

PERMANENT UNIVERSITY FUND

FINANCIAL STATEMENTS

Years Ended August 31, 2002 and 2001

Deloitte & Touche LLP
Suite 2300
333 Clay Street
Houston, Texas 77002-4196

Tel: (713) 982-2000
Fax: (713) 982-2001
www.us.deloitte.com



INDEPENDENT AUDITORS' REPORT

The Board of Directors
The University of Texas Investment Management Company
Austin, Texas

We have audited the accompanying statements of investment assets and liabilities, and the comparison summary of investment in securities of the Permanent University Fund (PUF) as of August 31, 2002 and 2001, the related statements of operations and changes in net investment assets for the years then ended, and the schedule of changes in cost of investments and investment income for the year ended August 31, 2002. These financial statements are the responsibility of the PUF's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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. Our procedures included confirmation of securities owned as of August 31, 2002 and 2001, by correspondence with the custodian. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The financial statements referred to above include only the investment assets and liabilities and changes therein related to the investments of the PUF which are managed by The University of Texas Investment Management Company. The PUF's 2.1 million acres of land are not included in this report.

In our opinion, except for the effect of not including the fair value of PUF Lands as mentioned in the preceding paragraph, the statements of investment assets and liabilities, the comparison summary of investment in securities, the statements of operations and changes in net investment assets, and the schedule of changes in cost of investments and investment income referred to above present fairly, in all material respects, the financial position and the comparative investment in securities of the PUF as of August 31, 2002 and 2001, its operations and the changes in its net investment assets for the years then ended, and the changes in cost of its investments and investment income for the year ended August 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

October 18, 2002

Deloitte
Touche
Tohmatsu

PERMANENT UNIVERSITY FUND

Comparison Summary of Investment in Securities, at Value

August 31, 2002 and 2001

(in thousands)

	2002	2001
Equity Securities		
Index Funds	\$ 1,281,021	\$ 1,380,116
Commingled Investments	1,125,861	1,169,366
Domestic Common Stock	1,008,546	1,516,996
Limited Partnerships	886,013	1,020,811
Foreign Common Stock	192,579	227,378
Other	5,053	4,373
Total Equity Securities	4,499,073	5,319,040
Debt Securities		
U.S. Government Obligations (Direct and Guaranteed)	180,180	390,017
U.S. Government Agencies (Non-Guaranteed)	353,554	529,902
U.S. Government Agencies (Non-Guaranteed) (Non-U.S. Dollar Denominated)	1,599	-
Foreign Government and Provincial Obligations (U.S. Dollar Denominated)	9,099	5,397
Foreign Government and Provincial Obligations (Non-U.S. Dollar Denominated)	100,015	109,296
Municipal and County Bonds	15,743	27,844
Corporate Bonds	430,147	504,326
Foreign Corporate Bonds	20,425	20,248
Commingled Investment	17,307	23,281
Commercial Paper	-	5,000
Other	2,949	7,771
Total Debt Securities	1,131,018	1,623,082
Preferred Stock		
Domestic Preferred Stock	2,472	13,120
Foreign Preferred Stock	1,202	1,305
Total Preferred Stock	3,674	14,425
Convertible Securities	2,719	3,709
Cash and Cash Equivalents		
Money Markets and Cash Held at State Treasury	1,197,944	887,575
Total Investment in Securities	\$ 6,834,428	\$ 7,847,831

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

PERMANENT UNIVERSITY FUND

Statements of Investment Assets and Liabilities

August 31, 2002 and 2001

(in thousands)

Investment Assets	2002	2001
Investment in Securities, at Value (Cost \$7,416,247 and \$8,052,312, respectively)	\$ 6,834,428	\$ 7,847,831
Collateral for Securities Loaned, at Value	127,482	134,397
Deposit with Broker for Futures Contracts	43,810	34,892
Unrealized Gains on Foreign Currency Exchange Contracts	14,878	5,526
Receivables		
Investment Securities Sold	119,664	196,295
Accrued Income	15,410	20,651
Other	<u>551</u>	<u>2,372</u>
Total Investment Assets	<u>7,156,223</u>	<u>8,241,964</u>
Liabilities		
Payable Upon Return of Securities Loaned	127,482	134,397
Unrealized Losses on Foreign Currency Exchange Contracts	4,529	1,889
Payables		
Investment Securities Purchased	283,507	563,322
Other	<u>2,430</u>	<u>2,208</u>
Total Liabilities	<u>417,948</u>	<u>701,816</u>
Net Investment Assets	<u>\$ 6,738,275</u>	<u>\$ 7,540,148</u>
Net Investment Assets Consist Of:		
Contributions from PUF Lands	\$ 3,479,267	\$ 3,398,756
Accumulated Undistributed Net Realized Gain on Investments including Foreign Currency Transactions	3,830,585	4,345,011
Net Unrealized Depreciation of Investments including Translation of Assets and Liabilities in Foreign Currencies	<u>(571,577)</u>	<u>(203,619)</u>
Net Investment Assets	<u>\$ 6,738,275</u>	<u>\$ 7,540,148</u>

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

PERMANENT UNIVERSITY FUND

Statements of Operations and Changes in Net Investment Assets

Years Ended August 31, 2002 and 2001

(in thousands)

	<u>2002</u>	<u>2001</u>
Investment Income		
Interest	\$ 78,204	\$ 128,481
Dividends	62,752	58,966
Income Distributions from Limited Partnerships	8,998	9,980
Other	<u>3,162</u>	<u>4,939</u>
Total Investment Income	<u>153,116</u>	<u>202,366</u>
Expenses		
Investment Management and Consulting Fees	11,252	9,476
PUF Lands Expense	5,221	4,368
UTIMCO Management Fee	3,275	2,646
Custodial Fees and Expenses	1,016	803
Other Expenses	<u>283</u>	<u>203</u>
Total Expenses	<u>21,047</u>	<u>17,496</u>
Net Investment Income	<u>132,069</u>	<u>184,870</u>
Realized and Unrealized Loss on Investments		
Net Realized Loss on Investment Securities and Foreign Currency Related Transactions	(308,061)	(160,444)
Net Unrealized Depreciation on Investment Securities and Foreign Currency Related Transactions	<u>(367,958)</u>	<u>(735,176)</u>
Net Loss on Investments	<u>(676,019)</u>	<u>(895,620)</u>
Net Decrease in Net Investment Assets Resulting from Operations	\$ (543,950)	\$ (710,750)
Net Investment Assets		
Beginning of Period	7,540,148	8,452,336
Contributions from PUF Lands	80,511	115,643
Distributions to Available University Fund	<u>(338,434)</u>	<u>(317,081)</u>
End of Period	<u>\$ 6,738,275</u>	<u>\$ 7,540,148</u>

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

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Schedule of Changes in Cost of Investments and Investment Income

Year ended August 31, 2002

(in thousands)

	Beginning Cost	Purchases	Sales, Maturities & Redemptions	Gains (Losses)	Reclass	Ending Cost	Investment Income
Equity Securities							
Index Funds	\$ 1,626,711	\$ 1,166,961	\$ (1,071,955)	\$ (90,584)	\$ -	\$ 1,631,133	\$ 20,138
Commingled Investments	1,227,834	159,700	(148,914)	(66,853)	-	1,171,767	5,746
Domestic Common Stock	1,418,359	1,446,334	(1,773,547)	(143,463)	16,353	964,036	33,012
Limited Partnerships	1,027,318	134,782	(94,734)	37,052	(16,353)	1,088,065	8,998
Foreign Common Stock	274,617	262,199	(257,628)	(39,019)	-	240,169	3,569
Other	1,309	-	(233)	-	-	1,076	704
Rights and Warrants	-	-	(11)	11	-	-	-
Total Equity Securities	<u>5,576,148</u>	<u>3,169,976</u>	<u>(3,347,022)</u>	<u>(302,856)</u>	<u>-</u>	<u>5,096,246</u>	<u>72,167</u>
Debt Securities							
U.S. Government Obligations (Direct and Guaranteed)	376,689	1,207,646	(1,426,199)	14,560	-	172,696	9,888
U.S. Government Agencies (Non-Guaranteed)	510,821	2,265,080	(2,459,072)	17,592	-	334,421	17,096
U.S. Government Agencies (Non-Guaranteed) (Non-U.S. \$)	-	1,448	-	-	-	1,448	42
Foreign Government and Provincial Obligations (U.S. \$)	5,098	12,599	(9,133)	418	-	8,982	634
Foreign Government and Provincial Obligations (Non-U.S. \$)	105,341	549,297	(567,402)	7,930	-	95,166	1,786
Municipal and County Bonds	25,918	1,004	(13,968)	1,489	-	14,443	1,262
Corporate Bonds	490,828	407,101	(469,659)	(385)	-	427,885	27,630
Foreign Corporate Bonds	20,282	10,798	(11,642)	(226)	-	19,212	861
Commingled Investment	24,448	1,924	(5,218)	(377)	-	20,777	1,924
Commercial Paper	5,000	83,537	(88,567)	30	-	-	150
Repurchase Agreements	-	1,091,800	(1,091,800)	-	-	-	60
Other	7,771	529	-	-	-	8,300	(601)
Total Debt Securities	<u>1,572,196</u>	<u>5,632,763</u>	<u>(6,142,660)</u>	<u>41,031</u>	<u>-</u>	<u>1,103,330</u>	<u>60,732</u>
Purchased Options	<u>-</u>	<u>2,155</u>	<u>(324)</u>	<u>(1,831)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Preferred Stock							
Domestic Preferred Stock	11,423	1,000	-	-	(5,505)	6,918	68
Foreign Preferred Stock	1,189	1,060	(1,160)	(29)	-	1,060	213
Total Preferred Stock	<u>12,612</u>	<u>2,060</u>	<u>(1,160)</u>	<u>(29)</u>	<u>(5,505)</u>	<u>7,978</u>	<u>281</u>
Convertible Securities	<u>3,826</u>	<u>1,633</u>	<u>(153)</u>	<u>(77)</u>	<u>5,505</u>	<u>10,734</u>	<u>5</u>
Cash and Cash Equivalents							
Money Markets and Cash Held at State Treasury	887,530	354,728*	-	(44,299)**	-	1,197,959	18,588
Securities Lending	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,343</u>
Total Investment in Securities	<u>\$ 8,052,312</u>	<u>\$ 9,163,315</u>	<u>\$ (9,491,319)</u>	<u>\$ (308,061)</u>	<u>\$ -</u>	<u>\$ 7,416,247</u>	<u>\$ 153,116</u>

* Net increase in cash and money markets during the year.

** Includes net realized losses on futures contracts and foreign currency contracts.

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

PERMANENT UNIVERSITY FUND

Notes to Financial Statements

Note 1 – Organization

(A) The Permanent University Fund (PUF) is a state endowment contributing to the support of eligible institutions of The University of Texas System (UT System) and The Texas A&M University System (TAMU System). The PUF was established in the Texas Constitution of 1876 through the appropriation of land grants previously given to the University of Texas, as well as an additional one million acres. Additional land grants to the PUF were completed in 1883 with the contribution of another one million acres. Today, the PUF contains over 2.1 million acres of land located in 24 counties primarily in West Texas (PUF Lands).

PUF Lands produce two streams of income: mineral and surface. Mineral income is contributed to the PUF and surface income is distributed to the Available University Fund (AUF). The investments of the PUF are managed by The University of Texas Investment Management Company (UTIMCO). The PUF Lands are managed by UT System administration.

(B) The Texas Constitution allows for (a) distributions to the AUF from the “total return” on PUF investments, including income return as well as capital gains (realized and unrealized) and (b) the payment of PUF expenses from PUF assets. The Texas Constitution directs the Board of Regents of UT System to establish a distribution policy that provides stable, inflation adjusted annual distributions to the AUF and preserves the real value of the PUF investments over the long term. Accordingly, distributions to the AUF in any given fiscal year are subject to the following: (1) A minimum amount equal to the amount needed to pay debt service on PUF bonds; (2) No increase from the preceding year (except as necessary to pay debt service on PUF bonds) unless the purchasing power of PUF investments for any rolling 10-year period has been preserved; (3) A maximum amount equal to seven percent of the average net fair market value of PUF assets in any fiscal year, except as necessary to pay debt service on PUF bonds. The PUF distribution to the AUF for the year ending August 31, 2003, in the amount of \$363,022,043 was paid September 3, 2002.

(C) The accompanying financial statements report the investment in securities of the PUF, including the assets, liabilities and investment income. Expenses related to the PUF’s investments and PUF Lands are also included. The PUF Lands asset values are not included in this report.

These financial statements follow the form and content of investment company financial statements and related disclosures in accordance with accounting principles generally accepted in the United States of America. The principles followed will differ from the principles applied in governmental and fund accounting. The Schedule of Changes in Cost of Investments and Investment Income has been prepared for the purpose of complying with the reporting requirement of Section 66.05 of the Texas Education Code.

The annual combined financial statements of UT System are prepared in accordance with Texas Comptroller of Public Accounts’ Annual Financial Reporting Requirements and include information related to the PUF. The accompanying financial statements may differ in presentation from governmental accounting principles or the Texas Comptroller of Public Accounts’ Annual Financial Reporting Requirements.

Note 2 – Significant Accounting Policies

(A) **Security Valuation** -- Investments are primarily valued on the basis of market valuations provided by independent pricing services.

Fixed income securities held directly by the PUF are valued based upon prices supplied by Merrill Lynch Securities Pricing Service and other major fixed income pricing services, external broker quotes and internal pricing matrices.

Equity security market values are based on the New York Stock Exchange composite closing prices, if available. If not available, the market value is based on the closing price on the primary exchange on which the security is traded (if a closing price is not available, the average of the last reported bid and ask price is used).

Limited partnerships and other are valued based on a fair valuation determined as specified by policies established by the UTIMCO Board of Directors. Limited partnerships are valued using the partnership's capital account balance at the closest available reporting period (usually June 30), as communicated by the general partner, adjusted for contributions and withdrawals subsequent to the latest available reporting period. In the rare case when no ascertainable value is available, the limited partnership is valued at cost.

Securities held by the PUF in index funds are generally valued as follows:

Stocks traded on security exchanges are valued at closing market prices on the valuation date.

Stocks traded on the over-the-counter market are valued at the last reported bid price, except for National Market System OTC stocks, which are valued at their closing market prices.

Fixed income securities are valued based upon bid quotations obtained from major market makers or security exchanges.

Commingled investments are valued based on the net asset value per share provided by the investment company.

(B) **Foreign Currency Translation** -- The accounting records of the PUF are maintained in U.S. dollars. Investments in securities are valued at the daily rates of exchange on the valuation date. Purchases and sales of securities of foreign entities and the related income receipts and expense payments are translated into U.S. dollars at the exchange rate on the dates of the transactions. The PUF does not isolate that portion of the results of operations resulting from changes in foreign exchange rates on investments from fluctuations arising from changes in market prices of securities held. Such fluctuations are included with the net realized and unrealized gain or loss from

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

investments. Security classifications on the comparison summary of investment in securities, at value are based on currency.

(C) ***Investment Income*** -- Interest income is accrued as earned. Dividend income is recorded on the ex-dividend date. Dividend and interest income is recorded net of foreign taxes where recovery of such taxes is not assured. Investment income includes net realized and unrealized currency gains and losses recognized between accrual and payment dates on dividend and interest transactions. Premiums and discounts on bonds are not amortized.

(D) ***Security Transactions*** -- Security transactions are recorded on a trade date basis for most securities. International index fund transactions are recorded on a settle date basis due to trading practices which impose restrictions in acquiring per unit information on the trade date. Gains and losses on securities sold are determined on the basis of average cost. A loss is recognized if there is an impairment in the value of the security that is determined to be other than temporary.

(E) ***Federal Income Taxes*** -- The PUF is not subject to federal income tax.

(F) ***Use of Estimates*** -- The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from these estimates.

(G) ***Foreign Currency Contracts*** -- The PUF enters into forward foreign currency exchange contracts to hedge against foreign currency exchange rate risks on its non-U.S. dollar denominated investment securities and to facilitate trading strategies primarily as a tool to increase or decrease market exposure to various foreign currencies. When entering into a forward currency contract, the PUF agrees to receive or deliver a fixed quantity of foreign currency for an agreed-upon price on an agreed future date. These contracts are valued daily and the PUF's net equity therein, representing unrealized gain or loss on the contracts as measured by the difference between the forward foreign exchange rates at the dates of entry into the contracts and the forward rates at the reporting date, is included in the statements of assets and liabilities. Realized and unrealized gains and losses are included in the statements of operations. These instruments involve market and/or credit risk in excess of the amount recognized in the statement of investment assets and liabilities. Risks arise from the possible inability of counterparties to meet the terms of their contracts and from movement in currency and securities values and interest rates.

(H) ***Cash and Cash Equivalents*** -- Cash and Cash Equivalents consist of money markets, cash held at the State Treasury, foreign currencies and other overnight funds.

(I) ***Options Written*** -- When the PUF writes an option, an amount equal to the premium received by the PUF is recorded as a liability and is subsequently adjusted to the current fair value of the option written. Premiums received from writing options that expire unexercised are treated by the PUF on the expiration date as realized gains from investments. The difference between the premium and the amount paid on effecting a closing purchase transaction, including brokerage commissions, is also treated as a realized gain, or, if the premium is less than the amount paid for the closing purchase transaction, as a realized loss. If a call option is exercised, the premium is added to the proceeds from the sale of the underlying security or currency in determining whether the PUF has realized a

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

gain or loss. If a put option is exercised, the premium reduces the cost basis of the securities purchased by the PUF. The PUF as writer of an option bears the market risk of an unfavorable change in the price of the security underlying the written option.

Note 3 – Investment Activity

The cost of purchases and proceeds from sales and maturities of investments (excluding cash and cash equivalents) were \$8,808,586,197 and \$9,491,318,606, respectively, for the year ended August 31, 2002. For the year ended August 31, 2001, the cost of purchases and proceeds from sales and maturities were \$8,974,616,197 and \$8,774,879,086, respectively. Such transactions were made at current market prices on the dates of the transactions.

Note 4 – Fees and Expenses

The PUF incurs investment management fees from various external managers of the PUF. The fees, generally assessed quarterly, are based on a percentage of the market value of investments held by each individual investment manager and currently range from 0.01% to 1.0%. In addition to quarterly investment management fees, the PUF may pay annual performance-based management fees for investment performance in excess of certain defined benchmarks as provided for in the managers' contracts. In addition, the PUF incurs consulting fees for investment planning and oversight services with regard to limited partnerships and hedge funds.

The PUF is assessed a fee to cover expenses related to the management of the PUF Lands. The fee assessed for the years ended August 31, 2002 and 2001, was \$5,220,999 and \$4,367,721, respectively.

UTIMCO assesses the PUF a management fee to cover the costs of managing the PUF investments and providing day-to-day operations. The fee assessed for the years ended August 31, 2002 and 2001, was \$3,274,506 and \$2,645,610, respectively.

Custodial fees and expenses are assessed by the financial institution which holds the PUF's assets. Fees are based on the number of accounts, market value of the PUF, and transaction activity in accordance with the contractual agreement with the institution. Additional fees are assessed for performance measurement, risk measurement and on-line communication services per the contractual agreement.

The PUF incurs other expenses related to its operations primarily consisting of audit fees, subscription fees, printing and graphic expenses, legal expenses and consultation fees.

Note 5 – Index Funds

The index funds, managed by the same investment manager, consist of several funds with different investment objectives, as follows:

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Notes to Financial Statements (cont.)

The Mid-Cap Index Fund B Lendable is a portfolio of common stocks with the objective of approximating as closely as practicable the capitalization weighted total rate of return of the segment of the U.S. and Canadian markets for publicly traded common stocks represented by the medium capitalized companies. The fund tracks the S&P Mid-Cap 400 Index.

The Equity Index Fund B Lendable is a portfolio of common stocks with the objective of approximating as closely as practicable the capitalization weighted total return of that segment of the U.S. market for publicly traded common stocks represented by the larger capitalized markets. The fund tracks the S&P 500 Index.

The EAFE Equity Index Fund B is managed to replicate the Morgan Stanley Capital International Europe, Australia and Far East Index (EAFE). Individual index funds are established to represent each country within the EAFE Index. The fund is a commingled 'superfund' comprised from the individual EAFE Index country funds managed in their appropriate capitalization weights.

The Russell 2000 Alpha Tilts Fund B's objective is approximating the capitalization weighted total rate of return of the Russell 2000 Index. The fund is selected and maintained in accordance with a formula designed to select stocks through optimized tilts toward particular stock characteristics. The formula is designed to provide systematic exposure to such characteristics with the objective of producing long-term returns in excess of the total rate of return of the Russell 2000 Index.

The Emerging Markets Structured Tiered Fund B attempts to approximate the capitalization weighted total rates of return of the equity securities in the Morgan Stanley Capital International Emerging Markets Free Index for selected countries. The fund adopts a structured tier weighting approach across the countries.

The Provisional EAFE Equity Index was a temporary fund established to accommodate the reconstitution of the current MSCI EAFE Index (Morgan Stanley Capital International Europe, Australia and Far East Index). The MSCI EAFE Index did not fully represent the international equity markets and was reconstituted to create a more representative benchmark. The Provisional EAFE Index was folded into the standard MSCI EAFE Index Fund B upon completion of the reconstitution and final transition in May 2002.

The Russell 2000 Index Fund B's objective is approximating as closely as practicable the capitalization weighted total return of the segment of the U.S. market for publicly traded common stocks represented by the Russell 2000 Index.

When deemed appropriate, a portion of the index funds may be invested in futures contracts for the purpose of acting as a temporary substitute for investment in common stocks.

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Notes to Financial Statements (cont.)

The Mid-Cap Index Fund B Lendable is majority owned, and the Emerging Markets Structured Tiered Fund B is solely owned by the PUF and The University of Texas System General Endowment Fund. The market values of the PUF's interests in these index funds are as follows:

	August 31,	
	2002	2001
Mid-Cap Index Fund B Lendable	\$ 570,464,012	\$ 627,991,931
Equity Index Fund B Lendable	197,627,598	314,918,931
EAFE Equity Index Fund B	382,334,592	-
Russell 2000 Alpha Tilts Fund B	74,462,698	-
Emerging Markets Structured Tiered Fund B	56,132,542	-
Provisional EAFE Equity Index	-	365,689,653
Russell 2000 Index Fund B	-	71,515,189
	<u>\$ 1,281,021,442</u>	<u>\$ 1,380,115,704</u>

Note 6 – Commingled Investments

The commingled investments consist of investments in other entities in which the PUF has an ownership percentage, shares or limited partnership interest. The market values of the commingled investments consist of the following:

	August 31,	
	2002	2001
Equity Commingled Investments:		
Merger Arbitrage and Special Situation Funds	\$ 477,940,743	\$ 467,135,797
Hedge Fund	289,321,681	292,178,089
Emerging Market Mutual Funds	222,499,570	224,147,851
Small Capitalization International Stock Fund	100,801,027	185,903,870
Emerging Market Absolute Return Fund	<u>35,297,592</u>	<u>-</u>
Total Equity Commingled Investments	<u>\$ 1,125,860,613</u>	<u>\$ 1,169,365,607</u>
Debt Commingled Investment:		
High Yield Bond Fund	<u>\$ 17,306,568</u>	<u>\$ 23,280,889</u>

The merger arbitrage and special situation funds invest in merger arbitrage, corporate restructuring, distressed investments, distressed convertibles and liquidations. The hedge fund invests primarily in medium and large capitalization U.S. equities in which performance is driven by long and short security selection with a low net exposure to industry and country risk. The emerging market funds utilize a long and short investment strategy and invest primarily in emerging and developed markets in Asia and the Pacific region and emerging markets in Latin America, Eastern Europe, the Middle East, and Russia.

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Notes to Financial Statements (cont.)

Note 7 – Limited Partnerships

The limited partnerships consist of interests in privately held investments that are not registered for sale on public exchanges. The market values of the limited partnerships consist of the following:

	August 31,	
	2002	2001
U.S. Private Equity	\$ 452,802,148	\$ 514,843,939
Venture Capital	168,636,160	268,488,276
Non-U.S. Private Equity	107,306,281	91,878,072
Mezzanine	73,693,410	91,513,478
Opportunistic	71,492,831	45,148,928
Direct Investments	8,284,913	8,284,913
Oil and Gas	3,797,496	653,940
	<u>\$ 886,013,239</u>	<u>\$ 1,020,811,546</u>

The U.S. private equity interests consist of investments in private equity funds which primarily invest in the equity securities of private businesses that are considered to be in the post-start-up phase and that are profitable and generating income. Venture capital consists of interests in private equity funds that provide capital to companies that are in the early stages of development. Opportunistic consists of interests in private equity funds that invest in distressed debt and that purchase limited partnership interests in private equity funds on a secondary basis. Non-U.S. private equity interests consist of investments in private equity and venture capital funds that are based outside of the U.S. These funds focus on making investments in companies that have operations in countries other than the U.S. Mezzanine interests consist of investments in private equity funds that purchase private debt and equity securities of private businesses to provide temporary financing. Direct investments represent the PUF's direct interests in private companies. Oil and Gas consists of interests in private partnerships that hold royalty interests and other non-working interests in oil and gas properties. These properties create an income stream over the life of the partnership.

Note 8 – Securities Lending

The PUF loans securities to certain brokers who pay the PUF negotiated lenders' fees. These fees are included in investment income. The PUF receives qualified securities and/or cash as collateral against the loaned securities. The collateral, when received, will have a market value of 102% of loaned securities of U.S. issuers and a market value of 105% for loaned securities of non-U.S. issuers. If the market value of the collateral held in connection with loans of securities of U.S. issuers is less than 100% at the close of trading on any business day, the borrower is required to deliver additional collateral by the close of the next business day to equal 102% of the market value. For non-U.S. issuers, the collateral should remain at 105% of the market value of the loaned securities at the close of any business day. If it falls below 105%, the borrower must deliver additional collateral by the close of the following business day. The value of securities loaned and the value of collateral held are as follows at August 31, 2002 and 2001:

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Notes to Financial Statements (cont.)

Securities on Loan	2002 Value	2001 Value	Type of Collateral	2002 Value of Collateral	2001 Value of Collateral
U.S. Government	\$ 55,425,205	\$ 80,982,141	Cash	\$ 55,914,798	\$ 82,292,650
Foreign Government	832,596	215,358	Cash	873,180	226,600
Corporate Bonds	49,909,136	31,743,769	Cash	51,699,500	32,512,670
Common Stock	<u>18,068,081</u>	<u>18,316,410</u>	Cash	<u>18,994,692</u>	<u>19,365,434</u>
Total	\$ <u>124,235,018</u>	\$ <u>131,257,678</u>	Total	\$ <u>127,482,170</u>	\$ <u>134,397,354</u>
U.S. Government	<u>\$ 4,502,822</u>	<u>\$ 2,462,280</u>	Non-Cash	<u>\$ 4,794,959</u>	<u>\$ 2,732,188</u>

Cash received as collateral for securities lending activities is recorded as an asset with an equal and offsetting liability to return the collateral. Investments received as collateral for securities lending activities are not recorded as assets because the investments remain under the control of the transferor, except in the event of default.

Note 9 – Commitments

The PUF had unfunded contractual commitments for Limited Partnerships and Other assets of \$534,667,878 as of August 31, 2002.

Note 10 – Written Options

During the year ended August 31, 2001, the PUF wrote put options on short-term interest rate futures contracts. At August 31, 2001, there were 1,102 contracts on short-term fixed income futures contracts outstanding with a principal notional value of \$1,102,000,000. The principal notional value is used as a mechanism to determine the day-to-day fluctuations in the value of the options written and is not indicative of the risk of loss to the PUF. At option expiry, for each basis point the underlying futures price is below the contract strike price, the PUF is subject to a \$25 reduction in the value of each outstanding contract. For example, if the PUF had written the 1,102 put options on short-term interest rate futures contracts at 4.00% (i.e., a eurodollar futures price of 96.00), and interest rates increased to 4.50% (i.e., a eurodollar futures price of 95.50), the PUF would recognize a loss in an amount equal to \$1,377,500 (1,102 X \$25 X 50 basis points) less the premium received at the time the contract was written.

The 1,102 contracts outstanding as of August 31, 2001, represented contracts on 90 Day Eurodollar futures with a weighted average interest rate of 4.58%. These contracts expired during the year ended August 31, 2002, and the PUF recognized gains in the amount of \$11,975.

Transactions in put options written during the year ended August 31, 2002, were as follows:

	Number of Contracts	Premiums Received
Put Options Outstanding at August 31, 2001	1,102	\$ 443,783
Options Expired	<u>(1,102)</u>	<u>(443,783)</u>
Put Options Outstanding at August 31, 2002	<u>-</u>	<u>\$ -</u>

Transactions in put options written during the year ended August 31, 2001 were as follows:

PERMANENT UNIVERSITY FUND*Notes to Financial Statements (cont.)*

	<u>Number of Contracts</u>	<u>Premiums Received</u>
Put Options Outstanding at August 31, 2000	-	\$ -
Options Written	1,555	666,157
Options Expired	<u>(453)</u>	<u>(222,374)</u>
Put Options Outstanding at August 31, 2001	<u>1,102</u>	<u>\$ 443,783</u>

At August 31, 2002, there were no put options outstanding. The fair value of the put options outstanding as of August 31, 2001, was \$11,975. This amount was included in Other Liabilities on the statement of assets and liabilities. The PUF recognized gains in the amount of \$654,182 on put options written for the year ended August 31, 2001. At August 31, 2001, no securities were held as collateral for the put options written by the PUF.

The PUF also wrote call options on Treasury bond futures contracts during the years ended August 31, 2002 and 2001. There were no open positions in call options written as of August 31, 2002. As of August 31, 2001, the principal notional value of the 127 Treasury bond futures contracts outstanding was \$13,525,500 based on an August 31, 2001, price of \$106.50.

Transactions in call options written during the year ended August 31, 2002 were as follows:

	<u>Number of Contracts</u>	<u>Premiums Received</u>
Call Options Outstanding at August 31, 2001	127	\$ 63,792
Options Written	84	57,561
Options Exercised	(84)	(57,561)
Options Expired	<u>(127)</u>	<u>(63,792)</u>
Call Options Outstanding at August 31, 2002	<u>-</u>	<u>\$ -</u>

Transactions in call options written during the year ended August 31, 2001 were as follows:

	<u>Number of Contracts</u>	<u>Premiums Received</u>
Call Options Outstanding at August 31, 2000	-	\$ -
Options Written	647	316,374
Options Expired	<u>(520)</u>	<u>(252,582)</u>
Call Options Outstanding at August 31, 2001	<u>127</u>	<u>\$ 63,792</u>

The fair value of the call options outstanding as of August 31, 2001, was \$89,125. This amount was included in Other Liabilities on the statement of assets and liabilities. During the year ended August 31, 2002, the PUF recognized losses in the amount of \$629 on call options written. During the year ended August 31, 2001, the PUF recognized gains in the amount of \$227,249 on call options written.

Note 11 – Futures Contracts

The PUF's activities include trading in derivatives such as futures contracts. During the years ended August 31, 2002 and 2001, the futures contracts were used to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes of the PUF. The asset classes that used futures include domestic and foreign equities, domestic and foreign debt, and

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

commodities. Commodity index exposure was obtained through the Goldman Sachs Commodity Index (GSCI). The GSCI is a composite index of commodity sector returns, representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. The PUF had \$43,809,926 and \$34,892,298 on deposit with a broker for collateral as margin for the futures contracts as of August 31, 2002 and 2001, respectively. It is the intention of the PUF not to utilize leverage when entering into these contracts and to maintain cash balances that when combined with the collateral deposited with a broker exceed the notional value of the futures contracts held. Short futures may be used by a limited number of external managers for the PUF to hedge the PUF's interest rate or country risk associated with security positions. Futures contracts are marked to market daily; that is, they are valued at the close of business each day, and a gain or loss is recorded between the value of the contracts that day and on the previous day. The daily gain or loss is referred to as the daily variation margin which is settled in cash with the broker each morning for the amount of the previous day's mark to market. The amount that is settled in cash with the broker each morning is the carrying and fair value of the futures contracts. The amount of net realized loss on the futures contracts was \$46,185,245 and \$61,421,628 for the years ended August 31, 2002 and 2001, respectively. The PUF executes such contracts either on major exchanges or with major international financial institutions and minimizes market and credit risk associated with these contracts through the managers' various trading and credit monitoring techniques.

The following discloses the notional, carrying and fair values at August 31, 2002, and the average carrying and fair values for the year ended August 31, 2002, for futures contracts:

	Notional Value at August 31, 2002		Carrying and Fair Value at August 31, 2002		Average Carrying and Fair Value for the Year Ended August 31, 2002	
	Long	Short	Assets	Liabilities	Assets	Liabilities
Domestic Equity Futures	\$ 417,191,940	\$ 10,362,825	\$ 102,030	\$ 1,457	\$ 1,455,612	\$ 1,703,571
International Equity Futures	25,621,117	19,465,687	399,959	377,130	498,235	487,316
Commodity Futures	178,767,300	-	83,225	-	738,662	624,036
Domestic Fixed Income Futures	76,192,172	155,464,891	151,170	245,101	480,304	483,656
International Fixed Income Futures	215,443,016	86,895,459	491,971	52,938	256,972	247,346

PERMANENT UNIVERSITY FUND*Notes to Financial Statements (cont.)*

The following discloses the notional, carrying and fair values at August 31, 2001, and the average carrying and fair values for the year ended August 31, 2001, for futures contracts:

	Notional Value at August 31, 2001		Carrying and Fair Value at August 31, 2001		Average Carrying and Fair Value for the Year Ended August 31, 2001	
	<u>Long</u>	<u>Short</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>
Domestic Equity Futures	\$ 215,896,000	\$ 6,333,525	\$ 1,101,710	\$ 6,075	\$ 1,053,877	\$ 1,308,631
International Equity Futures	30,023,908	18,459,244	216,746	302,141	352,126	362,712
Commodity Futures	-	-	-	-	2,615,207	2,555,011
Domestic Fixed Income Futures	94,534,219	130,796,625	151,251	139,267	205,830	223,691
International Fixed Income Futures	81,061,323	35,240,535	149,261	73,882	103,517	90,931

Note 12 – Foreign Currency Exchange Contracts

The tables below summarize by currency the contractual amounts of the PUF's foreign currency exchange contracts at August 31, 2002 and 2001. Foreign currency amounts are translated at exchange rates as of August 31, 2002 and 2001. The "Net Buy" amounts represent the U.S. dollar equivalent of net commitments to purchase foreign currencies, and the "Net Sell" amounts represent the U.S. dollar equivalent of net commitments to sell foreign currencies.

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

Currency	Net Buy August 31, 2002	Net Sell August 31, 2002	Unrealized Gains on Foreign Currency Exchange Contracts August 31, 2002	Unrealized Losses on Foreign Currency Exchange Contracts August 31, 2002
Australian Dollar	\$ 7,251,442	\$ -	\$ 727,279	\$ 4,646
Canadian Dollar	-	16,575,827	677,196	251,973
Danish Krone	351,521	-	15,564	-
Euro	78,868,365	-	1,511,226	32,209
Japanese Yen	118,038,269	-	6,453,112	716,428
New Zealand Dollar	9,977,266	-	69,062	39,420
Norwegian Krone	9,798,409	-	4,740,335	582,652
Singapore Dollar	2,177,766	-	241	197,202
Swedish Krona	41,612,454	-	207,427	151,793
Swiss Franc	-	44,041,740	302,488	1,925,110
UK Pound	24,614,254	-	173,873	627,618
	<u>\$ 292,689,746</u>	<u>\$ 60,617,567</u>	<u>\$ 14,877,803</u>	<u>\$ 4,529,051</u>

Currency	Net Buy August 31, 2001	Net Sell August 31, 2001	Unrealized Gains on Foreign Currency Exchange Contracts August 31, 2001	Unrealized Losses on Foreign Currency Exchange Contracts August 31, 2001
Australian Dollar	\$ 18,777,562	\$ -	\$ 234,623	\$ 7,187
Canadian Dollar	-	14,964,215	208,892	44,379
Danish Krone	2,569,246	-	156,278	288
Euro	85,572,743	-	401,519	567,961
Hungarian Forint	321,863	-	25,736	-
Japanese Yen	56,512,363	-	2,333,738	139,455
New Zealand Dollar	-	10,423,376	-	447,038
Norwegian Krone	36,459,370	-	944,553	-
Singapore Dollar	-	11,231,303	553	255,702
Swedish Krona	-	34,495,197	8,767	137,683
Swiss Franc	19,512,105	-	638,434	180,973
UK Pound	34,581,563	-	572,623	108,420
	<u>\$ 254,306,815</u>	<u>\$ 71,114,091</u>	<u>\$ 5,525,716</u>	<u>\$ 1,889,086</u>