% as a result of an increase in services provided to Medi-Cal beneficiaries and LPCH's continued capacity limitations. Capacity issues have hampered LPCH's ability to expand inpatient services. The Medi-Cal program reimburses LPCH at significantly less than those of commercial payers. Medi-Cal patients represented 41% of gross patient revenue in FY07 and 39% in FY06.

- > Unrestricted cash and investments increased by \$119 million to \$437 million at August 31, 2007. Despite this significant increase, days cash on hand increased only slightly, from 261 to 280, due to the dilutive effect of including the Pediatric Faculty Practice's operations in FY07. Other than cash generated from operations, the increase in unrestricted cash and investments is largely the result of reimbursement from bond proceeds for the acquisition of approximately \$50 million in buildings and ground leases purchased in late FY06. It is anticipated that these sites will be used for future expansion to meet the continued high demand for complex children's and obstetrics services.

LPCH continues to battle with inpatient capacity issues which are being addressed by current and planned expansions of bed and operating room capacity, as well as by adding additional LPCH-managed satellite operations throughout the greater community. Construction of additional beds and new outpatient centers for heart, dialysis and cancer, as well as surgical suites and enhancements to diagnostic laboratory and radiology services are scheduled to be completed by the summer of 2008.

In Summary

Stanford continues to enjoy record investment returns, strong operating results and outstanding donor support. The consolidated net assets of the University and the Hospitals have nearly doubled over the last five years. Despite these excellent results, we are always mindful of the long term health of the University in our management of day-to-day operating activities.

We continue to anticipate that federal research funding will grow more slowly than the University's costs over the next several years and to seek other sources of funding for the leading edge research that is being performed.

On the health care side, we continue to see rapidly escalating costs of personnel and equipment that often exceed the increases in medical reimbursement rates. Due to inpatient capacity constraints, the Hospitals have limited ability to absorb these increased costs through greater volume. In addition, the Hospitals have begun the formal process of seeking approval from local au-

thorities to construct new facilities to meet community health care needs.

The University and the Hospitals have achieved outstanding results in large part due to the many faculty, staff, students, trustees, alumni, parents and others who have helped to support us in our endeavors to remain a leading edge research university. We look forward to their continued support which will allow us to build on the past years' financial successes and sustain the University's future.



RANDALL S. LIVINGSTON
Vice President for Business Affairs and
Chief Financial Officer
Stanford University



M. SUZANNE CALANDRA
Controller
Stanford University



DANIEL J. MORISSETTE
Chief Financial Officer
Stanford Hospital and Clinics



TIMOTHY W. CARMACK
Chief Financial Officer
Lucile Salter Packard Children's Hospital

Selected Financial Data

FISCAL YEARS ENDED AUGUST 31

	2007	2006	2005	2004	2003	2002
	(in millions of dollars)					
STATEMENT OF ACTIVITIES DATA:						
Student income (A)	\$ 394	\$ 376	\$ 356	\$ 332	\$ 318	\$ 305
Sponsored research support	1,058	994	973	924	860	802
Health care services	1,999	1,851	1,699	1,501	1,277	1,181
Current year gifts in support of operations	198	168	144	105	113	104
Net assets released from restrictions	122	117	104	64	72	51
Investment income distributed for operations	710	609	514	460	495	436
Special program fees and other income	423	396	351	329	320	292
Total revenues	4,904	4,511	4,141	3,715	3,455	3,171
Total expenses	4,520	4,212	3,842	3,572	3,319	3,145
Excess of revenues over expenses	384	299	299	143	136	26
Other changes in net assets	3,673	2,709	2,598	1,596	1,028	(487)
Net change in total net assets	4,057	3,008	2,897	1,739	1,164	(461)
FINANCIAL POSITION HIGHLIGHTS:						
Cash and cash equivalents	\$ 647	\$ 579	\$ 629	\$ 638	\$ 602	\$ 522
Pledges receivable, net	758	619	507	454	475	513
Investments at fair value	23,119	19,263	16,351	13,318	11,806	9,520
Plant facilities, net of accumulated depreciation	3,472	3,164	2,800	2,743	2,723	2,527
Notes and bonds payable:						
University	1,494	1,309	1,266	1,288	1,275	1,246
Hospitals	1,015	1,006	582	587	591	224
Total net assets, end of year	23,938	19,881	16,873	13,976	12,237	11,073
University endowment	17,165	14,085	12,205	9,922	8,614	7,613
STUDENTS:						
ENROLLMENT: (B)						
Undergraduate	6,759	6,689	6,705	6,753	6,654	6,731
Graduate	8,186	8,201	8,176	8,093	7,800	7,608
DEGREES CONFERRED:						
Bachelor's degrees	1,709	1,756	1,790	1,713	1,788	1,692
Advanced degrees	3,100	3,093	2,945	2,931	2,855	2,777
FACULTY:						
Members of the Academic Council	1,428	1,418	1,400	1,410	1,396	1,377
ANNUAL UNDERGRADUATE TUITION RATE						
(in dollars)	\$ 32,994	\$ 31,200	\$ 29,847	\$ 28,563	\$ 27,204	\$ 25,917

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

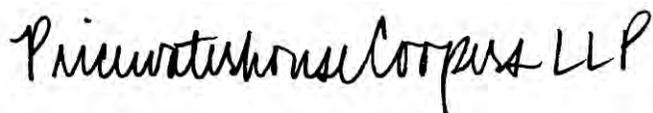
(B) Enrollment for fall quarter immediately following fiscal year end.

Report of Independent Auditors

To the Board of Trustees
Stanford University

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of activities and cash flows, which appear on pages 27 through 51, present fairly, in all material respects, the financial position of Stanford University (the University) at August 31, 2007 and 2006, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, in 2007 the University adopted Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. As described in Note 1, the fiscal year 2006 consolidated statement of cash flows has been restated.

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

San Francisco, California
December 18, 2007

Consolidated Statements of Financial Position

AT AUGUST 31, 2007 AND 2006 (in thousands of dollars)

	2007			2006
	University	Hospitals	Consolidated	Consolidated
ASSETS				
Cash and cash equivalents	\$ 546,294	\$ 100,326	\$ 646,620	\$ 579,084
Accounts receivable, net	259,642	397,254	656,896	566,716
Receivables (payables) from SHC and LPCH, net	56,336	(56,336)	-	-
Prepaid expenses and other assets	85,055	152,606	237,661	162,931
Pledges receivable, net	667,461	90,170	757,631	618,805
Student loans receivable, net	65,626	-	65,626	63,374
Faculty and staff mortgages and other loans receivable, net	334,268	-	334,268	297,956
Investments at fair value, including securities pledged or on loan of \$553,869 and \$573,229 for 2007 and 2006, respectively	21,167,073	1,951,582	23,118,655	19,263,211
Plant facilities, net of accumulated depreciation	2,705,877	766,492	3,472,369	3,163,930
Works of art and special collections	-	-	-	-
TOTAL ASSETS	\$ 25,887,632	\$ 3,402,094	\$ 29,289,726	\$ 24,716,007
LIABILITIES AND NET ASSETS				
LIABILITIES:				
Accounts payable and accrued expenses	\$ 576,485	\$ 340,287	\$ 916,772	\$ 856,230
Accrued post retirement benefit costs	210,309	66,964	277,273	135,980
Pending trades	141,838	-	141,838	105,796
Liabilities under security agreements	648,723	-	648,723	658,196
Deferred rental income	392,999	-	392,999	367,565
Income beneficiary share of split interest agreements	413,403	-	413,403	344,921
Notes and bonds payable	1,493,761	1,014,746	2,508,507	2,314,764
U.S. government refundable loan funds	52,685	-	52,685	52,394
TOTAL LIABILITIES	3,930,203	1,421,997	5,352,200	4,835,846
NET ASSETS:				
Unrestricted	16,407,029	1,507,241	17,914,270	14,623,263
Temporarily restricted	1,101,035	247,456	1,348,491	1,115,216
Permanently restricted	4,449,365	225,400	4,674,765	4,141,682
TOTAL NET ASSETS	21,957,429	1,980,097	23,937,526	19,880,161
TOTAL LIABILITIES AND NET ASSETS	\$ 25,887,632	\$ 3,402,094	\$ 29,289,726	\$ 24,716,007

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

Consolidated Statements of Activities

FOR THE YEARS ENDED AUGUST 31, 2007 AND 2006 (in thousands of dollars)

	2007			2006
	University	Hospitals	Consolidated	Consolidated
UNRESTRICTED NET ASSETS				
REVENUES:				
Student income:				
Undergraduate programs	\$ 227,359	\$ -	\$ 227,359	\$ 213,352
Graduate programs	222,858	-	222,858	210,380
Room and board	99,907	-	99,907	95,327
Student financial aid	(156,062)	-	(156,062)	(142,898)
TOTAL STUDENT INCOME	394,062	-	394,062	376,161
Sponsored research support:				
Direct costs - University	541,073	-	541,073	523,886
Direct costs - Stanford Linear Accelerator Center	345,725	-	345,725	297,979
Indirect costs	171,360	-	171,360	172,249
TOTAL SPONSORED RESEARCH SUPPORT	1,058,158	-	1,058,158	994,114
Health care services:				
Patient care, net	-	1,986,267	1,986,267	1,835,058
Physicians' services and support - SHC and LPCH, net	353,308	(353,308)	-	-
Physicians' services and support - other facilities, net	13,170	-	13,170	16,098
TOTAL HEALTH CARE SERVICES	366,478	1,632,959	1,999,437	1,851,156
CURRENT YEAR GIFTS IN SUPPORT OF OPERATIONS	198,454	-	198,454	167,700
Net assets released from restrictions:				
Payments received on prior year pledges	53,878	-	53,878	60,098
Prior year gifts released from donor restrictions	41,807	26,748	68,555	56,946
TOTAL NET ASSETS RELEASED FROM RESTRICTIONS	95,685	26,748	122,433	117,044
Investment income distributed for operations:				
Endowment	608,969	-	608,969	534,734
Expendable funds pool and other investment income	100,580	-	100,580	74,149
TOTAL INVESTMENT INCOME DISTRIBUTED FOR OPERATIONS	709,549	-	709,549	608,883
SPECIAL PROGRAM FEES AND OTHER INCOME	332,694	89,816	422,510	396,358
TOTAL REVENUES	3,155,080	1,749,523	4,904,603	4,511,416
EXPENSES:				
Salaries and benefits	1,711,691	917,029	2,628,720	2,459,438
Depreciation	201,944	64,267	266,211	254,334
Other operating expenses	991,070	634,240	1,625,310	1,498,751
TOTAL EXPENSES	2,904,705	1,615,536	4,520,241	4,212,523
EXCESS OF REVENUES OVER EXPENSES	\$ 250,375	\$ 133,987	\$ 384,362	\$ 298,893

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

Consolidated Statements of Activities

FOR THE YEARS ENDED AUGUST 31, 2007 AND 2006 (in thousands of dollars)

	2007			2006
	University	Hospitals	Consolidated	Consolidated
UNRESTRICTED NET ASSETS (continued)				
EXCESS OF REVENUES OVER EXPENSES	\$ 250,375	\$ 133,987	\$ 384,362	\$ 298,893
Other changes in unrestricted net assets:				
Investment returns not included in operations	2,665,705	202,816	2,868,521	1,861,724
Current year gifts not included in operations	38,365	-	38,365	3,215
Hospital equity transfers	10,844	(10,844)	-	-
Capital and other gifts released from restrictions	127,763	15,065	142,828	61,412
Capital gifts released to Hospitals	-	2,547	2,547	764
Decrease in minimum pension liability	-	3,593	3,593	46,611
Transfer to permanently restricted net assets	(29,140)	(11,536)	(40,676)	(30,917)
Transfer to temporarily restricted net assets	(14,598)	-	(14,598)	(6,726)
Swap interest and unrealized losses	(2,262)	438	(1,824)	(12,965)
Cumulative effect of change in accounting principle	(93,286)	11,054	(82,232)	(17,897)
Other	4,473	(14,352)	(9,879)	(4,241)
NET CHANGE IN UNRESTRICTED NET ASSETS	2,958,239	332,768	3,291,007	2,199,873
TEMPORARILY RESTRICTED NET ASSETS				
Gifts and pledges, net	273,399	162,196	435,595	633,774
Investment gains	60,540	14,833	75,373	61,257
Change in value of split interest agreements, net	(9,769)	-	(9,769)	(3,085)
Net assets released to operations	(95,685)	(26,748)	(122,433)	(117,044)
Capital and other gifts released to unrestricted net assets	(127,763)	(15,065)	(142,828)	(61,412)
Capital gifts released to Hospitals' unrestricted net assets	(2,547)	-	(2,547)	(764)
Transfer from unrestricted net assets	14,598	-	14,598	6,726
Transfer to permanently restricted net assets	(12,875)	(599)	(13,474)	(55,169)
Other	-	(1,240)	(1,240)	(2,966)
NET CHANGE IN TEMPORARILY RESTRICTED NET ASSETS	99,898	133,377	233,275	461,317
PERMANENTLY RESTRICTED NET ASSETS				
Gifts and pledges, net	342,284	18,646	360,930	223,572
Investment gains	161,332	-	161,332	61,225
Change in value of split interest agreements, net	(39,130)	-	(39,130)	(28,273)
Transfer from unrestricted net assets	29,140	11,536	40,676	30,917
Transfer from temporarily restricted net assets	12,875	599	13,474	55,169
Other	(8,057)	3,858	(4,199)	3,749
NET CHANGE IN PERMANENTLY RESTRICTED NET ASSETS	498,444	34,639	533,083	346,359
NET CHANGE IN TOTAL NET ASSETS	3,556,581	500,784	4,057,365	3,007,549
Total net assets, beginning of year	18,400,848	1,479,313	19,880,161	16,872,612
TOTAL NET ASSETS, END OF YEAR	\$ 21,957,429	\$ 1,980,097	\$ 23,937,526	\$ 19,880,161

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

Consolidated Statements of Cash Flows

FOR THE YEARS ENDED AUGUST 31, 2007 AND 2006 (in thousands of dollars)

	2007			2006
	University	Hospitals	Consolidated	Consolidated
CASH FLOW FROM OPERATING ACTIVITIES:				(as restated, note 1)
Change in net assets	\$ 3,556,581	\$ 500,784	\$ 4,057,365	\$ 3,007,549
Adjustments to reconcile change in net assets to net cash provided by operating activities:				
Cumulative effect of change in accounting principle	93,286	(11,054)	82,232	17,897
Depreciation, amortization and loss on disposal of fixed assets	215,186	65,936	281,122	242,505
Net realized and unrealized gains on investments and security agreements	(3,291,636)	(85,600)	(3,377,236)	(2,197,463)
Net realized and unrealized losses (gains) on derivatives	2,262	106	2,368	(24,559)
Actuarial change on split interest agreements	46,966	3,858	50,824	18,493
Permanently restricted investment (income) loss	(38,891)	11,753	(27,138)	(9,427)
Gifts restricted for long-term investments	(273,545)	(82,107)	(355,652)	(317,604)
Gifts of securities	(219,696)	-	(219,696)	(205,055)
Net increase in accounts receivable, pledges receivable and receivables from SHC and LPCH	(52,801)	(58,155)	(110,956)	(398,803)
Increase in prepaid expenses and other assets	(50,064)	(58,145)	(108,209)	(29,209)
Increase (decrease) in accounts payable and accrued expenses	48,963	(27,801)	21,162	18,872
Increase in accrued post retirement costs	45,395	2,702	48,097	5,670
Increase in deferred rental income	25,434	-	25,434	5,401
Increase (decrease) in U.S. government refundable loan funds	291	-	291	(1,611)
NET CASH PROVIDED BY OPERATING ACTIVITIES	107,731	262,277	370,008	132,656
CASH FLOW FROM INVESTING ACTIVITIES:				
Land, building and equipment purchases	(334,582)	(188,759)	(523,341)	(572,133)
Student, faculty and other loans:				
New loans made	(75,645)	-	(75,645)	(69,691)
Principal collected	37,112	-	37,112	40,437
Purchases of investments	(13,141,515)	(236,099)	(13,377,614)	(11,124,689)
Sales and maturities of investments	13,042,957	83,561	13,126,518	10,806,196
NET CASH USED FOR INVESTING ACTIVITIES	(471,673)	(341,297)	(812,970)	(919,880)
CASH FLOW FROM FINANCING ACTIVITIES:				
Gifts and reinvested income of endowment, capital projects and other restricted purposes	236,267	82,107	318,374	260,169
(Decrease) increase in investment income for restricted purposes	38,891	(14,371)	24,520	9,492
Proceeds from borrowing	186,211	1,150	187,361	491,500
Bond issuance costs	(816)	-	(816)	(18,987)
Repayment of notes and bonds payable	(715)	(8,753)	(9,468)	(25,322)
(Decrease) increase in liabilities under security agreements	(9,473)	-	(9,473)	26,241
Other	-	-	-	(6,000)
NET CASH PROVIDED BY FINANCING ACTIVITIES	450,365	60,133	510,498	737,093
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	86,423	(18,887)	67,536	(50,131)
Cash and cash equivalents, beginning of year	459,871	119,213	579,084	629,215
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 546,294	\$ 100,326	\$ 646,620	\$ 579,084
SUPPLEMENTAL DATA:				
Interest paid during the year	\$ 69,953	\$ 46,391	\$ 116,344	\$ 96,946
Gifts of equipment	\$ 1,477	\$ -	\$ 1,477	\$ 16,627
Gifts of securities	\$ 219,696	\$ -	\$ 219,696	\$ 205,055
Cash collateral received under securities lending agreements	\$ 583,872	\$ -	\$ 583,872	\$ 599,191

Notes to the Consolidated Financial Statements

1. Basis of Presentation and Significant Accounting Policies

BASIS OF PRESENTATION The consolidated financial statements include the accounts of Stanford University (the University), Stanford Hospital and Clinics (SHC), Lucile Salter Packard Children's Hospital at Stanford (LPCH) and other majority-owned or controlled entities. All significant inter-entity transactions and balances have been eliminated upon consolidation. Certain prior year amounts have been reclassified to conform to the current year's presentation and the purchases and sales of investments in the prior year statement of cash flows have been revised to correct the presentation to be consistent with the presentation in 2007. These reclassifications and revisions had no impact on the change in net assets, total net assets or net cash used for investing activities.

University

The University is a private, not-for-profit educational institution, founded in 1885 by Senator Leland and Mrs. Jane Stanford in memory of their son, Leland Stanford Jr. A Board of Trustees (the Board) governs the University, which is organized into seven schools with 1,829 faculty and 14,945 graduate and undergraduate students. The "University" category presented in the financial statements comprises all of the accounts of the University, including the Stanford Alumni Association (SAA), the Hoover Institution and other institutes and research centers, the Stanford Management Company and the Stanford Linear Accelerator Center (SLAC).

The University manages and operates SLAC for the Department of Energy (DOE) under a management and operating contract; therefore, the revenues and expenditures of SLAC are included in the statement of activities. SLAC is a federally funded research and development center owned by the DOE and, accordingly, the assets and liabilities are not included in the University's statement of financial position, other than employee-related accrued compensation and related receivables from the DOE.

Hospitals

The health care activities of SHC and LPCH (the Hospitals), including revenues, expenses, assets and liabilities, are consolidated into these financial statements. Each of the Hospitals is a California not-for-profit public benefit corporation. The University is the sole member of each of the Hospitals. The Hospitals support the mission of medical education and clinical research of the University's School of Medicine. They operate two licensed acute care and specialty hospitals on the Stanford campus and numerous physician clinics on the campus, in community settings and in association with regional hospitals in the San Francisco Bay Area. The Hospitals jointly control a captive insurance company.

Each of the Hospitals prepares separate, stand-alone financial statements. For purposes of presentation of the Hospitals' balance sheets, statements of operations and changes in net assets and statements of cash flows in these consolidated financial statements, conforming reclassifications have been made to the Hospitals' revenues, expenses, investment income and inter-entity receivables and payables consistent with categories in these consolidated financial statements.

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

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

Unrestricted Net Assets

Unrestricted net assets are expendable resources used to support the University's core activities of teaching and research or the Hospitals' patient care, teaching and research missions. These net assets may be designated by the University or the Hospitals for specific purposes under internal operating and administrative arrangements or be subject to contractual agreements with external parties. Donor-restricted contributions that relate to the University's or the Hospitals' core activities and are received and expended, or deemed expended based on the nature of donors' restrictions, are classified as unrestricted. Donor-restricted resources intended for capital projects are initially recorded as temporarily restricted and released from their temporary restrictions and reclassified as unrestricted support when the asset is placed in service. All expenses are recorded as a reduction of unrestricted net assets. Unrestricted net assets include funds designated for operations, plant facilities, endowment and certain investment gains and funds functioning as endowment.

Management considers all revenues and expenses to be related to operations. Investment gains and current year gifts not included in operations, capital and other gifts released from restrictions, hospital equity transfers, minimum pension liability and certain other non-operating changes are reported in other changes in unrestricted net assets.

Temporarily Restricted Net Assets

Temporarily restricted net assets include gifts and pledges that are subject to donor-imposed restrictions that expire with the passage of time, payment of pledges or specific actions to be undertaken by the University or the Hospitals, at which time they are released and reclassified to unrestricted support. Of the amounts included in temporarily restricted net assets, approximately 53% are for capital projects and 47% are for other institutional support.

Permanently Restricted Net Assets

Permanently restricted net assets consist principally of endowment, annuity and life income funds, which are subject to donor-imposed restrictions requiring that the principal be invested in perpetuity. Permanently restricted net assets may also include funds reclassified from other classes of net assets as a consequence of donor-imposed stipulations.

CASH AND CASH EQUIVALENTS Cash and cash equivalents consist of U.S. Treasury bills, bankers' acceptances, commercial paper, certificates of deposit, money market funds and all other short-term investments with remaining maturities of 90 days or less at the time of purchase. These amounts are carried at cost, which approximates market. Cash and cash equivalent amounts held for investment purposes, collateral held for securities loaned and certain cash restricted in its use, are classified as investments.

PLEDGES RECEIVABLE Unconditional promises to give are included in the financial statements as pledges receivable and are classified as temporarily restricted or permanently restricted, depending upon donor requirements. Conditional promises, which depend on the occurrence of a specified future and uncertain event, such as matching gifts from other donors, are recognized when the conditions are substantially met.

ACCOUNTS AND STUDENT LOANS RECEIVABLE Accounts and student loans receivable are carried at cost, less an allowance for doubtful accounts.

INVESTMENTS Investments are recorded at fair value. The values of publicly traded fixed income, equity securities and mutual funds are based on quoted market prices and exchange rates, if applicable. Securities transactions are reported on a trade-date basis.

Assets held by other trustees, limited partnerships, real estate and improvements, split interest agreements and other investments are recorded based on estimated fair values. Methods for determining estimated fair values include discounted cash flows and estimates provided by trustees and general partners. The estimated fair value of certain of the limited partnership and hedge fund investments is based on valuations provided by the external investment managers as of June 30, adjusted for cash receipts, cash disbursements, significant known valuation changes in

market values of publicly held securities contained in the portfolio and securities distributions through August 31. The University believes the carrying amounts of these investments are a reasonable estimate of fair value. Because the limited partnership investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed. Such differences could be material.

Donated assets are recorded at fair value at the date of donation. Estimates of fair value involve assumptions and estimation methods that are uncertain and, therefore, the estimates could differ from actual results.

Undeveloped land is reported at fair value at the date of acquisition. Under the original endowment from Senator Leland and Mrs. Jane Stanford, a significant portion of University land may not be sold.

DERIVATIVES Derivative financial instruments are recorded at fair value with the resulting gain or loss recognized in the consolidated statement of activities (see Note 5).

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

The useful lives used in calculating depreciation for the years ended August 31, 2007 and 2006 are as follows:

	UNIVERSITY	HOSPITALS
Land improvements	10-25 years	10-25 years
Buildings and building improvements	13-50 years	7-40 years
Furniture, fixtures and medical equipment	5-10 years	3-20 years
Equipment, books and software	3-10 years	3-10 years

ASSET RETIREMENT OBLIGATIONS Asset retirement obligations (AROs) are estimated costs and obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value as accrued expenses and the related asset retirement costs are recorded as an increase in other changes in unrestricted net assets. Asset retirement costs are subsequently accreted over the useful lives of the related assets.

WORKS OF ART AND SPECIAL COLLECTIONS Works of art, historical treasures, literary works and artifacts, which are preserved and protected for educational, research and public exhibition purposes, are not capitalized. Purchases of such collections are recorded as operating expenses in the period in which they are acquired.

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

DONOR-ADVISED FUNDS The University invests gifts received from donors under donor-advised fund agreements (DAFs). These funds are owned and controlled by the University and are separately identified by donor. The donors have advisory privileges with respect to the distribution of the amounts in the funds. DAFs are recorded as unrestricted net assets at the full amount of the gift. Transfers of funds to other charitable organizations are recorded as a reduction to other changes in unrestricted net assets at the time the transfer is made.

SPLIT INTEREST AGREEMENTS Split interest agreements represent trusts with living income beneficiaries where the University has a residual interest. The discounted present value of any income beneficiary interest is reported as a liability in the statement of financial position based on actuarial tables established by the Internal Revenue Service. Gifts subject to such agreements are recorded as revenue, net of the income beneficiary share, at the date of gift. Actuarial gains or losses are included in change in value of split interest agreements in the statement of activities.

Resources that are expendable upon maturity are classified as temporarily restricted net assets; all others are classified as permanently restricted net assets.

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

HEALTH CARE SERVICES The Hospitals derive a majority of patient-care revenues from contractual agreements with third-party payers including Medicare, Medi-Cal and other payers. Payments under these agreements and programs are based on a percentage of charges, per diem, per discharge, per service, a fee schedule, cost reimbursement or negotiated charges.

The University has entered into various operating agreements with the Hospitals for professional services of faculty members from the School of Medicine, telecommunications services and other services and facilities charges.

CHARITY CARE The Hospitals provide care to patients who meet certain criteria under their charity care policies without charge or at amounts less than their established rates. Amounts determined to qualify as charity care are not reported as net patient-service revenue. The amount of charity care services, quantified at established rates, was \$42,619,000 and \$37,988,000 for the years ended August 31, 2007 and 2006, respectively. The Hospitals also provide services to other patients under Medi-Cal and other publicly sponsored programs, which reimburse at amounts less than the cost of the services provided to the recipients. Estimated costs in excess of reimbursements for Medi-Cal and county services for the years ended August 31, 2007 and 2006 were \$184,774,000 and \$153,975,000, respectively.

TAX STATUS The University and the Hospitals are exempt from federal and state income taxes to the extent provided by Section 501(c)(3) of the Internal Revenue Code and equivalent state provisions.

RECENT PRONOUNCEMENTS In 2007, the University adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (FAS 158). FAS 158 requires organizations to recognize a net asset or liability in their statement of financial position and to reflect the funded status of their defined benefit pension and other post retirement benefit plans. It also requires changes in the funded status of the plans to be recognized in the year in which they occur in the statement of activities. The provision of FAS 158 that requires measurement of plan assets and benefit obligations as of the end of the fiscal year is effective for the University for the fiscal year ended August 31, 2009. The effect of FAS 158's adoption is discussed in notes 13 and 14 for the University and Hospitals, respectively.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 establishes a common definition for fair value to be applied to generally accepted accounting principles requiring use of fair value, establishes a framework for measuring fair value and expands the related disclosure requirements about fair value measurements. This accounting standard is effective for the University and the Hospitals for their fiscal year ending August 31, 2009. The University and the Hospitals are assessing the impact of adopting FAS 157.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115* (FAS 159). FAS 159 permits entities to choose to measure eligible items at fair value at specific election dates (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected shall be reported in earnings at each subsequent reporting period. This accounting standard is effective for the University and the Hospitals for their fiscal year ending August 31, 2009. The University and the Hospitals are assessing the impact of adopting FAS 159.

RESTATEMENT OF FISCAL YEAR 2006 CONSOLIDATED STATEMENT OF CASH FLOWS The fiscal year 2006 consolidated statement of cash flows has been restated to reflect cash activity related to long-term pledges as financing activities and the sale of contributed securities as investing activities. Previously, these amounts were classified primarily as operating and financing activities, respectively. The University historically has classified gifts of securities in operating or financing activities, depending on the nature of the gift, because the University's practice is to sell these securities immediately upon receipt. The effect of these changes on the accompanying fiscal year 2006 consolidated statement of cash flows is as follows, in thousands of dollars:

	AS PREVIOUSLY REPORTED	ADJUSTMENT	AS RESTATED
Net cash provided by operating activities	\$ 562,950	\$ (430,294)	\$ 132,656
Net cash used for investing activities	(1,158,478)	238,598	(919,880)
Net cash provided by financing activities	545,397	191,696	737,093
Decrease in cash and cash equivalents	(50,131)	-	(50,131)

2. Accounts Receivable

Accounts receivable at August 31, 2007 and 2006, in thousands of dollars, are as follows:

	2007	2006
UNIVERSITY:		
U.S. government	\$ 84,820	\$ 79,555
Non-government sponsors	29,428	27,896
Due from brokers	89,628	99,673
Accrued interest on investments	12,166	16,385
Student	6,752	5,689
Other	38,959	29,744
	261,753	258,942
Less allowances for losses	(2,111)	(1,927)
University accounts receivable, net	259,642	257,015
HOSPITALS:		
Patient receivables	418,659	400,759
Other	66,916	14,718
	485,575	415,477
Less bad debt allowances	(88,321)	(105,776)
Hospitals accounts receivable, net	397,254	309,701
CONSOLIDATED ACCOUNTS RECEIVABLE, NET	\$ 656,896	\$ 566,716

3. Pledges Receivable

Pledges are recorded at the present value of the discounted future cash flows, net of allowances. At August 31, 2007 and 2006, pledges receivable are as follows, in thousands of dollars:

	2007			2006
	University	Hospitals	Consolidated	Consolidated
One year or less	\$ 67,915	\$ 39,373	\$ 107,288	\$ 75,435
Between one year and five years	548,061	61,295	609,356	565,841
More than five years	314,360	5,882	320,242	228,580
	930,336	106,550	1,036,886	869,856
Less discount/allowance	(262,875)	(16,380)	(279,255)	(251,051)
PLEDGES RECEIVABLE, NET	\$ 667,461	\$ 90,170	\$ 757,631	\$ 618,805

Conditional pledges for the University, which depend on the occurrence of a specified future and uncertain event, were \$50,000 and \$43,545,000 at August 31, 2007 and 2006, respectively. During fiscal year 2007, approximately \$43,500,000 of conditional pledges related to matching gifts were satisfied. The Hospitals do not have any conditional pledges.

4. Faculty and Staff Mortgages

In a program to attract and retain excellent faculty and senior staff, the University provides home mortgage financing assistance. Notes amounting to \$333,359,000 and \$296,851,000 at August 31, 2007 and 2006, respectively, from University faculty and staff are included in faculty and staff mortgages and other loans receivable, net in the consolidated statements of financial position and are collateralized by deeds of trust on properties concentrated in the region surrounding the University.

5. Investments

Investments held by the University and the Hospitals at August 31, 2007 and 2006 are as follows, in thousands of dollars:

	2007			2006
	University	Hospitals	Consolidated	Consolidated
Cash, short-term investments and derivatives	\$ 1,036,232	\$ 500,734	\$ 1,536,966	\$ 1,375,947
Collateral held for securities loaned	583,872	.	583,872	599,191
Bonds and mutual funds	589,120	141,968	731,088	978,041
Public and private equities and investment funds	8,213,716	32,333	8,246,049	8,175,235
Assets held by other trustees (net of income beneficiary share of \$86,263 and \$78,667 at August 31, 2007 and 2006, respectively)	156,885	17,655	174,540	104,933
Real estate and improvements, including Stanford Shopping Center and Research Park	1,767,651	.	1,767,651	1,542,698
Limited partnership investments	10,003,199	.	10,003,199	6,417,208
Other	75,290	.	75,290	69,958
	22,425,965	692,690	23,118,655	19,263,211
The Hospitals' investment in University's Merged Pool	(1,258,892)	1,258,892	.	.
INVESTMENTS AT FAIR VALUE	\$ 21,167,073	\$ 1,951,582	\$ 23,118,655	\$ 19,263,211

The University manages a portion of the Hospitals' investments, with a combined market value of \$1,493,012,000 and \$1,171,472,000 at August 31, 2007 and 2006, respectively.

Total investment returns reflected in the statements of activities for the years ended August 31, 2007 and 2006, in thousands of dollars, are as follows:

	2007			2006
	University	Hospitals	Consolidated	Consolidated
Investment income	\$ 337,363	\$ 49,946	\$ 387,309	\$ 394,755
Net realized and unrealized gains	3,244,670	170,321	3,414,991	2,197,171
TOTAL INVESTMENT RETURN	\$ 3,582,033	\$ 220,267	\$ 3,802,300	\$ 2,591,926

Investment returns are net of investment management expenses, including both external management fees and internal University salaries, benefits and operating expenses. For the years ended August 31, 2007 and 2006, total investment returns of \$3,058,918,000 and \$1,952,849,000, respectively, were reinvested by the University and Hospitals after the distributions to operations and split interest agreement beneficiaries. These amounts are reported in other changes in unrestricted net assets and changes in temporarily and permanently restricted net assets.

The University's investments are held in various pools or in specific instruments to comply with donor requirements as indicated in the following table, as of August 31, 2007 and 2006, in thousands of dollars:

	2007	2006
UNIVERSITY:		
Merged pool	\$ 19,548,492	\$ 15,848,335
Expendable funds pool	1,880,264	1,657,595
Endowment income funds pool	287,216	295,758
Other investment pools	500,592	558,240
Specific investments	2,217,366	1,824,661
	<u>24,433,930</u>	<u>20,184,589</u>
Less amounts included in cash and cash equivalents	(461,600)	(436,874)
Less funds cross-invested in investment pools (including the Hospitals' investment of \$1,258,892 and \$711,763 in 2007 and 2006, respectively, in the University's Merged Pool)	(2,805,257)	(2,223,049)
	<u>21,167,073</u>	<u>17,524,666</u>
HOSPITALS:		
Investments	1,951,582	1,738,545
INVESTMENTS AT FAIR VALUE	\$ 23,118,655	\$ 19,263,211

The Merged Pool (MP) is the primary investment pool in which endowment (see Note 10) and other long-term funds are invested. The MP is invested with the objective of maximizing long-term total return. It is a unitized pool in which the fund holders purchase investments and withdraw funds based on a monthly market value. The University's Board approves an annual distribution amount per share (payout) to be distributed to endowment fund holders to support operations. The policy governing the amounts paid annually from the MP to support current operations is designed to protect the value of the endowment and other long-term funds against the expected impact of inflation while also funding a relatively constant portion of the University's current operating expenditures. The sources of the payout are earned income on endowment assets (interest, dividends, rents and royalties), a portion of realized capital gains and funds functioning as endowment, as needed.

Earned income and realized gains on endowment funds were distributed for operations in fiscal years 2007 and 2006, as follows, in thousands of dollars:

	2007	2006
Endowment income	\$ 235,450	\$ 258,093
Realized gains	373,519	276,641
APPROVED PAYOUT	\$ 608,969	\$ 534,734

The Expendable Funds Pool (EFP) and Endowment Income Funds Pool (EIFP) are the principal investment vehicles for the University's expendable funds. A substantial portion of the EFP is cross-invested in the MP. The EIFP holds income previously distributed to holders of permanently restricted endowment funds that has not yet been expended. The EIFP is invested in highly liquid instruments and is included in the statement of financial position as cash and cash equivalents. The total return on investments in the EIFP is distributed to fund holders. For the years ended August 31, 2007 and 2006, the distributions were \$8,393,000 and \$7,896,000, respectively.

The Board has established a policy for the distribution of the investment returns of the EFP. The difference between the actual return of this pool and the approved payout is deposited in, or withdrawn from, funds functioning as endowment. For the years ended August 31, 2007 and 2006, the results of the EFP, in thousands of dollars, are as follows:

	2007	2006
Total investment return of the EFP	\$ 314,021	\$ 240,958
Less distributions to fund holders and operations	(87,155)	(61,202)
AMOUNTS ADDED TO THE ENDOWMENT	\$ 226,866	\$ 179,756

The University utilizes derivatives and other strategies to reduce investment risk, to serve as a temporary surrogate for investment in stocks and bonds, to manage interest exposure on the University's variable rate debt or to achieve specific exposure to foreign currencies. The University's derivative positions include forward contracts, swaps, options and futures contracts. The net unrealized appreciation (depreciation) on these derivatives was \$178,164,000 and (\$52,820,000) at August 31, 2007 and 2006, respectively.

Foreign currency forward contracts, interest rate swaps and stock lending and repurchase agreements necessarily involve counterparty credit risk. The University seeks to control this risk by entering into transactions with high-quality counterparties and through counterparty credit evaluations and approvals, counterparty credit limits and exposure monitoring.

The University holds certain investment properties that it leases to third parties. Future minimum rental income due from the Stanford Shopping Center, Research Park and other properties under noncancelable leases in effect with tenants at August 31, 2007, is as follows, in thousands of dollars:

YEAR	
2008	\$ 55,247
2009	54,493
2010	52,279
2011	46,989
2012	42,883
Thereafter	1,223,354
TOTAL	\$ 1,475,245

6. Plant Facilities

Plant facilities at August 31, 2007 and 2006, in thousands of dollars, are as follows:

	2007			2006
	University	Hospitals	Consolidated	Consolidated
Land and improvements	\$ 352,419	\$ 30,396	\$ 382,815	\$ 299,053
Buildings and building improvements	2,902,464	692,633	3,595,097	3,406,394
Furniture, fixtures and medical equipment	52,286	232,310	284,596	244,930
Equipment, books and software	1,338,461	123,563	1,462,024	1,402,967
Construction in progress	249,306	322,423	571,729	417,143
Plant facilities	4,894,936	1,401,325	6,296,261	5,770,487
Less accumulated depreciation	(2,189,059)	(634,833)	(2,823,892)	(2,606,557)
PLANT FACILITIES,				
NET OF ACCUMULATED DEPRECIATION	\$ 2,705,877	\$ 766,492	\$ 3,472,369	\$ 3,163,930

At August 31, 2007, \$999,000,000 of fully depreciated plant facilities were still in use.

7. Liabilities Under Security Agreements

At August 31, 2007 and 2006, the University held \$583,872,000 and \$599,191,000, respectively, of short-term U.S. government obligations and cash as collateral deposits for certain securities loaned temporarily to brokers. The University also entered into certain forward sale and purchase agreements totaling \$64,851,000 and \$59,005,000 at August 31, 2007 and 2006, respectively. These amounts are included as investments and liabilities in the University's financial statements. The estimated fair value of securities on loan at August 31, 2007 and 2006, was \$553,869,000 and \$573,229,000, respectively. It is the University's policy to require receipt of collateral on securities lending contracts and repurchase agreements equal to a minimum of 102% of the fair market value of the security loaned.

8. University Notes and Bonds Payable

Notes and bonds payable at August 31, 2007 and 2006, in thousands of dollars, are as follows:

	YEAR OF MATURITY	EFFECTIVE INTEREST RATE	OUTSTANDING PRINCIPAL	
			2007	2006
TAX-EXEMPT:				
California Educational Facilities Authority (CEFA)				
Fixed Rate Revenue Bonds:				
Series M	2026	5.3%	\$ 28,320	\$ 28,320
Series N	2027	5.2%	180,000	180,000
Series O	2031	5.1%	89,555	89,555
Series P	2013-2023	5.1%	110,440	110,440
Series Q	2032	5.3%	101,860	101,860
Series R	2011-2021	4.9%	111,585	111,585
Series T-1	2039	5.0%	111,775	-
CEFA Variable Rate Revenue Notes and Bonds:				
Series L	2014-2022	3.9%	83,818	83,818
Series S	2039-2050	3.7%*	181,200	181,200
Commercial Paper	2039-2050	3.7%	24,751	-
TAXABLE:				
Fixed Rate Notes and Bonds:				
Stanford University Bonds	2024	6.9%	150,000	150,000
Medium Term Notes	2009-2026	6.6%	150,000	150,000
Other	2015-2016	various	8,925	9,042
Variable Notes and Bonds:				
Stanford University Bonds PARS	2032	5.2%	50,000	50,000
Commercial Paper	2006	5.3%*	98,200	63,000
University notes and bonds payable			1,480,429	1,308,820
Premium (discounts)			13,332	(258)
TOTAL			\$ 1,493,761	\$ 1,308,562

*Exclusive of interest rate swaps.

At August 31, 2007 and 2006, the fair value of these debt instruments approximated their recorded value.

Stanford's tax exempt debt is borrowed through the California Educational Facilities Authority (CEFA). The CEFA debt is a general obligation of the University secured by its revenues. Although CEFA is the borrower, Stanford is responsible for repayment of the tax exempt debt.

The University uses interest rate swaps to manage the interest rate exposure of its variable rate debt portfolio. Under the terms of these agreements, the University pays a fixed interest rate, determined at inception, and receives a variable rate on the underlying notional principal amount. At August 31, 2007, the University had swap agreements expiring November 1, 2039 to pay an interest rate of approximately 3.7% on \$130,000,000 of the outstanding balance of the CEFA S auction rate bonds and swap agreements expiring through 2011 to pay an interest rate of approximately 5.8% on approximately \$31,846,000 of the variable rate commercial paper.

In June 2007, the University issued CEFA T-1 Bonds (the Bonds) with a par value of \$111,775,000 plus an original issue premium of \$13,891,000 at an interest rate of 5.0%. The Bonds mature on March 15, 2039. The Bonds are subject to optional redemption prior to maturity at the option of the Authority at the direction of the University. The University incurred interest expense of approximately \$67,327,000 and \$65,352,000 for fiscal years 2007 and 2006, respectively, which is net of approximately \$3,070,000 and \$804,000, respectively, in interest capitalized as a cost of construction. Interest payments on swap agreements, which are included in other changes in unrestricted net assets, totaled \$600,000 and \$1,624,000 for fiscal years 2007 and 2006, respectively.

The University has a taxable commercial paper credit facility that provides for borrowings up to \$200,000,000 outstanding at any time. The outstanding balance at August 31, 2007, was \$98,200,000. The weighted average days to maturity were 20.8 and the weighted average effective interest rate was 5.3% as of August 31, 2007.

The University also has a tax-exempt commercial paper credit facility that allows for borrowings up to \$150,000,000 through CEFA. The outstanding balance at August 31, 2007, was \$24,751,000. The weighted average days to maturity were 18.3 and the weighted average effective interest rate was 3.7% as of August 31, 2007.

Scheduled principal payments on notes and bonds, in thousands of dollars, are:

YEAR ENDING AUGUST 31	PRINCIPAL
2008 tax exempt commercial paper	\$ 24,751
2008 commercial paper	98,200
2008 other	775
2009	50,833
2010	899
2011	50,972
2012	62,635
Thereafter	1,191,364
TOTAL	\$ 1,480,429

9. Hospitals' Notes and Bonds Payable

Bonds, certificates of participation and capital lease obligations at August 31, 2007 and 2006, in thousands of dollars, are as follows:

	YEAR OF MATURITY	EFFECTIVE INTEREST RATE	OUTSTANDING PRINCIPAL	
			2007	2006
SHC:				
California Health Facilities Financing Authority (CHFFA):				
1998 Series B Fixed Rate Bonds	2031	5.0%	\$ 170,775	\$ 174,185
2003 Series A Fixed Rate Bonds	2007-2023	2.0% - 5.0%	96,310	100,000
2003 Series B, C and D Variable Rate Bonds	2036	3.6% *	150,000	150,000
2006 Series A Variable Rate Bonds	2040	3.6% *	260,300	260,300
2006 Series B Variable Rate Bonds	2045	3.6% *	168,200	168,200
Promissory Note	2014	7.0%	1,132	-
LPCH:				
Variable Rate Certificates of Participation (Certificates)	2023	3.9% *	32,400	33,600
California Health Facilities Financing Authority (CHFFA):				
Auction Rate Revenue Bonds	2027-2033	3.5% - 3.8%	60,000	60,000
Fixed Rate Revenue Bonds	2013-2027	4.9%	55,000	55,000
Capital lease obligation			16,016	-
Hospitals notes and bonds payable			1,010,133	1,001,285
Premiums			4,613	4,917
TOTAL			\$ 1,014,746	\$ 1,006,202

*Exclusive of interest rate swaps.

At August 31, 2007 and 2006, the fair value of these debt instruments approximated their recorded value.

At August 31, 2007, SHC had swap agreements expiring through November 15, 2040 to pay an interest rate of approximately 3.4% on the 2003 Variable rate bonds, 3.7% on the 2006 Series A Variable rate bonds and 3.6% on the 2006 Series B Variable rate bonds based on an amount equal to the outstanding balance of the bonds.

At August 31, 2007, LPCH had swap agreements expiring through 2023 to pay a fixed interest rate of 6.2% on an amount equal to the outstanding balance of the Certificates.

The Hospitals' tax exempt debt is borrowed through the California Health Facilities Financing Authority (CHFFA). The CHFFA debt is a general obligation of the Hospitals. Payments of principal and interest on the Hospitals' bonds are collateralized by a pledge against the revenues of the respective hospital. Although CHFFA is the borrower, the Hospitals are responsible for the repayment of the tax exempt debt. Certain of the bonds and certificates of participation are insured by municipal bond guaranty policies.

SHC and LPCH are each subject to separate Master Trust Indentures which include, among other things, limitations on the incurrence of additional indebtedness, liens on property, restrictions on disposition or transfer of assets and compliance with certain financial ratios. The Hospitals may redeem the bonds and certificates, in whole or in part, prior to the stated maturities.

Holders of the Certificates have the option to tender the certificates weekly. In order to ensure the availability of funds to purchase any certificates tendered that the remarketing agent is unable to remarket, LPCH has obtained a standby bond purchase agreement that expires in September 2015. LPCH may redeem the Certificates, in whole or in part, prior to the stated maturities at par value. LPCH has the option to convert the Certificates to a fixed rate. The University is not an obligor or guarantor with respect to any obligations of SHC or LPCH, nor are SHC or LPCH obligors or guarantors with respect to obligations of the University.

SHC has two irrevocable letters of credit with a bank in the amount of \$22,014,000, which are required as security for the workers' compensation self-insurance arrangement. No amounts have been drawn on these letters of credit as of August 31, 2007.

Estimated principal payments on bonds, certificates and capital lease obligations, in thousands of dollars, are summarized below:

YEAR ENDING AUGUST 31	PRINCIPAL
2008	\$ 10,034
2009	10,032
2010	11,024
2011	11,485
2012	23,489
Thereafter	944,069
TOTAL	\$ 1,010,133

10. University Endowment

The University classifies a substantial portion of its financial resources as endowment. These assets include pure endowment funds, endowed lands, term endowment funds and funds functioning as endowment. Depending on the nature of the donor's stipulation, these resources are recorded as permanently restricted, temporarily restricted or unrestricted net assets. The endowment is intended to generate investment income that can be used to support the current operations of the University.

Pure endowment funds and endowed lands are subject to the restrictions of the gift instruments requiring that the principal be held in perpetuity and the income and an appropriate portion of gains be spent only as provided for under the California Uniform Management of Institutional Funds Act (CUMIFA). In the absence of further donor restrictions, the amount of gains that are to be expended in a given year is determined through the endowment payout policy discussed in Note 5. The University classifies the original endowment gift as permanently restricted net assets and all reinvested gains as unrestricted net assets, except when a donor requires the gains to be reinvested as permanently restricted net assets. The University recognizes the limitations on expending such gains that are specified in CUMIFA.

Term endowments are similar to other endowment funds except that, upon the passage of a stated period of time or the occurrence of a particular event, all or part of the principal may be expended. These resources are classified as temporarily restricted net assets.

Funds functioning as endowment are University resources designated as endowment and are invested for long-term appreciation and current income. These assets, however, remain available and may be spent at the Board's discretion. Funds functioning as endowment are recorded as unrestricted net assets.

Changes in the University's endowment, excluding pledges, for the years ended August 31, 2007 and 2006, in thousands of dollars, are as follows:

	2007	2006
ENDOWMENT, BEGINNING OF YEAR	\$ 14,084,676	\$ 11,883,535
Investment returns:		
Earned endowment income	235,450	257,702
Unrealized and realized gains	2,792,706	1,940,801
Total investment returns	3,028,156	2,198,503
Amounts distributed for operations	(608,969)	(534,734)
Gifts and pledge payments	361,401	252,572
Funds invested in endowment, net	107,473	105,989
EFP returns invested in endowment	226,866	179,756
Other	(34,767)	(945)
Net increase in endowment	3,080,160	2,201,141
ENDOWMENT, END OF YEAR	\$ 17,164,836	\$ 14,084,676

11. University Gifts and Pledges

The University's Office of Development (OOD) reports total gifts based on contributions received in cash or property during the fiscal year. Gifts and pledges reported for financial statement purposes are recorded on the accrual basis. The following summarizes gifts and pledges received for the years ended August 31, 2007 and 2006, per the statement of activities reconciled to the cash basis (as reported by OOD), in thousands of dollars:

	2007	2006
Current year gifts in support of operations	\$ 198,454	\$ 167,700
Current year gifts not included in operations	38,365	3,215
Temporarily restricted — general	261,888	573,092
Temporarily restricted — capital	11,511	17,541
Permanently restricted — endowment	342,282	204,847
Permanently restricted — student loans	2	146
TOTAL PER STATEMENT OF ACTIVITIES	852,502	966,541
Adjustments to gift total as reported by OOD:		
New pledges	(404,430)	(542,319)
Payments made on pledges	266,416	286,447
Pledge discounts and other adjustments	53,724	141,569
Donor advised funds not designated for Stanford	(19,827)	-
Revocable gifts	14,085	-
Non-cash gifts	8,096	-
Non-government grants, recorded as sponsored research support when earned	60,434	58,870
Other	1,345	55
TOTAL AS REPORTED BY OOD	\$ 832,345	\$ 911,163

Gifts restricted to particular purposes are used for those purposes subject to the University's restricted fund policy. Under this policy, 8% of the expenditure from restricted funds is allocated for space and infrastructure charge. Gifts for building projects and payout from endowments whose primary purpose is to fund financial aid, undergraduate research and tenure-line faculty salaries, are exempt from the infrastructure charge. The policy also provides that no interest is credited to gifts that are fully expendable.

12. Functional Expenses

Expenses for each of the years ended August 31, 2007 and 2006 are categorized on a functional basis as follows, in thousands of dollars:

	2007	2006
UNIVERSITY:		
Organized research (direct costs)	\$ 820,098	\$ 814,231
Instruction and departmental research	969,687	878,124
Auxiliary activities	501,933	499,222
Administration and general	192,841	192,221
Libraries	140,111	137,514
Development	66,762	55,572
Student services	108,604	83,742
SLAC construction	104,669	74,360
	2,904,705	2,734,986
HOSPITALS:		
Health care services	1,615,536	1,477,537
TOTAL CONSOLIDATED EXPENSES	\$ 4,520,241	\$ 4,212,523

Depreciation, interest and operations and maintenance expenses are allocated to program and supporting activities, except for SLAC construction. Auxiliary activities include housing and dining services, intercollegiate athletics, SAA, other activities and certain patient care provided by the School of Medicine faculty.

13. University Retirement Plans

The University provides retirement benefits through both contributory and noncontributory retirement plans for substantially all of its employees. The University also provides certain health care benefits for retired employees (post retirement medical benefits).

In 2007, the University adopted FAS 158. The incremental effect of adopting FAS 158 is as follows, in thousands of dollars:

	BEFORE APPLICATION	PENSION PLAN	POST RETIREMENT MEDICAL	AFTER APPLICATION
CONSOLIDATED FINANCIAL STATEMENTS:				
Prepaid expenses and other assets	\$ 49,815	\$ 35,240	\$ -	\$ 85,055
Total assets	25,852,392	35,240	-	25,887,632
Accrued post retirement benefit costs	81,783	-	128,526	210,309
Total liabilities	3,801,677	-	128,526	3,930,203
Total net assets	22,050,715	35,240	(128,526)	21,957,429
Change in net assets	3,649,867	35,240	(128,526)	3,556,581
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE:				
Unrecognized net actuarial gain (loss)	\$ -	\$ 43,035	\$ (63,880)	\$ (20,845)
Unrecognized prior service cost	-	(7,795)	(64,646)	(72,441)
	\$ -	\$ 35,240	\$ (128,526)	\$ (93,286)

DEFINED CONTRIBUTION PLAN The University offers a defined contribution plan to eligible faculty and staff. University and participant contributions are invested in annuities and mutual funds. University contributions under this plan, which are vested immediately to participants, amounted to approximately \$89,000,000 and \$83,000,000 for the years ended August 31, 2007 and 2006, respectively.

DEFINED BENEFIT PENSION PLAN Retirement benefits for certain employees are provided through a noncontributory defined benefit pension plan (the Pension plan). The University's policy is to fund pension costs in accordance with the Employee Retirement Income Security Act minimum funding requirements.

POST RETIREMENT MEDICAL BENEFIT PLAN The University's employees may become eligible for post retirement medical benefits upon retirement. Retiree health plans are paid for in part by retiree contributions, which are adjusted annually. Benefits are provided through various health care payers or health maintenance organizations, whose charges are based on either the benefits paid during the year or annual premiums. Health benefits are provided to retirees and their covered dependents. The University recognizes the current cost of post retirement medical benefits over the periods that employees render service and the prior service obligation over 20 years.

The University uses June 30 as the measurement date to value the plan assets and the benefit obligation of the Pension and Post Retirement Medical Benefit plans.

The change in Pension and Post Retirement Medical Benefit plan assets, the related change in benefit obligation and the amounts recognized in the financial statements, in thousands of dollars, are as follows:

	PENSION		POST RETIREMENT MEDICAL	
	2007	2006	2007	2006
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	\$ 274,434	\$ 262,427	\$ 81,189	\$ 70,444
Actual return on plan assets	32,539	30,963	17,857	4,102
Employer contributions	-	-	13,642	16,313
Plan participants' contributions	-	-	5,805	5,000
Benefits paid	(17,327)	(18,956)	(16,412)	(14,670)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	\$ 289,646	\$ 274,434	\$ 102,081	\$ 81,189
CHANGE IN PROJECTED BENEFIT OBLIGATION				
Benefit obligation at beginning of year	\$ 267,778	\$ 282,486	\$ 263,053	\$ 328,847
Service cost	4,465	5,425	9,562	10,257
Interest cost	16,049	14,288	16,714	16,966
Plan participants' contributions	-	-	5,805	5,000
Amendments	398	5,029	-	-
Actuarial (gain) loss	(20,809)	(20,494)	33,454	(83,347)
Benefits paid, net of federal subsidy	(17,327)	(18,956)	(15,220)	(14,670)
BENEFIT OBLIGATION AT END OF YEAR	\$ 250,554	\$ 267,778	\$ 313,368	\$ 263,053
AMOUNTS RECOGNIZED IN FINANCIAL STATEMENTS				
Plan assets minus projected benefit obligation	\$ 39,092	\$ 6,656	\$ (211,287)	\$ (181,864)
Contributions after the measurement date	-	-	978	3,035
Unrecognized prior service cost	-	9,005	-	72,251
Unrecognized net actuarial (gain) loss	-	(11,809)	-	42,528
NET AMOUNT RECOGNIZED IN THE STATEMENT OF FINANCIAL POSITION	\$ 39,092	\$ 3,852	\$ (210,309)	\$ (64,050)

The accumulated benefit obligation for the Pension plan was \$244,939,000 and \$260,560,000 as of June 30, 2007 and 2006, respectively.

Net benefit expense related to the Pension and Post Retirement Medical Benefit plans for the years ended August 31, 2007 and 2006, in thousands of dollars, includes the following components:

	PENSION		POST RETIREMENT MEDICAL	
	2007	2006	2007	2006
Service cost	\$ 4,465	\$ 5,425	\$ 9,562	\$ 10,257
Interest cost	16,049	14,288	16,714	16,966
Expected return on plan assets	(18,421)	(20,150)	(6,750)	(5,636)
Amortization of prior service cost	1,608	1,025	7,605	7,605
Recognized net actuarial losses	-	-	995	6,138
NET PERIODIC BENEFIT EXPENSE	\$ 3,701	\$ 588	\$ 28,126	\$ 35,330

The prior service costs and net actuarial (gain) loss expected to be amortized from change in net assets to net periodic benefit expense over the next fiscal year are as follows, in thousands of dollars:

	PENSION	POST RETIREMENT MEDICAL
Net actuarial (gain) loss	\$ (2,126)	\$ 2,184
Prior service cost	\$ 1,654	\$ 7,605

ACTUARIAL ASSUMPTIONS The weighted average assumptions used to determine the benefit obligations for the Pension and Post Retirement Medical Benefit plans are shown below:

	PENSION		POST RETIREMENT MEDICAL	
	2007	2006	2007	2006
Discount rate	6.25%	6.25%	6.25%	6.25%
Covered payroll growth rate	5.52%	5.52%	N/A	N/A

The weighted average assumptions used to determine the net periodic benefit cost for the Pension and Post Retirement Medical Benefit plans are shown below:

	PENSION		POST RETIREMENT MEDICAL	
	2007	2006	2007	2006
Discount rate	6.25%	5.25%	6.25%	5.25%
Expected return on plan assets	7.00%	8.00%	8.00%	8.00%
Covered payroll growth rate	5.52%	5.52%	N/A	N/A

To develop the 7% and 8% expected long-term rate of return on asset assumptions for the Pension and Post Retirement Medical Benefit plans, respectively, the University considered historical returns and future expectations for returns in each asset class, as well as the target asset allocation of the portfolios.

To determine the accumulated post retirement medical benefit obligation as of June 30, 2007, a 9% annual rate of increase in the per capita costs of covered health care was assumed for 2007-2008, declining gradually to 5% by 2016 and remaining at this rate thereafter. For covered dental plans, a 6% annual rate of increase was assumed for 2007-2008, declining to 5% by 2010 and remaining at this rate thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated post retirement medical benefit obligation by \$45,883,000 and the aggregate annual service and interest cost by \$5,072,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post retirement medical benefit obligation by \$37,625,000 and the aggregate annual service and interest cost by \$4,015,000.

PLAN ASSETS Asset allocations by asset category at June 30 are as follows:

ASSET CATEGORY	PENSION		POST RETIREMENT MEDICAL	
	2007	2006	2007	2006
Domestic equity	33%	29%	38%	-
International equity	11%	9%	37%	-
Fixed income	54%	26%	25%	86%
Short term investments	1%	20%	-	-
Real estate	-	15%	-	14%
Other	1%	1%	-	-
TOTAL PORTFOLIO	100%	100%	100%	100%

The weighted-average target asset allocation for the Pension plan is 45% equity and 55% fixed income. For the Post Retirement Medical Benefit plan the weighted-average target asset allocation is 38% domestic equity, 37% international equity and 25% fixed income. These target asset allocations are meant to result in a favorable long-term rate of return from a diversified portfolio.

EXPECTED CONTRIBUTIONS No contributions are expected to be made to the Pension plan for the fiscal year ending August 31, 2008. The University expects to contribute \$17,746,000 to its Post Retirement Medical Benefit plan during the fiscal year ending August 31, 2008.

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

FISCAL YEAR	PENSION PLAN	POST RETIREMENT	
		EXCLUDING MEDICARE SUBSIDY	WITH MEDICARE SUBSIDY
2008	\$ 27,010	\$ 13,247	\$ 11,905
2009	21,850	15,024	13,484
2010	22,265	16,772	15,033
2011	22,253	18,495	16,532
2012	21,387	20,276	18,065
2013 - 2017	97,477	127,818	111,815

14. Hospitals' Retirement Plans

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

In 2007, the Hospitals adopted FAS 158. The incremental effect of adopting FAS 158 is as follows, in thousands of dollars:

	BEFORE APPLICATION	PENSION PLAN	POST RETIREMENT MEDICAL	AFTER APPLICATION
CONSOLIDATED FINANCIAL STATEMENTS:				
Prepaid expenses and other assets	\$ 152,298	\$ 308	\$ -	\$ 152,606
Total assets	3,401,786	308	-	3,402,094
Accrued post retirement benefit costs	78,326	(3,316)	(8,046)	66,964
Total liabilities	1,433,359	(3,316)	(8,046)	1,421,997
Total net assets	1,969,043	3,008	8,046	1,980,097
Change in net assets	489,730	3,008	8,046	500,784
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE:				
Unrecognized net actuarial gain	\$ -	\$ 3,008	\$ 4,627	\$ 7,635
Unrecognized prior service credit	-	-	3,419	3,419
	\$ -	\$ 3,008	\$ 8,046	\$ 11,054

DEFINED CONTRIBUTION PLAN Employer contributions to the defined contribution retirement plan are based on a percentage of participant annual compensation. Employer contributions to this plan amounted to approximately \$45,039,000 and \$38,013,000 for the years ended August 31, 2007 and 2006, respectively.

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

POST RETIREMENT MEDICAL BENEFIT PLAN The Hospitals currently provide health insurance coverage for employees upon retirement as early as age 55, with years of service as defined by specific criteria. The health insurance coverage for retirees who are under age 65 is the same as that provided to active employees. A Medicare supplement option is provided for retirees over age 65. The obligation for these benefits has been recorded in the statements of financial position.

The Hospitals use June 30 as a measurement date to value the plan assets and the benefit obligation of their Pension and Post Retirement Medical Benefit plans.

The change in Pension and Post Retirement Medical Benefit plan assets, the related change in benefit obligation and the amounts recognized in the financial statements, in thousands of dollars, are as follows:

	PENSION		POST RETIREMENT MEDICAL	
	2007	2006	2007	2006
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	\$ 140,724	\$ 123,886	\$ -	\$ -
Actual return on plan assets	23,094	13,469	-	-
Plan participants' contributions	-	-	680	525
Employer contributions	1,152	10,690	3,344	3,982
Benefits paid	(7,514)	(7,321)	(4,024)	(4,507)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	\$ 157,456	\$ 140,724	\$ -	\$ -
CHANGE IN PROJECTED BENEFIT OBLIGATION				
Benefit obligation at beginning of year	\$ 157,562	\$ 181,797	\$ 68,497	\$ 67,719
Service cost	1,720	2,144	1,660	1,954
Interest cost	10,062	9,374	4,257	3,298
Plan participants' contributions	-	-	680	525
Actuarial (gain) loss	798	(28,432)	(4,731)	(492)
Benefits paid	(7,514)	(7,321)	(4,024)	(4,507)
BENEFIT OBLIGATION AT END OF YEAR	\$ 162,628	\$ 157,562	\$ 66,339	\$ 68,497
AMOUNTS RECOGNIZED IN FINANCIAL STATEMENTS				
Plan assets minus projected benefit obligation	\$ (5,172)	\$ (16,838)	\$ (66,339)	\$ (68,497)
Contributions made after measurement date	4,262	-	607	705
Unrecognized prior service cost	-	-	-	(4,253)
Unrecognized net actuarial loss	-	9,188	-	115
NET AMOUNT RECOGNIZED IN THE STATEMENT OF FINANCIAL POSITION	\$ (910)	\$ (7,650)	\$ (65,732)	\$ (71,930)

The accumulated benefit obligation for the Pension plan was \$152,418,000 and \$147,500,000 as of June 30, 2007 and 2006, respectively.

Net benefit expense related to the plans for the years ended August 31, 2007 and 2006, in thousands of dollars, includes the following components:

	PENSION		POST RETIREMENT MEDICAL	
	2007	2006	2007	2006
Service cost	\$ 1,720	\$ 2,144	\$ 1,660	\$ 1,954
Interest cost	10,062	9,374	4,257	3,298
Expected return on plan assets	(10,215)	(9,729)	-	-
Amortization of prior service cost	-	-	(834)	(834)
Recognized net actuarial losses	115	2,403	11	60
NET PERIODIC BENEFIT EXPENSE	\$ 1,682	\$ 4,192	\$ 5,094	\$ 4,478

The prior service costs and net actuarial loss expected to be amortized from change in net assets to net periodic benefit expense over the next fiscal year are as follows, in thousands of dollars:

	PENSION		POST RETIREMENT MEDICAL	
	2007	2006	2007	2006
Net actuarial gain	\$ -	-	\$ 448	-
Prior service credit	\$ -	-	\$ 834	-

ACTUARIAL ASSUMPTIONS The weighted average assumptions used to determine the benefit obligations for the Pension and Post Retirement Medical Benefit plans are shown below:

	PENSION		POST RETIREMENT MEDICAL	
	2007	2006	2007	2006
Discount rate	6.43 - 6.47%	6.49 - 6.53%	6.35%	6.42%
Covered payroll growth rate	5.50%	5.50%	N/A	N/A

The weighted average assumptions used to determine the net periodic benefit cost for the Pension and Post Retirement Medical Benefit plans are shown below:

	PENSION		POST RETIREMENT MEDICAL	
	2007	2006	2007	2006
Discount rate	6.49 - 6.53%	5.25%	6.42%	5.00%
Expected return on plan assets	3.00 - 8.00%	3.00 - 8.00%	N/A	N/A
Covered payroll growth rate	5.50%	5.50%	N/A	N/A

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

To determine the accumulated post retirement medical benefit obligation as of June 30, 2007, a 9.5% annual rate of increase in the pre-65 per capita costs, an 11.5% annual rate of increase in the post-65 prescription drug per capita costs and a 9.0% rate of increase in the post-65 per capita cost of all other medical benefits was assumed for 2007-2008, declining to 5% by 2013 for the pre-65 per capita costs, 2014 for the post-65 prescription drug per capita cost and 2011 for the post-65 per capita costs of all other medical benefits and remaining at this rate thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated post retirement medical benefit obligation by \$2,063,000 and the aggregate annual service and interest cost by \$185,000. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post retirement medical benefit obligation by \$1,858,000 and the aggregate annual service and interest cost by \$165,000.

PLAN ASSETS Asset allocations by asset category at June 30 are as follows:

ASSET CATEGORY	PENSION	
	2007	2006
Cash equivalents	3%	4%
Equity securities	66%	64%
Fixed income	21%	21%
Real estate	10%	11%
TOTAL PORTFOLIO	100%	100%

The weighted-average target asset allocation of 62% equity securities, 30% fixed income, 8% real estate and less than 1% cash and cash equivalents is meant to result in a favorable long-term rate of return from a diversified portfolio.

EXPECTED CONTRIBUTIONS No contributions are expected to be made to the Pension plan for the fiscal year ending August 31, 2008. The Hospitals expect to contribute \$4,501,000 to their Post Retirement Medical Benefit plan during the fiscal year ending August 31, 2008.

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

FISCAL YEAR	PENSION PLAN	POST RETIREMENT	
		EXCLUDING MEDICARE SUBSIDY	WITH MEDICARE SUBSIDY
2008	\$ 7,372	\$ 4,854	\$ 4,501
2009	7,858	5,201	4,783
2010	8,416	5,560	5,073
2011	9,023	5,991	5,438
2012	9,734	6,396	5,773
2013 – 2017	59,438	36,141	31,958

15. Operating Leases

The University and the Hospitals lease certain equipment and facilities under operating leases expiring at various dates. Total rental expense under these leases for the years ended August 31, 2007 and 2006 was \$26,716,000 and \$29,760,000, respectively, for the University and \$42,118,000 and \$35,990,000, respectively, for the Hospitals. Net minimum future operating lease payments and related present value assuming a 6.25% discount rate for periods subsequent to August 31, 2007, in thousands of dollars, are as follows:

YEAR ENDING AUGUST 31	MINIMUM LEASE PAYMENTS		PRESENT VALUE OF MINIMUM LEASE PAYMENTS	
	UNIVERSITY	HOSPITALS	UNIVERSITY	HOSPITALS
2008	\$ 21,272	\$ 31,775	\$ 20,569	\$ 30,885
2009	18,790	27,976	17,101	25,593
2010	15,401	23,637	13,192	20,351
2011	11,904	19,360	9,596	15,688
2012	10,189	15,607	7,730	11,903
Thereafter	48,049	65,756	29,527	44,406
TOTAL	\$ 125,605	\$ 184,111	\$ 97,715	\$ 148,826

16. Related Party Transactions

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

17. Commitments and Contingencies

Management is of the opinion that none of the following commitments and contingencies will have a material adverse effect on the University's consolidated financial position.

SPONSORED PROJECTS The University conducts substantial research for the federal government pursuant to contracts and grants from federal agencies and departments. The University records reimbursements of direct and indirect costs (facilities and administrative costs) from grants and contracts as operating revenues. The Office of Naval Research is the University's cognizant federal agency for determining indirect cost rates charged to federally sponsored agreements. It is supported by the Defense Contract Audit Agency, which has the responsibility for auditing direct and indirect charges under those agreements. Costs recovered by the University in support of sponsored research are subject to audit and adjustment.

HEALTH CARE Cost reports filed under the Medicare program for services based upon cost reimbursement are subject to audit. The estimated amounts due to or from the program are reviewed and adjusted annually based upon the status of such audits and subsequent appeals.

The health care industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time. Recently, government activity has increased with respect to

investigations and allegations concerning possible violations by health care providers. These investigations could result in the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. The Hospitals are subject to similar regulatory reviews, and while such reviews may result in repayments and/or civil remedies that could have a material effect on the Hospitals' results of operations in a given period, management believes that such repayments and/or civil remedies would not have a material adverse effect on the Hospitals' financial position.

LABOR AGREEMENTS Approximately 7% of the University's, 39% of SHC's and 50% of LPCH's employees are covered under union contract arrangements and are, therefore, subject to labor stoppages when contracts expire. There are currently no expired agreements.

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

CONTRACTUAL COMMITMENTS At August 31, 2007, the University had contractual obligations of approximately \$170,812,000 in connection with major construction projects. Remaining expenditures on construction in progress are estimated to be \$471,156,000 and will be financed with certain gifts, operating funds, reserves and debt.

At August 31, 2007, commitments on contracts for the construction and remodeling of Hospital facilities were approximately \$199,055,000.

The University has committed to invest in numerous investment partnerships over a period of years pursuant to provisions of the individual partnership agreements. As of August 31, 2007, the aggregated amount of such unfunded commitments was \$4,845,648,000.

GUARANTEES AND INDEMNIFICATIONS The University and the Hospitals enter into mutual indemnification agreements in the normal course of their business. The impact of these agreements is not expected to be material. As a result, no liabilities related to guarantees and indemnifications have been recorded as of August 31, 2007.

SUBSEQUENT EVENTS In June 2007, the University entered into a forward contract with CEFA for the issuance of \$25,360,000 of fixed rate CEFA T-3 revenue bonds (the CEFA T-3 Bonds). CEFA issued the T-3 Bonds and loaned the proceeds to the University on September 6, 2007. The CEFA T-3 Bonds bear interest at the rate of 5% and mature on March 15, 2026. The proceeds from the issuance will be used to refund a portion of the CEFA M Bonds redeemable on December 1, 2007. The Bonds are subject to optional redemption prior to maturity at the option of CEFA at the direction of the University.

In September 2007, CEFA issued \$187,550,000 of variable rate CEFA T-2 revenue bonds (the CEFA T-2 Bonds) and loaned the proceeds to the University. The proceeds will be used to refund the CEFA N Bonds redeemable on December 1, 2007. The CEFA T-2 Bonds are Auction Rate Securities with the interest rate determined by periodic auction. The interest rate may be converted to a different variable rate mode or a fixed rate at the option of the University. The CEFA T-2 Bonds may be redeemed at the option of the University, in whole or in part, on the interest payment date immediately following the end of an auction period as defined in the official statement. The CEFA T-2 Bonds mature on March 15, 2033.

Management Responsibility for Financial Statements

The University is the sole member of Stanford Hospital and Clinics and Lucile Packard Children's Hospital; however, each of the Hospitals has its own separate management with responsibility for its own financial reporting.

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

In accumulating and controlling financial data, management of the University and the Hospitals maintain separate systems of internal accounting controls. Management of the respective entities believe that effective internal controls are maintained and communication of accounting and business policies, by selection and training of qualified personnel and by programs of internal audits, give reasonable assurance, at reasonable cost, that assets are protected and that transactions and events are recorded properly.

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

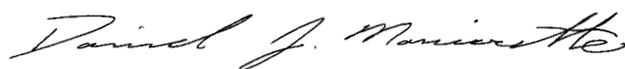
The Board of Trustees of the University and the separate Boards of Directors of the Hospitals, through their respective Audit Committees, comprised of trustees and directors not employed by the University or the Hospitals, are responsible for engaging the independent auditors and meeting with management,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



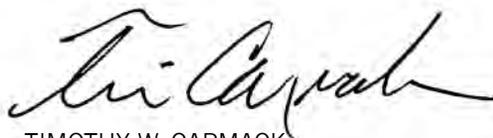
RANDALL S. LIVINGSTON
Vice President for Business Affairs and
Chief Financial Officer
Stanford University



M. SUZANNE CALANDRA
Controller
Stanford University



DANIEL J. MORISSETTE
Chief Financial Officer
Stanford Hospital and Clinics



TIMOTHY W. CARMACK
Chief Financial Officer
Lucile Salter Packard Children's Hospital

Report from the Stanford Management Company

The Stanford Management Company (SMC) was established in 1991 to manage Stanford's financial assets. SMC is a division of the University with oversight by a Board of Directors appointed by the University Board of Trustees. The SMC board consists of investment and real estate professionals, the University president, the University chief financial officer, the chairman of the Board of Trustees and the CEO of SMC. The Board approves SMC asset allocation targets, oversees the hiring of external asset managers and evaluates the performance of SMC investments and professionals. SMC oversees approximately \$21.6 billion of endowment and trust assets, temporarily invested expendable funds and commercial real estate investments.

The majority of the University's endowment assets is invested through the Merged Pool (MP), which is a diversified portfolio of actively managed financial and real estate assets valued at approximately \$18.8 billion as of June 30, 2007. MP performance measurements are calculated on the 12 months ended June 30, 2007, to facilitate the comparison of returns with results of other endowments and foundations. The following discussion of endowment performance relates solely to investments in the MP. The MP generated a 23.4% investment return for the 12 months ended June 30, 2007. Over the past 10 years, the MP achieved an annualized rate of return of 15.1%, growing from \$4.3 billion to \$18.8 billion. This investment performance places Stanford in the top 5% of all reporting university and college endowments during this period, according to the consulting firm Cambridge Associates.

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

SMC, with assistance from the Board of Directors, actively manages the MP, selecting third-party managers to deploy the MP's capital. Stanford University's brand and SMC's reputation as a stable long-term source of capital enable SMC to gain access to the best third-party managers in the world. Within each asset class, we endeavor to place capital with a diversified set of managers across geographies and investment strategies. We seek to benefit from drivers of economic growth through a broadly diversified and hedged portfolio that is less subject to drawdown than the more concentrated portfolio of the late 1990's. SMC also seeks to add value through effective risk management, tactical portfolio rebalancing and opportunistic investment tilts.

STANFORD MP ASSET ALLOCATION Given the perpetual nature of the University, SMC's investment horizon is long-term. Our objective is to generate optimal total return relative to an appropriate level of risk for Stanford. Each June, SMC and the Board reevaluate portfolio asset allocation targets, as well as expected risk, return and correlation

among asset classes. This annual review takes into account current market conditions and historical characteristics of each asset class. The strategic asset allocation targets for the MP as of June 30, 2007, are listed below:

LONG-TERM POLICY TARGETS

ASSET CLASS	STRATEGIC ALLOCATION
Public Equity	37%
Real Estate	16%
Private Equity	12%
Natural Resources	7%
Absolute Return	18%
Fixed Income	10%

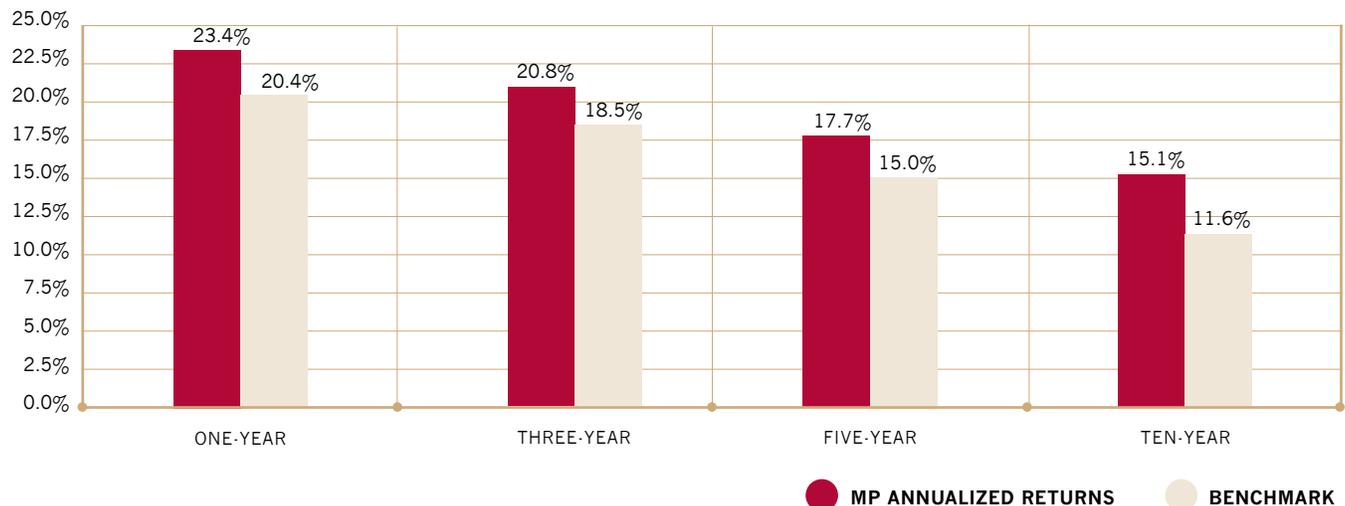
STANFORD MP PERFORMANCE COMPARED TO INFLATION The table below outlines annualized returns for various periods ending June 30, 2007. Stanford’s objective is to return a minimum of 6.75% over the rate of inflation as measured by the GDP Deflator. If this real return target is achieved over time, the value of the MP, net of annual payouts to support operating activities, will be maintained. Over the past one-, three-, five- and 10-year periods, Stanford’s annualized real return has substantially exceeded the 6.75% target.

MP PERFORMANCE COMPARED TO INFLATION

	ONE-YEAR	THREE-YEAR	FIVE-YEAR	TEN-YEAR
Nominal Endowment Return	23.4%	20.8%	17.7%	15.1%
GDP Deflator	3.1%	3.1%	2.8%	2.3%
Real Endowment Return	20.3%	17.7%	14.9%	12.8%

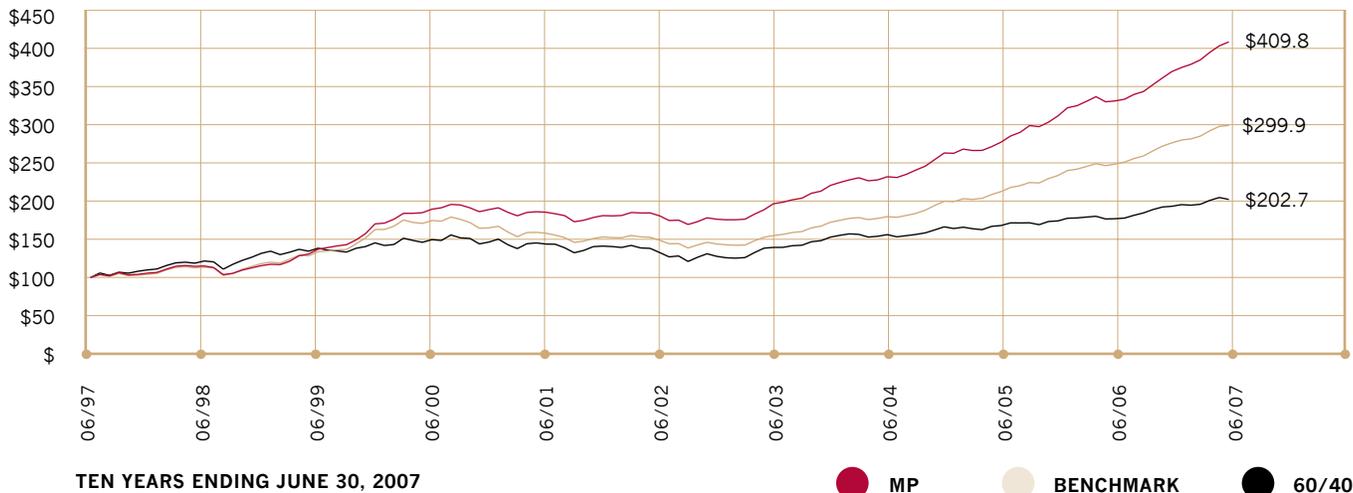
STANFORD MP PERFORMANCE COMPARED TO BENCHMARKS SMC evaluates the performance of investment managers by comparing their returns to benchmarks that are appropriate for each individual asset class. The SMC Board reviews asset class benchmarks on an annual basis to ensure comparability. SMC compares overall MP performance to the composite benchmark return, which represents a blend of the benchmark returns for each asset class weighted by the strategic allocations above. In the table below, actual performance, net of management fees, is compared to the composite benchmark for periods ended June 30, 2007.

STANFORD MP VS. STANFORD COMPOSITE BENCHMARK



SMC's effectiveness in implementing its investment strategies through top-level manager selection has resulted in consistent and long-term outperformance over the composite benchmark. This has added an excess of \$4.8 billion to the value of the MP over this 10-year period. The cumulative return chart below compares the growth of \$100 in Stanford's MP, a composite benchmark portfolio, and a 60% stock / 40% bond portfolio over the past 10 years:

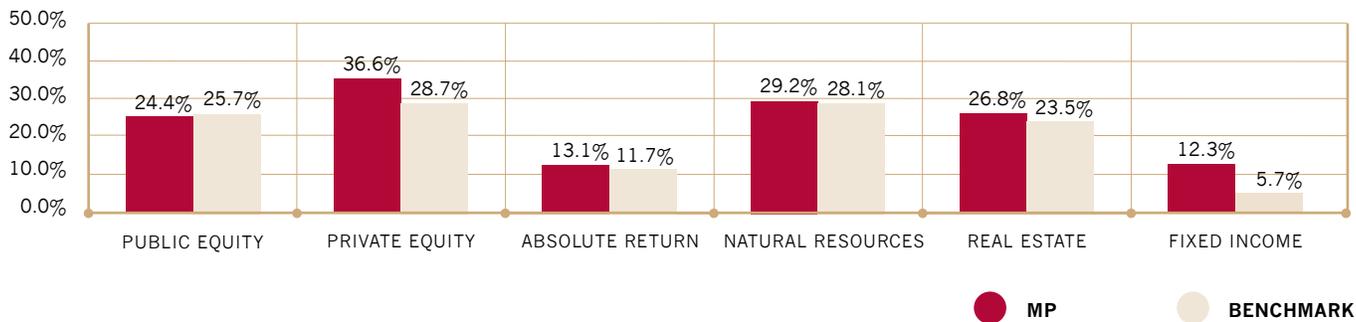
STANFORD MP VS. STANFORD COMPOSITE BENCHMARK VS. PASSIVE 60% EQUITY/40% BOND COMPOSITE



Relative one-year performance of the MP versus the benchmark was strong with overall portfolio excess return of 3.0% over the benchmark. This excess return was driven by outperformance in a number of asset classes, especially Private Equity and Real Estate. Total return in all asset classes was strong for the year as all asset classes exhibited double-digit annual returns.

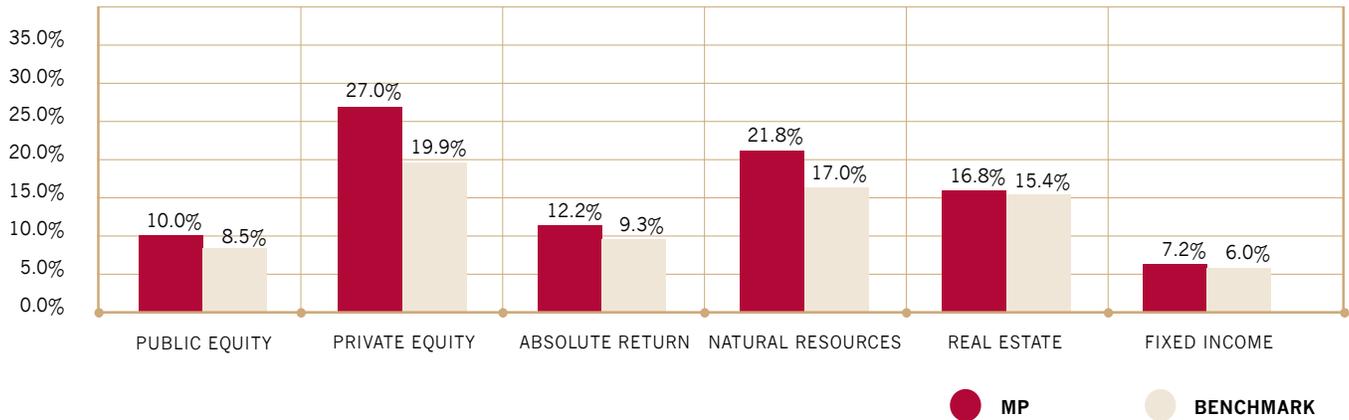
INDIVIDUAL ASSET CLASS PERFORMANCE The performance of individual asset classes for the 12 months ended June 30, 2007, relative to each asset class benchmark, is illustrated in the graph below:

STANFORD MP ONE-YEAR ASSET CLASS RETURNS VS. BENCHMARK



As outlined below, the results of 10-year asset class returns, relative to benchmark, illustrate the value of SMC's ability to shift investment styles/strategies and identify outstanding managers in each asset class:

STANFORD MP TEN-YEAR ANNUALIZED ASSET CLASS RETURNS VS. BENCHMARK



The year ending June 2007 was the fourth of an extraordinary series of years during which global economic expansion and abundant liquidity from a variety of sources combined to lift virtually all markets. Public equity markets in the United States and abroad benefited from an extended economic expansion. Real estate and private equity market performance was fueled by attractive financing conditions. Natural Resources investments, particularly in energy, surged as economic growth and political uncertainty drove commodity prices higher. Finally, the Absolute Return portfolio experienced strong performance from multi-strategy hedge funds, which are able to allocate capital opportunistically across all asset classes.

The year ending June 2007 was also a pivotal year as SMC initiated an organizational transformation focused on long-term performance sustainability. After substantial turnover in the year ending June 2006, the organization was re-staffed, and significant effort was spent on refining business processes. In 2008, we will focus on the ongoing task of portfolio improvement, while looking to strengthen risk management.

While the Stanford Management Company will continue to navigate through changes and developments in the investment environment, we remain committed to protect and grow the endowment of the University. We are pleased that the MP has continued to deliver solid performance, demonstrated by a 23.4% annual return. Moreover, the MP's three-year and five-year annualized returns remained strong at 20.8% and 17.7%, respectively. Our goal is to pursue consistent and strong, risk-adjusted returns and to administer dependable and growing financial support to the University's legacy of providing the highest-quality education possible and setting a new standard of excellence.

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