

**Deloitte &  
Touche**

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**PERMANENT UNIVERSITY FUND**

**FINANCIAL STATEMENTS**

**Years Ended August 31, 1999 and 1998**

**INDEPENDENT AUDITORS' REPORT**

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

We have audited the accompanying statements of investment assets and liabilities, and the comparison summary of investment in securities of the Permanent University Fund (PUF) as of August 31, 1999 and 1998, the related statements of investment income and the statements of changes in net investment assets for the years then ended, and the schedule of changes in cost of investments for the year ended August 31, 1999. 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 generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of August 31, 1999 and 1998, by correspondence with the custodian. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the statements of investment assets and liabilities, the comparison summary of investment in securities, the statements of investment income, the statements of changes in net investment assets, and the schedule of changes in cost of investments referred to above present fairly, in all material respects, the financial position and the comparative investment in securities of the PUF as of August 31, 1999 and 1998, its investment income and the changes in its net investment assets for the years then ended, and the changes in cost of its investments for the year ended August 31, 1999 in conformity with generally accepted accounting principles.

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

*Deloitte & Touche LLP*

October 29, 1999

## PERMANENT UNIVERSITY FUND

### *Financial Statements*

#### STATEMENTS OF INVESTMENT ASSETS AND LIABILITIES

August 31, 1999 and 1998

(in thousands)

INVESTMENT ASSETS	1999	1998
Investment in Securities, at Value (Cost \$5,986,378 and \$5,405,896, respectively)	\$ 7,428,306	\$ 6,401,385
Collateral for Securities Loaned, at Value	395,314	326,534
Deposit with Broker for Futures Contracts	11,155	-
Receivables		
Investment Securities Sold	9,568	104,705
Accrued Income	43,728	44,644
	<u>7,888,071</u>	<u>6,877,268</u>
<b>TOTAL INVESTMENT ASSETS</b>	<b>7,888,071</b>	<b>6,877,268</b>
LIABILITIES		
Payable to the Available University Fund	24,075	21,256
Payable Upon Return of Securities Loaned	395,314	326,534
Payables		
Investment Securities Purchased	2,290	12,391
Other	831	-
	<u>422,510</u>	<u>360,181</u>
<b>TOTAL LIABILITIES</b>	<b>422,510</b>	<b>360,181</b>
<b>NET INVESTMENT ASSETS</b>	<b><u>\$ 7,465,561</u></b>	<b><u>\$ 6,517,087</u></b>

#### STATEMENTS OF CHANGES IN NET INVESTMENT ASSETS

Years Ended August 31, 1999 and 1998

(in thousands)

<b>BEGINNING NET INVESTMENT ASSETS</b>	<b>\$ 6,517,087</b>	<b>\$ 6,368,278</b>
Contributions from PUF Lands	54,314	79,534
Investment Income	263,915	259,978
Investment Income Distributed	(263,915)	(259,978)
Net Realized Gains	447,722	467,553
Net Unrealized Appreciation (Depreciation)	446,438	(398,278)
	<u>7,465,561</u>	<u>6,517,087</u>
<b>ENDING NET INVESTMENT ASSETS</b>	<b><u>\$ 7,465,561</u></b>	<b><u>\$ 6,517,087</u></b>

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

# PERMANENT UNIVERSITY FUND

## Financial Statements

### COMPARISON SUMMARY OF INVESTMENT IN SECURITIES

August 31, 1999 and 1998

(in thousands)

	1999		1998	
	Value	Cost	Value	Cost
<b>DEBT SECURITIES</b>				
U. S. Govt. Obligations (Direct and Guaranteed)	\$ 461,710	\$ 456,196	\$ 439,655	\$ 385,865
U. S. Govt. Agencies (Non-Guaranteed)	356,029	351,716	418,900	378,981
Foreign Government Obligations	102,389	98,541	111,200	98,475
Municipal and County Bonds	110,448	109,059	122,344	109,289
Corporate Bonds	1,185,249	1,165,053	1,304,751	1,197,547
Other	7,150	7,150	4,993	4,993
<b>TOTAL DEBT SECURITIES</b>	<b>2,222,975</b>	<b>2,187,715</b>	<b>2,401,843</b>	<b>2,175,150</b>
<b>PREFERRED STOCKS</b>	<b>9,534</b>	<b>9,373</b>	<b>3,156</b>	<b>3,072</b>
<b>CONVERTIBLE DEBENTURES</b>	<b>2,438</b>	<b>2,438</b>	<b>-</b>	<b>-</b>
<b>EQUITY SECURITIES</b>				
Domestic Common Stocks	1,787,651	1,138,580	1,522,491	1,178,931
Limited Partnerships	718,704	674,835	454,445	448,376
Index Funds	2,316,494	1,617,674	1,866,082	1,449,485
Other	21,416	6,669	9,885	7,399
<b>TOTAL EQUITY SECURITIES</b>	<b>4,844,265</b>	<b>3,437,758</b>	<b>3,852,903</b>	<b>3,084,191</b>
<b>CASH AND CASH EQUIVALENTS</b>				
Money Markets and Cash Held at State Treasury	349,094	349,094	143,483	143,483
<b>TOTAL CASH AND CASH EQUIVALENTS</b>	<b>349,094</b>	<b>349,094</b>	<b>143,483</b>	<b>143,483</b>
<b>TOTAL INVESTMENT IN SECURITIES</b>	<b>\$ 7,428,306</b>	<b>\$ 5,986,378</b>	<b>\$ 6,401,385</b>	<b>\$ 5,405,896</b>

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

## PERMANENT UNIVERSITY FUND

### *Financial Statements*

#### STATEMENTS OF INVESTMENT INCOME

Years Ended August 31, 1999 and 1998

(in thousands)

	<u>1999</u>	<u>1998</u>
<b>DEBT SECURITIES</b>		
U. S. Govt. Obligations (Direct and Guaranteed)	\$ 31,966	\$ 30,247
U. S. Govt. Agencies (Non-Guaranteed)	27,738	29,418
Foreign Government Obligations	7,538	7,533
Municipal and County Bonds	8,232	8,258
Corporate Bonds	93,660	96,884
Other	543	-
<b>TOTAL DEBT SECURITIES</b>	<u>169,677</u>	<u>172,340</u>
<b>PREFERRED STOCKS</b>	<u>111</u>	<u>230</u>
<b>EQUITY SECURITIES</b>		
Domestic Common Stocks	39,239	36,445
Limited Partnerships	5,829	6,159
Index Funds	31,312	32,162
Other	1,386	2,576
<b>TOTAL EQUITY SECURITIES</b>	<u>77,766</u>	<u>77,342</u>
<b>CASH AND CASH EQUIVALENTS</b>		
Money Markets and Cash Held at State Treasury	15,110	8,598
Commercial Paper	-	173
<b>TOTAL CASH AND CASH EQUIVALENTS</b>	<u>15,110</u>	<u>8,771</u>
<b>OTHER INVESTMENT INCOME</b>		
Securities Lending	1,251	1,295
<b>TOTAL INVESTMENT INCOME</b>	<u><u>\$ 263,915</u></u>	<u><u>\$ 259,978</u></u>

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

PERMANENT UNIVERSITY FUND

Financial Statements

SCHEDULE OF CHANGES IN COST OF INVESTMENTS

Year Ended August 31, 1999

(in thousands)

Type of Investment	Beginning Cost	Purchases	Sales, Maturities & Redemptions	Gains (Losses)	Reclass & Amortization	Ending Cost
<b>DEBT SECURITIES</b>						
U.S. Govt. Obligations (Direct and Guaranteed)	\$ 385,865	\$ 91,064	\$ (21,193)	\$ 33	\$ 427	\$ 456,196
U.S. Govt. Agencies (Non-Guaranteed)	378,981	-	(29,436)	267	1,904	351,716
Foreign Government Obligations	98,475	-	-	-	66	98,541
Municipal and County Bonds	109,289	-	(260)	-	30	109,059
Corporate Bonds	1,197,547	-	(34,711)	729	1,488	1,165,053
Other	4,993	2,157	-	-	-	7,150
<b>TOTAL DEBT SECURITIES</b>	<b>2,175,150</b>	<b>93,221</b>	<b>(85,600)</b>	<b>1,029</b>	<b>3,915</b>	<b>2,187,715</b>
<b>PREFERRED STOCKS</b>	<b>3,072</b>	<b>6,380</b>	<b>(150)</b>	<b>71</b>	<b>-</b>	<b>9,373</b>
<b>CONVERTIBLE DEBENTURES</b>	<b>-</b>	<b>2,438</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,438</b>
<b>EQUITY SECURITIES</b>						
Domestic Common Stocks	1,178,931	573,174	(677,451)	42,556	21,370	1,138,580
Limited Partnerships	448,376	275,027	(81,346)	54,148	(21,370)	674,835
Index Funds	1,449,485	449,990	(604,731)	322,930	-	1,617,674
Other	7,399	-	(726)	(4)	-	6,669
<b>TOTAL EQUITY SECURITIES</b>	<b>3,084,191</b>	<b>1,298,191</b>	<b>(1,364,254)</b>	<b>419,630</b>	<b>-</b>	<b>3,437,758</b>
<b>CASH AND CASH EQUIVALENTS</b>						
Money Markets and Cash Held at State Treasury	143,483	178,619 <sup>(1)</sup>	-	26,992 <sup>(2)</sup>	-	349,094
<b>TOTAL INVESTMENT IN SECURITIES</b>	<b>\$ 5,405,896</b>	<b>\$ 1,578,849</b>	<b>\$ (1,450,004)</b>	<b>\$ 447,722</b>	<b>\$ 3,915</b>	<b>\$ 5,986,378</b>

(1) Net increase in cash and money markets during the year

(2) Includes realized gains on futures contracts.

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

## PERMANENT UNIVERSITY FUND

*Notes to Financial Statements*

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### **Note 1 -- Organization**

(A) The Permanent University Fund (PUF) is a state endowment contributing to the support of eligible institutions of The University of Texas System (U. T. 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 plus 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 2,109,190 acres located in 24 counties primarily in West Texas.

The PUF's 2.1 million acres of West Texas land produce two streams of income: mineral and surface. Mineral income is retained forever as part of the PUF; however, surface income is distributed to the Available University Fund (AUF).

The investments of the PUF are managed by The University of Texas Investment Management Company (UTIMCO). Investment management fees are charged directly to the AUF.

The accompanying financial statements include only the assets and liabilities and investment income related to the investments of the PUF which are managed by UTIMCO. The PUF's 2.1 million acres of West Texas land is not included in this report.

(B) The constitutional provisions governing the PUF prohibit the expenditure of corpus, and consequently, gains and losses on sales of securities remain in the PUF. Conversely, the Constitution of Texas mandates that all dividend and interest income be distributed to the AUF on an accrual basis.

(C) The audited financial statements and schedules have been prepared for the purpose of complying with the reporting requirements of Section 66.05 and 66.08(f) of the Texas Education Code and for the purpose of presenting the statement of investment income.

### **Note 2 -- Significant Accounting Policies**

(A) *Cash and Cash Equivalents* - Cash and cash equivalents consist of cash held at the State Treasury, commercial paper and money market instruments.

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

Fixed income securities directly held 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.

## PERMANENT UNIVERSITY FUND

*Notes to Financial Statements (cont.)*

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

Limited Partnerships and Other are valued based on a fair valuation determined as specified by policies established by the UTIMCO Board of Directors. At August 31, 1999, certain conditions existed that warranted an adjustment to several limited partnerships and one direct investment which was not specifically addressed by the Board policy. The policy states that if a direct investment is held by a partnership, the valuation used by the PUF is the price used by the partnership. Additionally, the limited partnership is valued based on the capital account balance at the closest available reporting period, as communicated by the general partner, adjusted for intra valuation date contributions and withdrawals. There were two significant sales that were consummated prior to the PUF's year end but were not reflected in the general partners' June 30, 1999 financial statements. Accordingly, valuation adjustments were made to more accurately reflect the market value of these investments at August 31, 1999. Proceeds from the sales of these investments were received in September 1999.

Securities held in index funds are generally valued as follows:

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

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

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

(C) *Foreign Currency Translation* - The accounting records of the PUF are maintained in U.S. dollars. Purchases and sales of securities of foreign entities and the related income receipts are translated into U.S. dollars at the exchange rate on the dates of the transactions. The portion of currency gains and losses resulting from changes in foreign exchange rates on purchases and sales of securities is included with net realized and unrealized gain or loss from investments. The currency gains and losses on dividend and interest payments resulting from changes in foreign exchange rates between the accrual date and the payment date are included in investment income.

(D) *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. Bonds are amortized over the life of the security using the interest method, which is a method of amortizing discounts or premiums that result in constant rates of interest.



## PERMANENT UNIVERSITY FUND

*Notes to Financial Statements (cont.)*

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

(F) *Recently Issued Accounting Standards* – In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, “Accounting for Derivative Instruments and Hedging Activities.” SFAS No. 133 standardizes the accounting for derivative instruments, by requiring an entity to recognize those items as assets or liabilities in the Statements of Assets and Liabilities and measure them at fair value. This statement is effective for fiscal years beginning after June 15, 2000. The PUF’s financial statements are not expected to change as a result of the adoption of SFAS No. 133. The PUF currently accounts for its derivative instruments at fair value.

(G) *Use of Estimates* - The preparation of financial statements in conformity with generally accepted accounting principles 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.

### **Note 3 -- Investment Activity**

The cost of purchases and proceeds from sales and maturities of investments (excluding cash and cash equivalents) were \$1,400,230,388 and \$1,450,003,764, respectively, for the year ended August 31, 1999. For the year ended August 31, 1998, the cost of purchases and proceeds from sales and maturities were \$1,601,657,450 and \$1,638,513,583, respectively. Such transactions were made at current market prices on the dates of the transactions.

### **Note 4 -- Securities Lending**

The PUF loaned securities to certain brokers who paid the PUF negotiated lenders' fees. These fees are included in investment income. The PUF receives qualified securities and/or cash as collateral against the loaned securities. The collateral when received will have a market value of 102% of loaned securities of United States issuers and a market value of 105% for loaned securities of non-United States issuers. If the market value of the collateral held in connection with loans of securities of United States 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-United States issuers, the collateral should remain 105% of the market value of the loaned securities at the close of any business day. If it falls below the 105%, the borrower must deliver additional collateral by the close of the following business day.

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

The value of securities loaned and the value of collateral held as of August 31, 1999 and 1998 are as follows:

Securities on Loan	1999 Value	1998 Value	Type of Collateral	1999 Value of Collateral	1998 Value of Collateral
U.S. Government	\$ 376,230,804	\$ 293,735,448	Cash	\$383,425,026	\$298,296,499
Corporate Bonds	7,513,232	21,030,198	Cash	7,706,250	22,034,870
Common Stock	<u>4,063,775</u>	<u>5,327,432</u>	Cash	<u>4,182,602</u>	<u>6,202,169</u>
Total	<u>\$ 387,807,811</u>	<u>\$ 320,093,078</u>	Total	<u>\$395,313,878</u>	<u>\$326,533,538</u>
U.S. Government	\$ 50,147,308	\$ 12,434,830	Non-Cash	\$ 52,665,859	\$ 12,851,250
Corporate Bonds	<u>-</u>	<u>5,971,625</u>	Non-Cash	<u>-</u>	<u>6,125,000</u>
Total	<u>\$ 50,147,308</u>	<u>\$ 18,406,455</u>	Total	<u>\$ 52,665,859</u>	<u>\$ 18,976,250</u>

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

**Note 5 -- Investment Commitments**

Unfunded contractual commitments for Limited Partnerships and Other assets were \$585,732,628 at August 31, 1999.

**Note 6 -- Index Funds**

The index funds consist of the Equity Index Fund B Lendable, which is majority-owned by the PUF and The University of Texas System's Long Term Fund, and the Mid Cap Index Fund B Lendable, which is majority-owned by the PUF. Also included in the index funds are twenty-one MSCI Equity Index Fund B international funds which are invested in Europe, Australia and the Far East. The values of the funds, as of August 31, 1999 and 1998 are as follows:

	August 31,	
	1999	1998
Equity Index Fund B Lendable	\$ 1,102,392,137	\$ 936,699,381
Mid Cap Index Fund B Lendable	717,407,908	513,003,187
MSCI Equity Index Fund B	<u>496,694,447</u>	<u>416,379,542</u>
	<u>\$ 2,316,494,492</u>	<u>\$ 1,866,082,110</u>

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

**Note 7 - Futures Contracts**

During the year ended August 31, 1999, the PUF began trading in S&P 500 equity futures. The PUF does not utilize leverage when entering into these contracts. S&P 500 equity futures were used to maintain market exposure to the S&P 500 index. The PUF maintained money market and collateral balances equivalent to the notional value of the S&P 500 contracts to produce interest income. The PUF's money market balance associated with the contracts as of August 31, 1999 was \$166,692,484 in addition to \$11,155,241 held on deposit with broker. 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 difference is referred to as the daily variation margin which is settled in cash with the broker each morning for the amount of the previous days' mark to market. The amount of net realized gain on the S&P 500 futures contracts was \$27,037,966 for the year ended August 31, 1999. The PUF executes the contracts on a major exchange and minimizes market and credit risk associated with these contracts through various trading and credit monitoring techniques.

The following discloses the notional, carrying and fair values at August 31, 1999 and the average carrying and fair values for the year ended August 31, 1999 for futures contracts:

	<b>Notional Value at August 31, 1999</b>		<b>Carrying and Fair Value at August 31, 1999</b>		<b>Average Carrying and Fair Value for the Year Ended August 31, 1999</b>	
	<u>Long</u>	<u>Short</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>
S&P 500 Equity Futures	\$176,853,200	\$ -	\$ -	\$830,800	\$792,527	\$1,178,509

**Note 8 -- Year 2000 (Unaudited)**

The PUF could be adversely affected if the computer systems it uses and those used by the PUF's managers, custodian and other major service providers, do not properly process and calculate date-related information and data from and after January 1, 2000. This is commonly known as the Year 2000 problem.

All internal processes and programs, hardware and software products have been analyzed and are considered Year 2000 ready. As of August 31, 1999, Mellon Trust, the custodian and the major service provider for the PUF, had completed 100% of the remediation and system testing for their mission critical and high business value systems and consider themselves ready for the Year 2000. The PUF's other key service providers have taken steps that UTIMCO believes are reasonable in addressing Year 2000.