

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

**FINANCIAL STATEMENTS**

**Years Ended August 31, 2003 and 2002**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)**

Our discussion and analysis of The University of Texas System Long Term Fund's (Fund) financial performance provides an overview of its activities for the fiscal year ended August 31, 2003. This discussion was prepared by The University of Texas Investment Management Company "UTIMCO" and should be read in conjunction with the Fund's financial statements and notes. The Fund is an internal UT System mutual fund for the pooled investment of 6,208 privately raised endowments and other long-term funds of the 15 component institutions of the UT System. The Texas Constitution and various state statutes designate The University of Texas System Board of Regents (UT Board) as the fiduciary for the management of certain public endowment and operating funds. The UT Board has entered into an Investment Management Services Agreement delegating investment management responsibility for all investments to UTIMCO.

On March 1, 2001, the Fund purchased units in the newly created GEF in exchange for the contribution of its investment assets. The GEF, established by the UT Board 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 University of Texas System Permanent Health Fund (PHF), also established by the UT Board. 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 UT Board and is provided day-to-day operations by UTIMCO.

The purpose of the MD&A is to provide an objective and easily readable analysis of the Fund's financial statements based upon currently known facts, decisions or conditions.

### **Financial Highlights**

- The Fund's net asset value, after contributions, withdrawals and distributions, increased by \$244.7 from \$2,595.1 million to \$2,839.8 million or approximately 9.4% during the year.
- Participant contributions to the Fund increased by 7.2% from fiscal year 2002 to 2003. Fiscal year contributions of \$113.2 million represented 4.2% of the average value of the Fund assets during the year. Participant contributions consist of endowment and other long-term funds that have been forwarded to the Fund for management by UTIMCO.
- The Fund posted a net investment return of 12.78% for the fiscal year ended August 31, 2003, compared to a net investment return of negative 6.97% for the prior fiscal year.
- The Fund's distribution rate per unit was increased by 2.8%, approximately the average rate of inflation, during the year. This equated to an increase in the 2003 rate to \$0.258 per unit from the 2002 rate of \$0.251 per unit. The fiscal year distributions represented 5.40% of the Fund's average net asset value during the year.

### **Market Commentary**

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. Therefore, the Fund's

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investment results are dependent on the GEF's investment activities. The following paragraphs provide a market commentary for the GEF's investment results for the fiscal year ended August 31, 2003.

The fiscal year ended August 31, 2003 was a year of two remarkably contrasting periods. The first was the period leading up to the conclusion of the major conflict in Iraq, where uncertainty and global market weakness prevailed. The second was the subsequent months following the market low registered on March 11, during which risk taking around the world was financially rewarded. The table below outlines the dramatic contrast in results between these two periods:

<u>Index</u>	<u>Equity Description</u>	<u>9/1/02 - 3/11/03</u>	<u>3/11/03 - 8/31/03</u>
S&P 500	U.S. Large Capitalization	-11.1%	26.9%
Russell 2000	U.S. Small Capitalization	-10.8%	44.3%
MSCI EAFE	International Developed Markets	-15.7%	29.8%
MSCI Emerging Markets Free	International Emerging Markets	-7.6%	40.9%

Navigating these two disparate investment environments proved challenging. However, by maintaining a diversified asset exposure - including a meaningful allocation to absolute return strategies (hedge funds) - the GEF was able to preserve capital during the dramatic negative results of the first six months. In addition, positive performance by many of the GEF's active managers added to returns. Finally, decisions to tactically reallocate capital during the spring and summer months away from defensive assets, including fixed income, and towards more economically sensitive instruments, such as small cap and emerging markets equities, enabled the GEF to participate in the financial markets' eventual anticipation of a strong global recovery which resulted in superior investment returns.

### **Use of Financial Statements and Notes**

The Fund financial statements were prepared in accordance with standards issued by the Governmental Accounting Standards Board (GASB). Three financial statements are required under GASB: the Statement of Net Assets and the Statement of Operations and Changes in Net Assets, and the Statement of Cash Flows. We have also included as part of the basic financial statements the Financial Highlights.

The notes to the financial statements contain supplemental information that is essential for the fair presentation of the financial statements.

### **Statement of Net Assets**

The Statement of Net Assets presents assets, liabilities, and net assets of the Fund as of the end of the fiscal year. This statement, along with all of the Fund's financial statements, is prepared using the accrual basis of accounting, whereby Fund investment income is recognized when earned and Fund expenses are recognized when incurred.

Since the Fund no longer invests in individual securities except for GEF units and a negligible amount of cash, the majority of the Fund's balance sheet is reflected in its investment in GEF units. As of August 31, 2003 the Fund owned 27,696,705 GEF units representing an ownership percentage

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of 79.22%. As of August 31, 2003, the fair value of the GEF units was \$2,840.0 million compared to the cost basis of \$2,716.4 million (\$123.6 million of unrealized appreciation).

The GEF invests in a broad mix of investments and is actively managed to its benchmark, the Endowment Policy Portfolio. The Endowment Policy Portfolio is the index or benchmark for the endowment funds that UTIMCO manages. The return of the Endowment Policy Portfolio is the sum of the weighted benchmark returns for each asset class that comprise it. UTIMCO allocates GEF's assets to internally and externally managed portfolios in accordance with approved asset allocation policies, and attempts to supplement the original endowment corpus by increasing purchasing power over time. In doing so, UTIMCO increases the endowment resources available to fund the teaching, research, and health care programs specified by the various donors.

The composition of the GEF's investment portfolio and the results of its operations for fiscal years 2003 and 2002, are detailed in Note 5 to the financial statements.

Net assets consist of participant contributions and accumulated undistributed realized and unrealized gains on investments.

### **Statement of Operations and Changes in Net Assets**

Changes in net assets as presented on the Statement of Operations and Changes in Net Assets are based on activity of the Fund. The purpose of this statement is to present the results of operations, the changes in value of the investments of the Fund, the net participant contributions, and the distributions to participants.

The Fund earned realized and unrealized investment gains of \$275.4 million during the year compared to realized and unrealized losses of \$255.0 million for the year ended August 31, 2002. Expenses totaled \$6.2 million in fiscal year 2003 and \$5.3 million in fiscal year 2002.

The net increase in net assets resulting from operations totaled \$329.0 million for the fiscal year ended August 31, 2003, compared to a net decrease in net assets totaling \$202.7 for the fiscal year ended August 31, 2002.

Distributions to participants totaled \$143.9 million and \$134.8 million, respectively, for the years ended August 31, 2003 and 2002. The increase in distributions is a result in the UT Board increasing the distribution rate from \$0.251 to \$0.258 for fiscal year 2003, and additional contributions into the Fund. The Fund is structured as a mutual fund in which each endowment or account purchases units at the Fund's market value per unit. Cash distributions are paid quarterly, on a per unit basis, directly to the UT System institution of record.

The Fund's two primary investment objectives are:

- Provide for current beneficiaries by increasing the annual distribution rate at least equal to the rate of inflation so that real purchasing power is maintained, and
- Provide for future beneficiaries by increasing the market value of endowment funds after the annual distribution at a rate at least equal to the rate of inflation so that future distributions maintain purchasing power as well.

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Fund distributions are controlled by a spending policy approved by the UT Board. The key to preservation of endowment purchasing power over the long-term is control of spending through a target distribution rate. This target rate should not exceed the endowment's average annual investment return after fund expenses and inflation. The Fund distributions are increased annually at an average rate of inflation provided that the distribution rate remains within a range of 3.5% to 5.5% of the Fund's net asset value. As reported on the financial highlights statement on page 9, the ratio of distributions to average net assets (12-quarter average) has remained between 3.5% to 5.5%.

### **Statement of Cash Flows**

The Statement of Cash Flows provides relevant information about the cash receipts and cash payments of the Fund for the periods. The Fund sells GEF units in order to create cash to pay the quarterly distributions as well as to meet any withdrawal requirements. Proceeds from the sale of GEF units was \$169.8 million and \$155.4 million, respectively, for years ended August 31, 2003 and 2002. In fiscal years 2003 and 2002, the Fund realized losses of \$4.4 million and \$6.6 million, respectively, as a result of the sale of GEF units.

### **Statement of Financial Highlights**

The inclusion of the Financial Highlights statement is to report the selected per unit data and financial ratios of the Fund over the past five years. As reported in the statement, the Fund's net asset value per unit increased in fiscal year 2003, reversing declines reported in the prior two fiscal years of 2002 and 2001.

### **Contacting UTIMCO**

The above financial highlights are designed to provide a general overview of the Fund's investment results and insight into the following financial statements. Additional information may be found on our website and inquiries may be directed to UTIMCO via [www.utimco.org](http://www.utimco.org).

## Report of Independent Auditors

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

We have audited the accompanying statement of net assets of The University of Texas System Long Term Fund (the "Fund") as of August 31, 2003, and the related statements of operations, changes in net assets, cash flows and financial highlights for the year then ended. 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 audit. The financial statements (excluding a statement of cash flows) of The University of Texas Long Term Fund for the year ended August 31, 2002 and the financial highlights for each of the four years in the period ended August 31, 2002, were audited by other auditors whose report dated October 18, 2002, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. 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. 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 audit provides a reasonable basis for our opinion.

Management's discussion and analysis on pages 1 through 4 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In our opinion, the 2003 financial statements and financial highlights, referred to above present fairly, in all material respects, the financial position of The University of Texas System Long Term Fund as of August 31, 2003, the results of its operations, its cash flows, and changes in its net assets for the year then ended, in conformity with accounting principles generally accepted in the United States.

*Ernst & Young LLP*

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**Statements of Net Assets**

*August 31, 2003 and 2002*

*(Dollars in thousands, except per unit amounts)*

	<u>2003</u>	<u>2002</u>
<b>Assets</b>		
General Endowment Fund Units, at Fair Value (Cost \$2,716,370 and \$2,770,120, respectively)	\$ 2,839,986	\$ 2,595,134
Other Investments	1	7
Cash and Cash Equivalents	1	52
Receivable for Investment Securities Sold	<u>40,492</u>	<u>12,998</u>
<b>Total Assets</b>	<u>2,880,480</u>	<u>2,608,191</u>
<b>Liabilities</b>		
Payable to Participants	40,492	12,998
Other Payables	<u>142</u>	<u>130</u>
<b>Total Liabilities</b>	<u>40,634</u>	<u>13,128</u>
<b>Net Assets</b>	<u>\$ 2,839,846</u>	<u>\$ 2,595,063</u>
<b>Supplementary Disclosure:</b>		
<b>Net Assets Consist Of:</b>		
Participant Contributions (Net of Withdrawals)	\$ 1,868,227	\$ 1,797,084
Accumulated Undistributed Net Realized Gain on Investments	848,003	972,972
Net Unrealized Appreciation (Depreciation) of Investments	<u>123,616</u>	<u>(174,993)</u>
<b>Net Assets for 555,329,487 Units and 542,049,359 Units, respectively</b>	<u>\$ 2,839,846</u>	<u>\$ 2,595,063</u>
<b>Net Asset Value Per Unit</b>	<u>\$ 5.114</u>	<u>\$ 4.788</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, 2003 and 2002 (in thousands)*

	<u>2003</u>	<u>2002</u>
<b>Investment Income</b>		
Allocation of General Endowment Fund Net Investment Income	\$ 56,635	\$ 55,291
Other	<u>8</u>	<u>-</u>
<b>Total Investment Income</b>	<u>56,643</u>	<u>55,291</u>
<b>Expenses</b>		
UTIMCO Management Fee	3,135	2,285
Fee for Endowment Compliance	2,441	2,383
Internal Fee for Educational Purposes	536	551
Other Expenses	<u>71</u>	<u>57</u>
<b>Total Expenses</b>	<u>6,183</u>	<u>5,276</u>
Receipt of Funds from UT System for UTIMCO Management Fee	<u>3,135</u>	<u>2,285</u>
<b>Net Investment Income</b>	<u>53,595</u>	<u>52,300</u>
<b>Realized and Unrealized Gain (Loss) on Investments</b>		
Net Realized Loss on General Endowment Fund Units	(4,361)	(6,612)
Net Realized Gain on Investment Securities	240	193
Allocation of General Endowment Fund Realized Loss	(19,075)	(96,304)
Net Unrealized Appreciation (Depreciation) on Investment Securities	7	(6)
Net Unrealized Appreciation (Depreciation) on		
General Endowment Fund Units	<u>298,602</u>	<u>(152,308)</u>
<b>Net Gain (Loss) on Investments</b>	<u>275,413</u>	<u>(255,037)</u>
<b>Net Increase (Decrease) in Net Assets Resulting from Operations</b>	\$ 329,008	\$ (202,737)
<b>Net Assets</b>		
Beginning of Period	2,595,063	2,843,300
Participant Contributions (including reinvestments of \$7,587 and \$5,990 for the years ended August 31, 2003 and 2002, respectively)	113,164	105,595
Participant Withdrawals:		
Cost	(42,021)	(13,223)
Gain	(11,516)	(3,119)
Distributions to Participants:		
Net Investment Income	(53,595)	(52,300)
Net Realized Appreciation	<u>(90,257)</u>	<u>(82,453)</u>
End of Period	<u>\$ 2,839,846</u>	<u>\$ 2,595,063</u>

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

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**Statements of Cash Flows**

*Years Ended August 31, 2003 and 2002*

*(in thousands)*

	<b>2003</b>	<b>2002</b> (unaudited)
	<u>                    </u>	<u>                    </u>
<b>Cash Flows From Operating Activities:</b>		
Cash received on interest, dividends and other	\$          8	\$          2
Cash payments to UTIMCO for management fee	(3,135)	(2,285)
Cash payments to UT System	(2,965)	(2,947)
Cash payments to service providers	(71)	(57)
Purchase of investment securities	(110,073)	(103,515)
Proceeds from sale of investment securities	169,782	155,415
Cash received from UT System for reimbursement of UTIMCO Fees	<u>3,135</u>	<u>2,285</u>
<b>Net Cash Provided By Operating Activities</b>	<u>56,681</u>	<u>48,898</u>
<b>Cash Flows from Financing Activities:</b>		
Contributions from participants	113,164	105,595
Withdrawals by participants	(26,044)	(20,485)
Distributions to participants	<u>(143,852)</u>	<u>(134,753)</u>
<b>Net Cash Used in Financing Activities</b>	<u>(56,732)</u>	<u>(49,643)</u>
<b>Net decrease in cash and cash equivalents</b>	(51)	(745)
Cash and cash equivalents at beginning of year	<u>52</u>	<u>797</u>
Cash and cash equivalents at end of year	<u>\$          1</u>	<u>\$          52</u>
<b>Reconciliation of net increase (decrease) in net assets provided by operating activities:</b>		
Net increase (decrease) in net assets	\$      329,008	\$      (202,737)
Adjustments to reconcile net increase in net investment assets to net cash provided by operating activities:		
Net allocation of income, gains and losses from General Endowment Fund	(37,560)	41,013
Unrealized (gains) losses on investments	(298,609)	152,314
Cost of investment securities purchased	(110,073)	(103,515)
Cost of investment securities sold	201,397	157,691
(Increase) decrease in receivables:		
Investment securities sold	(27,494)	4,143
Accrued income	-	2
Increase (decrease) in other payables	<u>12</u>	<u>(13)</u>
<b>Net Cash Provided by Operating Activities</b>	<u>\$      56,681</u>	<u>\$      48,898</u>

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

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**Financial Highlights**

*Years Ended August 31,*

	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b>Selected Per Unit Data</b>					
Net Asset Value, Beginning of Period	\$ 4.788	\$ 5.412	\$ 6.198	\$ 5.347	\$ 4.568
Income from Investment Operations					
Net Investment Income	0.097	0.098	0.140	0.142	0.121
Net Realized and Unrealized Gain (Loss) on Investments	<u>0.487</u>	<u>(0.471)</u>	<u>(0.681)</u>	<u>0.939</u>	<u>0.868</u>
Total Income (Loss) from Investment Operations	<u>0.584</u>	<u>(0.373)</u>	<u>(0.541)</u>	<u>1.081</u>	<u>0.989</u>
Less Distributions					
From Net Investment Income	0.097	0.098	0.140	0.142	0.121
From Net Realized Gain	<u>0.161</u>	<u>0.153</u>	<u>0.105</u>	<u>0.088</u>	<u>0.089</u>
Total Distributions	<u>0.258</u>	<u>0.251</u>	<u>0.245</u>	<u>0.230</u>	<u>0.210</u>
Net Asset Value, End of Period	<u>\$ 5.114</u>	<u>\$ 4.788</u>	<u>\$ 5.412</u>	<u>\$ 6.198</u>	<u>\$ 5.347</u>

**Ratios and Supplemental Data**

Net Assets, End of Period (in thousands)	\$ 2,839,846	\$ 2,595,063	\$ 2,843,300	\$3,136,229	\$2,602,274
Ratio of Expenses to Average Net Assets	0.40%	0.39%	0.23%	0.33%	0.35%
Ratio of Net Investment Income to Average Net Assets	2.01%	1.89%	2.44%	2.45%	2.42%
Ratio of Distributions to Average Net Assets (5-quarter average)	5.40%	4.86%	4.31%	3.99%	4.19%
Ratio of Distributions to Average Net Assets (12-quarter average)	4.86%	4.38%	4.12%	3.98%	4.02%

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

**Note 1 – Organization and Basis of Presentation**

The University of Texas System 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 Fund uses the accrual method of accounting, recognizing income when such items are earned and expenses when such items are incurred. The Fund is subject to the pronouncements of the Governmental Accounting Standards Board (GASB) and accounts for its activities as a proprietary enterprise fund. The Fund also applies all applicable pronouncements of the Financial Accounting Standards Board that do not conflict with pronouncements of the GASB.

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 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, 2003, the Fund is the majority participant in the GEF, with ownership of 27,696,705 units, which represents 79.2% of the GEF. At August 31, 2002, the Fund held 28,539,389 units, which represented 78.8% 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.)*

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monthly basis for accounting purposes, the GEF allocates its net investment income and realized gain or loss to the Fund based on its ownership of GEF units at month end. The allocated investment income and realized gain amounts are considered reinvested as GEF contributions. Any allocated 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 5 reports financial information of the GEF for the years ended August 31, 2003 and 2002.

**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 which is based on fair value.
- (B) **Investment Income** -- Interest income is accrued as earned.
- (C) **Security Transactions** -- A gain or loss is recognized on GEF unit sales on the basis of average cost.
- (D) **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, 2003, the quarterly rate was \$.0645 which equates to a yearly rate of \$.258 per unit. For the fiscal year ended August 31, 2002, the quarterly distribution rate was \$.06275 which equated to a yearly rate of \$.251 per unit. The ratio of distributions to average net assets (12-quarter average) was 4.86% as of August 31, 2003. 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.
- (E) **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.
- (F) **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.
- (G) **Participants' Net Assets** -- All participants in the Fund have a proportionate undivided interest in the Fund's net assets.
- (H) **Federal Income Taxes** -- The Fund is not subject to federal income tax.

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*Notes to financial Statements (cont.)*

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(I) **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.

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

(K) **Recently Issued Accounting Standards** -- In March 2003, GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures – An Amendment of GASB Statement No. 3*, which modifies and expands disclosures regarding deposits and investments. This statement is not effective for the Fund until the fiscal year ending 2005. Management does not anticipate that the implementation of the new statement will have a material impact on the Fund's financial statement balances.

(L) **Reclassifications** -- Certain items in the 2002 financial statements have been reclassified to conform with 2003 classification.

**Note 4 – Fees and Expenses**

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, 2003 and 2002, were \$3,135,100 and \$2,285,475, 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 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 fees assessed for the years ended August 31, 2003 and 2002, were \$2,441,003 and \$2,383,242, respectively.

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, 2003 and 2002. The fees assessed for the years ended August 31, 2003 and 2002, were \$536,407 and \$550,880, respectively.

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

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*Notes to financial Statements (cont.)*

**Note 5 – Financial Information on GEF**

The following presents the investments and net assets of the GEF, in thousands, as of August 31, 2003 and 2002.

	<u>2003</u>	<u>2002</u>
<b>Equity Securities</b>		
Commingled Investments	\$ 992,944	\$ 617,064
Index Funds	793,380	775,885
Domestic Common Stock	566,279	507,797
Limited Partnerships	376,667	353,556
Foreign Common Stock	126,286	98,713
Other	1,784	1,263
<b>Total Equity Securities</b>	<u>2,857,340</u>	<u>2,354,278</u>
<b>Debt Securities</b>		
U.S. Government Obligations (Direct and Guaranteed)	46,115	110,388
U.S. Government Agencies (Non-Guaranteed)	215,261	196,481
U.S. Government Agencies (Non-Guaranteed) (Non-U.S. Dollar Denominated)	567	899
Foreign Government and Provincial Obligations (U.S. Dollar Denominated)	7,479	5,865
Foreign Government and Provincial Obligations (Non-U.S. Dollar Denominated)	79,997	58,928
Municipal and County Bonds	2,542	2,831
Corporate Bonds	128,837	221,220
Foreign Corporate Bonds	10,219	10,117
Commingled Investment	10,209	8,711
Commercial Paper	-	3,086
Other	1,037	1,470
<b>Total Debt Securities</b>	<u>502,263</u>	<u>619,996</u>
<b>Preferred Stock</b>		
Domestic Preferred Stock	7,719	5,047
Foreign Preferred Stock	117	618
<b>Total Preferred Stock</b>	<u>7,836</u>	<u>5,665</u>
<b>Purchased Options</b>	<u>6,315</u>	<u>-</u>
<b>Convertible Securities</b>	<u>715</u>	<u>2,183</u>
<b>Cash and Cash Equivalents</b>		
Money Market Funds Maintained to Back Futures Contracts	212,955	201,279
Money Market Funds – Other	84,430	203,621
<b>Total Cash and Cash Equivalents</b>	<u>297,385</u>	<u>404,900</u>
<b>Total Investment in Securities</b>	<u>\$ 3,671,854</u>	<u>\$ 3,387,022</u>
<b>Other Assets</b>	202,948	178,863
<b>Liabilities</b>	<u>(290,037)</u>	<u>(272,691)</u>
<b>Net Assets</b>	\$ 3,584,765	\$ 3,293,194
<b>Fund Ownership</b>	<u>79.22%</u>	<u>78.80%</u>
<b>Value of Fund Interest</b>	<u>\$ 2,839,986</u>	<u>\$ 2,595,134</u>

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

*Notes to financial Statements (cont.)*

The following presents information on the operations of the GEF, in thousands, for the year ended August 31, 2003 and 2002.

	<u>2003</u>	<u>2002</u>
<b>Investment Income</b>		
Interest	\$ 34,052	\$ 40,067
Dividends	34,685	34,458
Income Distributions from Limited Partnerships	7,060	2,887
Other	1,426	1,504
<b>Total Investment Income</b>	<u>77,223</u>	<u>78,916</u>
<b>Total Expenses</b>	<u>5,781</u>	<u>7,245</u>
<b>Net Investment Income</b>	<u>71,442</u>	<u>71,671</u>
<b>Realized And Unrealized Gain (Loss) on Investments</b>		
Net Realized Loss on Investments Securities and Foreign Currency Related Transactions	(24,341)	(124,188)
Net Unrealized Appreciation (Depreciation) on Investment Securities and Foreign Currency Related Transactions	370,615	(199,983)
<b>Net Gain (Loss) on Investments</b>	<u>346,274</u>	<u>(324,171)</u>
<b>Net Increase (Decrease) in Net Assets Resulting From Operations</b>	\$ 417,716	\$ (252,500)
<b>Net Assets</b>		
Beginning of Period	3,293,194	3,723,912
Participant Contributions	110,074	103,516
Participant Withdrawals:		
Cost	(242,111)	(290,653)
Loss	5,892	8,919
<b>Ending Net Assets</b>	<u>\$ 3,584,765</u>	<u>\$ 3,293,194</u>
<b>The Fund's share of the above transactions are as follows:</b>		
Beginning Value of Fund Interest	\$ 2,595,134	\$ 2,842,644
Net Investment Income	56,635	55,291
Net Realized Losses	(19,075)	(96,304)
Net Unrealized Appreciation (Depreciation)	298,602	(152,308)
General Endowment Fund Unit Purchases	110,074	103,516
Sale of General Endowment Fund Units	(201,384)	(157,705)
<b>Ending Value of Fund Interest</b>	<u>\$ 2,839,986</u>	<u>\$ 2,595,134</u>