

**PERMANENT UNIVERSITY FUND**

**FINANCIAL STATEMENTS**

**Years Ended August 31, 2001 and 2000**

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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statements of investment assets and liabilities, and the comparison summary of investment in securities of the Permanent University Fund (PUF) as of August 31, 2001 and 2000, the related statements of operations and changes in net investment assets for the years then ended, and the schedule of changes in cost of investments and investment income for the year ended August 31, 2001. These financial statements are the responsibility of the PUF's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of August 31, 2001 and 2000, 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 operations and changes in net investment assets, and the schedule of changes in cost of investments and investment income referred to above present fairly, in all material respects, the financial position and the comparative investment in securities of the PUF as of August 31, 2001 and 2000, its operations and the changes in its net investment assets for the years then ended, and the changes in cost of its investments and investment income for the year ended August 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

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

*Deloitte & Touche LLP*

October 19, 2001

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Deloitte  
Touche  
Tohmatsu

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## PERMANENT UNIVERSITY FUND

### Comparison Summary of Investment in Securities, at Value

August 31, 2001 and 2000

(in thousands)

	<u>2001</u>	<u>2000</u>
<b>Equity Securities</b>		
Domestic Common Stock	\$ 1,516,996	\$ 1,639,643
Index Funds	1,380,116	1,802,004
Commingled Investments	1,169,366	1,164,205
Limited Partnerships	1,020,811	1,123,614
Foreign Common Stock	227,378	316,210
Other	4,373	10,993
<b>Total Equity Securities</b>	<u>5,319,040</u>	<u>6,056,669</u>
<b>Debt Securities</b>		
U.S. Government Obligations (Direct and Guaranteed)	390,017	529,467
U.S. Government Agencies (Non-Guaranteed)	529,902	326,067
Foreign Government and Provincial Obligations (U.S. Dollar Denominated)	5,397	6,709
Foreign Government and Provincial Obligations (Non-U.S. Dollar Denominated)	109,296	67,141
Municipal and County Bonds	27,844	26,376
Corporate Bonds	504,326	529,309
Foreign Corporate Bonds	20,248	23,202
Commingled Investment	23,281	-
Commercial Paper	5,000	2,601
Other	7,771	7,771
<b>Total Debt Securities</b>	<u>1,623,082</u>	<u>1,518,643</u>
<b>Preferred Stock</b>		
Domestic Preferred Stock	13,120	12,325
Foreign Preferred Stock	1,305	4,060
<b>Total Preferred Stock</b>	<u>14,425</u>	<u>16,385</u>
<b>Convertible Securities</b>	<u>3,709</u>	<u>-</u>
<b>Cash and Cash Equivalents</b>		
Money Markets and Cash Held at State Treasury	887,575	1,039,885
<b>Total Investment in Securities</b>	<u>\$ 7,847,831</u>	<u>\$ 8,631,582</u>

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

## PERMANENT UNIVERSITY FUND

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### Statements of Investment Assets and Liabilities

August 31, 2001 and 2000

(in thousands)

<b>Investment Assets</b>	<b>2001</b>	<b>2000</b>
Investment in Securities, at Value (Cost \$8,052,312 and \$8,100,267, respectively)	\$ 7,847,831	\$ 8,631,582
Collateral for Securities Loaned, at Value	134,397	318,957
Deposit with Broker for Futures Contracts	34,892	63,556
Unrealized Gains on Foreign Currency Exchange Contracts	5,526	5,726
Receivables		
Investment Securities Sold	196,295	35,919
Accrued Income	20,651	23,209
Other	<u>2,372</u>	<u>3,667</u>
<b>Total Investment Assets</b>	<u>8,241,964</u>	<u>9,082,616</u>
<b>Liabilities</b>		
Payable Upon Return of Securities Loaned	134,397	318,957
Unrealized Losses on Foreign Currency Exchange Contracts	1,889	6,388
Payables		
Investment Securities Purchased	563,322	298,686
Other	<u>2,208</u>	<u>6,249</u>
<b>Total Liabilities</b>	<u>701,816</u>	<u>630,280</u>
<b>Net Investment Assets</b>	<u>\$ 7,540,148</u>	<u>\$ 8,452,336</u>
<b>Net Investment Assets Consist Of:</b>		
Contributions from PUF Lands	\$ 3,398,756	\$ 3,283,113
Accumulated Undistributed Net Realized Gain on Investments including Foreign Currency Transactions	4,345,011	4,637,666
Net Unrealized Appreciation (Depreciation) of Investments including Translation of Assets and Liabilities in Foreign Currencies	<u>(203,619)</u>	<u>531,557</u>
<b>Net Investment Assets</b>	<u>\$ 7,540,148</u>	<u>\$ 8,452,336</u>

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

## PERMANENT UNIVERSITY FUND

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### Statements of Operations and Changes in Net Investment Assets

Years Ended August 31, 2001 and 2000

(in thousands)

	<u>2001</u>	<u>2000</u>
<b>Investment Income</b>		
Interest	\$ 128,481	\$ 161,889
Dividends	58,966	68,744
Income Distributions from Limited Partnerships	9,980	7,149
Other	<u>4,939</u>	<u>2,838</u>
<b>Total Investment Income</b>	<u>202,366</u>	<u>240,620</u>
<b>Expenses (Note 4)</b>		
Investment Management and Consulting Fees	9,476	7,779
PUF Lands Expense	4,368	3,548
UTIMCO Management Fee	2,646	2,235
Custodial Fees and Expenses	803	220
Other Expenses	<u>203</u>	<u>133</u>
<b>Total Expenses</b>	<u>17,496</u>	<u>13,915</u>
<b>Net Investment Income</b>	<u>184,870</u>	<u>226,705</u>
<b>Realized and Unrealized Gain (Loss) on Investments</b>		
Net Realized Gain (Loss) on Investment Securities and Foreign Currency Related Transactions	(160,444)	1,884,858
Net Unrealized Depreciation on Investment Securities and Foreign Currency Related Transactions	<u>(735,176)</u>	<u>(910,366)</u>
<b>Net Gain (Loss) on Investments</b>	<u>(895,620)</u>	<u>974,492</u>
<b>Net Increase (Decrease) in Net Investment Assets</b>		
<b>Resulting from Operations</b>	\$ (710,750)	\$ 1,201,197
<b>Net Investment Assets</b>		
Beginning of Period	8,452,336	7,465,561
Contributions from PUF Lands	115,643	83,141
Distributions to Available University Fund	<u>(317,081)</u>	<u>(297,563)</u>
End of Period	<u>\$ 7,540,148</u>	<u>\$ 8,452,336</u>

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

# PERMANENT UNIVERSITY FUND

## SCHEDULE OF CHANGES IN COST OF INVESTMENTS AND INVESTMENT INCOME

Year ended August 31, 2001

(in thousands)

	Beginning Cost	Purchases	Sales, Maturities & Redemptions	Gains (Losses)	Reclass	Ending Cost	Investment Income
<b>Equity Securities</b>							
Domestic Common Stock	\$ 1,294,849	\$ 1,335,480	\$ (1,199,491)	\$ (64,903)	\$ 52,424	\$ 1,418,359	\$ 28,743
Index Funds	1,882,461	776,535	(903,295)	(128,990)	-	1,626,711	20,808
Commingled Investments	1,142,752	297,544	(190,324)	(22,138)	-	1,227,834	5,724
Limited Partnerships	904,235	202,897	(141,487)	114,097	(52,424)	1,027,318	9,980
Foreign Common Stock	320,215	258,646	(266,121)	(39,332)	1,209	274,617	3,553
Other	1,577	-	(268)	-	-	1,309	2,182
Rights and Warrants	-	-	(1)	1	-	-	-
<b>Total Equity Securities</b>	<u>5,546,089</u>	<u>2,871,102</u>	<u>(2,700,987)</u>	<u>(141,263)</u>	<u>1,209</u>	<u>5,576,148</u>	<u>70,990</u>
<b>Debt Securities</b>							
U.S. Government Obligations (Direct and Guaranteed)	516,956	2,814,321	(2,977,344)	22,756	-	376,689	23,927
U.S. Government Agencies (Non-Guaranteed)	319,096	1,804,097	(1,625,582)	13,210	-	510,821	22,606
Foreign Government and Provincial Obligations (U.S. \$)	6,478	4,883	(6,750)	487	-	5,098	352
Foreign Government and Provincial Obligations (Non-U.S. \$)	68,685	993,744	(963,359)	(1,704)	7,975	105,341	761
Municipal and County Bonds	26,173	10,336	(11,387)	796	-	25,918	2,201
Corporate Bonds	526,249	374,829	(416,754)	6,504	-	490,828	35,884
Foreign Corporate Bonds	23,953	53,168	(48,220)	(644)	(7,975)	20,282	698
Commingled Investment	-	24,448	-	-	-	24,448	1,147
Commercial Paper	2,601	16,653	(14,253)	(1)	-	5,000	150
Other	7,771	-	-	-	-	7,771	680
<b>Total Debt Securities</b>	<u>1,497,962</u>	<u>6,096,479</u>	<u>(6,063,649)</u>	<u>41,404</u>	<u>-</u>	<u>1,572,196</u>	<u>88,406</u>
<b>Purchased Options</b>	<u>-</u>	<u>2,893</u>	<u>(2,697)</u>	<u>(196)</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Preferred Stock</b>							
Domestic Preferred Stock	12,323	321	(5,983)	4,762	-	11,423	134
Foreign Preferred Stock	3,996	325	(1,563)	(30)	(1,539)	1,189	2
<b>Total Preferred Stock</b>	<u>16,319</u>	<u>646</u>	<u>(7,546)</u>	<u>4,732</u>	<u>(1,539)</u>	<u>12,612</u>	<u>136</u>
<b>Convertible Securities</b>	<u>-</u>	<u>3,496</u>	<u>-</u>	<u>-</u>	<u>330</u>	<u>3,826</u>	<u>2</u>
<b>Cash and Cash Equivalents</b>							
Money Markets and Cash Held at State Treasury	1,039,897	-	(87,248)*	(65,119)**	-	887,530	41,158
<b>Securities Lending</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,674</u>
<b>Total Investment in Securities</b>	<u>\$ 8,100,267</u>	<u>\$ 8,974,616</u>	<u>\$ (8,862,127)</u>	<u>\$ (160,444)</u>	<u>\$ -</u>	<u>\$ 8,052,312</u>	<u>\$ 202,366</u>

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

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

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

## PERMANENT UNIVERSITY FUND

### *Notes to Financial Statements*

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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 over 2.1 million acres of land located in 24 counties primarily in West Texas (PUF Lands).

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

(B) Amendments to the Texas Constitution were approved by voters in a statewide election held on November 2, 1999. The amendments were effective November 29, 1999, and allow for a) distributions to the Available University Fund (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. Before the effective date of the amendments, the constitutional provisions governing the PUF prohibited the expenditure of corpus, and consequently, gains and losses on sales of securities remained in the PUF. Conversely, the Texas Constitution mandated that all dividend and interest income be distributed to the AUF on an accrual basis. The amendments directed the Board of Regents of U.T. 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 now 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, 2002, in the amount of \$338,433,636 was paid September 4, 2001.

(C) The accompanying financial statements report the investment in securities of the PUF, including the assets, liabilities and investment income. Beginning November 29, 1999, expenses related to the PUF's investments and PUF Lands are also included in accordance with the constitutional amendments. The PUF Lands are not included in this report.

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

The annual combined financial statements of U.T. System are prepared in accordance with Texas Comptroller of Public Accounts' Annual Financial Reporting Requirements and include information related to the PUF. The accompanying financial statements may differ in presentation from

governmental accounting principles or the Texas Comptroller of Public Accounts' Annual Financial Reporting Requirements.

## **Note 2 Significant Accounting Policies**

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

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

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

Limited Partnerships and Other are valued based on a fair valuation determined as specified by policies established by the UTIMCO Board of Directors. The valuation policy was amended during the year ended August 31, 2000, to allow for significant events not reflected by the partnership including, but not limited to, consummated sales and significant market fluctuations that occurred after the June 30 valuation reporting period of the partnership. Previously, the policy stated that if a direct investment was held by a partnership, the valuation used by the PUF was the price used by the partnership. Additionally, the limited partnership was 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.

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

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

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

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

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

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



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

(C) **Investment Income** -- Interest income is accrued as earned. Dividend income is recorded on the ex-dividend date. Dividend and interest income is recorded net of foreign taxes where recovery of such taxes is not assured. Investment income includes net realized and unrealized currency gains and losses recognized between accrual and payment dates on dividend and interest transactions. Subsequent to the effective date of the constitutional amendments, premiums and discounts on bonds are no longer being amortized. Any effects attributable to amortization in current and future periods will be reported in the net unrealized appreciation or depreciation of the PUF's investment securities instead of as an addition to or deduction from interest income. This change has no effect on the PUF's net asset value or total investment return.

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

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

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

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

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

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

realized loss. If a call option is exercised, the premium is added to the proceeds from the sale of the underlying security or currency in determining whether the PUF has realized a gain or loss. If a put option is exercised, the premium reduces the cost basis of the securities purchased by the PUF. The PUF as writer of an option bears the market risk of an unfavorable change in the price of the security underlying the written option.

### **Note 3 Investment Activity**

The cost of purchases and proceeds from sales and maturities of investments (excluding cash and cash equivalents) were \$8,974,616,197 and \$8,774,879,086, respectively, for the year ended August 31, 2001. For the year ended August 31, 2000, the cost of purchases and proceeds from sales and maturities were \$9,633,892,981 and \$10,003,554,607, respectively. Such transactions were made at current market prices on the dates of the transactions.

### **Note 4 Fees and Expenses**

Beginning November 29, 1999, expenses related to the PUF investments and PUF Lands are paid by the PUF in accordance with the constitutional amendments as mentioned in Note 1. Previously, these expenses were paid by the AUF. These expenses are as follows:

- a) 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, 2001 was \$4,367,721. The fee assessed for the period beginning November 29, 1999 to August 31, 2000 was \$3,547,507.
- b) 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, 2001, was \$2,645,610. The fee assessed for the period beginning November 29, 1999 to August 31, 2000 was \$2,234,898.
- c) 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' contract. In addition, the PUF incurs consulting fees for investment planning and oversight services with regard to limited partnerships and hedge funds.
- d) 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 and on-line communication services per the contractual agreement.
- e) The PUF incurs other expenses related to its operations primarily consisting of audit fees, subscription fees, printing and graphic expenses, legal expenses and consultation fees.

## **Note 5 Index Funds**

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

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

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

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

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

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

*The Emerging Markets Index Fund* is a portfolio of international equity securities, registered investment companies, other investment funds and derivative assets with the objective of providing returns which approximate the capitalization weighted total rates of return of the markets in certain countries for equity securities traded outside the U.S.

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

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

	<b>August 31,</b>	
	<u>2001</u>	<u>2000</u>
Equity Index Fund B Lendable	\$ 314,918,931	\$ 314,614,415
Mid-Cap Index Fund B Lendable	627,991,931	770,333,872
Provisional EAFE Equity Index	365,689,653	-
Russell 2000 Index Fund B	71,515,189	228,743,843
EAFE Equity Index Fund B	-	467,146,063
Emerging Markets Index Fund	<u>-</u>	<u>21,166,069</u>
	<u>\$ 1,380,115,704</u>	<u>\$ 1,802,004,262</u>

**Note 6 Commingled Investments**

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

	<b>August 31,</b>	
	<u>2001</u>	<u>2000</u>
<b>Equity Commingled Investments:</b>		
Emerging Market Mutual Funds	\$ 224,147,851	\$ 318,081,664
Small Capitalization International Stock Fund	185,903,870	311,418,327
Merger Arbitrage and Special Situation Funds	467,135,797	305,844,423
Hedge Fund	<u>292,178,089</u>	<u>228,860,270</u>
<b>Total Equity Commingled Investments</b>	<u>\$ 1,169,365,607</u>	<u>\$ 1,164,204,684</u>
<b>Debt Commingled Investment:</b>		
High Yield Bond Fund	<u>\$ 23,280,889</u>	<u>\$ -</u>

The merger arbitrage and special situation funds invest in merger arbitrage, corporate restructuring, distressed investments, distressed convertibles and liquidations. The hedge fund invests primarily in medium and large capitalization U.S. equities in which performance is driven by long and short security selection with a low net exposure to industry and country risk.

**Note 7 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 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

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**Notes to Financial Statements (cont.)**

as follows at August 31, 2001 and 2000:

<b>Securities on Loan</b>	<b>2001 Value</b>	<b>2000 Value</b>	<b>Type of Collateral</b>	<b>2001 Value of Collateral</b>	<b>2000 Value of Collateral</b>
U.S. Government	\$ 80,982,141	\$ 274,603,759	Cash	\$ 82,292,650	\$ 278,413,675
Foreign Government	215,358	657,706	Cash	226,600	690,000
Corporate Bonds	31,743,769	17,160,685	Cash	32,512,670	17,468,690
Common Stock	<u>18,316,410</u>	<u>21,505,974</u>	Cash	<u>19,365,434</u>	<u>22,384,409</u>
<b>Total</b>	<b><u>\$ 131,257,678</u></b>	<b><u>\$ 313,928,124</u></b>	<b>Total</b>	<b><u>\$ 134,397,354</u></b>	<b><u>\$ 318,956,774</u></b>
U.S. Government	<u>\$ 2,462,280</u>	<u>\$ 3,568,466</u>	Non-Cash	<u>\$ 2,732,188</u>	<u>\$ 4,292,936</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 8 Commitments**

The PUF had unfunded contractual commitments for Limited Partnerships and Other assets of \$506,269,569 as of August 31, 2001.

**Note 9 Written Options**

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

The 1,102 contracts outstanding as of August 31, 2001 represent contracts on 90 Day Eurodollar futures with a weighted average interest rate of 4.58%. As of October 19, 2001, the current rate on the December Eurodollar Futures was 2.29% (i.e., a price of 97.71), indicating that it would be highly improbable that the outstanding put options outstanding will be exercised, and therefore the PUF would recognize as realized gain the premium received of \$443,783 upon expiration of the put options in December 2001.

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

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

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

The fair value of the put options outstanding as of August 31, 2001, was \$11,975. This amount is included in Other Liabilities on the statement of assets and liabilities. The PUF recognized gains in the amount of \$222,374 on put options written during the year. As of August 31, 2001, no securities were held as collateral for the put options written by the PUF.

The PUF also wrote call options on Treasury bond futures contracts during the year ended August 31, 2001. As of August 31, 2001 the principal notional value of the 127 Treasury bond futures contracts outstanding was \$13,525,500 based on an August 31, 2001 price of \$106.50. The PUF held positions in the underlying futures contracts as of August 31, 2001, thus reducing its risk of loss.

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

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

The fair value of the call options outstanding as of August 31, 2001 was \$89,125. This amount is included in Other Liabilities on the statement of assets and liabilities. During the year ended August 31, 2001, the PUF recognized gains in the amount of \$252,582 on call options written.

**Note 10 Futures Contracts**

The PUF's activities include trading in derivatives such as futures contracts. During the years ended August 31, 2001 and 2000, the futures contracts were used to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes of the PUF. The asset classes that used futures include domestic and foreign equities, domestic and foreign debt and commodities. Commodity index exposure was obtained through the Goldman Sachs Commodity Index (GSCI). The GSCI is a composite index of commodity sector returns, representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. The PUF had \$34,892,298 and \$63,556,206 on deposit with a broker for collateral as margin for the futures contracts as of August 31, 2001 and 2000, respectively. It is the intention of the PUF not to utilize leverage when entering into these contracts, and to maintain cash balances that when combined with the collateral deposit with a broker exceed the notional value of the futures contracts held. Short futures may be used by a limited number of external managers for the PUF to hedge the PUF's interest rate or country risk associated with security positions. Futures contracts are marked to market daily; that is, they are valued at the close of business each day, and a gain or loss is recorded between the value of the contracts that day and on the previous day. The daily gain or loss is referred to as the daily variation

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

margin which is settled in cash with the broker each morning for the amount of the previous day's mark to market. The amount that is settled in cash with the broker each morning is the carrying and fair value of the futures contracts. The amount of net realized loss on the futures contracts was \$61,421,628 for the year ended August 31, 2001. The amount of net realized gain on the futures contracts was \$96,480,985 for the year ended August 31, 2000. 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 manager's various trading and credit monitoring techniques.

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

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

The following discloses the notional, carrying and fair values at August 31, 2000, and the average carrying and fair values for the year ended August 31, 2000 for futures contracts:

	Notional Value at August 31, 2000		Carrying and Fair Value at August 31, 2000		Average Carrying and Fair Value for the Year Ended August 31, 2000	
	Long	Short	Assets	Liabilities	Assets	Liabilities
Domestic Equity Futures	\$ 171,135,000	\$ 1,611,150	\$ 3,314,742	\$ 9,545	\$ 645,101	\$ 653,915
International Equity Futures	27,408,120	38,460,134	241,222	245,248	365,326	388,047
Commodity Futures	313,378,875	-	-	577,125	2,018,703	1,453,021
Domestic Fixed Income Futures	17,707,031	54,239,594	66,702	258,142	37,812	50,505
International Fixed Income Futures	86,959,974	-	173,848	1,973	52,980	50,541

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

**Note 11 Foreign Currency Exchange Contracts**

The tables below summarize by currency the contractual amounts of the PUF's foreign currency exchange contracts at August 31, 2001 and 2000. Foreign currency amounts are translated at exchange rates as of August 31, 2001 and August 31, 2000. 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, 2001	Net Sell August 31, 2001	Unrealized Gains on Foreign Currency Exchange Contracts August 31, 2001	Unrealized Losses on Foreign Currency Exchange Contracts August 31, 2001
Euro	\$ 85,572,743	\$ -	\$ 401,519	\$ 567,961
UK Pound	34,581,563	-	572,623	108,420
New Zealand Dollar	-	10,423,376	-	447,038
Swiss Franc	19,512,105	-	638,434	180,973
Canadian Dollar	-	14,964,215	208,892	44,379
Norwegian Krone	36,459,370	-	944,553	-
Japanese Yen	56,512,363	-	2,333,738	139,455
Australian Dollar	18,777,562	-	234,623	7,187
Swedish Krona	-	34,495,197	8,767	137,683
Singapore Dollar	-	11,231,303	553	255,702
Danish Krone	2,569,246	-	156,278	288
Hungarian Forint	321,863	-	25,736	-
	<u>\$ 254,306,815</u>	<u>\$ 71,114,091</u>	<u>\$ 5,525,716</u>	<u>\$ 1,889,086</u>

Currency	Net Buy August 31, 2000	Net Sell August 31, 2000	Unrealized Gains on Foreign Currency Exchange Contracts August 31, 2000	Unrealized Losses on Foreign Currency Exchange Contracts August 31, 2000
Euro	\$ 48,990,881	\$ -	\$ 1,455,584	\$ 1,961,526
UK Pound	18,529,965	-	500,076	1,208,928
New Zealand Dollar	-	18,465,061	1,475,915	379,300
Swiss Franc	2,159,552	-	58,624	504,562
Canadian Dollar	15,579,322	-	124,070	66,940
Norwegian Krone	38,347,068	-	300,063	1,257,739
Japanese Yen	64,820,726	-	144,062	293,939
Australian Dollar	-	8,673,392	367,005	88,123
Swedish Krona	-	41,057,241	902,352	202,901
Hong Kong Dollar	-	8,070,330	25,292	-
Singapore Dollar	14,681,416	-	170,882	19,808
Danish Krone	4,087,147	-	-	81,674
Greek Drachma	3,522,233	-	-	222,876
Various	5,878,886	-	201,740	99,597
	<u>\$ 216,597,196</u>	<u>\$ 76,266,024</u>	<u>\$ 5,725,665</u>	<u>\$ 6,387,913</u>