

Financial Statements

Permanent University Fund

Years Ended August 31, 2006 and 2005

Permanent University Fund

Financial Statements

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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

We have audited the accompanying financial statements of The Permanent University Fund (PUF) as of and for the years ended August 31, 2006 and 2005, as listed in the table of contents. 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. 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. 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.

As discussed in Note 1, the financial statements present only the Permanent University Fund and do not purport to, and do not, present fairly the fiduciary net assets of The University of Texas Investment Management Company nor The University of Texas System as of August 31, 2006 and 2005 and the changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States.

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 (UTIMCO) and are not intended to be a complete presentation of the PUF's assets, liabilities, income, and expenses. The PUF's 2.1 million acres of land are not included in this report (see Note 1).

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the PUF managed by UTIMCO as of August 31, 2006 and 2005, and the changes in the fiduciary net assets for the years then ended, in conformity with accounting principles generally accepted in the United States.

Management's discussion and analysis on pages 3 through 6 is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States. 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.

Our audits were conducted for the purpose of forming opinions on the financial statements of the Permanent University Fund. The supplemental schedules are presented for purposes of additional analysis and are not a required part of the financial statements. The supplemental schedules as of August 31, 2006 and for the years then ended have been subjected to the audit procedures applied in the audits of the financial statements and, in our opinion, based on our audits, are fairly stated in relation to the financial statements taken as a whole.

Ernst & Young LLP

October 27, 2006

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MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

Our discussion and analysis of the Permanent University Fund's (PUF) financial performance provides an overview of its activities for the period ended August 31, 2006. This discussion was prepared by The University of Texas Investment Management Company (UTIMCO) and should be read in conjunction with the PUF's financial statements and notes. The PUF is a public endowment contributing to the support of 18 institutions and 6 agencies in The University of Texas System (UT System) and The Texas A&M University System (TAMU 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.

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

Financial Highlights

- The PUF's net fiduciary assets after distributions increased by \$886.7 million from \$9,426.7 million to \$10,313.4 million, or approximately 9.4% for the year ended August 31, 2006, compared to an increase of \$1,338.8 or approximately 16.6% for the year ended August 31, 2005. The change in net fiduciary assets from year to year is mainly attributable to the following:
 1. Fiscal year 2006 contributions of PUF Lands mineral income increased by 11.3% from \$193.1 million to \$215.0 million and represented 2.1% of the average value of the PUF investments during the year, compared to fiscal year 2005 contributions which increased by 31.7%, from \$146.7 million to \$193.1 million and represented 2.2% of the average value of the PUF investments during the year. PUF Lands consist of more than 2.1 million acres in 19 counties primarily in West Texas.
 2. The PUF posted a net investment return of 11.17% for the year ended August 31, 2006. Investments in real estate investment trusts, private market investments and global equities were the leading contributors to the 2006 return. For the fiscal year ended August 31, 2005, the commodities, private market investments and global equity asset classes were the leading performers contributing to a net investment return of 18.80%.
 3. The PUF's annual distribution to the Available University Fund (AUF) increased by 4.7% in fiscal year 2006, compared to a decrease of 2.0% in fiscal year 2005.

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Use of Financial Statements and Notes

The PUF's financial statements were prepared in accordance with standards issued by the Governmental Accounting Standards Board (GASB). Two financial statements are typically required under GASB: the Statement of Fiduciary Net Assets and the Statement of Changes in Fiduciary Net Assets.

In compliance with the reporting requirements of Section 66.05 of the Texas Education Code, we have included as supplementary information a Schedule of Changes in Cost of Investments and Investment Income. We have also included as supplementary information a Comparison Summary of Investments.

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

Statements of Fiduciary Net Assets

The Statements of Fiduciary Net Assets present assets, liabilities, and net assets of the PUF under UTIMCO management as of the end of the fiscal year. These statements, along with all of the PUF's financial statements, are prepared using the accrual basis of accounting, whereby PUF investment income is recognized when earned and PUF expenses are recognized when incurred.

The PUF 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 PUF investment 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 PUF resources available to fund the debt service on bonds issued by the UT Board and the Texas A&M System Board of Regents to fund capital expenditures and to fund academic excellence programs at The University of Texas at Austin, Texas A&M University, and Prairie View A&M.

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The following summarizes the Statements of Fiduciary Net Assets (in millions):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Assets			
Investments	\$ 10,477.1	\$ 9,575.6	\$ 8,080.4
Other Assets	<u>1,341.5</u>	<u>1,224.0</u>	<u>970.0</u>
Total Assets	<u>11,818.6</u>	<u>10,799.6</u>	<u>9,050.4</u>
Total Liabilities	<u>1,505.2</u>	<u>1,372.9</u>	<u>962.5</u>
Net Assets Held in Trust	<u>\$ 10,313.4</u>	<u>\$ 9,426.7</u>	<u>\$ 8,087.9</u>

Statements of Changes in Fiduciary Net Assets

Changes in fiduciary net assets as presented on the Statements of Changes in Fiduciary Net Assets are based on activity of the PUF investments. The purpose of these statements is to present additions to the PUF resulting from net investment income and contributions from PUF Lands mineral income and to present deductions from the PUF resulting from the distributions to the AUF.

The net increase in investments of the PUF was \$845.3 million during the year compared to \$1,298.7 million for the year ended August 31, 2005. Investment expenses totaled \$76.8 million, \$46.0 million, and \$23.4 million, respectively, for the years ended August 31, 2006, 2005, and 2004.

The PUF'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.

Distributions to the AUF increased by \$16.1 million, from \$341.2 million in fiscal year 2005 to \$357.3 million, in fiscal year 2006. The fiscal year 2005 distribution amount decreased by \$6.8 million from the fiscal year 2004 distribution of \$348.0 million. PUF distributions are controlled by a spending policy approved by the UT Board as directed by the Texas Constitution, which directs the UT Board to establish a distribution policy that provides stable, inflation-adjusted distributions to the AUF and preserves the real value of the PUF investments over the long term. To achieve this, the annual

PERMANENT UNIVERSITY FUND

distribution is currently established at 4.75% of the prior twelve quarters' average net asset value of the PUF investments, as determined each February 28 for the following fiscal year.

The distributions to the AUF are subject to the following overriding conditions:

1. Distributions must be at least equal to the amount needed to pay debt service on PUF Bonds;
2. Distributions may not 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. Distributions may not exceed 7 percent of the average net fair market value of PUF investments in any fiscal year, except as necessary to pay debt service on PUF Bonds.

The following table summarizes the Statements of Changes in Fiduciary Net Assets (in millions):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Investment Income	\$ 1,111.6	\$ 1,537.9	\$ 1,072.5
Less Investment Expenses	(76.8)	(46.0)	(23.4)
PUF Lands Contributions	215.0	193.1	146.7
Total Additions	<u>1,249.8</u>	<u>1,685.0</u>	<u>1,195.8</u>
Administrative Expenses			
PUF Lands Expenses	5.3	4.7	4.7
UT System Oversight Fee	0.5	0.3	-
Distributions to Available University Fund	357.3	341.2	348.0
Total Deductions	<u>363.1</u>	<u>346.2</u>	<u>352.7</u>
Change in Fiduciary Net Assets	886.7	1,338.8	843.1
Net Asset Held in Trust, Beginning of Period	9,426.7	8,087.9	7,244.8
Net Assets Held in Trust, End of Period	<u>\$ 10,313.4</u>	<u>\$ 9,426.7</u>	<u>\$ 8,087.9</u>

Contacting UTIMCO

The above financial highlights are designed to provide a general overview of the PUF'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.

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Statements of Fiduciary Net Assets

August 31, 2006 and 2005

(in thousands)

Assets	2006	2005
Investments:		
Equity Securities	\$ 1,542,800	\$ 1,842,238
Preferred Stock	2,483	2,690
Debt Securities	1,932,380	1,640,094
Convertible Securities	114	5,010
Investment Funds	5,717,408	4,748,465
Purchased Options	47,982	20,153
Cash and Cash Equivalents	1,233,886	1,316,942
Total Investments	10,477,053	9,575,592
Collateral for Securities Loaned, at Fair Value	990,531	914,938
Deposit with Brokers for Derivative Contracts	137,568	64,164
Deposit with Broker for Securities Sold Short	7,476	-
Unrealized Gains on Foreign Currency Exchange Contracts	12,296	10,903
Swaps, at Fair Value	3,895	10,809
Receivables:		
Investment Securities Sold	161,250	203,320
Accrued Income	26,901	19,901
Other	1,612	-
Total Receivables	189,763	223,221
Total Assets	11,818,582	10,799,627
Liabilities		
Payable Upon Return of Securities Loaned	990,531	914,938
Options Written, at Fair Value	77,163	35,548
Swaps, at Fair Value	22,514	12,083
Securities Sold Short, at Fair Value	8,476	-
Unrealized Losses on Foreign Currency Exchange Contracts	18,335	8,607
Payables:		
Investment Securities Purchased	373,509	387,385
Other	14,660	14,323
Total Payables	388,169	401,708
Total Liabilities	1,505,188	1,372,884
Net Assets Held in Trust	\$10,313,394	\$ 9,426,743

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

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Statements of Changes in Fiduciary Net Assets

Years Ended August 31, 2006 and 2005

(in thousands)

	<u>2006</u>	<u>2005</u>
Additions		
Investment Income:		
Net Increase in Investments	\$ 845,348	\$ 1,298,679
Interest	145,078	107,905
Dividends	54,017	75,977
Income Distributions from Private Market Investment Funds	19,665	29,897
Securities Lending Income	44,764	23,384
Other	2,744	2,123
Total Investment Income	<u>1,111,616</u>	<u>1,537,965</u>
Less Investment Expenses:		
Investment Management and Consulting Fees	29,316	19,580
Securities Lending Fees	42,296	20,943
UTIMCO Management Fee	3,247	3,401
Custodial Fees and Expenses	951	1,035
Legal	471	620
Analytical and Risk Measurement Fees	256	276
Other	237	118
Total Investment Expenses	<u>76,774</u>	<u>45,973</u>
Net Investment Income	1,034,842	1,491,992
Contributions from PUF Lands	214,955	193,092
Total Additions	<u>1,249,797</u>	<u>1,685,084</u>
Administrative Expenses		
PUF Lands Expenses	5,338	4,746
UT System Oversight Fee	471	299
Total Administrative Expenses	<u>5,809</u>	<u>5,045</u>
Distributions to Available University Fund	357,337	341,174
Total Deductions	<u>363,146</u>	<u>346,219</u>
Change in Fiduciary Net Assets	886,651	1,338,865
Net Assets Held in Trust, Beginning of Period	9,426,743	8,087,878
Net Assets Held in Trust, End of Period	<u><u>\$ 10,313,394</u></u>	<u><u>\$ 9,426,743</u></u>

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

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Notes to Financial Statements

Note 1 – Organization and Basis of Presentation

(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 primarily in 19 counties in West Texas (PUF Lands).

PUF Lands are managed by UT System administration and produce two streams of income: mineral and surface. UT System administration remits mineral income to the PUF, and distributes surface income to the Available University Fund (AUF). The mineral income retained by the PUF is invested and managed by The University of Texas Investment Management Company (UTIMCO).

(B) The accompanying financial statements report the investment in securities of the PUF, including the assets, liabilities, mineral contributions and investment income. Expenses related to the PUF's security investments and PUF Lands, as well as distributions from the PUF to the AUF, are also included. The PUF Lands asset values are not included in the accompanying financial statements.

The activities of the PUF are accounted for as a fiduciary fund. The financial statements of the PUF use an economic resources measurement focus and the accrual basis of accounting, whereby revenues are recorded when earned and expenses are recorded when a liability is incurred regardless of the timing of cash flows. The financial statements of the PUF are prepared in accordance with the requirements of the Governmental Accounting Standards Board (GASB).

The supplemental Schedule of Changes in Cost of Investments and Investment Income has been prepared for the purpose of complying with the reporting requirements 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 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

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Notes to Financial Statements (cont.)

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).

Private market investment funds and other equity securities are valued based on the equity method of accounting 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 private market investment funds are valued at cost.

Securities held by the PUF in index and exchange traded 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.

Marketable alternative, U.S. equity, non-U.S. developed equity, emerging market and fixed income investment funds and certain other investment funds are valued using the equity method of accounting based on net asset value information 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 the change in fiduciary net assets 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 increase in investments.

(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. 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.

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Notes to Financial Statements (cont.)

(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) *Derivative Applications* -- Derivative securities are financial instruments whose value is derived, in whole or part, from the value of any one or more underlying securities or assets, or index of securities or assets, such as stocks, bonds, commodities, or currencies. The PUF from time to time uses various derivative applications, as allowed under Board of Regent approved investment policy guidelines. These derivative applications are utilized in compliance with a derivative investment policy established by the UTIMCO Board of Directors, and by guidelines established in contracts with external investment managers. Derivative applications included under these policies and contracts include futures, forwards, swaps and all forms of options. Futures contracts are valued at closing market prices on valuation date. Written options and swaps are valued by using independent broker quotes or using models with externally verifiable model inputs. Derivative applications in the PUF are used to achieve the following objectives:

- implement investment strategies in a low cost and efficient manner,
- alter the PUF's market (systematic) exposure without trading the underlying cash market securities,
- construct portfolios with risk and return characteristics that could not be created with cash market securities,
- hedge and control risks so that the PUF's risk/return profile is more closely aligned with the PUF's targeted risk/return profile, and
- facilitate transition trading.

Through the use of derivative applications, the complex risks that are bound together in traditional cash market investments can be separated and managed independently. The primary intent of the PUF's investment in derivative securities is to hedge its risk or to implement investment strategies more effectively and at a lower cost than would be possible in the cash market.

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 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. Options are marked to market on a daily basis, and are included as a liability on the statements of fiduciary net assets.

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Notes to Financial Statements (cont.)

Swaps -- The PUF invests in certain types of swaps to increase or decrease its exposure to long-term interest rates and to certain commodity sector returns. Swaps are agreements between two parties to exchange periodic payments on the notional value of the contract multiplied by a stated fixed interest rate versus a stated floating interest rate, or on a commodity sector return versus a specified cost per contract. Swaps are marked to market on a daily basis, and are included, at fair value, on the statements of fiduciary net assets. Cash flows occur when a swap is opened, when it resets, if or when it is prematurely terminated by both parties to the agreement, and when it reaches maturity. The frequency of the resets is defined by the term sheet of the particular swap agreement, and varies from instrument to instrument.

Futures Contracts – The PUF enters into futures contracts to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes. Upon entering into a futures contract, initial margin deposit requirements are satisfied by the segregation of specific securities as collateral for the account of the broker (the PUF's agent in acquiring the futures position). During the period the futures positions are open, the 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, and is included as an other receivable or other payable on the statements of fiduciary net assets. 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.

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 fiduciary net assets. Realized and unrealized gains and losses are included in the statements of changes in fiduciary net assets. These instruments involve market and/or credit risk in excess of the amount recognized in the statements of fiduciary net assets. 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) *Securities Sold Short* -- The PUF may sell securities it does not own in anticipation of a decline in the fair value of that security. When the PUF sells a security short, it must borrow the security sold short and deliver it to the broker-dealer through which it made the short sale as collateral for its obligation to deliver the security upon conclusion of the sale. The Deposit with Broker for Securities Sold Short was \$7,476,175 as of August 31, 2006. The market value of securities sold short as of August 31, 2006 was

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Notes to Financial Statements (cont.)

\$8,475,707. There were no securities sold short during the year ended August 31, 2005. The PUF must pay dividends or interest on the securities sold short. Until the PUF covers its short sales, it is exposed to market risk to the extent that subsequent market fluctuations may require purchasing securities sold short at prices which may be significantly higher than the market value reflected in the statements of fiduciary net assets.

(I) **Cash and Cash Equivalents** -- Cash and cash equivalents consist of money markets, cash held at the State Treasury, foreign currencies and other overnight funds. A portion of the PUF's cash and cash equivalents are maintained to support the notional value of future contracts held (see Note 8). Cash and cash equivalents are an integral part of the PUF's investment activities, and as such are included in the investments balance on the statement of fiduciary net assets.

(J) **Contributions from PUF Lands** -- The mineral income earned from PUF Lands is recorded on a cash basis as remitted by UT System administration and presented on the accompanying statements of changes in fiduciary net assets as an addition to fiduciary net assets, styled "Contributions from PUF Lands."

(K) **Reclassifications** -- Certain items in the 2005 financial statements and related notes have been reclassified to conform with 2006 classification.

Note 3 – Investment Risk

The investment risk disclosure that follows relates to the PUF's investments before securities lending transactions and the investment of cash collateral. Disclosures relating to securities lending are provided in Note 4.

(A) **Credit Risk**

Article VII, Section 11b of the Texas Constitution authorizes the Board of Regents, subject to procedures and restrictions it establishes, to invest the PUF in any kind of investment and in amounts it considers appropriate, provided that it adheres to the prudent investor standard. This standard provides that the Board of Regents, in making investments, may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all of the assets of the fund rather than a single investment.

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment.

This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The PUF's investment policy limits investments in U.S. Domestic bonds and non-dollar denominated bond investments to those that are rated investment grade, Baa3 or better by Moody's Investor Services, BBB- or better, by Standard & Poor's Corporation, or BBB- or better, by Fitch Investors Service at the time of acquisition. This requirement does not apply to investment managers that are authorized by the terms of an investment advisory agreement to invest in below investment grade bonds. Per GASB Statement No. 40 (GASB 40), *Deposit and Investment Risk Disclosures, an amendment to GASB Statement No. 3*, unless there is information to the contrary, obligations of the U.S. government or obligations explicitly

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Notes to Financial Statements (cont.)

guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. GASB 40 also provides that securities with split ratings, or a different rating assignment between NRSROs, are disclosed using the rating indicative of the greatest degree of risk. The following table presents each applicable investment type grouped by rating at August 31, 2006 and 2005:

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Notes to Financial Statements (cont.)

Investment Type	August 31,		Rating
	2006	2005	
Investments:			
U.S. Government Guaranteed	\$ 941,500,304	\$ 790,948,277	Exempt from Disclosure
U.S. Government Non-Guaranteed:			
U.S. Agency	22,495,507	74,365,601	AAA
U.S. Agency	-	6,973,200	A
U.S. Agency Asset Backed	258,354,317	296,764,647	AAA
Total U.S. Government Non-Guaranteed	280,849,824	378,103,448	
Total U.S. Government	1,222,350,128	1,169,051,725	
Corporate Obligations:			
Domestic	62,957,174	51,515,221	AAA
Domestic	16,390,703	7,468,645	AA
Domestic	31,906,859	50,702,626	A
Domestic	39,291,054	31,795,269	BAA/BBB
Domestic	-	13,022,833	BBB
Domestic	272,627	9,267,204	BAA
Domestic	6,250,413	10,067,914	BA/BB
Domestic	675,750	4,878,256	BB
Domestic	2,396,191	447,704	BA
Domestic	10,825,660	5,308,414	B
Domestic	314,062	568,075	CAA
Domestic	-	508,913	CA
Domestic	214,725	-	CCC
			Rating
Domestic	-	3,200,468	Withdrawn
Commercial Paper	367,707,619	63,174,559	P
Commercial Paper	9,270,683	-	A
Foreign	14,525,682	18,171,840	AAA
Foreign	4,126,010	1,836,940	AA
Foreign	14,073,864	7,743,068	A
Foreign	15,616,781	6,515,084	BAA/BBB
Foreign	-	412,574	BBB
Foreign	-	669,298	BAA
Foreign	-	184,275	BA/BB
Total Corporate Obligations	596,815,857	287,459,180	
Foreign Government and Provincial Obligations	69,987,530	128,595,030	AAA
Foreign Government and Provincial Obligations	18,146,253	17,815,716	AA
Foreign Government and Provincial Obligations	6,329,396	2,839,229	A
Foreign Government and Provincial Obligations	4,782,530	6,781,635	BAA/BBB
Foreign Government and Provincial Obligations	-	316,950	BAA
Foreign Government and Provincial Obligations	1,590,876	5,741,745	BA
Foreign Government and Provincial Obligations	-	1,994,411	B
Total Foreign Government and Provincial Obligations	100,836,585	164,084,716	
Other Debt Securities	3,969,722	8,270,200	AAA
Other Debt Securities	1,296,235	1,754,051	AA
Other Debt Securities	-	2,466,629	A
Other Debt Securities	7,111,208	7,007,669	BAA/BBB
Total Other Debt Securities	12,377,165	19,498,549	
Total Debt Securities	\$ 1,932,379,735	\$ 1,640,094,170	
Other Investment Funds - Debt	\$ 66,347,671	\$ 2,041,171	AAA
Other Investment Funds - Debt	96,111,721	-	AA
Other Investment Funds - Debt	8,150,615	21,929,620	BB
Total Other Investment Funds - Debt	\$ 170,610,007	\$ 23,970,791	
Cash and Cash Equivalents - Money Market Funds	\$ 1,222,640,410	\$ 1,297,001,002	AAA
Cash and Cash Equivalents - Other	11,245,940	19,941,012	Exempt from Disclosure
Total Cash and Cash Equivalents	\$ 1,233,886,350	\$ 1,316,942,014	
Deposit with Brokers for Derivative Contracts:			
U.S. Government Guaranteed	\$ 84,823,711	\$ 56,437,849	Exempt from Disclosure
Cash	52,744,196	7,725,856	Exempt from Disclosure
	\$ 137,567,907	\$ 64,163,705	
Deposit with Broker for Securities Sold Short:			
Cash	\$ 7,476,175	\$ -	Exempt from Disclosure
	\$ 7,476,175	\$ -	

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

(B) Concentrations of Credit Risk

The PUF's investment policy statement contains the limitation that no more than 5% of the market value of domestic fixed income securities may be invested in corporate or municipal bonds of a single issuer. As of August 31, 2006 and 2005, the PUF does not hold any direct investments in any one issuer that represents five percent or more of total investments.

(C) Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the PUF will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the PUF will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Texas State Statutes and the PUF's investment policy statements do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments. As of August 31, 2006 and 2005, the PUF does not have any deposits or investments that are exposed to custodial credit risk.

(D) Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its value to changes in market interest rates. Interest rate risk inherent in the PUF is measured by monitoring the modified duration of the overall investment portfolio. Modified duration estimates the sensitivity of the PUF's investments to changes in interest rates. The PUF has no specific policy statement limitations with respect to its overall modified duration. The table below summarizes the PUF's modified duration by investment type at August 31, 2006 and 2005.

PERMANENT UNIVERSITY FUND
Notes to Financial Statements (cont.)

Investment Type	August 31,			
	2006		2005	
	Value	Modified Duration	Value	Modified Duration
Investments:				
U.S. Government Guaranteed:				
U.S. Treasury Bonds and Notes	\$ 240,121,771	7.22	\$ 214,361,842	6.31
U.S. Treasury Strips	5,619,945	5.00	7,279,180	6.00
U.S. Treasury Bills	8,440,906	0.04	13,616,702	0.14
U.S. Treasury Inflation Protected	670,527,380	7.95	537,547,502	8.04
U.S. Agency Asset Backed	16,790,302	5.16	18,143,051	5.39
Total U.S. Government Guaranteed	<u>941,500,304</u>	7.62	<u>790,948,277</u>	7.36
U.S. Government Non-Guaranteed:				
U.S. Agency	22,495,507	2.36	81,338,801	5.56
U.S. Agency Asset Backed	258,354,317	4.99	296,764,647	3.41
Total U.S. Government Non-Guaranteed	<u>280,849,824</u>	4.78	<u>378,103,448</u>	3.87
Total U.S. Government	<u>1,222,350,128</u>	6.97	<u>1,169,051,725</u>	6.23
Corporate Obligations:				
Domestic	171,997,674	4.42	188,751,543	5.02
Commercial Paper	376,475,846	0.07	63,174,559	0.22
Foreign	48,342,337	11.22	35,533,078	6.32
Total Corporate Obligations	<u>596,815,857</u>	2.22	<u>287,459,180</u>	4.13
Foreign Government and Provincial Obligations	<u>100,836,585</u>	7.42	<u>164,084,716</u>	7.21
Other Debt Securities	<u>12,377,165</u>	10.81	<u>19,498,549</u>	9.54
Total Debt Securities	<u>1,932,379,735</u>	5.55	<u>1,640,094,170</u>	6.00
Other Investment Funds - Debt	<u>170,610,007</u>	3.76	<u>23,970,791</u>	5.96
Cash and Cash Equivalents:				
Money Market Funds	1,222,640,410	0.08	1,297,001,002	0.08
Other	11,245,940	-	19,941,012	-
Total Cash and Cash Equivalents	<u>1,233,886,350</u>	0.08	<u>1,316,942,014</u>	0.08
Total	<u>\$ 3,336,876,092</u>	3.44	<u>\$ 2,981,006,975</u>	3.39
Deposit with Brokers for Derivative Contracts:				
U.S. Government Guaranteed:				
U.S. Treasury Bonds and Notes	\$ -	-	\$ 203,478	0.41
U.S. Treasury Bills	84,823,711	0.13	56,234,371	0.21
Total U.S. Government Guaranteed	<u>84,823,711</u>	0.13	<u>56,437,849</u>	0.21
Cash	<u>52,744,196</u>	-	<u>7,725,856</u>	-
Total Deposit with Brokers for Derivative Contracts	<u>\$ 137,567,907</u>	0.08	<u>\$ 64,163,705</u>	0.18
Deposit with Broker for Securities Sold Short:				
Cash	<u>\$ 7,476,175</u>	-	<u>\$ -</u>	-

(E) Investments with Fair Values That Are Highly Sensitive to Interest Rate Changes

In accordance with the PUF's investment policy statement, the PUF may invest in various mortgage backed securities, such as collateralized mortgage backed obligations. The PUF also may invest in investments that have floating rates with periodic coupon changes in market rates, zero coupon bonds and stripped Treasury and Agency securities created from coupon securities. As of August 31, 2006 and 2005, the PUF's investments include the following investments that are highly sensitive to interest rate changes:

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

Collateralized mortgage obligations which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities. These securities amounted to \$84,611,496 and \$114,208,947 as of August 31, 2006 and 2005, respectively.

Mortgage backed securities which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities. These securities amounted to \$236,996,121 and \$155,278,025 as of August 31, 2006 and 2005, respectively.

Asset backed securities which are backed by home equity loans, auto loans, equipment loans and credit card receivables. Prepayments by the obligees of the underlying assets in periods of decreasing interest rates could reduce or eliminate the stream of income that would have been received. These securities amounted to \$23,386,086 and \$21,235,066 as of August 31, 2006 and 2005, respectively.

Step-up notes that grant the issuer the option to call the note on certain specified dates. At each call date, should the issuer not call the note, the coupon rate of the note increases (steps up) by an amount specified at the inception of the note. The call feature embedded within a step-up note causes the fair value of the instrument to be considered highly sensitive to interest rate changes. These securities amounted to \$2,558,496 and \$7,940,387 as of August 31, 2006 and 2005, respectively.

(F) Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of the PUF's non-U.S. dollar investments. The PUF's investment policy statement limits investments in non-U.S. denominated bonds to 50% of the PUF's total fixed income exposure. The table below summarizes the PUF's non-U.S. dollar investments by asset type at August 31, 2006 and 2005.

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

Investment Type	August 31,	
	2006	2005
Foreign Common Stock:		
Australian Dollar	\$ 16,499,188	\$ 19,685,669
Canadian Dollar	75,585,560	69,967,844
Swiss Franc	10,378,942	16,323,020
Danish Krone	3,612,338	3,734,421
Euro	43,954,967	123,903,374
UK Pound	52,762,374	40,393,465
Hong Kong Dollar	21,194,451	7,468,954
Japanese Yen	231,668,385	197,780,953
South Korean Won	6,250,811	3,026,225
Norwegian Krone	5,491,197	18,202,601
New Zealand Dollar	669,683	-
Swedish Krona	6,976,106	7,836,508
Singapore Dollar	10,728,221	11,281,848
Total Foreign Common Stock	485,772,223	519,604,882
Other - Equity Securities:		
Canadian Dollar	48	-
Foreign Government and Provincial Obligations:		
Australian Dollar	-	890,061
Canadian Dollar	127,064	646,187
Danish Krone	2,466,736	2,512,493
Euro	80,585,557	130,886,845
Japanese Yen	3,718,898	-
Polish Zloty	3,081,607	2,839,229
UK Pound	-	9,386,303
Total Foreign Government and Provincial Obligations	89,979,862	147,161,118
Corporate Obligations:		
Euro	24,619,480	15,209,803
UK Pound	3,311,744	3,283,894
Japanese Yen	5,762,839	-
Total Corporate Obligations	33,694,063	18,493,697
Purchased Options:		
Canadian Dollar	67,369	1,257,214
Euro	949,491	40,678
UK Pound	145,096	-
Japanese Yen	3,132,648	-
Total Purchased Options	4,294,604	1,297,892
Private Market Investments:		
Euro	98,926,472	77,172,078
UK Pound	6,691,668	10,583,599
Total Private Market Investment Funds	105,618,140	87,755,677
Cash and Cash Equivalents:		
Australian Dollar	165,989	123,814
Canadian Dollar	1,341,214	6,040,801
Swiss Franc	112,256	120,616
Danish Krone	44,296	25,224
Euro	1,718,211	1,965,790
UK Pound	579,252	22,520
Hong Kong Dollar	223,245	17,193
Japanese Yen	8,837,728	21,559,455
Mexican New Peso	-	177
Norwegian Krone	58,560	13,252
New Zealand Dollar	233,048	1
Polish Zloty	355,151	163,394
Swedish Krona	133,510	37,873
Singapore Dollar	306,505	89,348
New Taiwan Dollar	992,660	996,252
Total Cash and Cash Equivalents	15,101,625	31,175,710
Total	\$ 734,460,565	\$ 805,488,976

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

Note 4 – Securities Lending

In accordance with the prudent investor investment standards, the PUF loans securities to certain brokers who pay the PUF negotiated lenders' fees. These fees are included in investment income, and related expenses are included in investment expenses. 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, 2006 and August 31, 2005:

Securities on Loan	2006 Value	2005 Value	Type of Collateral	2006 Value of Collateral	2005 Value of Collateral
U.S. Government	\$ 725,905,176	\$ 690,148,767	Cash	\$738,197,245	\$ 697,889,734
Foreign Government	11,031,766	22,252,445	Cash	11,576,419	23,365,980
Corporate Bonds	11,836,052	11,696,791	Cash	12,139,900	12,020,843
Common Stock	219,321,315	174,098,254	Cash	228,617,153	181,661,565
Total	\$ 968,094,309	\$ 898,196,257	Total	\$ 990,530,717	\$ 914,938,122
Common Stock	\$ 1,397,330	\$ 330,537	Non-Cash	\$ 1,425,627	\$ 341,911
U.S. Government	14,154,872	22,666,389	Non-Cash	14,808,629	24,356,521
Total	\$ 15,552,202	\$ 22,996,926	Total	\$ 16,234,256	\$ 24,698,432

Cash received as collateral for securities lending activities is invested and reinvested in a commingled pool managed exclusively for the benefit of the PUF, the General Endowment Fund, the Intermediate Term Fund and other Board of Regent accounts that participate in securities lending activities by the securities lending agent. The pool is managed in accordance with investment guidelines established in the securities lending contract between the PUF and its securities lending agent. The maturities of the investments in the pool do not necessarily match the term of the loans, rather the pool is managed to maintain a maximum dollar weighted average maturity of 60 days and an overnight liquidity of 20 percent. Lending income is earned if the returns on those investments exceed the rebate paid to borrowers of the securities for interest on the cash collateral received. The income remaining after the borrower rebates is then shared by the PUF and the securities lending agent on a contractually negotiated split. If the investment of the cash collateral does not provide a return exceeding the rebate or if the investment incurs a loss of principal, the payment of the shortfall to the borrower is made from the PUF and the securities lending agent in the same proportion as income is shared.

The PUF's pro-rata share of collateral pool investments, rating by NRSRO, and weighted average maturity at August 31, 2006 and 2005 is shown in the following table.

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

Description	August 31,					
	2006			2005		
	Fair Value	Rating	Weighted Average Maturity In Days	Fair Value	Rating	Weighted Average Maturity In Days
		No			No	
		Rating			Rating	
Repurchase Agreements	\$ 360,618,038	Available	14	\$ 431,176,486	Available	1
Commercial Paper	430,757,870	P	26	370,595,246	P	36
Floating Rate Notes	56,532,430	AAA		8,375,488	AAA	
Floating Rate Notes	<u>40,604,505</u>	AA		<u>93,724,729</u>	AA	
Total Floating Rate Notes	<u>97,136,935</u>		69	<u>102,100,217</u>		37
Certificates of Deposit	123,934,917	P	67	13,780,760	P	50
Asset Backed Securities	1,776,447	AAA	11	522,304	AAA	168
Other Receivables/Payables	<u>(23,693,490)</u>	Not Rated	-	<u>(3,236,891)</u>	Not Rated	-
Total Collateral Pool Investment	<u>\$ 990,530,717</u>		31	<u>\$ 914,938,122</u>		20

Collateral pool investments are uninsured, and are held by the PUF's securities lending agent, in its name, on behalf of the PUF, except for the investments in repurchase agreements which are held in the securities lending agent's name by a third party custodian not affiliated with the PUF or the borrower of the associated loaned securities. Therefore, the collateral pool is not exposed to custodial credit risk because the pool investments are not held by counterparties to the lending transactions or a counterparties trust department or agent.

Cash collateral is recorded as an asset with an equal and offsetting liability to return the collateral on the statements of fiduciary net assets. 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.

In the event of default, where the borrower is unable to return the securities loaned, the PUF has authorized the securities lending agent to seize the collateral held. The collateral is then used to replace the borrowed securities where possible. Due to some market conditions, it is possible that the original securities cannot be replaced. If the collateral is insufficient to replace the securities, the securities lending agent has indemnified the PUF from any loss due to borrower default.

As of August 31, 2006 and 2005, the PUF had no credit risk exposure to borrowers because the amounts the PUF owed to borrowers exceeded the amounts the borrowers owed the PUF.

There were no significant violations of legal or contractual provisions, no borrower or securities lending agent default losses, and no recoveries of prior period losses during the years ended August 31, 2006 and 2005.

Note 5 – Investment Funds

Investment funds include exchange traded funds, index funds, SEC regulated mutual funds and externally managed funds, limited partnerships, and corporate structures which are generally unrated and may be unregulated. The composition of investment funds at August 31, 2006 and 2005 is summarized in the table below as they are classified within the asset mix of the PUF.

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

	August 31,	
	2006	2005
Marketable Alternatives:		
Absolute Return Strategies	\$1,763,658,673	\$1,430,289,209
Directional Equity	858,978,126	807,457,474
Total Marketable Alternatives	<u>2,622,636,799</u>	<u>2,237,746,683</u>
Private Markets	973,740,367	841,448,191
Public Markets:		
U.S. Equity:		
Private Placements	694,426,740	387,272,051
Exchange Traded Funds	341,789,777	175,995,104
Index Funds	-	386,316,425
Total U.S. Equity	<u>1,036,216,517</u>	<u>949,583,580</u>
Non-U.S. Developed Equity:		
Private Placements	338,881,768	56,250,847
Exchange Traded Funds	-	19,437,294
Index Funds	-	315,629,497
Total Non-U.S. Developed Equity	<u>338,881,768</u>	<u>391,317,638</u>
Emerging Markets:		
Private Placements	366,906,922	43,205,403
Exchange Traded Funds	32,494,606	51,634,724
Publicly Traded Mutual Funds	175,920,415	135,881,918
Index Funds	-	73,676,011
Total Emerging Markets	<u>575,321,943</u>	<u>304,398,056</u>
Fixed Income:		
Private Placements	160,239,287	-
Publicly Traded Mutual Funds	10,370,720	23,970,791
Total Fixed Income	<u>170,610,007</u>	<u>23,970,791</u>
Total Investment Funds	<u>\$ 5,717,407,401</u>	<u>\$4,748,464,939</u>

Marketable alternatives funds are invested in private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These investment managers may invest in both long and short securities and may utilize leverage in their portfolios. The funds invested may be subject to a lock-up restriction of one or more years before the investment may be withdrawn from the manager without significant penalty. There are certain risks associated with these private placements, some of which include investment manager risk, market risk, and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Private markets funds are invested in limited partnerships with external investment managers or general partners who invest primarily in private equity securities. These investments are domestic and international, are illiquid and may not be realized for a period of several years after the investments are made. There are certain risks associated with these investments, some of which are liquidity risk, market risk, event risk, and investment manager risk. The PUF has committed \$1,101,669,491 of future funding to various private market investments as of August 31, 2006.

Public market funds are invested in exchange traded funds, index funds, and private placements with external investment managers who invest in equity and fixed income securities of both domestic and international

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

issuers. These funds are characterized as public market funds based on individual risk/return characteristics and their relationship to the overall asset mix of the PUF. Some of these investment managers may invest in both long and short securities and may utilize modest leverage in their portfolios. There are certain risks associated with these investments, some of which are investment manager risk, market risk, and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Marketable alternative, private market, and public market funds include investments in private placement vehicles that are subject to risk which could result in the loss of invested capital. The risks include the following:

- *Non-regulation risk* -- Some of these funds are not registered with the Securities Exchange Commission, and therefore are not subject to regulatory controls.
- *Key personnel risk* -- The success of certain funds is substantially dependent on key investment managers and the loss of those individuals may adversely impact the fund's performance.
- *Liquidity risk* -- Many of the PUF's investment funds may impose lockup periods which would cause the PUF to incur penalties to redeem its units or prevent the PUF from redeeming its shares until a certain period of time has elapsed.
- *Limited transparency* -- As private placement investment vehicles, these funds may not disclose the holdings of their portfolios.
- *Investment strategy risk* -- These funds often employ sophisticated investment strategies and may use leverage which could result in the loss of invested capital.

Note 6 – Written Options

For the year ended August 31, 2006, the PUF wrote call options on Treasury note, commodity, and domestic and international equity index futures and exchange traded funds. Transactions in call options written during the year ended August 31, 2006 were as follows:

	<u>Contracts</u>	<u>Premiums Received</u>
Call Options Outstanding at August 31, 2005	1,473,043	\$ 5,011,038
Options Written	2,173,252	8,106,587
Options Expired	(473,600)	(5,517,907)
Options Exercised	(1,820)	(304,846)
Options terminated in closing purchase transactions	(22,331)	(716,604)
Call Options Outstanding at August 31, 2006	<u>3,148,544</u>	<u>\$ 6,578,268</u>

The fair value of call options outstanding as of August 31, 2006, was \$48,729,702. This amount is included on the statement of fiduciary net assets as written options, at fair value. The PUF had \$2,828,782 on deposit with a broker for collateral for call options written as of August 31, 2006. The PUF recognized losses of \$48,307,122 on call options written for the year ended August 31, 2006.

For the year ended August 31, 2005, the PUF wrote call options on Treasury note, commodity, and domestic and international equity index futures and exchange traded funds. Transactions in call options written during the year ended August 31, 2005 were as follows:

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

	Contracts	Premiums Received
Call Options Outstanding at August 31, 2004	-	\$ -
Options Written	1,474,897	5,672,471
Options Expired	(1,854)	(661,433)
Call Options Outstanding at August 31, 2005	<u>1,473,043</u>	<u>\$ 5,011,038</u>

The fair value of call options outstanding as of August 31, 2005, was \$31,222,625. This amount is included on the statement of fiduciary net assets as written options, at fair value. The PUF had \$649,996 on deposit with a broker for collateral for call options written as of August 31, 2005. The PUF recognized losses of \$25,561,987 on call options written for the year ended August 31, 2005.

The PUF also wrote put options on Treasury note, commodity, and domestic and international equity index futures for the year ended August 31, 2006. Transactions in put options written during the year ended August 31, 2006, were as follows:

	Contracts	Premiums Received
Put Options Outstanding at August 31, 2005	1,230,113	\$ 347,568
Options Written	2,428,557	10,445,551
Options Expired	(273,597)	(1,226,526)
Options Exercised	(237,587)	(578,657)
Options terminated in closing purchase transactions	(157,585)	(5,136,884)
Put Options Outstanding at August 31, 2006	<u>2,989,901</u>	<u>\$ 3,851,052</u>

The fair value of put options outstanding as of August 31, 2006, was \$28,433,649. This amount was included on the statement of fiduciary net assets as written options, at fair value. The PUF had \$1,650,587 on deposit with a broker for collateral for call options written as of August 31, 2006. The PUF recognized losses in the amount of \$25,712,374 on put options written for the year ended August 31, 2006.

The PUF also wrote put options on Treasury note, commodity, and domestic and international equity index futures for the year ended August 31, 2005. Transactions in put options written during the year ended August 31, 2005, were as follows:

	Contracts	Premiums Received
Put Options Outstanding at August 31, 2004	-	\$ -
Options Written	1,396,618	1,424,492
Options Expired	(166,505)	(1,076,924)
Put Options Outstanding at August 31, 2005	<u>1,230,113</u>	<u>\$ 347,568</u>

The fair value of put options outstanding as of August 31, 2005, was \$4,325,291. This amount was included on the statement of fiduciary net assets as written options, at fair value. The PUF recognized losses in the amount of \$2,901,759 on put options written for the year ended August 31, 2005.

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

Note 7 – Swaps

During the year the PUF entered into interest rate, credit default and commodity swap contracts. The following discloses the notional amount, the coupon rate, and the fair values of the outstanding swap contracts as of August 31, 2006:

	Coupon	Notional Value	Maturity Date	Fair Value at August 31, 2006	
				Assets	Liabilities
Interest Rate					
Australian Dollar					
	6.000%	\$ 33,900,000	6/15/2010	\$ -	\$ 213,171
	6.000%	19,400,000	6/15/2015	169,389	-
UK Pound					
	0.670%	930,000	9/20/2014	-	1,123
	4.250%	4,100,000	6/12/2036	280,732	-
	4.500%	30,800,000	9/15/2017	46,420	-
	5.000%	3,500,000	6/15/2008	-	13,630
	5.000%	35,000,000	6/15/2009	-	337,773
	5.000%	23,700,000	9/15/2010	-	188,916
	5.000%	400,000	9/15/2015	-	3,089
	5.000%	600,000	6/18/2034	86,649	-
Canadian Dollar					
	5.000%	1,400,000	6/15/2015	49,672	-
	5.500%	-	8/31/2006	-	194,302
	5.500%	-	9/8/2006	-	58,599
Euro					
	2.040%	1,300,000	2/21/2011	-	6,396
	2.103%	4,000,000	10/15/2010	5,564	-
	2.146%	900,000	10/15/2010	4,203	-
	4.000%	6,970,000	6/17/2010	-	90,708
	4.000%	22,930,000	6/16/2014	-	225,201
	4.500%	5,400,000	6/17/2015	-	295,260
	5.000%	2,300,000	6/16/2014	223,574	-
	5.000%	100,000	6/17/2015	10,287	-
	6.000%	700,000	6/18/2034	128,726	-
Japanese Yen					
	0.800%	720,000,000	3/30/2012	156,346	-
	1.000%	-	9/18/2008	7,709	-
	2.000%	-	9/4/2006	-	199,440
	2.000%	1,850,000,000	6/20/2010	-	192,529
	2.000%	530,000,000	6/15/2012	-	176,301
	2.000%	1,490,000,000	12/20/2013	-	1,035,105
	2.000%	7,350,000,000	12/15/2015	-	1,017,122
	2.500%	1,470,000,000	12/15/2035	-	146,791
	5.000%	3,700,000,000	3/18/2008	70,423	-
U.S. Dollar					
	4.000%	24,600,000	6/21/2007	-	343,710
	4.000%	27,600,000	12/15/2008	-	780,825
	5.000%	109,400,000	12/15/2007	-	267,760
	5.000%	9,300,000	12/20/2008	-	23,917
	5.000%	58,000,000	6/18/2009	-	9,268
	5.000%	41,600,000	12/20/2011	301,080	-
	5.000%	35,700,000	12/20/2013	450,054	-
	5.000%	33,600,000	12/20/2016	728,747	-
	5.000%	8,400,000	12/20/2036	-	497,371
				<u>2,719,575</u>	<u>6,318,307</u>

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

				<u>Fair Value at August 31, 2006</u>	
	<u>Coupon</u>	<u>Notional Value</u>	<u>Maturity Date</u>	<u>Assets</u>	<u>Liabilities</u>
Commodity					
U.S. Dollar					
	TBILL + 23 Basis Points	\$ 50,950,000	26-Sep-06	\$ -	\$ 3,050,372
	TBILL + 27 Basis Points	35,040,000	26-Sep-06	-	2,098,979
				<u>-</u>	<u>5,149,351</u>
Credit Default					
U.S. Dollar					
	0.410%	1,000,000	20-Jun-07	1,931	-
	1.800%	100,000	20-Sep-06	446	-
	3.650%	200,000	20-Jun-11	14,214	-
	4.30%	1,000,000	20-Jun-10	45,949	-
	4.55%	700,000	20-Jun-07	23,580	-
	4.60%	600,000	20-Jun-07	20,509	-
				<u>106,629</u>	<u>-</u>
Structured					
U.S. Dollar					
	Emerging	26,000,000	7-Apr-07	-	585,184
	Emerging	32,500,000	13-Apr-07	-	560,814
	Emerging	26,000,000	20-Apr-07	-	326,113
	Emerging	32,500,000	27-Apr-07	-	329,566
	Emerging	32,500,000	4-May-07	-	631,020
	Emerging	16,250,000	11-May-07	-	379,763
	Emerging	48,750,000	18-May-07	-	1,041,439
	Emerging	29,250,000	25-May-07	-	1,799,076
	Emerging	48,750,000	4-Jun-07	-	3,949,030
	TOPIX	26,000,000	4-May-07	-	1,426,728
	TOPIX	21,450,000	7-Apr-07	83,197	-
	TOPIX	16,250,000	8-Apr-07	319,583	-
	TOPIX	32,500,000	9-Apr-07	666,533	-
	TOPIX	7,800,000	15-Apr-07	-	17,892
				<u>1,069,313</u>	<u>11,046,625</u>
Total				<u>\$ 3,895,517</u>	<u>\$ 22,514,283</u>

The following discloses the notional amount, the coupon rate, and the fair values of the outstanding swap contracts as of August 31, 2005:

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

Currency	Coupon	Notional Value	Maturity Date	Fair Value at August 31, 2005	
				Assets	Liabilities
Interest Rate					
Australian Dollar					
	6.000%	\$ 18,700,000	6/15/2010	\$ 316,586	\$ -
	6.000%	15,200,000	6/15/2010	257,332	-
	6.000%	10,700,000	6/15/2015	-	291,062
	6.000%	8,700,000	6/15/2015	-	237,572
UK Pound					
	5.000%	16,800,000	9/15/2010	792,855	-
	5.000%	6,600,000	9/15/2010	311,479	-
	5.000%	4,700,000	9/15/2010	221,810	-
	5.000%	2,500,000	9/15/2010	117,984	-
	5.000%	2,400,000	9/15/2010	113,265	-
	5.000%	1,100,000	6/18/2034	112,526	-
	5.000%	2,000,000	6/15/2008	41,565	-
	5.000%	1,500,000	6/15/2008	31,174	-
	5.000%	400,000	9/15/2010	18,877	-
	5.000%	200,000	9/15/2010	9,439	-
	5.000%	1,200,000	6/18/2034	-	123,693
	5.000%	1,100,000	6/18/2034	-	113,385
	5.000%	1,200,000	9/15/2015	-	93,271
	5.000%	300,000	9/15/2015	-	23,318
	5.000%	200,000	9/15/2015	-	15,545
Canadian Dollar					
	5.500%	2,900,000	12/16/2014	-	94,683
	5.500%	2,200,000	12/16/2014	-	71,828
	5.500%	2,000,000	12/16/2014	-	65,298
	4.500%	600,000	6/15/2025	-	376
Euro					
	5.000%	2,300,000	6/16/2014	417,006	-
	4.000%	3,200,000	6/17/2010	233,932	-
	4.000%	1,600,000	6/17/2010	116,947	-
	5.000%	100,000	6/17/2015	18,843	-
	4.000%	34,630,000	6/16/2014	-	3,001,413
	4.000%	8,570,000	6/17/2010	-	626,399
	4.000%	3,000,000	12/15/2014	-	238,769
	4.500%	1,700,000	6/17/2015	-	232,249
	4.500%	1,500,000	6/17/2015	-	204,925
	4.500%	1,500,000	6/17/2015	-	204,925
	4.500%	700,000	6/17/2015	-	95,632
	4.000%	1,200,000	12/15/2014	-	95,508
Japanese Yen					
	1.000%	800,000,000	3/20/2009	50,952	-
	0.800%	720,000,000	3/30/2012	44,327	-
	2.000%	870,000,000	12/20/2013	-	516,121
	2.000%	530,000,000	6/15/2012	-	333,901
	2.000%	110,000,000	12/20/2013	-	65,257

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

				Fair Value at August 31, 2005	
Currency	Coupon	Notional Value	Maturity Date	Assets	Liabilities
Interest Rate					
U.S. Dollar					
	4.000%	\$ 24,800,000	12/15/2010	\$ 324,357	\$ -
	4.000%	20,800,000	12/15/2010	296,197	-
	4.000%	36,900,000	12/15/2007	178,801	-
	4.000%	7,100,000	12/15/2010	101,105	-
	5.500%	2,800,000	12/16/2014	93,000	-
	5.500%	2,300,000	12/16/2014	76,393	-
	4.000%	4,100,000	12/15/2010	58,385	-
	5.500%	1,600,000	12/16/2014	53,143	-
	4.000%	2,300,000	12/15/2010	32,752	-
	5.000%	33,000,000	12/15/2015	-	1,362,213
	5.000%	32,700,000	12/15/2012	-	1,181,797
	3.000%	95,900,000	6/15/2006	-	777,349
	5.000%	14,300,000	12/15/2015	-	590,292
	5.000%	11,000,000	12/15/2015	-	454,071
	5.000%	7,400,000	12/15/2015	-	305,466
	5.000%	4,700,000	12/15/2015	-	194,012
	5.000%	3,600,000	12/15/2015	-	148,605
	5.000%	2,900,000	12/15/2015	-	119,710
	4.000%	24,600,000	6/21/2007	-	84,553
	5.000%	1,400,000	12/15/2015	-	57,791
	5.000%	800,000	12/15/2015	-	33,023
	5.000%	700,000	12/15/2012	-	25,298
	4.000%	300,000	12/15/2007	-	1,454
	4.000%	200,000	12/15/2007	-	969
				4,441,032	12,081,733
Credit Default					
U.S. Dollar					
	4.550%	700,000	6/20/2007	29,054	-
	4.600%	600,000	6/20/2007	25,417	-
	3.500%	1,000,000	6/20/2006	16,269	-
	3.000%	800,000	6/20/2006	9,837	-
	3.200%	700,000	6/20/2006	9,720	-
	4.300%	1,000,000	6/20/2010	9,397	-
	2.450%	500,000	9/20/2007	-	1,210
				99,694	1,210
Commodity					
U.S. Dollar					
	TBill + 36.5 Basis Points	96,628,586	9/23/2005	3,652,561	-
	TBill + 45 Basis Points	69,200,000	9/23/2005	2,615,760	-
				6,268,321	-
Total				\$ 10,809,047	\$ 12,082,943

Note 8 – Futures

During the periods ended August 31, 2006 and 2005, the asset classes that used futures include domestic and foreign equities, domestic and foreign debt, and commodities. The PUF had \$86,202,519 and \$63,513,709 on deposit with a broker for collateral as margin for the futures contracts as of August 31, 2006 and 2005, respectively. Short futures were used by internal managers and may be used by a limited number of external managers of the PUF to hedge the PUF's interest rate or country risk associated with security positions. At August 31, 2006, the net realized loss on the futures contracts was \$8,792,816 compared to the net realized gain of \$103,700,479 for the year ended August 31, 2005.

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

The following discloses the name, number of contracts, notional value, and the carrying and fair values at August 31, 2006 for futures contracts:

Contract	Number of Contracts	Expiration	Notional Value at August 31, 2006		Carrying and Fair Value at August 31, 2006		
			Long	Short	Assets	Liabilities	
Domestic Fixed Income							
U.S. 5 Year Treasury Notes	728	Dec-06	\$ 76,519,625	\$ -	\$ 113,750	\$ -	
U.S. 10 Year Treasury Notes	170	Sep-06	-	18,261,719	-	89,360	
U.S. 10 Year Treasury Notes	336	Dec-06	36,078,000	-	55,860	-	
U.S. Treasury Bond	93	Sep-06	10,293,938	-	34,875	-	
U.S. Treasury Bond	89	Sep-06	-	9,851,187	-	33,375	
			<u>122,891,563</u>	<u>28,112,906</u>	<u>204,485</u>	<u>122,735</u>	
Domestic Equity							
Dow Jones Index	441	Sep-06	50,234,310	-	4,410	-	
Russell 2000 Index Mini	14,714	Sep-06	-	1,061,909,380	653,194	-	
Russell 2000 Index Mini	2,165	Dec-06	-	157,547,050	7,082	-	
S&P 500 Index	5,405	Sep-06	1,764,192,000	-	655,451	-	
			<u>1,814,426,310</u>	<u>1,219,456,430</u>	<u>1,320,137</u>	<u>-</u>	
Commodities							
Goldman Sachs Commodities	2,718	Sep-06	316,647,000	-	1,223,100	-	
Foreign Fixed Income							
90 Day Euro Dollar	323	Sep-06	76,393,538	-	10,094	-	
90 Day Euro Dollar	125	Dec-06	29,579,687	-	10,938	-	
90 Day Euro Dollar	55	Mar-07	13,032,937	-	6,188	-	
90 Day Euro Dollar	37	Jun-07	8,780,562	-	4,162	-	
90 Day Euro Dollar	130	Sep-07	30,889,625	-	16,250	-	
90 Day Euro Dollar	57	Dec-07	13,553,175	-	7,125	-	
90 Day Euro Dollar	23	Mar-08	5,469,688	-	2,875	-	
90 Day Euro Dollar	41	Sep-08	9,745,700	-	4,100	-	
90 Day Euro Dollar	41	Dec-08	9,741,600	-	4,100	-	
90 Day Euro Dollar	41	Mar-09	9,738,013	-	3,587	-	
90 Day Euro Dollar	41	Jun-09	9,733,912	-	3,075	-	
Euro-Bund	25	Sep-06	3,784,788	-	12,697	-	
Euro-Bund	1	Dec-06	150,521	-	4,024	-	
Japan 10 Year Bond	46	Sep-06	52,940,112	-	247,245	-	
Japan 10 Year Bond	31	Dec-06	35,573,957	-	243,767	-	
UK Long Gilt	3	Dec-06	-	628,680	-	2,531	
			<u>309,107,815</u>	<u>628,680</u>	<u>580,227</u>	<u>2,531</u>	
Foreign Equity							
Amsterdam Index	8	Sep-06	961,369	-	-	-	
CAC 40 Index	35	Sep-06	2,314,906	-	-	-	
DAX Index	6	Sep-06	1,125,356	-	-	-	
DJ Euro Stoxx 50	1,091	Sep-06	53,207,966	-	-	257,926	
FTSE 100 Index	1,541	Sep-06	173,044,169	-	-	1,306,833	
FTSE/JSE Top 40	138	Sep-06	3,850,028	-	-	116,756	
Hang Seng Index	4	Sep-06	446,922	-	-	43	
IBEX Index	6	Sep-06	933,848	-	-	-	
MSCI Singapore Index	272	Sep-06	10,267,022	-	48,828	-	
MSCI Taiwan Index	225	Sep-06	6,192,000	-	51,750	-	
OMX Index	55	Sep-06	754,690	-	-	-	
S&P/MIB Index	4	Sep-06	973,427	-	-	-	
SPI 200 Index	12	Sep-06	1,169,301	-	-	-	
Topix Index	33	Sep-06	4,598,926	-	-	9,578	
			<u>259,839,930</u>	<u>-</u>	<u>100,578</u>	<u>1,691,136</u>	
Total			<u>\$ 2,822,912,618</u>	<u>\$ 1,248,198,016</u>	<u>\$ 3,428,527</u>	<u>\$ 1,816,402</u>	

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

The following discloses the name, number of contracts, notional value, and the carrying and fair values at August 31, 2005 for futures contracts:

Contract	Number of Contracts	Expiration	Notional Value at August 31, 2005		Carrying and Fair Value at August 31, 2005		
			Long	Short	Assets	Liabilities	
Domestic Fixed Income							
U.S. 5 Year Treasury Notes	648	Dec-05	\$ 70,227,000	\$ -	\$ 198,499	\$ -	
U.S. 10 Year Treasury Notes	80	Sep-05	-	9,033,750	-	34,610	
U.S. 10 Year Treasury Notes	114	Dec-05	-	12,776,906	-	58,092	
U.S. Treasury Bond	154	Sep-05	18,229,750	-	105,875	-	
U.S. Treasury Bond	24	Dec-05	2,832,750	-	16,500	-	
			<u>91,289,500</u>	<u>21,810,656</u>	<u>320,874</u>	<u>92,702</u>	
Domestic Equity							
Dow Jones Index	488	Sep-05	51,249,760	-	424,560	-	
Russell 2000 Index Mini	8,110	Sep-05	-	541,099,200	-	10,786,300	
S&P 500 Index	1,527	Sep-05	466,269,450	-	4,884,942	-	
S&P 500 Index	1,490	Dec-05	457,355,500	-	4,769,580	-	
S&P 500 Index Mini	33	Sep-05	-	2,015,475	-	-	
S&P Midcap 400 Index Mini	57	Sep-05	4,066,950	-	68,970	-	
S&P Midcap 400 Index Mini	760	Sep-05	-	54,226,000	-	919,600	
			<u>978,941,660</u>	<u>597,340,675</u>	<u>10,148,052</u>	<u>11,705,900</u>	
Commodities							
Goldman Sachs Commodities	2,866	Sep-05	332,527,650	-	-	2,077,850	
Foreign Fixed Income							
90 Day Euro Dollar	217	Dec-05	52,036,600	-	70,525	-	
90 Day Euro Dollar	101	Mar-06	24,210,962	-	39,138	-	
Euro-Bund	255	Sep-05	38,872,177	-	909	-	
Euro-Bund	161	Dec-05	24,220,076	-	-	-	
Japan 10 Year Bond	41	Sep-05	51,508,710	-	-	314,176	
Japan 10 Year Bond	6	Dec-05	7,520,580	-	-	-	
UK Long Gilt	5	Sep-05	1,026,972	-	4,596	-	
			<u>199,396,077</u>	<u>-</u>	<u>115,168</u>	<u>314,176</u>	
Foreign Equity							
Amsterdam Index	107	Sep-05	10,259,064	-	-	-	
DJ Euro Stoxx 50	19	Sep-05	-	764,106	-	-	
DJ Euro Stoxx 50	1,963	Sep-05	78,944,194	-	676,237	-	
FTSE 100 Index	1,707	Sep-05	162,563,111	-	958,577	-	
FTSE/JSE Top 40	735	Sep-05	15,858,642	-	108,074	-	
Hang Seng Index	49	Sep-05	4,695,638	-	-	1,525	
IBEX Index	63	Sep-05	-	7,771,687	-	-	
MSCI Singapore Index	229	Sep-05	7,330,936	-	-	13,592	
MSCI Taiwan Index	736	Sep-05	18,473,600	-	-	-	
S&P/MIB Index	45	Sep-05	-	9,276,912	-	-	
S&P/TSE 60 Index	87	Sep-05	-	8,792,997	-	-	
SPI 200 Index	179	Sep-05	-	14,921,238	-	-	
Topix Index	375	Sep-05	42,870,157	-	-	46,336	
			<u>340,995,342</u>	<u>41,526,940</u>	<u>1,742,888</u>	<u>61,453</u>	
Total			<u>\$ 1,943,150,229</u>	<u>\$ 660,678,271</u>	<u>\$ 12,326,982</u>	<u>\$ 14,252,081</u>	

PERMANENT UNIVERSITY FUND*Notes to Financial Statements (cont.)***Note 9 – Foreign Currency Exchange Contracts**

The tables below summarize by currency the contractual amounts of the PUF's foreign currency exchange contracts at August 31, 2006 and 2005. Foreign currency amounts are translated at exchange rates as of August 31, 2006 and 2005. 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.

Currency	Net Buy August 31, 2006	Net Sell August 31, 2006	Unrealized Gains	Unrealized Losses
			on Foreign Currency Exchange Contracts August 31, 2006	on Foreign Currency Exchange Contracts August 31, 2006
Australian Dollar	\$ 12,652,476	\$ –	\$ 322,654	\$ 62,718
UK Pound	191,745,353	–	5,665,459	1,323,122
Canadian Dollar	–	4,360,753	306,159	450,111
Chilean Peso	282,678	–	458	–
Chinese Yuan Renminbi	29,314,104	–	194,239	713,246
Czech Koruna	526,068	–	10,143	75,311
Danish Krone	–	1,072,066	6,425	–
Euro	–	30,319,200	1,940,220	1,000,136
Hungarian Forint	–	467,765	40,503	91,868
Indian Rupee	57,255	–	109	–
Japanese Yen	266,644,559	–	2,438,177	11,814,037
Mexican New Peso	7,434,113	–	366,360	467,229
New Taiwan Dollar	8,613,028	–	112,250	400,592
New Zealand Dollar	–	3,538,888	314,118	309,228
Norwegian Krone	580,774	–	473	29,593
Polish Zloty	1,159,366	–	66,976	235,464
New Russian Rubel	357,060	–	2,240	–
South African Comm Rand	2,857,935	–	116,174	505,048
Singapore Dollar	12,361,321	–	105,368	544
Slovak Koruna	–	–	6,216	5,064
South Korean Won	6,157,567	–	108,588	271,165
Swedish Krona	7,002,804	–	43,552	66,185
Swiss Franc	14,214,405	–	129,104	514,134
	<u>\$ 561,960,866</u>	<u>\$ 39,758,672</u>	<u>\$ 12,295,965</u>	<u>\$ 18,334,795</u>

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

Currency	Net Buy August 31, 2005	Net Sell August 31, 2005	Unrealized Gains	Unrealized Losses
			on Foreign Currency Exchange Contracts August 31, 2005	on Foreign Currency Exchange Contracts August 31, 2005
Australian Dollar	\$ 21,006,327	\$ –	\$ 137,960	\$ 192,107
Canadian Dollar	–	44,241,372	157,597	623,896
Chilean Peso	211,478	–	3,799	–
Chinese Yuan Renminbi	23,736,172	–	375	360,101
Czech Koruna	2,228,118	–	47,603	5,905
Danish Krone	–	1,787,247	6,211	–
Euro	–	73,873,103	3,640,465	1,155,744
Hong Kong Dollar	4,648,253	–	266	1,111
Hungarian Forint	1,070,352	–	47,976	18,299
Indonesian Rupian	447,231	–	32,231	–
Japanese Yen	135,263,487	–	791,764	3,023,537
Mexican New Peso	8,468,512	–	188,049	28,995
New Zealand Dollar	–	1,452,918	29,740	13,923
Norwegian Krone	–	11,949,970	47,560	64,707
Polish Zloty	365,021	–	364,231	35,517
New Russian Rubel	238,736	–	133	922
Singapore Dollar	3,108,832	–	99,809	89,675
Slovak Koruna	470,891	–	57	5,634
South African Comm Rand	5,539,813	–	179,152	11,077
South Korean Won	10,858,291	–	86,780	333,537
Swedish Krona	5,079,572	–	166,078	190,716
Swiss Franc	6,358,485	–	28,934	362,165
New Taiwan Dollar	21,206,011	–	30,744	728,095
UK Pound	179,187,625	–	4,815,456	1,361,059
	<u>\$ 429,493,207</u>	<u>\$ 133,304,610</u>	<u>\$ 10,902,970</u>	<u>\$ 8,606,722</u>

Note 10 – Purchase Agreements

The PUF entered into note purchase agreements with the UT System Board of Regents and the Texas A&M System Board of Regents. The agreement with the UT System Board of Regents committed the PUF to acquire up to \$400,000,000 of UT System flexible rate notes in the event of a failed remarketing of such notes. This agreement was terminated effective November 10, 2005, when UTIMCO, as investment manager of the funds under the control of management of the UT System Board of Regents, entered into a security purchase agreement with the UT System Board of Regents. This agreement with the UT System Board of Regents terminates all prior agreements. The new agreement commits the funds under management, including the PUF, to purchase UT System notes and bonds outstanding up to \$1,285,000,000.

Based on the prior agreement with the UT System Board of Regents the PUF received an annual commitment fee equal to 0.15% of the notes outstanding. Under the new agreement the commitment fee was eliminated.

The agreement with the Texas A&M System Board of Regents committed the PUF to acquire up to

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

\$80,000,000 of Texas A&M System flexible rate notes in the event of a failed remarketing of such notes. Effective February 1, 2006, the Texas A&M flexible rate note program was increased to \$125,000,000. The note purchase agreement between the PUF and the Texas A&M System Board of Regents was amended effective November 1, 2005, to eliminate the annual commitment fee required under the original agreement. Under the original agreement the PUF received an annual commitment fee equal to 0.1% of the commitment amount.

The commitment fees earned by the PUF were \$13,443 and \$159,000, respectively, for the years ended August 31, 2006 and 2005.

Note 11 – Distributions to the Available University Fund

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, 2007, will be \$400,685,603. The first payment in the amount of \$100,171,401 was made September 1, 2006.

Note 12 – 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 private market and marketable alternative investments.

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 year ended August 31, 2006 was \$3,246,736, net of a rebate of \$2,344,400 of prior year reserves from UTIMCO to the PUF. The fee assessed for the year ended August 31, 2005 was \$3,400,636, net of a rebate of \$2,390,343 of prior year reserves from UTIMCO to the PUF.

The PUF is assessed a fee to cover expenses related to the management of the PUF Lands. The fee assessed for the year ended August 31, 2006 was \$5,338,378 and was \$4,745,460 for the year ended August 31, 2005. Beginning in fiscal year 2005, the PUF is assessed a fee to cover costs associated with UT System personnel and UT System consultants hired to provide assistance to the Board of Regents of UT

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

System and the Chancellor of the UT System in their oversight responsibilities of UTIMCO. The fee assessed for the year ended August 31, 2006 was \$471,337 and was \$298,771 for the year ended August 31, 2005.

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 legal fees associated with the review of new investment manager agreements and with due diligence efforts undertaken as part of the hiring of new investment managers.

Analytical and risk measurement fees are also incurred to implement and maintain a sophisticated risk measurement system for the PUF.

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

PERMANENT UNIVERSITY FUND
Supplemental Schedules

Comparison Summary of Investments

August 31, 2006 and, 2005

(in thousands)

	2006		2005	
Equity Securities				
Domestic Common Stock	\$ 971,465	9.30%	\$ 1,210,018	12.64%
Foreign Common Stock	565,609	5.37%	618,673	6.46%
Other	5,726	.05%	13,547	.14%
Total Equity Securities	1,542,800	14.72%	1,842,238	19.24%
Preferred Stock	2,483	.02%	2,690	.03%
Debt Securities				
U. S. Government Obligations	1,222,350	11.67%	1,169,052	12.21%
Foreign Government and Provincial Obligations	100,837	.96%	164,085	1.72%
Corporate Obligations	596,816	5.70%	287,459	3.00%
Other	12,377	.12%	19,498	.20%
Total Debt Securities	1,932,380	18.45%	1,640,094	17.13%
Convertible Securities	114	.00%	5,010	.05%
Purchased Options	47,982	.46%	20,153	.21%
Investment Funds				
Absolute Return Strategies	1,763,659	16.83%	1,430,289	14.94%
Directional Equity	858,978	8.20%	807,458	8.43%
Private Markets	973,740	9.29%	841,448	8.79%
U.S. Equity	1,036,217	9.89%	949,584	9.91%
Non-U.S. Developed Equity	338,882	3.24%	391,317	4.09%
Emerging Markets	575,322	5.49%	304,398	3.18%
Fixed Income	170,610	1.63%	23,971	.25
Total Investment Funds	5,717,408	54.57%	4,748,465	49.59%
Cash and Cash Equivalents				
Money Market Funds Maintained to Back Futures Contracts	894,772	8.54%	987,314	10.31%
Other Money Market Funds and Cash Held at State Treasury	339,114	3.24%	329,628	3.44%
Total Cash and Cash Equivalents	1,233,886	11.78%	1,316,942	13.75%
Total Investment in Securities	\$ 10,477,053	100.00%	\$ 9,575,592	100.00%

PERMANENT UNIVERSITY FUND

Supplemental Schedules (cont.)

Schedule of Changes in Cost of Investments and Investment Income

Year Ended August 31, 2006

(in thousands)

	Beginning Cost	Purchases	Sales, Maturities & Redemptions	Gains (Losses)	Reclass	Ending Cost	Investment Income
Equity Securities							
Domestic Common Stock	\$ 921,619	\$ 908,907	\$ (1,319,246)	\$ 260,804	\$ 15,931	\$ 788,015	\$ 22,231
Foreign Common Stock	510,168	565,107	(755,059)	149,615	9	469,840	10,685
Other	560	(1)	(453)	2	313	421	1,681
Total Equity Securities	<u>1,432,347</u>	<u>1,474,013</u>	<u>(2,074,758)</u>	<u>410,421</u>	<u>16,253</u>	<u>1,258,276</u>	<u>34,597</u>
Preferred Stock							
Domestic Preferred Stock	2,491	5	(178)	18	-	2,336	159
Debt Securities							
U. S. Government Obligations	1,152,167	5,389,240	(5,293,906)	(24,446)	-	1,223,055	60,200
Foreign Government and Provincial Obligations	152,498	419,413	(481,688)	1,313	500	92,036	5,390
Corporate Obligations	282,320	2,042,920	(1,727,878)	(1,496)	(500)	595,366	22,435
Swaps	-	-	-	-	-	-	5,941
Other	18,025	194,279	(201,283)	309	-	11,330	911
Total Debt Securities	<u>1,605,010</u>	<u>8,045,852</u>	<u>(7,704,755)</u>	<u>(24,320)</u>	<u>-</u>	<u>1,921,787</u>	<u>94,877</u>
Purchased Options	<u>1,295</u>	<u>19,250</u>	<u>(17,720)</u>	<u>(1,093)</u>	<u>-</u>	<u>1,732</u>	<u>-</u>
Convertible Securities	<u>13,986</u>	<u>-</u>	<u>-</u>	<u>(13,872)</u>	<u>-</u>	<u>114</u>	<u>-</u>
Investment Funds							
Marketable Alternative	1,700,528	1,132,429	(556,876)	155,508	-	2,431,589	3,820
Private Markets	1,206,985	299,010	(332,220)	(262,417)	(16,253)	895,105	19,665
U.S. Equity	871,293	1,082,424	(1,092,273)	73,377	-	934,821	6,730
Non U.S. - Developed Equity	346,017	382,124	(512,033)	101,637	-	317,745	4,002
Emerging Markets	266,640	742,315	(579,196)	85,062	-	514,821	6,390
Fixed Income	20,957	159,382	(17,198)	2,386	-	165,527	2,433
Total Investment Funds	<u>4,412,420</u>	<u>3,797,684</u>	<u>(3,089,796)</u>	<u>155,553</u>	<u>(16,253)</u>	<u>5,259,608</u>	<u>43,040</u>
Cash and Cash Equivalents							
Money Market Funds and Cash Held at State Treasury	1,317,279	-	(78,993) *	(4,245) **	-	1,234,041	44,937
Other	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,362</u>
Total Investment in Securities	<u>\$ 8,784,828</u>	<u>\$ 13,336,804</u>	<u>\$ (12,966,200)</u>	<u>\$ 522,462</u>	<u>\$ -</u>	<u>\$ 9,677,894</u>	<u>\$ 223,972</u>

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

** Includes net realized gains on futures contracts, written options and foreign currency contracts.