

Financial Statements

Permanent University Fund

Years ended August 31, 2004 and 2003

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Financial Statements

Years ended August 31, 2004 and 2003

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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 fiscal year ended August 31, 2004. 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 \$843.1 million from \$7,244.8 million to \$8,087.9 million, or approximately 11.6% during the year.
- Fiscal year 2004 contributions of PUF Lands mineral income increased by 43.6% from \$102.1 million to \$146.7 million and represented 1.9% 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.
- The PUF posted a net investment return of 14.73% for the fiscal year ended August 31, 2004, compared to a net investment return of 12.02% for the prior fiscal year.
- The PUF's annual distribution to the Available University Fund (AUF) decreased by 4.1% in fiscal year 2004.

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 by 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, at Fair Value.

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

Statement of Fiduciary Net Assets

The Statement of Fiduciary Net Assets presents assets, liabilities, and net assets of the PUF under UTIMCO management as of the end of the fiscal year. This statement, along with all of the PUF's financial statements, is 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 of the PUF 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.

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

	<u>2004</u>	<u>2003</u>	<u>Amount of Increase (Decrease)</u>	<u>Percent Change</u>
Assets				
Investments, at Fair Value	\$ 8,080.4	\$ 7,352.3	\$ 728.1	10%
Other Assets	<u>970.0</u>	<u>386.0</u>	<u>584.0</u>	<u>151</u>
Total Assets	<u>9,050.4</u>	<u>7,738.3</u>	<u>1,312.1</u>	<u>17</u>
Total Liabilities	<u>962.5</u>	<u>493.5</u>	<u>469.0</u>	<u>95</u>
Net Assets Held in Trust	<u>\$ 8,087.9</u>	<u>\$ 7,244.8</u>	<u>\$ 843.1</u>	<u>12%</u>

Statement of Changes in Fiduciary Net Assets

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

The net increase in fair value of investments of the PUF was \$899.9 million during the year compared to \$638.8 million for the year ended August 31, 2003. Investment expenses totaled \$21.1 million in fiscal year 2004 and \$15.2 million in fiscal year 2003.

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 decreased from \$363.0 million in fiscal year 2003 to \$348.0 million in fiscal year 2004. 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 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.

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

	<u>2004</u>	<u>2003</u>	<u>Amount of Increase (Decrease)</u>	<u>Percent Change</u>
Investment Income	\$ 1,070.2	\$ 787.7	\$ 282.5	36%
Less Investment Expenses	(21.1)	(15.2)	(5.9)	(39)
PUF Lands Contributions	146.7	102.1	44.6	44
Total Additions	1,195.8	874.6	321.2	37
PUF Lands Expenses	4.7	5.1	(0.4)	(8)
Distributions to Available University Fund	348.0	363.0	(15.0)	(4)
Total Deductions	352.7	368.1	(15.4)	(4)
Change in Fiduciary Net Assets	843.1	506.5	336.6	66
Net Asset Held in Trust, Beginning of Period	7,244.8	6,738.3	506.5	8
Net Assets Held in Trust, End of Period	\$ 8,087.9	\$ 7,244.8	\$ 843.1	12%

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.

Report of Independent Auditors

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

We have audited the accompanying financial statements of the Permanent University Fund (PUF) as of and for the years ended August 31, 2004 and 2003, 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, 2004 and 2003 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, 2004 and 2003, 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 1 through 4 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 basic financial statements. The supplemental schedules as of August 31, 2004 and 2003 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 22, 2004

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Statements of Fiduciary Net Assets

August 31, 2004 and 2003

(in thousands)

Assets	2004	2003
Investments, at Fair Value:		
Equity Securities	\$ 1,396,131	\$ 1,357,829
Preferred Stock	7,325	5,659
Debt Securities	1,270,321	1,011,033
Convertible Securities	4,812	5,009
Investment Funds	4,153,102	4,095,031
Purchased Options	–	11,147
Cash and Cash Equivalents	1,248,712	866,602
Total Investments	8,080,403	7,352,310
Collateral for Securities Loaned, at Fair Value	717,183	159,065
Deposit with Broker for Futures Contracts	83,406	54,591
Unrealized Gains on Foreign Currency Exchange Contracts	1,843	12,938
Receivables:		
Investment Securities Sold	148,726	143,690
Accrued Income	12,383	12,289
Other	6,405	3,419
Total Assets	9,050,349	7,738,302
Liabilities		
Payable Upon Return of Securities Loaned	717,183	159,065
Unrealized Losses on Foreign Currency Exchange Contracts	1,333	8,774
Payables:		
Investment Securities Purchased	230,050	323,058
Other	13,905	2,577
Total Liabilities	962,471	493,474
Net Assets Held in Trust	<u>\$ 8,087,878</u>	<u>\$ 7,244,828</u>

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, 2004 and 2003

(in thousands)

	<u>2004</u>	<u>2003</u>
Additions		
Investment Income:		
Net Increase in Fair Value of Investments	\$ 899,915	\$ 638,766
Interest	53,638	66,216
Dividends	79,362	63,899
Income Distributions from Limited Partnerships	33,418	15,158
Other	3,838	3,673
Total Investment Income	<u>1,070,171</u>	<u>787,712</u>
Less Investment Expenses:		
Investment Management and Consulting Fees	14,320	8,792
UTIMCO Management Fee	5,361	5,187
Custodial Fees and Expenses	781	675
Legal	329	220
Analytical and Risk Measurement Fees	169	233
Other	111	76
Total Investment Expenses	<u>21,071</u>	<u>15,183</u>
Net Investment Income	1,049,100	772,529
Contributions from PUF Lands	146,667	102,107
Total Additions	<u>1,195,767</u>	<u>874,636</u>
Deductions		
PUF Lands Expenses	4,683	5,061
Distributions to Available University Fund	348,034	363,022
Total Deductions	<u>352,717</u>	<u>368,083</u>
Change in Fiduciary Net Assets	843,050	506,553
Net Assets Held in Trust, Beginning of Period	7,244,828	6,738,275
Net Assets Held in Trust, End of Period	<u><u>\$ 8,087,878</u></u>	<u><u>\$ 7,244,828</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 fund 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 requirement 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 on which the security is traded (if a closing price is not available, the average of the last reported bid

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Notes to Financial Statements (cont.)

and ask price is used).

Limited partnerships and other equity securities are valued based on a fair valuation determined as specified by policies established by the UTIMCO Board of Directors. Limited partnerships are valued 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 limited partnership is 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.

Hedge funds and certain other investment funds are valued 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 fair value of investments. Security classifications, as domestic or foreign, on the comparison summary of investments, at fair 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. 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.

(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

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Notes to Financial Statements (cont.)

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 specified by policies 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. 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. Under the provisions of the derivatives policy, leverage is not employed in the derivative applications unless specifically authorized by the UTIMCO Board.

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.

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 monthly basis, and are included as an asset or liability on the statements of

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Notes to Financial Statements (cont.)

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 -- 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 asset or liability 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 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. A portion of the PUF's cash and cash equivalents are maintained to support the notional value of future contracts held (see Note 11). 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.

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Notes to Financial Statements (cont.)

(I) **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."

(J) **Reclassifications** -- Certain items in the 2003 financial statements and related notes have been reclassified to conform with 2004 classification.

Note 3 – Investments

The PUF invests in various investment vehicles. These investments are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investments, it is at least reasonably possible that changes in the values of investments may occur in the near term and that such changes could materially affect the amounts reported in the statement of fiduciary net assets.

To comply with the reporting requirements of GASB Statement No. 3, Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements, the Fund's investments are categorized in the tabulation titled "Investment Categories" to give an indication of credit risk assumed by the Fund at fiscal year-end.

Credit risk is the risk that another party to a deposit or investment transaction will not fulfill its obligations. This is not to be confused with market risk, which is the risk that the market value of an investment, collateral protecting a deposit or securities underlying a repurchase agreement, will decline. Market risk is not depicted in this note.

The following categories of credit risk are included:

- Category 1:** Investments that are insured or registered or for which the governmental entity or its agent in the governmental entity's name holds the securities.
- Category 2:** Uninsured and unregistered investments for which the securities are held by the broker's or dealer's trust department or agent in the governmental entity's name.
- Category 3:** Uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its trust department or agent but not in the governmental entity's name.

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Notes to Financial Statements (cont.)

(in thousands)	Category 1	Category 2	Category 3	Fair Value
Cash and/or Deposits	\$ 519	\$ -	\$ -	\$ 519
(Held in Treasury)				
Investments -- by category:				
U.S. Government and Agency Obligations	253,603	-	-	253,603
U.S. Government Agency Mortgage Obligations	201,857	-	-	201,857
Collateralized Mortgage Obligations	17,322	-	-	17,322
Corporate Obligations	158,150	-	-	158,150
Foreign Obligations	175,745	-	-	175,745
Political Subdivision Obligations	9,748	-	-	9,748
Commercial Paper	89,090	-	-	89,090
Corporate Stock	985,170	-	-	985,170
Foreign Stock	347,384	-	-	347,384
Investments -- uncategorized:				
Mutual Funds	-	-	-	1,755,750
Mineral Interests	-	-	-	6,413
Private Placement for Venture Capital	-	-	-	772,716
Other Investments	-	-	-	2,682,457
Securities Lending Collateral	-	-	-	717,183
Investments Held by Broker/Dealers Under Securities Lending Agreements:				
U.S. Government and Agency Obligations	-	-	-	422,292
Corporate Obligations	-	-	-	18,479
Corporate Stock	-	-	-	24,481
Foreign Stock	-	-	-	44,819
Mutual Funds	-	-	-	197,814
Totals by Asset	<u>\$ 2,238,588</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,880,992</u>

The total balance in the table above is comprised of the following components on the Statement of Fiduciary Net Assets (in thousands):

Investments, at Fair Value	\$ 8,080,403
Collateral for Securities Loaned, at Fair Value	717,183
Deposit with Broker for Futures Contracts	83,406
Total	<u>\$ 8,880,992</u>

Because the investments listed as uncategorized in the above table are not evidenced by securities in physical or book entry form, these investments are not categorized in accordance with GASB Statement Number 3.

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

Note 4 – Hedge Funds

Hedge fund investments are broadly defined to include nontraditional investment strategies whereby the majority of the underlying securities are traded on public exchanges or are otherwise readily marketable. The fair values of the hedge fund investments consist of the following:

	August 31,	
	2004	2003
Equity		
Long/Short - Global Equity	\$ 463,417,837	\$ 463,487,873
Long/Short - U.S.	83,538,437	53,595,994
Long/Short - Emerging Markets	54,952,290	44,686,514
Long/Short - Technology and Life Sciences	30,954,891	-
Long/Short - Developed Asia	31,532,158	-
Total Equity	<u>664,395,613</u>	<u>561,770,381</u>
Absolute Return		
Multistrategy - Global Event Oriented and Arbitrage	741,962,913	581,755,897
Long/Short - Global Market Neutral	132,056,675	-
Fund of Funds	130,142,152	88,127,748
Multistrategy - Global Market Neutral	52,807,167	-
Total Absolute Return	<u>1,056,968,907</u>	<u>669,883,645</u>
Total Hedge Funds	<u>\$1,721,364,520</u>	<u>\$1,231,654,026</u>

Equity hedge fund investments include U.S. and international long/short equity strategies. These strategies attempt to exploit profits from stock selection skills by taking long and short positions in various equity securities and can be directional biased to the equity market. Equity hedge fund investments are made through private placement agreements.

Absolute return hedge fund investments include arbitrage and event oriented strategies. Arbitrage strategies attempt to exploit pricing discrepancies between closely related securities, utilizing a variety of different tactics primarily within equity, fixed income and convertible securities markets. Event oriented strategies attempt to exploit discreet events or anticipated events such as bankruptcies, mergers, takeovers, spinoffs and recapitalizations in equity and debt securities. Absolute return hedge funds investments are also made through private placement agreements. Market risk is generally hedged.

The fund of funds invests in other hedge funds including merger arbitrage and special situation fund, and other relative value hedge funds and equity return strategies.

Note 5 – Index Funds

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

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 Active International Equity Fund B attempts to match or outperform the returns of any of the National or Regional Divisions of the MSCI EAFE Index or MSCI Canada Index by investing in collective funds in whatever proportion among National or Regional Divisions recommended by the Active International Equity Strategy.

The Russell 3000 Alpha Tilts Fund B's objective is approximating the capitalization weighted total rate of return of the Russell 3000 Index. The fund is selected and maintained in accordance with a quantitative formula designed to select stocks through optimized tilts toward particular stock characteristics. The formula is designed to provide systematic exposure to such characteristics with the objective of producing long-term returns in excess of the total rate of return of the Russell 3000 Index.

The Russell 2000 Alpha Tilts Fund B's objective is approximating the capitalization weighted total rate of return of the Russell 2000 Index. The fund is selected and maintained in accordance with a formula designed to select stocks through optimized tilts toward particular stock characteristics. The formula is designed to provide systematic exposure to such characteristics with the objective of producing long-term returns in excess of the total rate of return of the Russell 2000 Index.

The Emerging Markets Structured Tiered Fund B attempts to approximate the capitalization weighted total rates of return of the equity securities in the Morgan Stanley Capital International Emerging Markets Free Index for selected countries. The fund adopts a structured tier weighting approach across the countries.

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 U.S. 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 Russell 2000 Equity 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 Transition Fund was a temporary fund established to

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

accommodate the transition of existing investments into an existing index fund. The EAFE Equity Index Transition Fund was folded into the EAFE Equity Index Fund B upon completion of the transition.

The Russell 2000 Equity Index Transition Fund was a temporary fund established to accommodate the transition of existing investments into an existing index fund. The Russell 2000 Equity Index Transition Fund was folded into the Russell 2000 Index Fund B upon completion of the transition.

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 Active International Equity Fund B is majority owned by the PUF and The University of Texas System General Endowment Fund. The fair values of the PUF's interests in these index funds are as follows:

	August 31,	
	2004	2003
EAFE Equity Index Fund B	\$ 295,451,521	\$ 281,251,540
Active International Equity Fund B	167,315,907	135,691,424
Russell 3000 Alpha Tilts Fund B	152,835,970	104,377,981
Russell 2000 Alpha Tilts Fund B	127,003,548	212,154,484
Emerging Markets Structured Tiered Fund B	88,670,026	218,705,253
Equity Index Fund B Lendable	72,159,163	108,695,766
Mid-Cap Index Fund B Lendable	32,266,482	468,330,163
Russell 2000 Equity Index Fund B	–	5,323,981
EAFE Equity Index Transition Fund	–	412,619
Russell 2000 Equity Index Transition Fund	–	21,032
	<u>\$ 935,702,617</u>	<u>\$ 1,534,964,243</u>

Note 6 – Limited Partnerships

The limited partnerships consist of interests in privately held investments that are not registered for sale on public exchanges. The fair values of the limited partnerships consist of the following:

	August 31,	
	2004	2003
U.S. Private Equity	\$ 384,335,097	\$ 427,450,782
Non-U.S. Private Equity	122,295,181	125,483,673
Venture Capital	116,487,352	114,657,694
Opportunistic	68,561,313	83,445,458
Mezzanine	60,101,058	64,670,130
Direct Investments	12,408,598	4,100,659
Oil and Gas	8,527,459	8,583,765
	<u>\$ 772,716,058</u>	<u>\$ 828,392,161</u>

The U.S. private equity interests consist of investments in private equity partnerships which primarily invest in the equity securities of private businesses that are considered to be in the post-start-up phase and that are profitable and generating income.

Venture capital consists of interests in partnerships that provide capital to companies that are in the early stages of development.

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Notes to Financial Statements (cont.)

Non-U.S. private equity interests consist of investments in private equity and venture capital partnerships that are based outside of the U.S. These partnerships focus on making investments in companies that have operations in countries other than the U.S.

The opportunistic category consists of interests in private equity partnerships that invest in distressed debt, specialized sectors or that purchase limited partnership interests in private equity partnerships on a secondary basis.

Mezzanine interests consist of investments in partnerships that make subordinated debt or minority equity investments in private companies.

Oil and Gas consists of interests in private partnerships that hold royalty interests and other non-working interests in oil and gas properties. These properties create an income stream over the life of the partnership.

Direct investments represent the PUF's direct interests in private companies.

Note 7 – Securities Lending

The PUF loans securities to certain brokers who pay 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 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, 2004 and 2003:

Securities on Loan	2004 Value	2003 Value	Type of Collateral	2004 Value of Collateral	2003 Value of Collateral
U.S. Government	\$ 416,432,428	\$ 62,899,948	Cash	\$422,163,748	\$ 63,659,881
Foreign Government	3,218,959	8,723,945	Cash	3,291,930	9,147,671
Corporate Bonds	15,260,347	33,253,536	Cash	15,607,230	34,353,149
Common Stock	266,626,615	49,684,339	Cash	276,120,435	51,904,234
Total	\$701,538,349	\$154,561,768	Total	\$717,183,343	\$ 159,064,935
Common Stock	\$ 486,664	\$ –	Non-Cash	\$ 499,617	\$ –
U.S. Government	5,859,806	510,071	Non-Cash	7,018,253	684,927
Total	\$ 6,346,470	\$ 510,071	Total	\$ 7,517,870	\$ 684,927

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

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

The PUF had unfunded contractual commitments for Limited Partnerships and Other assets of \$528,800,345 as of August 31, 2004.

Note 9 – Written Options

During the year ended August 31, 2004, the PUF wrote call options on Treasury bond and equity index futures. Transactions in call options written during the year ended August 31, 2004, were as follows:

	<u>Contracts</u>	<u>Premiums Received</u>
Call Options Outstanding at August 31, 2003	-	\$ -
Options Written	123,461	3,257,052
Options Expired	(715)	(744,708)
Options Exercised	<u>(122,746)</u>	<u>(2,512,344)</u>
Call Options Outstanding at August 31, 2004	<u>-</u>	<u>\$ -</u>

As of August 31, 2004 and 2003, there were no call options outstanding. The PUF recognized losses in the amount of \$154,606 on call options written for the year ended August 31, 2004. During the year ended August 31, 2003 there were no transactions in call options written.

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

Note 10 – Swaps

During the year the PUF entered into interest rate, total return 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, 2004:

Currency	Coupon	Notional Value	Maturity Date	Fair Value at August 31, 2004	
				Assets	Liabilities
Interest Rate					
UK Pound					
	5.000%	4,700,000	3/20/2013	\$ 37,001	\$ -
	5.000%	14,900,000	3/15/2032	-	507,248
	5.000%	9,800,000	6/15/2008	-	103,355
	5.250%	3,400,000	9/17/2018	-	20,215
Euro					
	6.000%	19,000,000	3/15/2032	4,070,596	-
	4.000%	19,100,000	3/15/2007	459,759	-
	4.000%	18,050,000	3/15/2007	434,485	-
	4.000%	28,800,000	6/16/2014	316,418	-
	5.000%	2,300,000	6/16/2014	200,863	-
	6.000%	5,600,000	3/20/2018	135,712	-
	4.000%	5,830,000	6/16/2014	64,053	-
	4.000%	3,200,000	6/17/2010	35,001	-
	5.750%	2,100,000	9/17/2018	27,925	-
	6.000%	19,000,000	3/15/2006	-	3,318,908
	4.000%	11,970,000	6/17/2010	-	130,927
Japanese Yen					
	0.800%	720,000,000	3/30/2012	227,543	-
	2.000%	870,000,000	12/20/2013	-	277,342
	2.000%	530,000,000	6/15/2012	-	176,226
Swedish Krona					
	4.500%	37,900,000	6/17/2008	45,534	-
	4.500%	38,200,000	6/17/2008	45,894	-
	4.500%	40,600,000	6/17/2008	48,778	-
U.S. Dollar					
	6.000%	19,600,000	12/18/2033	148,553	-
	6.000%	9,800,000	12/18/2033	74,277	-
	5.000%	35,000,000	12/15/2014	-	809,130
	6.000%	8,400,000	12/15/2024	-	753,274
	5.000%	8,600,000	12/15/2014	-	198,815
	5.000%	1,700,000	12/15/2014	-	39,301
	4.000%	17,800,000	12/15/2009	-	29,413
	5.000%	1,100,000	12/15/2014	-	25,430
	5.000%	800,000	12/15/2014	-	18,494
	4.000%	2,300,000	12/15/2009	-	3,801
				<u>6,372,394</u>	<u>6,411,879</u>
Total Return					
U.S. Dollar					
	-	700,000	9/30/2004	16,745	-
	-	700,000	11/1/2004	15,645	-
				<u>32,390</u>	<u>-</u>
Commodity					
U.S Dollar					
	TBill + 45 Basis Points	-	8/31/2004	-	1,673,113
	TBill + 45 Basis Points	-	8/31/2004	-	1,108,727
	TBill + 45 Basis Points	57,400,000	9/30/2004	-	-
	TBill + 45 Basis Points	82,000,000	9/30/2004	-	-
				<u>-</u>	<u>2,781,840</u>
Total				<u>\$ 6,404,784</u>	<u>\$ 9,193,719</u>

There were no outstanding swap contracts as of August 31, 2003.

Note 11 – Futures Contracts

During the years ended August 31, 2004 and 2003, 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. The PUF had \$83,406,268 and \$54,591,354 on deposit with a broker for collateral as margin for the futures contracts as of August 31, 2004 and 2003, 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. The amount of net realized gains on the futures contracts was \$64,446,069 and \$71,537,611 for the years ended August 31, 2004 and 2003, respectively.

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, 2004 for futures contracts:

Contract	Number of Contracts	Expiration	Notional Value at August 31, 2004		Carrying and Fair Value at August 31, 2004	
			Long	Short	Assets	Liabilities
Domestic Fixed Income						
U.S. 5 Year Treasury Notes	63	Sep-04	\$ 7,025,484	\$ -	\$ 19,688	\$ -
U.S. 5 Year Treasury Notes	91	Dec-04	10,071,141	-	29,860	-
U.S. 10 Year Treasury Notes	299	Sep-04	33,927,156	-	143,945	-
U.S. 10 Year Treasury Notes	267	Dec-04	29,987,437	-	52,780	-
			<u>81,011,218</u>	<u>-</u>	<u>246,273</u>	<u>-</u>
Domestic Equity						
Dow Jones Index	2,880	Sep-04	292,982,400	-	1,467,702	-
NASDAQ 100 Index	627	Sep-04	85,867,650	-	193,661	-
Russell 2000 Index Mini	643	Sep-04	35,242,830	-	279,705	-
Russell 2000 Index Mini	8,549	Sep-04	-	468,570,690	-	3,824,618
S&P 500 Index	2,081	Sep-04	574,408,025	-	2,685,887	-
S&P 500 Index	181	Sep-04	-	49,960,525	-	230,775
S&P 500 Index Mini	193	Sep-04	-	10,654,565	-	-
S&P Midcap 400 Index Mini	1,680	Sep-04	-	97,003,200	-	767,931
			<u>988,500,905</u>	<u>626,188,980</u>	<u>4,626,955</u>	<u>4,823,324</u>
Commodities						
Goldman Sachs Commodities	3,252	Sep-04	240,485,400	-	243,900	-
Foreign Fixed Income						
10 Year Swap Note	146	Sep-04	-	20,431,502	-	-
90 Day Euro Dollar	160	Sep-04	38,936,000	-	26,000	-
Euro-Bund	671	Sep-04	94,740,875	-	379,254	-
Euro-Bund	54	Dec-04	7,562,107	-	-	81,660
Japan 10 Year Bond	33	Sep-04	41,390,943	-	155,831	-
Japan 10 Year Bond	13	Dec-04	16,181,152	-	17,005	-
UK Long Gilt	5	Sep-04	964,957	-	2,416	-
			<u>199,776,034</u>	<u>20,431,502</u>	<u>580,506</u>	<u>81,660</u>
Foreign Equity						
All Shares Index	3,282	Sep-04	-	50,648,194	-	169,095
Amsterdam Index	202	Sep-04	15,924,975	-	-	-
CAC 40 Index	236	Sep-04	10,346,700	-	-	-
DAX Index	36	Sep-04	4,150,857	-	-	-
DJ Euro Stoxx 50	1,234	Sep-04	40,191,429	-	-	-
DJ Euro Stoxx 50	443	Sep-04	-	14,428,528	-	337,990
FTSE 100 Index	1,706	Sep-04	137,307,449	-	-	601,310
Hang Seng Index	25	Sep-04	2,054,180	-	-	-
Hang Seng Index	343	Sep-04	-	28,183,347	-	54
IBEX Index	27	Sep-04	-	2,587,477	-	-
MSCI Taiwan Index	1,987	Sep-04	-	48,562,280	218,570	-
Nikkei 225 Index	485	Sep-04	49,054,624	-	-	354,176
OMX Index	265	Sep-04	-	2,420,619	-	-
S&P/MIB Index	20	Sep-04	3,295,772	-	-	-
S&P/TSE 60 Index	695	Sep-04	49,086,749	-	397,881	-
SPI 200 Index	283	Sep-04	-	17,715,856	-	-
Topix Index	791	Sep-04	81,446,075	-	-	450,570
			<u>392,858,810</u>	<u>164,546,301</u>	<u>616,451</u>	<u>1,913,195</u>
Total			<u>\$1,902,632,367</u>	<u>\$ 811,166,783</u>	<u>\$ 6,314,085</u>	<u>\$ 6,818,179</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, 2003 for futures contracts:

Contract	Number of Contracts	Expiration	Notional Value at August 31, 2003		Carrying and Fair Value at August 31, 2003	
			Long	Short	Assets	Liabilities
Domestic Fixed Income						
U. S. 2 Year Treasury Notes	196	Sep-03	\$ -	\$ 42,060,375	\$ 21,438	\$ -
U. S. 5 Year Treasury Notes	455	Sep-03	-	50,725,391	63,982	-
U. S. 10 Year Swap Notes	342	Sep-03	-	36,914,625	64,125	4,688
U. S. 10 Year Treasury Notes	92	Sep-03	10,260,875	-	-	12,562
U. S. 10 Year Treasury Notes	1,075	Dec-03	117,947,656	-	-	117,566
U. S. Treasury Bonds	157	Sep-03	-	16,862,781	29,437	-
			<u>128,208,531</u>	<u>146,563,172</u>	<u>178,982</u>	<u>134,816</u>
Domestic Equity						
Russell 2000 Index	281	Sep-03	69,891,725	-	484,725	-
Russell 2000 Index	98	Sep-03	-	24,375,050	-	-
S&P 500 Index	22	Sep-03	-	5,542,350	-	-
S&P 500 Index	1,701	Sep-03	428,524,425	-	2,764,125	-
			<u>498,416,150</u>	<u>29,917,400</u>	<u>3,248,850</u>	<u>-</u>
Commodities						
Goldman Sachs Commodities	1,607	Sep-03	97,123,063	-	-	100,438
Foreign Fixed Income						
10 Year Swap Note	146	Sep-03	-	18,218,948	-	-
Australian 10 Year Bond	68	Sep-03	4,568,849	-	-	6,995
Canada 10 Year Bond	124	Dec-03	9,628,404	-	75,362	-
Euro-Bund	880	Sep-03	110,125,354	-	172,838	-
Euro-Bund	64	Dec-03	7,966,011	-	239,114	-
Japan 10 Year Bond	19	Sep-03	22,374,020	-	56,670	-
Japan 10 Year Bond	20	Sep-03	-	23,551,600	-	86,206
Japan 10 Year Bond	6	Dec-03	7,005,312	-	-	-
Swiss Fed Bond	22	Sep-03	-	2,027,289	-	75
UK Long Gilt	5	Sep-03	936,712	-	-	1,341
UK Long Gilt	164	Dec-03	-	30,495,887	-	108,561
			<u>162,604,662</u>	<u>74,293,724</u>	<u>543,984</u>	<u>203,178</u>
Foreign Equity						
Amsterdam Index	55	Sep-03	-	3,985,377	34,961	-
CAC 40 Index	225	Sep-03	-	8,207,489	-	112,745
DAX Index	80	Sep-03	7,664,440	-	277,133	317,446
FTSE 100 Index	343	Sep-03	-	22,637,492	48,576	-
Hang Seng Index	97	Sep-03	6,778,129	-	143,320	142,158
IBEX Index	111	Sep-03	8,693,375	-	35,439	-
MIB 30 Index	22	Sep-03	-	3,079,247	-	1,086
OMX Index	303	Sep-03	-	2,127,219	437	-
SPI 200 Index	88	Sep-03	-	4,552,368	-	68,000
Topix Index	71	Sep-03	6,100,231	-	-	13,610
			<u>29,236,175</u>	<u>44,589,192</u>	<u>539,866</u>	<u>655,045</u>
Total			<u>\$ 915,588,581</u>	<u>\$ 295,363,488</u>	<u>\$ 4,511,682</u>	<u>\$ 1,093,477</u>

PERMANENT UNIVERSITY FUND

Notes to Financial Statements (cont.)

Note 12 – Foreign Currency Exchange Contracts

The tables below summarize by currency the contractual amounts of the PUF’s foreign currency exchange contracts at August 31, 2004 and 2003. Foreign currency amounts are translated at exchange rates as of August 31, 2004 and 2003. 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, 2004	Net Sell August 31, 2004	Unrealized Gains on Foreign Currency Exchange Contracts August 31, 2004	Unrealized Losses on Foreign Currency Exchange Contracts August 31, 2004
Australian Dollar	\$ 2,251,642	\$ –	\$ 17,187	\$ 6,632
Canadian Dollar	–	10,139,490	8,515	34,383
Danish Krone	–	1,277,998	10,314	–
Euro	–	30,673,914	514,192	73,566
Japanese Yen	73,282,546	–	195,317	268,930
New Zealand Dollar	388,479	–	21,901	3,687
Norwegian Krone	–	8,688,997	317,303	192,038
Singapore Dollar	–	2,846,933	21,815	12,541
Slovak Koruna	221,508	–	–	2,582
South Korean Won	2,080,249	–	30,244	–
Swedish Krona	–	3,046,063	28,556	1,133
Swiss Franc	–	1,503,731	21,842	36,496
UK Pound	22,990,074	–	655,578	701,104
	<u>\$ 101,214,498</u>	<u>\$ 58,177,126</u>	<u>\$ 1,842,764</u>	<u>\$ 1,333,092</u>

Currency	Net Buy August 31, 2003	Net Sell August 31, 2003	Unrealized Gains on Foreign Currency Exchange Contracts August 31, 2003	Unrealized Losses on Foreign Currency Exchange Contracts August 31, 2003
Australian Dollar	\$ 27,268,134	\$ –	\$ 318,910	\$ 1,001,991
Canadian Dollar	–	44,951,328	553,914	559,836
Danish Krone	1,952,391	–	2,975	104,676
Euro	56,906,152	–	1,337,203	953,241
Hong Kong Dollar	261,499	–	2	72,401
Japanese Yen	123,325,998	–	2,025,842	1,142,503
Mexican New Peso	–	–	60,830	–
New Zealand Dollar	127,638	–	370,793	80,315
Norwegian Krone	–	4,407,362	2,631,780	116,033
Polish Zloty	1,412,058	–	35,287	94,712
Singapore Dollar	16,736,061	–	460,630	44,154
Swedish Krona	36,030,307	–	1,757,478	1,643,149
Swiss Franc	–	35,629,719	2,794,515	1,934,028
UK Pound	30,794,872	–	587,935	1,026,856
	<u>\$ 294,815,110</u>	<u>\$ 84,988,409</u>	<u>\$ 12,938,094</u>	<u>\$ 8,773,895</u>

Note 13 – Note Purchase Commitment

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Notes to Financial Statements (cont.)

During the fiscal year 2003, the PUF entered into note purchase agreements with the UT System Board of Regents and the Texas A&M System Board of Regents. These agreements committed the PUF to acquire up to \$400,000,000 of UT System flexible rate notes and \$80,000,000 of Texas A&M System flexible rate notes in the event of a failed remarketing of such notes.

The PUF and the UT System Board of Regents amended their note purchase agreement in fiscal year 2004. Based on the amended agreement the PUF receives an annual commitment fee equal to 0.15% of the notes outstanding. As of August 31, 2004, there were no UT System flexible rate notes outstanding. The note purchase agreement between the PUF and the Texas A&M System Board of Regents remained the same.

The commitment fees earned by the PUF were \$323,425 for the year ended August 31, 2004. The PUF received an annual commitment fee equal to 0.1% of the commitment amounts for fiscal year 2003. The commitment fees earned by the PUF were \$356,658 for the year ended August 31, 2003.

Note 14 – Revenue Sharing Agreements

The PUF has entered into revenue sharing agreements with certain external investment managers. These agreements specify that the PUF shall receive a certain percentage of the gross revenues received by the investment manager for a specified period of time. The percentages of revenue shared in these fee arrangements currently range from 7.5% to 25%. During the year ended August 31, 2004, the PUF received \$213,099 of revenue sharing income, which is included in other investment income on the Statement of Changes in Fiduciary Net Assets. The PUF did not receive any revenue sharing income for 2003.

Note 15 – 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, 2005, in the amount of \$341,174,270 will be paid quarterly. The first payment of \$85,293,568 was made on September 1, 2004.

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Notes to Financial Statements (cont.)

Note 16 – 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 limited partnerships and hedge funds.

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 years ended August 31, 2004 and 2003, was \$5,360,677 and \$5,187,122, respectively.

The PUF is assessed a fee to cover expenses related to the management of the PUF Lands. The fee assessed for the years ended August 31, 2004 and 2003, was \$4,682,804 and \$5,061,283, respectively.

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, at Fair Value

August 31, 2004 and 2003

(in thousands)

	2004		2003	
Equity Securities				
Domestic Common Stock	\$ 998,374	12.36%	\$1,093,492	14.87%
Foreign Common Stock	391,343	4.84%	257,202	3.50%
Other	6,414	.08%	7,135	.10%
Total Equity Securities	<u>1,396,131</u>	<u>17.28%</u>	<u>1,357,829</u>	<u>18.47%</u>
Preferred Stock				
Domestic Preferred Stock	6,465	.08%	5,432	.07%
Foreign Preferred Stock	860	.01%	227	–
Total Preferred Stock	<u>7,325</u>	<u>.09%</u>	<u>5,659</u>	<u>.07%</u>
Debt Securities				
U. S. Government Obligations	801,787	9.92%	566,328	7.70%
Foreign Government and Provincial Obligations	164,447	2.04%	137,812	1.87%
Corporate Obligations	291,027	3.60%	291,683	3.97%
Other	13,060	.16%	15,210	.21%
Total Debt Securities	<u>1,270,321</u>	<u>15.72%</u>	<u>1,011,033</u>	<u>13.75%</u>
Convertible Securities	<u>4,812</u>	<u>.06%</u>	<u>5,009</u>	<u>.07%</u>
Investment Funds				
Index Funds	935,703	11.58%	1,534,964	20.88%
Hedge Funds	1,721,365	21.30%	1,231,654	16.75%
Limited Partnerships	772,716	9.56%	828,392	11.27%
Exchange Traded Funds	358,941	4.44%	1,012	.01%
Other	364,377	4.51%	499,009	6.79%
Total Investment Funds	<u>4,153,102</u>	<u>51.39%</u>	<u>4,095,031</u>	<u>55.70%</u>
Purchased Options	<u>–</u>	<u>–</u>	<u>11,147</u>	<u>.15%</u>
Cash and Cash Equivalents				
Money Market Funds Maintained to Back Futures Contracts	950,781	11.77%	578,373	7.87%
Other Money Market Funds and Cash Held at State Treasury	297,931	3.69%	288,229	3.92%
Total Cash and Cash Equivalents	<u>1,248,712</u>	<u>15.46%</u>	<u>866,602</u>	<u>11.79%</u>
Total Investment in Securities	<u>\$ 8,080,403</u>	<u>100.00%</u>	<u>\$7,352,310</u>	<u>100.00%</u>

PERMANENT UNIVERSITY FUND

Supplemental Schedules (cont.)

The following discloses PUF investments as of August 31, 2004, by industry classification:

Industry	Value	Percentage		Industry	Value	Percentage	
		of Total	Investments			of Total	Investments
Agricultural Services	\$ 1,685,406	0.02%		Metal Mining	\$ 10,560,015	0.13%	
Agriculture Production-Crops	3,889,710	0.05%		Mineral Interests	6,413,402	0.08%	
Amusement and Recreation Services	8,850,574	0.11%		Miscellaneous Manufacturing Industries	6,443,857	0.08%	
Apparel and Other Finished Products	10,991,885	0.14%		Miscellaneous Retail	7,083,868	0.09%	
Apparel and Accessory Stores	9,433,966	0.12%		Mining, Quarry Nonmetal Minerals	2,203,959	0.03%	
Auto Dealers, Gas Stations	5,144,458	0.06%		Mortgage/Asset Backed	47,020,927	0.58%	
Auto Repair, Services, Parking	1,011,794	0.01%		Motion Pictures	2,983,982	0.04%	
Building Construction-General Contractor	15,138,839	0.19%		Motor Freight Transport, Warehouse	14,151,948	0.18%	
Building Material, Hardware, Garden-Retail	142,506	0.00%		Municipal	10,931,413	0.14%	
Business Services	59,199,947	0.73%		Nonclassifiable Establishment	1,431,203	0.02%	
Chemicals and Allied Products	67,804,051	0.84%		Nondepository Credit Institution	37,812,211	0.47%	
Coal Mining	4,881,273	0.06%		Nondurable Goods-Wholesale	9,159,367	0.11%	
Commercial Paper	89,090,164	1.10%		Oil and Gas Extraction	46,623,177	0.58%	
Communications	54,432,059	0.67%		Other - Debt Securities	13,059,605	0.16%	
Construction-Special Trade	2,655,600	0.03%		Other Industry	13,504,839	0.17%	
Depository Institutions	91,018,784	1.13%		Paper and Allied Products	4,750,236	0.06%	
Diversified Manufacturing	4,306,430	0.05%		Personal Services	1,899,995	0.02%	
Durable Goods-Wholesale	25,153,634	0.31%		Petroleum Refining and Related Industries	27,984,020	0.35%	
Eating and Drinking Places	13,250,945	0.16%		Pipe Lines, Except Natural Gas	4,768,361	0.06%	
Educational Services	639,711	0.01%		Primary Metal Industries	24,167,788	0.30%	
Electronics, Other Electronic Equipment, Except Computers	62,320,405	0.77%		Printing, Publishing and Allied Services	11,057,946	0.14%	
Electric, Gas, Sanitary Service	43,596,369	0.54%		Railroad Transportation	8,193,737	0.10%	
Engineering, Research, Management, and Related Services	19,824,628	0.25%		Real Estate	25,115,530	0.31%	
Metal Fabrication, Except Machinery and Transportation Equ	13,433,361	0.17%		Rubber and Miscellaneous Plastic Products	3,375,370	0.04%	
Food and Kindred Products	34,610,091	0.43%		Security and Commodity Brokers	14,178,015	0.18%	
Food Stores	8,320,212	0.10%		Social Services	92,092	0.00%	
Foreign Government and Provincial Obligations	164,446,705	2.04%		Stone, Clay, Glass, Concrete Products	4,480,550	0.06%	
Forestry	734,567	0.01%		Textile Mill Products	92,872	0.00%	
Furniture and Fixtures	2,507,927	0.03%		Tobacco Products	5,236,251	0.06%	
General Merchandise Stores	11,613,300	0.14%		Transit and Passenger Transportation	487,074	0.01%	
Health Services	8,049,446	0.10%		Transportation By Air	12,509,674	0.15%	
Heavy Construction-Not Building Construction	4,743,458	0.06%		Transportation Equipment	33,441,586	0.41%	
Real Estate Holding	407,482,736	5.04%		Transportation Services	2,342,569	0.03%	
Home Furniture and Equipment Stores	5,229,464	0.06%		U. S. Government Obligations	787,764,409	9.75%	
Hotels, Other Lodging Places	39,231,091	0.49%		Water Transportation	11,627,618	0.14%	
Industrial, Commercial Machinery, Computer Equipment	53,380,649	0.66%		Hedge Funds	1,721,364,520	21.30%	
Insurance Agents, Brokers and Service	1,089,572	0.01%		Index Funds	935,702,617	11.58%	
Insurance Carriers	52,072,845	0.64%		Limited Partnerships	772,716,058	9.56%	
Leather and Leather Products	2,956,982	0.04%		Exchange Traded Funds	358,941,082	4.44%	
Lumber and Wood Products, Except Furniture	3,530,154	0.04%		Other Investment Funds	364,376,917	4.51%	
Measurement Instruments, Photography Goods, Watches	57,744,174	0.71%		Money Market Funds	1,248,712,183	15.46%	
				Total Investment Assets	\$ 8,080,402,715	100.00%	

PERMANENT UNIVERSITY FUND

Supplemental Schedules (cont.)

Schedule of Changes in Cost of Investments and Investment Income

Year ended August 31, 2004

(in thousands)

	Beginning Cost	Purchases	Sales, Maturities & Redemptions	Gains (Losses)	Reclass	Ending Cost	Investment Income
Equity Securities							
Domestic Common Stock	\$ 888,747	\$ 1,228,884	\$ (1,523,303)	\$ 188,655	\$ 15,575	\$ 798,558	\$ 29,108
Foreign Common Stock	257,319	631,363	(558,061)	38,613	260	369,494	7,128
Other	885	-	(177)	(3)	8	713	1,160
Total Equities Securities	<u>1,146,951</u>	<u>1,860,247</u>	<u>(2,081,541)</u>	<u>227,265</u>	<u>15,843</u>	<u>1,168,765</u>	<u>37,396</u>
Preferred Stock							
Domestic Preferred Stock	9,854	-	(1,724)	4	-	8,134	1,511
Foreign Preferred Stock	223	5,579	(5,387)	371	-	786	27
Total Preferred Stock	<u>10,077</u>	<u>5,579</u>	<u>(7,111)</u>	<u>375</u>	<u>-</u>	<u>8,920</u>	<u>1,538</u>
Debt Securities							
U. S. Government Obligations	559,405	2,562,171	(2,339,511)	5,534	-	787,599	22,840
Foreign Government and Provincial Obligations	130,674	525,202	(512,631)	10,008	-	153,253	6,951
Corporate Obligations	286,066	680,125	(688,644)	5,397	-	282,944	13,381
Other	20,154	188,439	(188,449)	(15)	-	20,129	(996)
Total Debt Securities	<u>996,299</u>	<u>3,955,937</u>	<u>(3,729,235)</u>	<u>20,924</u>	<u>-</u>	<u>1,243,925</u>	<u>42,176</u>
Purchased Options	<u>11,255</u>	<u>-</u>	<u>(10,580)</u>	<u>(675)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Convertible Securities	<u>13,743</u>	<u>429</u>	<u>(1,125)</u>	<u>627</u>	<u>114</u>	<u>13,788</u>	<u>4</u>
Investment Funds							
Index Funds	1,503,472	466,588	(1,261,320)	184,627	-	893,367	26,468
Hedge Funds	1,005,333	685,051	(350,328)	32,426	-	1,372,482	1,483
Limited Partnerships	1,163,747	164,361	(270,724)	116,956	(15,957)	1,158,383	33,418
Exchange Traded Funds	1,009	720,715	(373,684)	10,674	-	358,714	2,512
Other	531,237	305,565	(539,525)	41,488	-	338,765	12,281
Total Investment Funds	<u>4,204,798</u>	<u>2,342,280</u>	<u>(2,795,581)</u>	<u>386,171</u>	<u>(15,957)</u>	<u>4,121,711</u>	<u>76,162</u>
Cash and Cash Equivalents							
Money Market Funds and Cash Held at State Treasury	866,585	284,990 *	-	97,158 **	-	1,248,733	9,142
Other	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,838</u>
Total Investment in Securities	<u>\$ 7,249,708</u>	<u>\$ 8,449,462</u>	<u>\$ (8,625,173)</u>	<u>\$ 731,845</u>	<u>\$ -</u>	<u>\$ 7,805,842</u>	<u>\$ 170,256</u>

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

** Includes net realized gains on futures contracts and foreign currency contract.