

**MINUTES OF MEETING OF  
THE AUDIT AND ETHICS COMMITTEE OF  
THE UNIVERSITY OF TEXAS INVESTMENT MANAGEMENT COMPANY**

The Audit and Ethics Committee of The University of Texas Investment Management Company (the "Committee") convened on the **4th day of November 1997**, by means of conference telephone enabling all persons participating in the meeting to hear each other, said meeting having been called by the Committee Chairman, with notice provided to each member in accordance with the Bylaws. Participating in the meeting were the following members of the Committee:

Robert H. Allen  
Susan M. Byrne  
A. W. "Dub" Riter

thus, constituting a majority and quorum of the Committee. Also participating in the meeting were Thomas G. Ricks, President of The University of Texas Investment Management Company (the "Corporation"); Cathy Iberg, Vice President - Investment Operations and Secretary of the Corporation; Jerry Turner, legal counsel for the Corporation; William Strange CPA, representing the firm of Deloitte and Touche LLP; and Charles Chaffin, Director of Internal Audits for The University of Texas System (the "System"). Robert H. Allen, Chairman, called the meeting to order at 10:00 a.m.

**Approval of the May 21, 1997 Minutes of the Audit and Ethics Committee**

The first matter to come before the Committee was approval of the Audit and Ethics Committee Minutes of the May 21, 1997 meeting, copies of which had previously been furnished to each Committee member. Mr. Ricks answered questions regarding the minutes. By motion duly made, and seconded, the following resolution was unanimously adopted:

RESOLVED, that the minutes of the meetings of the Audit and Ethics Committee held on May 21, 1997, be, and are hereby, approved in the form presented to the Committee.

**Presentation by Deloitte & Touche, LLP - Mr. William Strange**

Mr. Strange discussed with the Committee the SAS 61 letter, which explains to the Committee certain matters which may be of interest to the Committee in fulfilling their obligations to oversee the financial and disclosure process for which management is responsible. Copies of this letter were previously distributed to each Committee member. Mr. Strange discussed with the Committee each point disclosed in the letter and answered their questions.

The next item discussed by Mr. Strange was the Management Report in which it was stated that during testing for market values of fixed income securities, the auditors had observed that the market value of one security was incorrectly priced by the custodian. Copies of this report were previously furnished to

each member of the Committee. While the auditors had determined that the sample error is not material, that such error is not a prevalent problem and that the portfolio is reasonably valued on an overall basis, Mr. Strange pointed out that the report recommended that the Corporation request a written explanation from the custodian as to what failure in internal control caused the incorrect pricing to be undetected and, additionally, the steps which the custodian will employ to prevent reoccurrence of similar errors. Mr. Ricks reported that the Corporation staff had already requested and received the custodian's explanation on these matters. Mr. Ricks then reviewed the letter of explanation received from the custodian, Mellon Trust, copies of which had previously been distributed to each Committee member. Mellon Trust explained that the error occurred during the initial conversion of securities incident to Mellon Trust's appointment as custodian. Mellon Trust explained that the market price of the security at issue, which does not have an industry specific CUSIP number for identification purposes, was incorrectly cross-referenced with a similar security of the same issuer maturing on a different date. Mellon Trust also explained that it has adequate internal controls to assure that newly acquired securities are valued correctly. Further, to confirm that this error was an isolated problem, Mellon Trust reported that it had reviewed all other securities with non-standard CUSIP numbers and had determined that there were no other cross-referencing problems associated with any such securities. Mr. Strange and Mr. Ricks responded to questions of the Committee concerning the custodian's response to the management comment.

The next items presented by Mr. Strange were the separate financial statements and audit reports for the Permanent University Fund, The University of Texas System Long Term Fund, and The University of Texas System Short/Intermediate Fund, each for the year ended August 31, 1997, and the financial statements and audit report for the Corporation for the short period of September 1, 1996 through December 31, 1996. Copies of the draft audited financial statements had previously been distributed to each member of the Committee. The members of the Committee asked several questions regarding the audited financial statements. Mr. Strange and Mr. Chaffin explained the audit procedures that they performed. Mr. Strange proceeded to explain the opinion on each of the financial statements and answered the questions of the Committee. In response to a question from Mr. Allen, Mr. Strange stated that the footnotes to each of the financial statements were standard and customary. Mr. Ricks also answered the Committee's questions regarding the financial statements. Upon motion duly made and the seconded, the following resolution was unanimously adopted:

RESOLVED, that the separate annual financial statements and audit reports for the Permanent University Fund, and The University of Texas System Long Term Fund, and The University of Texas System Short/Intermediate Funds, each for the fiscal year ended August 31, 1997, and the financial statements and audit report for the Corporation for the short period of September 1, 1996 through December 31, 1996, be, and are hereby, approved in the form as presented to the Committee.

### **Conflict of Interest Policy**

Mr. Allen asked that the minutes of this meeting reflect that, at its meeting on October 30, 1997, the entire Board of Directors had approved a Conflict of Interest Policy relating to Directors and that such policy was not reviewed by this Committee prior to submission to the Board. Mr. Ricks reported to the Committee that Corporation staff was working on a comprehensive revision to the Corporation's Code of Ethics and that the revised code would be presented to the Committee for review prior to submission to the Board for approval. The Committee requested an update from management for their next meeting

addressing the status of the code revision project.

(At this point, Mr. Ricks, Ms. Iberg and Mr. Chaffin left the meeting.)

### **Executive Session**

Mr. Allen asked whether there was anything that Mr. Strange needed to report to the Committee that gave him discomfort. Mr. Strange stated he had nothing to report and that the Corporation staff had been very cooperative throughout the audit process. Mr. Strange was asked if he wanted to comment further regarding the custodian's error referred to in the Management Report. Mr. Strange said that the only comment he would have is that, when an entity with a large portfolio of securities changes custodians, problems of this sort are not unusual. After discussion by the Committee, Mr. Allen indicated that he would ask Mr. Ricks to describe at the next Committee meeting the internal procedures that the Corporation will follow to increase the likelihood that any error of this sort will be discovered by Corporation staff and promptly addressed.

At this point, Mr. Strange left and Mr. Chaffin rejoined the meeting. Mr. Allen asked whether there were any matters Mr. Chaffin, as the System's internal auditor, wanted to discuss with the Committee. Mr. Chaffin responded that he had nothing to report other than the fact that, as a result of recent legislation, the State Auditor was required to report on the failure of any agency to implement audit recommendations by the State Auditor. After discussion, Mr. Chaffin was requested to make a report to the Committee at a subsequent meeting as to the Corporation's status of compliance with any audit recommendations by the State Auditor. Mr. Chaffin was then asked to comment on the custodian's error mentioned in the Management Report. Mr. Chaffin replied that the error was isolated and was very much out of the norm. In response to a question from Ms. Byrne, Mr. Chaffin stated that the Corporation does have internal controls that check the accuracy of the custodian's reports; however, the Corporation relies upon market prices provided by the custodian. In response to another question, Mr. Chaffin agreed that the description of the securities on the Corporation's records should have been reconciled with the custodian's reports. Mr. Allen asked Mr. Chaffin to determine whether or not such a reconciliation had occurred.

Mr. Allen stated that he believed the Committee should meet again prior to the next meeting of the Board of Directors in order to receive a report from Mr. Ricks on the Code of Ethics revision project and a report from Mr. Chaffin as to the status of the Corporation's compliance with any audit recommendations by the State Auditor.

There being no further business to come before the Audit and Ethics Committee, the meeting was adjourned at approximately 11:15 p.m.

Approved \_\_\_\_\_  
Committee Chairman

Date: \_\_\_\_\_