

**THE UNIVERSITY OF TEXAS SYSTEM
LONG TERM FUND**

FINANCIAL STATEMENTS

Years Ended August 31, 2002 and 2001

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statements of assets and liabilities of The University of Texas System Long Term Fund (Fund) as of August 31, 2002 and 2001, the related statements of operations and changes in net assets for the years then ended, and the financial highlights for each of the five years in the period ended August 31, 2002. These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and financial highlights 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 and financial highlights 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.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of the Fund as of August 31, 2002 and 2001, the results of its operations and the changes in its net assets for the years then ended, and the financial highlights for each of the five years in the period ended August 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

October 18, 2002

Deloitte
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Tohmatsu

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Financial Highlights

Years Ended August 31,

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
Selected Per Unit Data					
Net Asset Value, Beginning of Period	\$ 5.412	\$ 6.198	\$ 5.347	\$ 4.568	\$ 4.672
Income from Investment Operations					
Net Investment Income	0.098	0.140	0.142	0.121	0.129
Net Realized and Unrealized Gain (Loss) on Investments	<u>(0.471)</u>	<u>(0.681)</u>	<u>0.939</u>	<u>0.868</u>	<u>(0.038)</u>
Total Income (Loss) from Investment Operations	<u>(0.373)</u>	<u>(0.541)</u>	<u>1.081</u>	<u>0.989</u>	<u>0.091</u>
Less Distributions					
From Net Investment Income and Undistributed Net Investment Income	0.098	0.140	0.142	0.121	0.140
From Net Realized Gain	<u>0.153</u>	<u>0.105</u>	<u>0.088</u>	<u>0.089</u>	<u>0.055</u>
Total Distributions	<u>0.251</u>	<u>0.245</u>	<u>0.230</u>	<u>0.210</u>	<u>0.195</u>
Net Asset Value, End of Period	<u>\$ 4.788</u>	<u>\$ 5.412</u>	<u>\$ 6.198</u>	<u>\$ 5.347</u>	<u>\$ 4.568</u>

Ratios and Supplemental Data

Net Assets, End of Period (in thousands)	\$ 2,595,063	\$ 2,843,300	\$3,136,229	\$2,602,274	\$2,147,715
Ratio of Expenses to Average Net Assets	0.39%	0.23%	0.33%	0.35%	0.32%
Ratio of Net Investment Income to Average Net Assets	1.89%	2.44%	2.45%	2.42%	2.66%
Ratio of Distributions to Average Net Assets (5-quarter average)	4.86%	4.31%	3.99%	4.19%	4.04%
Ratio of Distributions to Average Net Assets (12-quarter average)	4.38%	4.12%	3.98%	4.02%	4.14%

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

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Statements of Assets and Liabilities

August 31, 2002 and 2001

(Dollars in thousands, except per unit amounts)

	<u>2002</u>	<u>2001</u>
Assets		
General Endowment Fund Units, at Value (Cost \$2,770,120 and \$2,865,322, respectively)	\$ 2,595,134	\$ 2,842,644
Money Market and Other Investments	59	796
Receivables		
Investment Securities Sold	12,998	17,142
Accrued Income	<u>-</u>	<u>2</u>
Total Assets	<u>2,608,191</u>	<u>2,860,584</u>
Liabilities		
Payable to Participants	12,998	17,142
Other Payables	<u>130</u>	<u>142</u>
Total Liabilities	<u>13,128</u>	<u>17,284</u>
Net Assets	<u>\$ 2,595,063</u>	<u>\$ 2,843,300</u>
Net Assets Consist Of:		
Participant Contributions (Net of Withdrawals)	\$ 1,797,084	\$ 1,704,712
Accumulated Undistributed Net Realized Gain on Investments		
Including Foreign Currency Transactions	972,972	1,161,267
Net Unrealized Depreciation of Investments including		
Translation of Assets and Liabilities in Foreign Currencies	<u>(174,993)</u>	<u>(22,679)</u>
Net Assets for 542,049,359 Units and 525,401,525 Units, respectively	<u>\$ 2,595,063</u>	<u>\$ 2,843,300</u>
Net Asset Value Per Unit	<u>\$ 4.788</u>	<u>\$ 5.412</u>

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

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Statements of Operations and Changes in Net Assets

Years Ended August 31, 2002 and 2001 (in thousands)

	<u>2002</u>	<u>2001</u>
Investment Income		
Allocation of General Endowment Fund Net Investment Income	\$ 55,291	\$ 35,503
Interest	-	25,238
Dividends	-	11,772
Income Distributions from Limited Partnerships	-	1,331
Other	<u>-</u>	<u>721</u>
Total Investment Income	<u>55,291</u>	<u>74,565</u>
Expenses		
Fee for Endowment Compliance	2,383	-
UTIMCO Management Fee	2,285	1,840
Internal Fee for Educational Purposes	551	581
Other Expenses	55	122
Custodial Fees and Expenses	2	248
Investment Management and Consulting Fees	<u>-</u>	<u>1,361</u>
Total Expenses	<u>5,276</u>	<u>4,152</u>
Receipt of Funds from UT System for UTIMCO Fee	<u>2,285</u>	<u>1,840</u>
Net Investment Income	<u>52,300</u>	<u>72,253</u>
Realized and Unrealized Gain (Loss) on Investments		
Net Realized Loss on GEF Units	(6,612)	(1,220)
Net Realized Gain (Loss) on Investment Securities and Foreign Currency Related Transactions	193	(68,871)
Allocation of General Endowment Fund Realized Loss	(96,304)	(28,163)
Net Unrealized Depreciation on Investment Securities and Foreign Currency Related Transactions	(6)	(181,965)
Net Unrealized Depreciation on General Endowment Fund Units	<u>(152,308)</u>	<u>(70,826)</u>
Net Loss on Investments	<u>(255,037)</u>	<u>(351,045)</u>
Net Decrease in Net Assets Resulting from Operations	\$ (202,737)	\$ (278,792)
Net Assets		
Beginning of Period	2,843,300	3,136,229
Participant Contributions (including reinvestments of \$5,990 and \$8,509 for the years ended August 31, 2002 and 2001, respectively)	105,595	141,818
Participant Withdrawals:		
Cost	(13,223)	(19,710)
Gain	(3,119)	(8,934)
Distributions to Participants:		
Net Investment Income	(52,300)	(72,253)
Net Realized Appreciation	<u>(82,453)</u>	<u>(55,058)</u>
End of Period	<u>\$ 2,595,063</u>	<u>\$ 2,843,300</u>

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

Note 1 – Organization

The Long Term Fund (Fund) is a pooled fund established for the collective investment of private endowments and other long-term funds supporting various programs and purposes of the 15 institutions comprising The University of Texas System (UT System). The Fund was formerly known as the Common Trust Fund. The Long Term Fund was established February 9, 1995, by the Board of Regents of The University of Texas System (Board of Regents) to succeed the Common Trust Fund pooled investment fund. Fiduciary responsibility for the Fund rests with the Board of Regents. The day-to-day operational responsibilities of the Fund are delegated to The University of Texas Investment Management Company (UTIMCO), pursuant to an investment management services agreement with the Board of Regents.

On March 1, 2001, the Fund purchased units in the newly created General Endowment Fund (GEF) in exchange for the contribution of its investment assets. The GEF, established by the Board of Regents effective March 1, 2001, is a pooled fund for the collective investment of long-term funds under the control and management of the Board of Regents. The GEF has only two participants: the Fund and the Permanent Health Fund (PHF) also established by the Board of Regents. The GEF is organized as a mutual fund in which the Fund and the PHF purchase and redeem units quarterly. The GEF is under the fiduciary responsibility of the Board of Regents and is provided day-to-day operations by UTIMCO.

The accompanying 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 annual combined financial statements of The University of Texas System are prepared in accordance with Texas Comptroller of Public Accounts' Annual Financial Reporting Requirements and include information related to the Fund. 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 – Investment in GEF

Beginning with the purchase of GEF units on March 1, 2001, the Fund no longer invests in individual securities except for GEF units and a negligible amount of cash. The Fund also continues to receive securities as proceeds in class action suits from the securities the Fund previously owned.

These securities are normally sold when received, but from time to time will be reflected as a Fund investment. Subsequent participant contributions received by the Fund are also used to purchase GEF units. At August 31, 2002, the Fund is the majority participant in the GEF, with ownership of 28,539,389 units, which represents 78.8% of the GEF. At August 31, 2001, the Fund held 29,062,538 units, which represented 76.3% of the GEF.

The GEF and the Fund have identical investment objectives. Additionally, the GEF's accounting policies follow the Fund's, as described in Note 3, except for the distributions to participants. On a

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Notes to Financial Statements (cont.)

monthly basis for accounting purposes, the GEF distributes its net investment income and realized gain or loss to the Fund based on its ownership of GEF units at month end. The distributed investment income and realized gain amounts are considered reinvested as GEF contributions. Any distributed realized losses reduce the cost basis of the units in the GEF. Since the distribution is proportional to the percentage of ownership by the unitholders, no additional units are purchased. The Fund redeems GEF units quarterly to meet its distribution requirements to its unitholders. Note 7 reports financial information of the GEF for the year ended August 31, 2002, and for the period of inception (March 1, 2001) to August 31, 2001.

Note 3 – Significant Accounting Policies

(A) **Security Valuation** -- The Fund's investment in GEF Units is valued at the net asset value per unit reported by the GEF.

(B) **Foreign Currency Translation** -- The accounting records of the Fund are maintained in U.S. dollars. Prior to March 1, 2001, investments in securities and securities sold short were 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 were translated into U.S. dollars at the exchange rate on the dates of the transactions. The Fund did 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 were included with the net realized and unrealized gain or loss from investments.

(C) **Investment Income** -- Interest income is accrued as earned. Prior to March 1, 2001, dividend income was recorded on the ex-dividend date. Dividend and interest income was recorded net of foreign taxes where recovery of such taxes was not assured. Investment income included net realized and unrealized currency gains and losses recognized between accrual and payment dates on dividend and interest transactions. Premiums and discounts on bonds were not amortized.

(D) **Security Transactions** -- Prior to March 1, 2001, security transactions were recorded on a trade date basis for most securities. International index fund transactions were recorded on a settle date basis due to trading practices, which imposed restrictions in acquiring per unit information on the trade date. Gains and losses on securities sold were determined on the basis of average cost. A loss was recognized if there was an impairment in the value of the security that was determined to be other than temporary. Beginning March 1, 2001, a gain or loss is recognized on GEF unit sales on the basis of average cost.

(E) **Distributions to Participants** -- Cash distributions to participants are paid quarterly based on a per unit payout established by the Board of Regents. For the fiscal year ended August 31, 2002, the quarterly rate was \$.06275 which equates to a yearly rate of \$.251 per unit. For the fiscal year ended August 31, 2001, the quarterly distribution rate was \$.06125 which equated to a yearly rate of \$.245 per unit. The ratio of distributions to average net assets (12-quarter average) was 4.38% as of

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Notes to Financial Statements (cont.)

August 31, 2002. The investment policy provides that the annual payout will be adjusted by the average consumer price index of the prior 36 months including August 31 subject to a maximum distribution of 5.5% of the Fund's average market value and a minimum distribution of 3.5% of the Fund's average market value.

(F) **Fund Valuation** -- Valuation of the Fund's units occurs on a quarterly basis. Unit values are determined by dividing the value of the Fund's net assets by the number of units outstanding on the valuation date.

(G) **Purchases and Redemption of Units** -- The value of participating units, upon admission to the Fund, is based upon the market value of net assets held as of the valuation date. Redemptions from the Fund will also be made at the market value price per unit at the valuation date at the time of the withdrawal. There are no transaction costs incurred by participants for the purchase or redemption of units.

(H) **Participants' Net Assets** -- All participants in the Fund have a proportionate undivided interest in the Fund's net assets.

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

(J) **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 revenues and expenses during the reporting period. Actual results could differ from these estimates.

(K) **Foreign Currency Contracts** -- Prior to March 1, 2001, the Fund entered 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 Fund agreed to receive or deliver a fixed quantity of foreign currency for an agreed-upon price on an agreed future date. These contracts were valued daily and the Fund'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, was included in the statement of assets and liabilities. Realized and unrealized gains and losses were included in the statements of operations. These instruments involved market and/or credit risk in excess of the amount recognized in the statement of assets and liabilities. Risks arose from the possible inability of counterparties to meet the terms of their contracts and from movement in currency and securities values and interest rates.

(L) **Cash and Cash Equivalents** -- Cash and Cash Equivalents consist of money markets and other overnight funds.

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Notes to Financial Statements (cont.)

Note 4 – Acquisitions and Dispositions of Investments

Acquisitions and dispositions (including sales, maturities and prepayments) of securities, other than short-term securities, and the associated net realized losses, which include amounts allocated from the GEF, are as follows for the years ended August 31, 2002 and 2001:

	<u>2002</u>	<u>2001</u>
Acquisitions	\$ 158,806,894	\$4,281,236,190
Dispositions	(151,093,202)	(4,038,396,693)
Net Realized Losses on Investments	(102,723,020)	(98,254,229)

Included in acquisitions for the year ended August 31, 2001, is \$2,917,369,473 related to the initial purchase of GEF units by the Fund on March 1, 2001. Included in dispositions for the year ended August 31, 2001, is \$2,818,489,636 related to the contribution of investment assets to the GEF. The contribution of investment assets, excluding limited partnerships and certain other equity investments, to the GEF on March 1, 2001, was accounted for by the Fund as sales at the market value of the assets contributed. A realized loss in the amount of \$90,919,069 was recognized and is included in the net realized losses on investments. The contribution of the market value of the limited partnerships and certain other equity investments in the amount of \$424,753,235, which included cost basis of \$376,606,051 and unrealized appreciation of \$48,147,184, was accounted for as a carryover in basis, and therefore, no realized gain or loss was recorded.

The net realized losses on investments included \$18,541,639 of capital gains earned on the index funds and commingled investments for the year ended August 31, 2001. Also included in net realized losses were \$26,146,887 of currency exchanges losses for the year ended August 31, 2001.

Note 5 – Fees and Expenses

Beginning in the year ended August 31, 2002, the Fund is assessed an annual administrative fee on behalf of UT System component institutions based on 0.08% of the market value of the Fund for the support of enhanced and expanded endowment compliance efforts. The fee assessed for the year ended August 31, 2002 was \$2,383,242.

The Fund is assessed a management fee by UTIMCO to cover the costs of managing the Fund and providing day-to-day operations. The fees assessed for the years ended August 31, 2002 and 2001, were \$2,285,475 and \$1,839,534, respectively. The Fund, however, is reimbursed by UT System for the fee, which is shown in the statements of operations and changes in net assets as Receipt of Funds from UT System for UTIMCO Fee.

The Fund is assessed a quarterly internal fee by UT System for educational purposes based on 0.005% of the Fund's net asset value on the last day of each quarter for the years ended August 31, 2002 and 2001. The fees assessed for the years ended August 31, 2002 and 2001, were \$550,880 and \$581,026, respectively.

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Notes to Financial Statements (cont.)

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

Custodial fees and expenses were assessed by the financial institution which holds the Fund's assets. Fees were based on the number of accounts, market value of the Fund, and transaction activity in accordance with the contractual agreement with the institution. Additional fees were assessed for performance measurement and on-line communication services per the contractual agreement. Beginning March 1, 2001, the Fund is assessed only a negligible fee for the maintenance of two accounts.

Prior to March 1, 2001, the Fund incurred investment management fees from various external managers of the Fund. The fees, generally assessed quarterly, were based on a percentage of the market value of investments held by each individual investment manager and ranged from 0.01% to 1.0%. In addition to quarterly investment management fees, the Fund paid annual performance-based management fees for investment performance in excess of certain defined benchmarks as provided for in the manager's contract. Beginning March 1, 2001, the Fund no longer incurred external investment management fees.

Note 6 – Futures Contracts

Prior to March 1, 2001, the Fund's activities included trading in derivatives such as futures contracts. 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 Fund. When deemed appropriate, a portion of the index funds and commingled investments held by the Fund also may have been invested in futures contracts for the purpose of acting as a temporary substitute for other investments. The asset classes that used futures included domestic and foreign equities, domestic and foreign debt and 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. It was the intention of the Fund not to utilize leverage when entering into these contracts and to maintain cash balances that, when combined with the collateral deposit with a broker, exceeded the notional value of the futures contracts held. Futures contracts were marked to market daily; that is, they were valued at the close of business each day, and a gain or loss was recorded between the value of the contracts that day and on the previous day. The daily gain or loss was referred to as the daily variation margin, which was settled in cash with the broker each morning for the amount of the previous day's mark to market. The amount that was settled in cash with the broker each morning was the carrying and fair value of the futures contracts. The Fund recognized a loss on futures contracts of \$12,364,493 for the period ended February 28, 2001. The Fund executed such contracts either on major exchanges or with major international financial institutions and minimized market and credit risk associated with these contracts through the manager's various trading and credit monitoring techniques.

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Notes to Financial Statements (cont.)

Note 7 – Financial Information on GEF

The following presents the investments and net assets of the GEF, in thousands, as of August 31, 2002 and 2001.

	<u>2002</u>	<u>2001</u>
Equity Securities		
Index Funds	\$ 775,885	\$ 881,803
Commingled Investments	617,064	640,911
Domestic Common Stock	507,797	733,637
Limited Partnerships	353,556	366,491
Foreign Common Stock	98,713	116,147
Other	1,263	1,093
Total Equity Securities	<u>2,354,278</u>	<u>2,740,082</u>
Debt Securities:		
U.S. Government Obligations (Direct and Guaranteed)	110,388	204,349
U.S. Government Agencies (Non-Guaranteed)	196,481	303,343
U.S. Government Agencies (Non-Guaranteed) (Non-U.S. Dollar Denominated)	899	-
Foreign Government and Provincial Obligations (U.S. Dollar Denominated)	5,865	4,417
Foreign Government and Provincial Obligations (Non-U.S. Dollar Denominated)	58,928	62,569
Municipal and County Bonds	2,831	9,105
Corporate Bonds	221,220	230,395
Foreign Corporate Bonds	10,117	14,861
Commingled Investment	8,711	11,690
Commercial Paper	3,086	-
Other	1,470	3,331
Total Debt Securities	<u>619,996</u>	<u>844,060</u>
Preferred Stock		
Domestic Preferred Stock	5,047	12,842
Foreign Preferred Stock	618	1,305
Total Preferred Stock	<u>5,665</u>	<u>14,147</u>
Convertible Securities	<u>2,183</u>	<u>2,915</u>
Cash and Cash Equivalents		
Money Markets	404,900	320,832
Total Investment in Securities	<u>\$ 3,387,022</u>	<u>\$ 3,922,036</u>
Other Assets	178,863	171,399
Liabilities	<u>(272,691)</u>	<u>(369,523)</u>
Net Assets	\$ 3,293,194	\$ 3,723,912
Fund Ownership	<u>78.80%</u>	<u>76.33%</u>
Value of Fund Interest	<u>\$ 2,595,134</u>	<u>\$ 2,842,644</u>

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Notes to Financial Statements (cont.)

The following presents information on the operations of the GEF, in thousands, for the year ended August 31, 2002, and for the period from inception (March 1, 2001) to August 31, 2001.

	<u>2002</u>	<u>2001</u>
Investment Income		
Interest	\$ 40,067	\$ 29,790
Dividends	34,458	17,308
Income Distributions from Limited Partnerships	2,887	1,631
Other	1,504	1,187
Total Investment Income	<u>78,916</u>	<u>49,916</u>
Total Expenses	<u>7,245</u>	<u>3,402</u>
Net Investment Income	<u>71,671</u>	<u>46,514</u>
Realized And Unrealized Loss on Investments		
Net Realized Loss on Investments Securities and Foreign Currency Related Transactions	(124,188)	(36,860)
Net Unrealized Depreciation on Investment Securities and Foreign Currency Related Transactions	<u>(199,983)</u>	<u>(94,253)</u>
Net Loss on Investments	<u>(324,171)</u>	<u>(131,113)</u>
Net Decrease in Net Assets Resulting From Operations	\$ (252,500)	\$ (84,599)
Net Assets		
Beginning of Period	3,723,912	-
Contribution of Participant Net Assets to GEF on March 1, 2001	-	3,839,708
Subsequent Participant Contributions	103,516	71,544
Participant Withdrawals:		
Cost	(290,653)	(104,220)
Loss	8,919	1,479
Ending Net Assets	<u>\$ 3,293,194</u>	<u>\$ 3,723,912</u>
The Fund's share of the above transactions are as follows:		
Beginning Value of Fund Interest	\$ 2,842,644	\$ -
Net Investment Income	55,291	35,503
Net Realized Losses	(96,304)	(28,163)
Net Unrealized Depreciation	(152,308)	(70,826)
Initial Purchase of GEF units on March 1, 2001	-	2,917,369
GEF Unit Purchases	103,516	71,544
Sale of GEF Units	<u>(157,705)</u>	<u>(82,783)</u>
Ending Value of Fund Interest	<u>\$ 2,595,134</u>	<u>\$ 2,842,644</u>