AGENDA
for
SPECIAL CALLED MEETING
U. T. BOARD OF REGENTS

September 28, 2004
Austin, Texas

8.	**U. T. Austin: Request for acceptance of and approval of the location of donated outdoor works of art - statues of Darrell K Royal and Joseph D. Jamail**	*2:40 p.m.* **Action** *Dr. Faulkner*	**14**
9.	**U. T. Board of Regents: Presentation of certificate of appreciation to Vice Chancellor and General Counsel Godfrey**	*2:45 p.m.* *Chairman Huffines*	**15**

C. RECESS TO EXECUTIVE SESSION (IF NEEDED) *2:50 p.m.*

1. Personnel Matters Relating to Appointment, Employment, Evaluation, Assignment, Duties, Discipline, or Dismissal of Officers or Employees - Texas Government Code Section 551.074

   a. **U. T. Dallas: Discussion regarding personnel matters related to presidential search** *Chancellor Yudof, Dr. Sullivan*

   b. **U. T. System: Consideration of personnel matters relating to appointment, employment, evaluation, assignment, and duties of officers or employees**

   c. **U. T. System: Consideration of personnel matters relating to evaluation of presidents, U. T. System Executive Officers, and employees**

2. Consultation with Attorney Regarding Legal Matters or Pending and/or Contemplated Litigation or Settlement Offers - Texas Government Code Section 551.071

D. RECONVENE IN OPEN SESSION TO CONSIDER ACTION ON EXECUTIVE SESSION ITEM(S), IF ANY

E. ADJOURN (See Agenda for meeting of the Audit, Compliance, and Management Review Committee on Page iii behind separate tab) *3:00 p.m. approximately*

1. **<u>U. T. El Paso: Relocation of the Police Department - Amendment of FY 2004-2009 Capital Improvement Program and the FY 2004-2005 Capital Budget to include project; appropriation of funds and authorization of expenditure; resolution regarding parity debt; and authorization of institutional management</u>**

<u>RECOMMENDATION</u>

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Academic Affairs, the Executive Vice Chancellor for Business Affairs, and President Natalicio that the U. T. Board of Regents approve the recommendations for the Relocation of the Police Department project at The University of Texas at El Paso as follows:

Architecturally or Historically Significant:	Yes ☐ No ☒	
Institutional Management	Yes ☒ No ☐	
Project Delivery Method:	Competitive Sealed Proposals	
Substantial Completion Date:	April 2005	
Total Project Cost:	<u>Source</u>	<u>Proposed</u>
	Revenue Financing System Bond Proceeds	$1,700,000

a. amend the FY 2004-2009 Capital Improvement Program (CIP) and the FY 2004-2005 Capital Budget to include the project at a preliminary project cost of $1,700,000 with funding from Revenue Financing System Bond Proceeds;

b. appropriate funds and authorize expenditure of funds;

c. resolve in accordance with Section 5 of the Amended and Restated Master Resolution Establishing The University of Texas System Revenue Financing System that

- parity debt shall be issued to pay the project's cost, including any costs prior to the issuance of such parity debt;

- sufficient funds will be available to meet the financial obligations of the U. T. System, including sufficient Pledged Revenues as defined in the Master Resolution to satisfy the Annual Debt Service

Requirements of the Financing System, and to meet all financial obligations of the U. T. Board of Regents relating to the Financing System; and

- U. T. El Paso, which is a "Member" as such term is used in the Master Resolution, possesses the financial capacity to satisfy its direct obligation as defined in the Master Resolution relating to the issuance by the U. T. Board of Regents of tax-exempt parity debt in the aggregate amount of $1,700,000; and

d. authorize U. T. El Paso to manage the total project budgets, appoint architects, approve facility programs, prepare final plans, and award contracts.

BACKGROUND INFORMATION

Debt Service

The $1,700,000 in Revenue Financing System debt will be repaid from Designated Tuition. Annual debt service on the project is estimated at $142,255. Overall debt service coverage at U. T. El Paso is expected to be at least 1.5 times.

Project Description

The Relocation of the Police Department project at U. T. El Paso will convert 12,800 gross square feet of an existing 25,384 gross square foot warehouse/office building into a new consolidated headquarters for the campus police department. The existing warehouse operation will be reconfigured to allow for this construction. The facility will house police administration, a dispatch office, special services, investigations, a patrol department, and holding cells.

The campus police has operated out of two small residential buildings on the edge of campus for the past 14 years. The facilities are inadequate to house the current staff and community service aspects of the campus police operation. The new project will combine the department administration and patrol groups under one roof, in a facility adequate for more efficient operation.

U. T. El Paso Facilities Management personnel have the experience and capability to manage all aspects of the work.

This proposed off-cycle project has been approved by U. T. System staff and meets the criteria for inclusion in the Capital Improvement Program.

2. **<u>U. T. El Paso: Relocation of the Purchasing Department - Amendment of FY 2004-2009 Capital Improvement Program and the FY 2004-2005 Capital Budget to include project; appropriation of funds and authorization of expenditure; resolution regarding parity debt; and authorization of institutional management</u>**

<u>RECOMMENDATION</u>

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Academic Affairs, the Executive Vice Chancellor for Business Affairs, and President Natalicio that the U. T. Board of Regents approve the recommendations for the Relocation of the Purchasing Department project at The University of Texas at El Paso as follows:

Architecturally or Historically Significant:	Yes ☐ No ☒	
Institutional Management	Yes ☒ No ☐	
Project Delivery Method:	Competitive Sealed Proposals	
Substantial Completion Date:	May 2005	
Total Project Cost:	<u>Source</u>	<u>Proposed</u>
	Revenue Financing System Bond Proceeds	$678,000

a. amend the FY 2004-2009 Capital Improvement Program (CIP) and the FY 2004-2005 Capital Budget to include the project at a preliminary project cost of $678,000 with funding from Revenue Financing System Bond Proceeds;

b. appropriate funds and authorize expenditure of funds;

c. resolve in accordance with Section 5 of the Amended and Restated Master Resolution Establishing The University of Texas System Revenue Financing System that

- parity debt shall be issued to pay the project's cost, including any costs prior to the issuance of such parity debt;

- sufficient funds will be available to meet the financial obligations of the U. T. System, including sufficient Pledged Revenues as defined in the Master Resolution to satisfy the Annual Debt Service

Requirements of the Financing System, and to meet all financial obligations of the U. T. Board of Regents relating to the Financing System; and

- U. T. El Paso, which is a "Member" as such term is used in the Master Resolution, possesses the financial capacity to satisfy its direct obligation as defined in the Master Resolution relating to the issuance by the U. T. Board of Regents of tax-exempt parity debt in the aggregate amount of $678,000; and

d. authorize U. T. El Paso to manage the total project budgets, appoint architects, approve facility programs, prepare final plans, and award contracts.

BACKGROUND INFORMATION

Debt Service

The $678,000 in Revenue Financing System debt will be repaid from Designated Tuition. Annual debt service on the project is estimated at $56,735. Overall debt service coverage at U. T. El Paso is expected to be at least 1.5 times.

Project Description

The Relocation of the Purchasing Department project at U. T. El Paso will renovate 5,148 gross square feet on two floors in the existing Kelly Hall building to provide office and file management space for the Purchasing Department. This relocation of the Purchasing Office is part of an overall plan to bring together many of the University's research and business service centers currently located in facilities on the northern edge of the campus remote from the academic core. This effort will create and free up space in several other buildings and better serve the majority of clients.

U. T. El Paso Facilities Management personnel have the experience and capability to manage all aspects of the work.

This proposed off-cycle project has been approved by U. T. System staff and meets the criteria for inclusion in the Capital Improvement Program.

3. U. T. System: Approval to return an additional $3 million of U. T. System Professional Medical Liability Benefit Plan reserves to U. T. System health institutions and to authorize return of total of $13 million to participating institutions at direction of the Executive Vice Chancellor for Health Affairs

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Health Affairs and the Vice Chancellor and General Counsel that an additional $3 million in U. T. System Professional Medical Liability Benefit Plan reserves be returned to the six U. T. System health institutions.

It is further recommended that the additional $3 million, along with $10 million of the $35 million rebate approved by the Board on August 12, 2004, be returned to U. T. System health institutions for special projects as designated by the Executive Vice Chancellor for Health Affairs.

BACKGROUND INFORMATION

Pursuant to the authority of Chapter 59 of the Texas Education Code, the U. T. Board of Regents adopted The University of Texas System Professional Medical Liability Benefit Plan to provide coverage for certain physicians and medical students of the U. T. System. The Plan went into effect on April 1, 1977, and is funded primarily by the payment of premiums from the Faculty Physician Practice Plans of the component health institutions of the U. T. System.

Actuaries from Tillinghast-Towers Perrin recommend that the Plan's acceptable level of capital can be calculated by the relationship of liabilities to net assets and should be between 2:1 and 3:1. After returning the additional $3 million, that ratio is estimated to be in the range recommended by the actuary as acceptable.

At the August 2004 meeting, the U. T. Board of Regents approved the return of $35 million in proportion to premiums paid to participating institutions. At that time, Chancellor Yudof mentioned that he and Executive Vice Chancellor Shine might wish to specify projects at the participating health institutions to receive a portion of the rebate. Chancellor Yudof committed that he would consult the Board should he wish to make this additional recommendation.

Of the proposed $13 million, $1 million will be allocated to U. T. Health Science Center - San Antonio for the Laredo Regional Academic Health Center. The remaining $12 million will be returned to the six health institutions for projects.

The Board will receive notice of the projects identified for funding by the Executive Vice Chancellor for Health Affairs.

4. U. T. Board of Regents: Amendment of Regents' Rules and Regulations, Part One, Chapter I, Section 7, Subsection 7.3 related to referrals to The University of Texas Investment Management Company (UTIMCO) and related disclosures

RECOMMENDATION

The Chancellor recommends that the Regents' Rules and Regulations, Part One, Chapter I, Section 7, Subsection 7.3 related to referrals to The University of Texas Investment Management Company (UTIMCO) and related disclosures be amended as set forth below in congressional style:

Sec. 7. Committees and Other Appointments

. . .

7.3 The University of Texas Investment Management Company (UTIMCO)

7.31 Composition and Selection of Members of the Board
Pursuant to Texas Education Code Section 66.08, the U. T. Board of Regents shall appoint the nine directors of The University of Texas Investment Management Company (UTIMCO). Periodically, the U. T. Board of Regents will review the performance of the UTIMCO Board of Directors. At least three members of the U. T. Board of Regents and the Chancellor shall be appointed to the UTIMCO Board of Directors by the Chairman of the U. T. Board of Regents, by and with the consent of the U. T. Board of Regents. At least one director will be selected from a list of candidates with substantial background and expertise in investments, as submitted to the U. T. Board of Regents by the Board of Regents of The Texas A&M University System. The selection process for external members of the UTIMCO Board of Directors is as follows:

7.311 The Chairman of the U. T. Board of Regents and the Chairman of UTIMCO send a joint letter to leaders in the public and private sector soliciting nominations.

7.312 Nominations are to be provided to the Chairman of the U. T. Board of Regents.

7.313 The Chairman of the U. T. Board of Regents appoints a selection advisory committee to review nominations.

7.314 After review, the selection advisory committee makes recommendations to the Chairman of the U. T. Board of Regents.

7.315 At the direction of the Chairman of the U. T. Board of Regents, the Office of the Board of Regents asks individuals to complete a background questionnaire. The Office of the Board of Regents apprises those individuals of the UTIMCO Code of Ethics and disqualifications from service.

7.316 Using information from the questionnaires, the Office of the Board of Regents:

- (a) ~~7.361~~ confirms the educational degrees and professional certifications;
- (b) ~~7.362~~ assures that professional licensure and certifications are in good standing;
- (c) ~~7.363~~ reviews business relationships, if any, with members of the Board of Regents or the UTIMCO Board or with U. T. System or UTIMCO; and
- (d) ~~7.364~~ initiates review by the U. T. System Director of Police of the Texas conviction database and contacts local law enforcement.

7.317 The Chairman of the U. T. Board of Regents and the Chairman of UTIMCO conduct personal interviews, as needed, to assure that external UTIMCO directors possess varied investment backgrounds and risk management expertise.

7.318 The Chairman of the U. T. Board of Regents submits a recommended appointment for approval by the U. T. Board of Regents.

7.32 Referrals to UTIMCO and Related Disclosures

7.321 Members of the U. T. Board of Regents and U. T. System officers and employees shall avoid all appearance of conflict of interest pertaining to UTIMCO's investment opportunities. Referral of information related to investment opportunities outside of a posted open meeting of the U. T. Board of Regents or the UTIMCO Board of Directors must be made directly to the UTIMCO President and CEO without endorsement of the merits of the potential investment and with full disclosure concerning whether the investment opportunity involves any potential economic benefit to the individual making the referral or to an individual related within the second degree of affinity or the third degree of consanguinity to the individual making the referral. Referrals will be accepted with the understanding that decisions on individual investments are at the discretion of the UTIMCO Board and staff.

7.322 Members of the UTIMCO Board of Directors are to be guided by the same requirements through UTIMCO policies.

7.323 Should UTIMCO staff ultimately recommend to the UTIMCO Board an investment that was the subject of a direct referral from a member of the U. T. Board of Regents, an officer or employee of the U. T. System, or a member of the UTIMCO Board of Directors, UTIMCO staff is required to disclose the source of the referral and whether such referral involves any potential economic benefit to the individual making the referral or to an individual related within the second degree of affinity or the third degree of consanguinity to the individual making the referral.

BACKGROUND INFORMATION

The amendments to the Regents' Rules and Regulations are proposed at the suggestion of Chairman Huffines and Chancellor Yudof to establish a standard process for referrals of potential investment opportunities to UTIMCO and to assure full disclosure of all such referrals. The proposed amendments have been reviewed by the U. T. System Office of General Counsel and have been the subject of input from UTIMCO staff.

5. U. T. Board of Regents: Approval of proposed appointments of members to the Board of Directors of The University of Texas Investment Management Company (UTIMCO) and related recommendations

RECOMMENDATION

Chairman Huffines will make recommendations for two appointments to the UTIMCO Board of Directors and may make additional related recommendations.

BACKGROUND INFORMATION

Section 66.08 of the Texas Government Code requires that the U. T. Board of Regents appoint all members of the Board of Directors of UTIMCO. The positions to be filled were previously held by Mr. J. Luther King, Jr., and Ms. Susan M. Byrne and are not "affiliated Director" positions. Mr. King was appointed for a term expiring on April 1, 2004. Ms. Byrne was appointed to a term to expire on April 1, 2005; she has provided notice of intent to resign prior to the expiration of the term. The new terms will expire on April 1, 2007, and April 1, 2008.

6. U. T. Board of Regents: Proposed Incentive Compensation Program for The University of Texas Investment Management Company (UTIMCO)

RECOMMENDATION

The UTIMCO Board of Directors recommends that a proposed UTIMCO Compensation Program, approved by the UTIMCO Board on September 15, 2004, with editorial changes and formatting modifications as included in the document set out on Pages 11.1 - 11.24 be approved.

BACKGROUND INFORMATION

The proposed UTIMCO Compensation Program consists of two elements: base salary and an annual incentive plan, known as the Performance Incentive Plan. The basic provisions of the proposed Compensation Program are summarized as follows:

- The compensation philosophy is to "attract and retain high caliber employees from nationally recognized peer institutions and the investment community in general".

- The compensation survey used to set the targeted compensation levels was conducted by Mercer Human Resource Consulting and includes 10 large university endowments and five foundations and organizations that manage foundation funds.

- Total compensation (base salary plus Incentive Award) is targeted at the 50th percentile. Maximum total compensation is targeted at the 75th percentile.

- The Performance Incentive Plan is proposed to be effective on September 1, 2003.

- Each participant in the Plan is assigned an "Incentive Award Opportunity" (Opportunity) expressed as a percentage of base salary. The Opportunity is based on a combination of entity (UTIMCO) performance, asset class performance, and individual performance.

- Approved Awards are capped based on a percentage of the employee's salary and are paid 70% after the end of the performance period and the remaining 30% is scheduled to vest over three years (33 1/3% in year one, 66 2/3% in year two, and 100% in year three.)

- Vesting is contingent upon continued employment with UTIMCO.

- Entity performance for assessment of compensation is based on three-year rolling average of performance in excess of the Total Endowment Assets (PUF and GEF), adjusted for those employed less than three years. The performance of operating funds is not included in determination of entity performance. The maximum entity performance-related Award may be earned if the return on Total Endowment Assets equals or exceeds the 75th percentile (top quartile of 36 peer endowments, as identified on Page 11.24); eligibility for an entity performance-related Award is achieved for performance at the 40th percentile.

- Asset class performance is based on investment returns in excess of three-year rolling benchmark, adjusted for those employed less than three years.

- Individual performance is based on measurable qualitative factors.

- An individual may be considered for an Award if employed in an eligible position by March 31, three months before the end of the period set for calculating performance for each plan year.

- The Plan is in effect until terminated by the UTIMCO Board and may be changed, modified, or suspended by the UTIMCO Board.

The current UTIMCO Performance Compensation Plan was effective September 1, 2000. The proposed UTIMCO Compensation Program was approved by the UTIMCO Compensation Committee on September 13, 2004, and by the UTIMCO Board of Directors on September 15, 2004.

The most significant change from the UTIMCO current Compensation Plan is the shift to peer competitiveness. The current Compensation Plan is totally based on performance related to asset policy benchmarks and the achievement of individual nonquantitative goals. In addition, proposed maximum incentive compensation is increased significantly to correspond to the increased performance requirements of the proposed Plan.

The proposed Compensation Program was based on a plan developed by Mercer, revised by UTIMCO based upon comments of tax counsel and U. T. System staff, rewritten after input from UTIMCO Chairman Hunt on the determination of performance goals, modified as approved by the UTIMCO Compensation Committee, and revised prior to presentation to the UTIMCO Board to address governance issues identified by U. T. System staff as inconsistent with Bylaws revisions required by the U. T. Board. Following approval by the UTIMCO Board, the Plan was revised at the direction of Vice-Chairman Hunt, pursuant to authority delegated by the UTIMCO Board, to modify provisions providing authority to the UTIMCO Board to make Awards at variance with the outline of the Plan.

The proposed Compensation Program has been the subject of considerable review and discussion with U. T. System staff who have offered edits to assure that the language complies with federal requirements for tax-deferral for the deferred payment portions of the Performance Incentive Plan; to assure consistency with the governance responsibilities of the U. T. Board of Regents and recommended changes to UTIMCO Bylaws approved by the Board of Regents on August 12, 2004; and to improve clarity.

Also attached on Pages 11.25 - 11.27 for reference during discussion are three charts prepared by UTIMCO staff. Please note that the chart on Page 11.25 was produced using Russell/Mellon software and reference by that software to the 25th percentile is actually a reference to the top quartile; also all 36 endowments identified as peers for UTIMCO are not represented for the 5 and 10-year periods included on the chart because not all of the historical returns for all 36 endowments were available for these periods.

THE UNIVERSITY OF TEXAS
INVESTMENT MANAGEMENT COMPANY

UTIMCO
COMPENSATION PROGRAM

Table of Contents

1. PROGRAM STRUCTURE

The UTIMCO Compensation Program consists of two elements, base salary and an annual incentive plan (the "Performance Incentive Plan" or "Plan"):

Base Salary	+	Performance Incentive	=	Total Compensation

2. COMPENSATION PROGRAM OBJECTIVES

UTIMCO's Compensation Program serves a number of objectives:

- To attract and retain key investment and operations staff of outstanding competence and ability.
- To encourage key investment staff to develop a strong commitment to the performance of the assets for which UTIMCO has been delegated investment responsibility.
- To motivate key investment staff to focus on maximizing real, long-term returns for all funds managed by UTIMCO while assuming appropriate levels of risk.
- To facilitate teamwork so that members of UTIMCO operate as a cohesive group.

3. TOTAL COMPENSATION PROGRAM PHILOSOPHY

UTIMCO aspires to attract and retain high caliber employees from nationally recognized peer institutions and the investment management community in general. UTIMCO strives to provide a total compensation program that is competitive nationally, with the elements of compensation evaluated relative to comparably sized University endowments, foundations, in-house managed pension funds and for-profit investment management firms with a similar investment philosophy (e.g., externally managed funds).

UTIMCO's total Compensation Program is positioned against the competitive market as follows:

- Base salaries are targeted at the market median (e.g., 50th percentile).
- Target total compensation (salary plus target Incentive Award Opportunity) is positioned at the market median.
- Maximum total compensation (salary plus maximum Incentive Award Opportunity) is targeted at the market 75th percentile if performance is outstanding. (For this purpose, 0 is the lowest point and 100 is the highest.)

Although base salaries as well as target and maximum total compensation have a targeted positioning relative to market, an individual employee's actual total compensation may vary from the targeted positioning based on the individual's experience, education, knowledge, skills and performance as well as UTIMCO's investment performance as described in this document. Except as provided in Section 5.8 for purposes of determining the length of historical performance, base salaries and Incentive Award Opportunities (as well as the actual Performance Incentive Awards) are not determined based on seniority at UTIMCO.

4. BASE SALARY ADMINISTRATION

4.1. Salary Structure

(a) Base salaries are administered through a Salary Structure as set forth in this Section 4.1. Each position has its own salary range, with the midpoint set approximately equal to the market median base salary for positions with similar job content and level of responsibility. In most cases, the salary range will be from 20% below the midpoint to 20% above the midpoint.

(b) The salary range midpoints will be determined by the Compensation Committee based on consultation with an outside compensation consultant and with UTIMCO management. Salary range midpoints for key management, investment and operations positions will be updated at least every three years based on a salary benchmarking study conducted by a qualified compensation consultant selected by the Compensation Committee. In years in which the Compensation Committee does not commission a formal salary survey, the base salary midpoints may be adjusted at the Compensation Committee's discretion based on expected annual salary structure adjustments as reported in one or more published compensation planning surveys.

4.2. Salary Adjustments

(a) Individual employees' base salaries are determined by the Board. Base salaries will be set within the salary range for each position. An individual's base salary within the range may be higher or lower than the salary range midpoint based on his or her level of experience, education, knowledge, skills and performance. On an exception basis, the Board may set individual base salaries outside of the salary range if an individual either substantially exceeds or does not meet all of the market criteria for a particular position (e.g., recent promotion).

(b) Individuals may receive an annual adjustment (increase or decrease) of their base salaries at the discretion of the Board. Base salary adjustments, if any, will be determined based on each Participant's experience, education, knowledge, skills and performance. Employees are not guaranteed an annual salary increase.

5. PERFORMANCE INCENTIVE PLAN

5.1. Purpose of the Performance Incentive Plan and Effective Date

(a) The purpose of the Performance Incentive Plan is to provide an annual Performance Incentive Award based on specific objective criteria relative to UTIMCO's and each Participant's performance. The primary objectives of the Performance Incentive Plan are outlined in Section 2.

(b) The Performance Incentive Plan restates and supercedes the UTIMCO Performance Compensation Plan, which was effective September 1, 2000 ("Prior Plan"). The effective date of this restated Performance Incentive Plan is September 1, 2003 (the "Effective Date").

5.2. Performance Period

(a) For purposes of the Performance Incentive Plan, the Performance Period begins on July 1 of each year and ends the following June 30.

(b) Except as otherwise provided under Section 5.8 and Section 5.9, performance for a year in the historical performance period will be measured between July 1 and the following June 30 of the applicable year for gauging achievement of the Entity and Asset Class Performance Goals.

5.3. Eligibility and Participation

(a) Each employee (and only such an employee) who is (i) employed by UTIMCO in an "Eligible Position" and (ii) selected by the Board as eligible to participate in the Performance Incentive Plan will become a "Participant." "Eligible Positions" include senior management, investment staff, and other key positions as determined from time to time by the President and CEO, subject to approval by the Board. Eligible Positions will be confirmed by the Board within the first 60 days of the Performance Period. The Board in its discretion may also designate a newly hired or promoted employee to be in an Eligible Position during a Performance Period. An Eligible Position in one Performance Period is not automatically an Eligible Position in any subsequent Performance Period. A list of Eligible Positions for the 2003/2004 Performance Period is set forth on the table in Section 5.5(b).

(b) An employee in an Eligible Position who has been selected by the Board to participate in the Plan will become a Participant in the Plan on the latest of (i) the date he or she is employed in an Eligible Position, (ii) the date he or she is selected by the Board to participate in the Plan, or (iii) any later date as designated by the Board; provided, however, that an employee may not commence participation in the Plan and first become a Participant during the last three months of any Performance Period. If, during the last three months of any Performance Period, an employee has been selected by the Board to participate in the Plan or becomes employed in an Eligible Position, participation in the Plan will be delayed until the first day of the next Performance Period (assuming such employee is employed by UTIMCO in an Eligible Position on such date).

(c) An employee will cease to be a Participant in the Plan on the earliest to occur of: (i) the date such employee is no longer employed in an Eligible Position; (ii) the date of termination of such employee's employment with UTIMCO for any reason (including voluntary and involuntary termination, death, and disability); (iii) the date of termination of the Plan; (iv) the date such employee commences a leave of absence; (v) the date such employee begins participation in any other UTIMCO incentive program; (vi) the date the Board designates that such employee's employment position is not an Eligible Position; or (vii) any date designated by the Board as the date on which such employee is no longer a Participant.

(d) Except as provided in Sections 5.10(b), (c), and (d), only Participants are eligible to receive Performance Incentive Awards under the Performance Incentive Plan.

5.4. Performance Goals

(a) Within the first 60 days of each Performance Period, the President and CEO will recommend goals ("Performance Goals") for each Participant (other than the Performance Goals for the President and CEO, which are determined as provided in Section 5.4(c), and the Performance Goals for employees who are hired or promoted during a Performance Period) subject to approval by the Compensation Committee within the first 90 days of the Performance Period. The President and CEO will also recommend Performance Goals for employees who are hired or promoted during the Performance Period and become Participants (subject to confirmation by the Compensation Committee) at the time those employees are designated as Participants.

(b) There are three types of Performance Goals:

(1) Entity Performance (i.e., performance of the Total Endowment Assets)

(2) Asset Class Performance (e.g., US public equity, international equity, private capital, fixed income, etc.)

(3) Individual Performance

Except for the President and CEO, Individual Performance Goals will be defined jointly by each Participant and his or her supervisor. These Individual Performance Goals will be measurable and subject to approval by the President and CEO as well as the Compensation Committee. Individual Performance Goals may be established in one or more of the following areas:

- Leadership
- Implementation of operational goals
- Management of key strategic projects
- Effective utilization of human and financial resources

(c) The President and CEO's Performance Goals will be determined and approved by the Board.

(d) Each Performance Goal is assigned a weight as illustrated in the table in Section 5.5(b), which shows the weightings for each Eligible Position for the 2003/2004 Performance Period. For each Performance Period, the Compensation Committee will approve the weightings of the Performance Goals at the same time it approves the Performance Goals.

5.5. Incentive Award Opportunity Levels and Performance Incentive Awards

(a) At the beginning of each Performance Period, each Participant is assigned an "Incentive Award Opportunity" for each Performance Goal. The Incentive Award Opportunity is determined by the Board and is expressed as a percentage of base salary earned during the Performance Period. The Incentive Award Opportunities include a threshold, target, and maximum award for achieving commensurate levels of performance of the respective Performance Goal.

(b) Incentive Award Opportunities for the 2003/2004 Performance Period are set forth in the following table:

	Weighting			Incentive Award Opportunity (% of Base Salary)			
Eligible Position	**Entity**	**Asset Class**	**Individual**	**< Threshold**	**Threshold**	**Target**	**Maximum**
		Investment Professionals					
President, CEO & CIO	70%	0%	30%	0%	18%	90%	180%
Deputy CIO & MD of Marketable Alt. Invest.	40%	40%	20%	0%	13%	65%	130%
Risk Manager	70%	0%	30%	0%	12%	60%	120%
MD, Public Markets Invest.	20%	60%	20%	0%	12%	60%	120%
MD, Inflation Hedging Assets	20%	60%	20%	0%	12%	60%	120%
Co-MD, Non-Marketable Alt Inv (n=2)	30%	50%	20%	0%	12%	60%	120%
Portfolio Manager, Equity Invest.	20%	60%	20%	0%	10%	50%	100%
Sr. Portfolio Mgr., Fixed Income Invest.	20%	60%	20%	0%	10%	50%	100%
Portfolio Manager, Fixed Income Invest.	20%	60%	20%	0%	10%	50%	100%
Analytical Support	20%	60%	20%	0%	5%	25%	50%
		Operations/Support Professionals					
MD, Accounting, Finance & Admin.	70%	0%	30%	0%	12%	60%	120%
MD, Information Technology	70%	0%	30%	0%	12%	60%	120%
Manager, Finance & Administration	70%	0%	30%	0%	6%	30%	60%
Manager, Investment Reporting	70%	0%	30%	0%	6%	30%	60%
Manager, Portfolio Accounting & Ops.	70%	0%	30%	0%	6%	30%	60%

(c) Actual "Performance Incentive Awards" are the amounts that are actually awarded to Participants for the respective Performance Period. Actual Performance Incentive Awards will range from zero (if a Participant performs below threshold on all Performance Goals) to the maximum Incentive Award Opportunity (if a Participant performs at or above maximum on all Performance Goals) depending on performance relative to objectives. Awards are capped at maximum levels regardless of whether a Participant exceeds the stated maximum Performance Goals.

(d) Following the end of each Performance Period, the Compensation Committee will review the actual performance of each Participant against the Performance Goals of the respective Participant and determine the Participant's level of achievement of his or her Performance Goals. The Compensation Committee will seek, and may rely on, the independent confirmation of the level of Performance Goal achievement from an external investment consultant to evaluate Entity Performance and Asset Class Performance. The President and CEO will submit a written report to the Compensation Committee, which documents the Participant's performance relative to the Participant's Performance Goals set at the beginning of the Performance Period and upon which the Compensation Committee may rely in evaluating the Participant's performance. The Board will determine the President and CEO's level of achievement relative to the President and CEO's Performance Goals.

(e) Performance Incentive Awards will be calculated for each Participant based on the percentage achieved of each Performance Goal, taking into account the weighting for the Participant's Entity Performance, Asset Class Performance, and Individual Performance Goals and each Participant's Incentive Award Opportunity. The Compensation Committee will review all Performance Incentive Award calculations, based on the certification of its advisors, and submit its recommendations to the Board for approval.

(f) The methodology for calculating Incentive Award Opportunities and Performance Incentive Awards is presented in Appendix A.

(g) Within 150 days following the end of a Performance Period, the Compensation Committee will review and make recommendations concerning Performance Incentive Awards to Participants whom it determines to have met or exceeded the performance benchmarks for the Performance Period. Subject to the provisions of 7.1(a), the Board will approve Performance Incentive Awards.

(h) Following the approval of a Performance Incentive Award, the Board will promptly notify each Participant as to the amount, if any, of the Performance Incentive Award as well as the terms, provisions, conditions and limitations of the Nonvested Deferred Award, if any.

5.6. Form and Timing of Payouts of Performance Incentive Awards

Approved Performance Incentive Awards will be paid as follows:

(a) Seventy percent of the Performance Incentive Award will be paid to the Participant ("Paid Performance Incentive Award") within 150 days of the completion of the Performance Period, and

(b) Thirty percent of the Performance Incentive Award will be treated as a "Nonvested Deferred Award" subject to the terms of Section 5.7 and paid in accordance with that Section.

5.7. Deferred Awards

(a) Nonvested Deferred Awards will be credited to a hypothetical account on UTIMCO's books in the individual Participants' names ("Nonvested Deferred Award Account(s)") as of the date that the corresponding Paid Performance Incentive Awards are transmitted to Participants. For each Performance Period, a Nonvested Deferred Award Account will be established for each Participant to which will be credited the Nonvested Deferred Award of such Participant for such Performance Period. The Nonvested Deferred Award Accounts will be credited (or debited) monthly with an amount equal to the net investment returns of the Total Endowment Assets ("Net Returns") for the month multiplied by the balance of the respective Participant's Nonvested Deferred Award Account(s) as of the last day of the month. When the Nonvested Deferred Award is initially credited to the Nonvested Deferred Award Account, the Nonvested Deferred Award Account will be credited (or debited) with Net Returns for the month of the initial credit of a Nonvested Deferred Award, but the Net Returns will be prorated to reflect the number of days of the month during which the amounts were credited to the Nonvested Deferred Award Account. Participants are not entitled to their Nonvested Deferred Awards unless they become vested in those awards.

(b) Assuming continued employment with UTIMCO, except as provided in Section 5.10(c), Nonvested Deferred Awards for each respective Performance Period will vest and become payable according to the following schedule:

(1) On the first anniversary of the end of the Performance Period for which the Nonvested Deferred Award was earned, one third of the Nonvested Deferred Award Account then credited to the Participant will be vested and paid to the Participant.

(2) On the second anniversary of the end of the Performance Period for which the Nonvested Deferred Award was earned, one half of the Nonvested Deferred Award Account then credited to the Participant will be vested and paid to the Participant.

(3) On the third anniversary of the end of the Performance Period for which the Nonvested Deferred Award was earned, the remaining Nonvested

Deferred Award Account for that Performance period then credited to the Participant will be vested and paid to the Participant.

(c) Notwithstanding the provisions of paragraphs (a) and (b) of this Section 5.7, upon execution of an "Election to Defer Payment of Vested Deferred Awards" form authorized by the Compensation Committee, a Participant may elect to defer payment of all or part of his or her Nonvested Deferred Awards that have become vested in accordance with Section 5.7(b) (including credited Net Returns) ("Vested Deferred Awards"). Such election must be made within 30 days prior to the date such amounts become vested. Vested Deferred Awards will be credited to a hypothetical account on UTIMCO's books in the individual Participants' names ("Vested Deferred Award Account(s)") as of the date that such amounts become vested. Net Returns will be determined for each Vested Deferred Award Account at the end of each calendar year (or any earlier day in the calendar year on which the Participant terminates employment with UTIMCO) and will be allocated to a subaccount of the Participant's Vested Deferred Award Account ("Net Return Subaccount") established for the Participant each year. A Participant may elect to be paid all or any portion of his or her Vested Deferred Awards (but not amounts credited to his or her Net Return Subaccounts) allocated to his or her Vested Deferred Award Account at any time subject to reasonable administrative procedures established by UTIMCO; provided, however, that if the total balance of a Participant's Net Return Subaccounts is negative at the time he or she makes such an election, the Participant will not be able to withdraw more than the amount of his or her Vested Deferred Awards net of such negative balance. Any such Vested Deferred Awards elected to be withdrawn will be paid as soon as reasonably practicable after the Performance Measurement Date of the month during which the Participant makes the election. Each Net Return Subaccount of a Participant will be distributed to the Participant on the third anniversary of the date of allocation of such amounts to such subaccount, and the Participant will not be able to receive any amounts from his or her Net Return Subaccount prior to such time; provided, however, that if a Net Return Subaccount has a negative balance on such third anniversary, distribution of such subaccount will be made on the next following anniversary on which such Net Return Subaccount has a positive balance. Participants are responsible for all income tax consequences associated with Participant's Vested Deferred Award Account and Net Return Subaccounts.

(d) Notwithstanding the provisions of Section 5.7(c), each Participant who terminates employment with UTIMCO for any reason will be paid (or, in the case of a deceased Participant, his or her estate will be paid) the balance of his or her Vested Deferred Award Account, increased or decreased by the positive or negative balance of his or her Net Return Subaccounts. Such amounts will be paid as soon as reasonably practicable after the Performance Measurement Date of the month during which the Participant terminates employment with UTIMCO.

(e) Notwithstanding any provision of the Plan to the contrary, at any time prior to the time such amounts would otherwise be distributed under paragraphs (c) or (d) of this Section 5.7, the Board in its discretion may distribute to a Participant the balance of the Participant's Vested Deferred Award Account, increased or decreased by the positive or negative balance of his or her Net Return Subaccounts.

5.8. Performance Standards

(a) Entity Performance

(1) Entity Performance for purposes of the Performance Incentive Plan is the performance of the Total Endowment Assets. Entity Performance under the Performance Incentive Plan is based on performance relative to a Peer Group. Except as provided in Section 5.9, performance relative to the Peer Group will be measured based on 3-year rolling historical performance.

(2) The Board's chosen investment advisor will determine the performance of the Peer Group annually for the Performance Period. The Board's investment advisor will calculate a percentile rank for Entity Performance relative to the Peer Group, with the 100^{th} percentile representing the highest rank, the 50^{th} percentile representing the median and the 0^{th} percentile representing the lowest rank. Threshold awards will be earned for reaching the 40^{th} percentile, target awards will be earned for reaching the 60^{th} percentile, and maximum awards will be earned for reaching the 75^{th} percentile, with Performance Incentive Awards interpolated in a linear fashion between threshold and target as well as between target and maximum.

(b) Asset Class Performance

(1) Except as provided in subparagraph (2) below and Section 5.9, Asset Class Performance will be measured relative to the appropriate benchmark based on 3-year rolling historical performance. Performance standards for each asset class will vary depending on the ability to outperform the respective benchmark. The following table identifies the benchmarks for each asset class as well as threshold, target, and maximum performance standards. Performance Incentive Awards will be interpolated in a linear fashion between threshold and target as well as between target and maximum.

Asset Class	Benchmark	Policy Portfolio Weights (% of Portfolio)	Performance Standards Threshold	Target	Maximum
Entity: Peer goup	Peer group (Endowments w/ >$ 1 B assets)	n/a	40th %ile	60th %ile	75th %ile
US Public Equity	Russell 3000	20.0%	+0 bps	+31 bps	+62 bps
International Equity	MSCI All Country World Index, Ex US	17.0%	+0 bps	+52.5 bps	+105 bps
Fixed Income	Lehman Brothers Aggregate Bond Index	10.0%	+0 bps	+12.5 bps	+25 bps
Private Capital	Roll up of Private Equity & Venture Capital	15.0%			
Private Equity	Venture Economics Private Equity Database	--	+0 bps	+100 bps	+200 bps
Venture Capital	Venture Economics Venture Capital Database	--	+0 bps	+112.5 bps	+225 bps
Absolute Return Hedge Funds	91-Day T-Bill	15.0%	+300 bps	+350 bps	+400 bps
Equity Hedge Funds	91-Day T-Bill	10.0%	+400 bps	+465 bps	+530 bps
Inflation Hedge	Roll up of Commodities, TIPS & REITS	13.0%			
Commodities	Goldman Sachs Commodity Index	3.0%	-100 bps	-15 bps	+0 bps
TIPS	Lehman Brothers US TIPS Index	5.0%	+0 bps	+2.5 bps	+5 bps
REITS	Dow Jones Wishire Real Estate Securities Index	5.0%	+0 bps	+37.5 bps	+75 bps
Cash	91-Day T-Bill	0.0%	+0 bps	+0 bps	+0 bps
Short Intermediate Term Fund	SITF Policy Statement	--	+0 bps	+5 bps	+10 bps

(2) Performance for the private capital asset class is calculated differently than other asset classes due to its longer investment horizon and illiquidity of assets. Performance of the private capital asset class is determined based on the performance of partnership commitments made by the current private capital team since 2001 based on internal rates of return (IRR's) relative to the respective Venture Economics benchmarks.

(c) Individual Performance

Individual Performance will be measured based on performance during the Performance Period.

5.9. Modification of Performance Standards for Newly Hired Employees

(a) Although Entity Performance and most Asset Class Performance are measured based on three-year rolling historical performance, newly hired Participants will be phased into the Plan so that Entity and Asset Class Performance are measured over a period of time consistent with each Participant's tenure at UTIMCO. This provision ensures that Participants are measured and rewarded over a period of time consistent with which they influenced the performance of the entity or a particular asset class. In the Performance Period in which a Participant begins participation in the Plan, the Entity and Asset Class Performance component of the Incentive Award Opportunity will be based on one full year of historical performance (i.e., the performance for the Performance Period during which the Participant commenced Plan participation). During a Participant's second year of Plan participation, the Entity and Asset Class Performance component of the Incentive Award Opportunity will be based on two full years of historical performance. In the third year of a Participant's Plan participation and beyond, the Entity and Asset Class Performance component of the Incentive Award Opportunity will be based on the three full years of rolling historical performance. This provision will apply to Participants who are current UTIMCO employees and were hired after July 1, 2001.

(b) Notwithstanding the provisions of Section 5.8(a) and Section 5.9(a), if the Participant worked for UTIMCO for less than six full months in the Performance Period in which he or she was hired, Asset Class Performance calculations for that year will be based on the performance during the actual full months the Participant worked at UTIMCO. In order to prevent this partial year Performance Period from having too large an impact on Performance Incentive Award calculations over multiple Performance Periods, the weighting of the first Performance Period would be discounted in the following manner:

<u>Second Performance Period of Participation</u>
Weight for Performance Period 1 = ((Months worked in year 1)/6) x 50%
Weight for Performance Period 2 = 100% - weight for performance year 1

<u>Third Performance Period of Participation</u>
Weight for Performance Period 1 = ((Months worked in year 1)/6) x 33%
Weight for Performance Period 2 = (100% - Weight for performance year 1)/2
Weight for Performance Period 3 = (100% - Weight for performance year 1)/2

5.10. Termination Provisions

(a) Except as otherwise provided in this Section 5.10, any Participant who ceases to be a Participant (either because of termination of employment with UTIMCO or for any other reason stated in Section 5.3(c)) prior to the end of a Performance Period will not be eligible to receive payment of any Performance Incentive Award for that or any subsequent Performance Periods. In addition, a Participant will only continue to vest in Nonvested Deferred Awards while he or she is employed with UTIMCO and will forfeit any Nonvested Deferred Awards at termination of employment with UTIMCO. Unless distributed earlier under the terms of the Plan and subject to Sections 7.6 and 7.8, all Vested Deferred Awards are payable at termination of employment in accordance with Section 5.7(d).

(b) If a Participant ceases to be a Participant in the Plan under Section 5.3(c) prior to the end of a Performance Period because his or her employment position is no longer an Eligible Position (but such employee continues to be employed with UTIMCO), such Participant’s Performance Incentive Award for the current Performance Period, if any, will be calculated on a prorated basis from the first day of the Performance Period to the Performance Measurement Date immediately preceding or, if applicable, coinciding with the date the Participant ceases to be in an Eligible Position, and such individual will not be entitled to any Performance Incentive

Awards for any Performance Period thereafter (unless he or she again becomes a Participant in accordance with Sections 5.3(a) and (b)). All Nonvested Deferred Awards continue to vest subject to the provisions of Section 5.7(b).

(c) If a Participant ceases to be a Participant in the Plan under Section 5.3(c) prior to the end of a Performance Period because his or her employment with UTIMCO terminates due to death or disability (as defined in the Internal Revenue Code §22(e)(3)), the Participant's Performance Incentive Award for the Performance Period in which termination occurs will be paid at target on a prorated basis from the first day of the Performance Period to the Performance Measurement Date immediately preceding or, if applicable, coinciding with the date of the Participant's death or disability, and such individual will not be entitled to any Performance Incentive Awards for any Performance Period thereafter (unless he or she again becomes a Participant in accordance with Sections 5.3(a) and (b)). All Nonvested Deferred Awards will vest immediately and be paid. Payments under this provision will be made to the estate or designated beneficiaries of the deceased Participant or to the disabled Participant, as applicable, in accordance with Section 5.7(d) within 60 days of the date of termination of employment.

(d) If a Participant ceases to be a Participant in the Plan under Section 5.3(c) prior to the end of a Performance Period because he or she commences a Compensation Committee-approved leave of absence, such Participant's Performance Incentive Award for the current Performance Period, if any, will be calculated on a prorated basis from the first day of the Performance Period to the Performance Measurement Date immediately preceding or coinciding with the date the Participant commences such leave of absence, and such individual will not be entitled to any Performance Incentive Awards for any Performance Period thereafter (unless he or she again becomes a Participant in accordance with Sections 5.3(a) and (b)).

6. PLAN AUTHORITY AND RESPONSIBILITY

(a) Except as otherwise specifically provided in this Compensation Program with respect to powers, duties, and obligations of the Compensation Committee, the Compensation Program will be administered by the Board.

(b) The Board has all powers necessary or advisable to administer the Plan as it determines in its discretion, including, without limitation, the authority to:

(1) Establish the conditions for the determination and payment of compensation by establishing the provisions of the Performance Incentive Plan.

(2) Select the employees who are eligible to be Participants.

(3) Subject to the terms of the Plan, determine the amount and timing of Performance Incentive Awards under the Plan.

(4) Establish the base salaries, Performance Incentive Opportunity Levels and Performance Incentive Awards.

(5) Delegate to any other person, committee, or entity any of its ministerial powers and/or duties under the Plan as long as any such delegation is in writing and complies with the UTIMCO Bylaws.

7. PERFORMANCE INCENTIVE PLAN INTERPRETATION

7.1. Board Discretion

(a) The Board has the discretion to interpret the Plan and may from time to time adopt such rules and regulations, consistent with the provisions of the Plan that it may deem advisable to carry out the Plan. All decisions made by the Board in selecting the Participants approved to receive Performance Incentive Awards, including the amount thereof, and in construing the provisions of the Plan or the terms of any Performance Incentive Awards are final and binding on all Participants.

(b) Notwithstanding any provision of the Plan to the contrary, the Board shall have the discretion and authority to make changes in the terms of the Plan in determining a Participant's eligibility for, or amount of, a Performance Incentive Award for any Performance Period whenever it considers that circumstances have occurred during the Performance Period so as to make such changes appropriate in the opinion of the Board, provided however, any such change shall not deprive or eliminate a vested and accrued right of a Participant.

7.2. Duration, Amendment and Termination

The Board shall have the right in its discretion to amend the Plan or any portion thereof from time to time, to suspend it for a specified period, or to terminate it entirely or any portion thereof. However, if the Plan is suspended or terminated during a Performance Period, Participants will receive a prorated Performance Incentive Award based on performance achieved and base salary earned through the Performance Measurement Date immediately preceding such suspension or termination. The Plan shall be in effect until suspension or termination by the Board; provided, however, that if the Board so determines at the time of any suspension or termination, Nonvested Deferred Awards credited to Participants'

Nonvested Deferred Award Account(s) as of the effective date of such suspension or termination will continue to be administered under the terms of the Plan after any suspension or termination, except as the Board otherwise determines in its discretion at the time of such suspension or termination.

7.3. Record Keeping and Reporting

(a) All records for the Compensation Program shall be maintained by the Managing Director of Accounting, Finance and Administration at UTIMCO. Relative performance data and calculations shall be reviewed by UTIMCO's external investment consultant before Performance Incentive Awards are finalized and approved by the Board.

(b) UTIMCO will provide all Participants with a comprehensive report of the current value of their respective Nonvested and Vested Deferred Award Account balances, including a complete vesting status of those balances, on at least a quarterly basis.

7.4. Continued Employment

Nothing in the adoption of this Plan or the awarding of Performance Incentive Awards shall confer on any employee the right to continued employment with UTIMCO or affect in any way the right of UTIMCO to terminate his or her employment at any time.

7.5. Non-transferability of Awards

Except for the rights of the estate or designated beneficiaries of Participants to receive payments, as set forth herein, Performance Incentive Awards under the Plan are non-assignable and non-transferable and are not subject to anticipation, adjustment, alienation, encumbrance, garnishment, attachment or levy of any kind. The preceding notwithstanding, the Plan will pay a Vested Deferred Award in accordance with an order that meets the requirements of a "qualified domestic relations order" as set forth in Section 414(p) of the Internal Revenue Code and Section 206(d) of ERISA.

7.6. Unfunded Liability

(a) Neither the establishment of this Plan, the awarding of Performance Incentive Awards, the creation of Nonvested Deferred Awards Accounts, nor the creation of Vested Deferred Awards Accounts shall be deemed to create a trust. The Plan shall constitute an unfunded, unsecured liability of UTIMCO to make payments in accordance with the provisions of the Plan. Any amounts set aside by UTIMCO to assist it in the payment of Performance Incentive Awards or other benefits under the Plan, including without limitation, amounts set aside to pay for Nonvested Deferred Awards and Vested Deferred Awards, shall be the assets of UTIMCO, and no Participant shall have any security or other interest in any assets of UTIMCO or the Board of Regents of The University of Texas System by reason of the Plan.

(b) Nothing contained in the Plan shall be deemed to give any Participant, or any personal representative or beneficiary, any interest or title to any specific property of UTIMCO or any right against UTIMCO other than as set forth in the Plan.

7.7. Compliance with State and Federal Law

No portion of the Plan shall be effective at any time when such portion violates an applicable state or federal law, regulation or governmental order or directive.

7.8. Federal, State and Local Tax and Other Deductions

All Performance Incentive Awards under the Plan shall be subject to any deductions (1) for tax and withholding required by federal, state, or local law at the time such tax and withholding is due (irrespective of whether such Performance Incentive Award is deferred and not payable at such time) and (2) for any and all amounts owed by the Participant to UTIMCO at the time of payment of the Performance Incentive Award. UTIMCO shall not be obligated to advise an employee of the existence of the tax or the amount that UTIMCO will be required to withhold.

7.9. Prior Plan

(a) The Performance Incentive Plan restates and supercedes the Prior Plan.

(b) All nonvested deferred awards under the Prior Plan will retain the vesting schedule defined under the Prior Plan. However, as of the Effective Date, those nonvested deferred amounts will be credited or debited with the Net Returns over the remaining deferral period in accordance with Section 5.7(a). Nonvested deferred balances earned under the Prior Plan will be subject to the terms and conditions for Nonvested Deferred Awards under the Plan, except the vesting period which will remain the same as it was under the Prior Plan, and when such amounts become vested, they will be subject to the terms and conditions for Vested Deferred Awards under the Plan.

8. DEFINITION OF TERMS

8.1. **Asset Class Performance** is the performance of specific asset classes within the Total Endowment Assets (such as US public equity, private capital, etc.) based on the standards set forth in Section 5.8(b)(1).

8.2. **Board** is the UTIMCO Board of Directors.

8.3. **Compensation Committee** is the Compensation Committee of the UTIMCO Board of Directors.

8.4. **Compensation Plan** is defined in Section 1.

8.5. **Effective Date** is defined in Section 5.1(b).

8.6. **Eligible Position** is defined in Section 5.3(a).

8.7. **Entity Performance** represents the performance of the Total Endowment Assets (based on the standards set forth in Section 5.8(a)).

8.8. **Incentive Award Opportunity** is defined in Section 5.5(a).

8.9. **Net Returns** is the investment performance return of the Total Endowment Assets, net of fees. Net of fees factors in all administrative and other fees for managing the Total Endowment Assets. The net investment return will be calculated as follows:

$$\frac{\text{Permanent University Fund Beginning Net Asset Value}}{\text{Total Endowment Beginning Net Asset Value}} \times \text{Permanent University Fund Net Investment Return}$$

Plus

$$\frac{\text{General Endowment Fund Beginning Net Asset Value}}{\text{Total Endowment Beginning Net Asset Value}} \times \text{General Endowment Fund Net Investment Return}$$

8.10. **Nonvested Deferred Award** is defined in Section 5.6.

8.11. **Nonvested Deferred Award Account** is defined in Section 5.7(a).

8.12. **Paid Performance Incentive Award** is defined in Section 5.6(a).

8.13. **Participant** is defined in Section 5.3(a).

8.14. **Peer Group** is a peer group of endowment funds maintained by the Board's external investment advisor that is composed of all endowment funds with assets greater than $1 billion at the beginning of each Performance Period and is set forth on Appendix B, as such Appendix B is amended from time to time. Harvard University, Yale University and Total Endowment Assets are excluded from this peer group. The peer group will be updated annually at the beginning of each Performance Period, and Appendix B will be amended accordingly.

8.15. **Performance Goals** are defined in Section 5.4.

8.16. **Performance Incentive Award** is the component of a Participant's total compensation that is based on specific performance goals and awarded as current income or deferred at the end of a Performance Period in accordance with Section 5 and Appendix A.

8.17. **Performance Incentive Plan** is defined in Section 5.

8.18. **Performance Measurement Date** is the close of the last business day of the month.

8.19. **Performance Period** is defined in Section 5.2.

8.20. **Prior Plan** is the UTIMCO Performance Compensation Plan, effective September 1, 2000.

8.21. **Salary Structure** is described in Section 4.1.

8.22. **Total Endowment Assets** means the combination of the Permanent University Fund and the General Endowment Fund, but does not include any other endowment funds monitored by UTIMCO such as the Separately Invested Fund. Performance of the Total Endowment Assets is measured net of fees, meaning performance is measured after factoring in all administrative and other fees incurred for managing the Total Endowment Assets.

8.23. **Vested Deferred Award** is defined in Section 5.7(c).

8.24. **Vested Deferred Award Account** is defined in Section 5.7(c).

Appendix A
UTIMCO Compensation Program
Performance Incentive Award Methodology

I. Determine "Incentive Award Opportunities" for Each Participant[1]

1. Identify the weights to be allocated to each of the three Performance Goals for each Participant's Eligible Position. The weights vary for each Eligible Position and are set forth on the chart in Section 5.5(b). For example, for the President and CEO, the weight allocated to the Entity Performance Goal is 70%, the weight allocated to the Asset Class Performance Goal is 0%, and the weight allocated to the Individual Performance Goal is 30%. The total of the weights ascribed to the three Performance Goals must add up to 100% for each Participant.

2. Identify the percentage of base salary for the Participant's Eligible Position that determines the Performance Incentive Award for achievement of the Threshold, Target, and Maximum levels of the Performance Goals. The percentages vary for each Eligible Position and are set forth in the chart in Section 5.5(b). For example, the Performance Incentive Award for the President and CEO is 18% of his or her base salary for achievement of Threshold level performance of all three Performance Goals, 90% of his or her base salary for achievement of Target level performance of all three Performance Goals, and 180% of his or her base salary for achievement of Maximum level performance of all three Performance Goals.

3. Calculate the dollar amount of the Threshold, Target, and Maximum awards for each Participant by multiplying the Participant's base salary for the Performance Period by the applicable percentage in Step #2 above. For example, assuming the President and CEO has a base salary of $450,000 for the year, the President and CEO will be eligible for an award of a total of $81,000 (18% of his or her base salary) if he or she achieves Threshold level performance of all three Performance Goals, $405,000 (90% of his or her base salary) if he or she achieves Target level performance of all three Performance Goals, and $810,000 (180% of his or her base salary) if he or she achieves Maximum level performance of all three Performance Goals.

4. Because a Participant may achieve different levels of performance in different Performance Goals and be eligible for different levels of awards for that achievement (e.g., he or she may achieve Target performance in

[1] These Incentive Award Opportunities represent amounts that each Participant will be awarded if he or she achieves his or her Performance Goals at varying levels and are calculated at the beginning of each Performance Period.

the Equity Performance Goal and be eligible to receive a Target award for that goal and achieve Maximum performance in the Individual Performance Goal and be eligible to receive a Maximum award for that Performance Goal), it is necessary to determine the dollar amount (the "Incentive Award Opportunity") of the Threshold, Target, and Maximum award for each separate Performance Goal. This is done by multiplying the dollar amount of the Threshold, Target, and Maximum awards for the performance of all three Performance Goals calculated in Step #3 above for the Participant by the weight allocated for that Participant to the particular Performance Goal. For example, as determined in Step #3 above, the President and CEO will receive a Performance Incentive Award of $405,000 if he or she achieves Target level performance of all three Performance Goals. This $405,000 is broken up per Performance Goal as follows: If the President and CEO achieves Target level performance in the Entity Performance Goal, he or she will be awarded $283,500 (his or her weight allocation of 70% for this Performance Goal multiplied by the $405,000), and if he or she achieves Target level performance in his or her Individual Performance Goal, he or she will be awarded $121,500 (his or her weight allocation of 30% for this Performance Goal multiplied by the $405,000). Note that, because no weight allocation is given to the President and CEO for the Asset Class Performance Goal, no amount of the $405,000 is allocated to the achievement of that Performance Goal.

5. After Step #4 above is performed for each of the three levels of performance for each of the three Performance Goals, there will be nine different Incentive Award Opportunities for each Participant. For example, for the President and CEO (based on a Base Salary of $450,000 for the year), the nine different Incentive Award Opportunities for achievement of the Performance Goals for the Performance Period are as follows:

Incentive Award Opportunities for President and CEO

Performance Goal/Weight	Threshold Level Award	Target Level Award	Maximum Level Award
Entity (70%	$56,700	$283,500	$567,000
Asset Class (0%)	$0	$0	$0
Individual (30%	$24,300	$121,500	$243,000
Total (100%)	$81,000 (18% of salary)	$405,000 (90% of salary)	$810,000 (180% of salary)

II. Calculate Performance Incentive Award for Each Participant

6. Determine the achievement percentages that divide the Threshold, Target, and Maximum levels for each Performance Goal. These divisions are set forth in the chart in Section 5.8(b)(1) for the Entity and Asset Class Performance Goals. For example, as shown on the chart, achievement of the Entity Performance Goal in the 40th percentile is the Threshold

performance level, achievement of the Entity Performance Goal in the 60th percentile is the Target performance level, and achievement of the Entity Performance Goal in the 75th percentile is the Maximum performance level. As shown on the chart, the achievement percentile for the Asset Class Performance Goal is based on the attained basis points for a particular type of investment. Thus the measurement of the level of achievement (i.e., Threshold, Target, or Maximum) for the Asset Class Performance Goal differs for each Participant depending on the assets under that Participant's investment control. The measurement for the level of achievement (i.e., Threshold, Target, or Maximum) for the Individual Performance Goal is initially determined each Performance Period by the Participant's supervisor, if any, and then is approved (or adjusted) by the Compensation Committee as it deems appropriate in its discretion. If the Participant has no supervisor, the measurement for the level of achievement for the Individual Performance Goal is determined each Performance Period by the Compensation Committee.

7. Determine the percentile achieved of each of the Performance Goals for each Participant using the standards set forth in Sections 5.5 and 5.8 of the Plan, as modified in the case of new hires in Section 5.9.

8. Calculate the amount of each Participant's award attributable to each Performance Goal by determining the Incentive Award Opportunity amount for the applicable percentile of the Participant's level of achievement for each Performance Goal as determined in Step #4 and Step #5 above. That is, achievement of the Entity Performance Goal in the 40th percentile is the Threshold performance level and merits a Threshold level award, achievement in the 60th percentile is the Target performance level and merits a Target level award, and achievement in the 75th percentile is the Maximum performance level and merits a Maximum level award. For example, if the President and CEO achieved 100% of his or her Individual Performance Goal, he or she would have earned an award of $243,000 (Maximum award) for that Performance Goal for the Performance Period, and if the Entity Performance Goal of the 40th percentile is achieved, he or she would have earned an award of $56,700 (Threshold award) for that Performance Goal for the Performance Period.

9. An award for achievement percentiles in between the stated Threshold, Target, and Maximum levels is determined by linear interpolation. For example, if the 54th percentile of the Equity Performance Goal has been achieved, it is between the Threshold (40th percentile) and the Target (60th percentile) levels. To determine the amount of the award attributable to a 54th percentile achievement of the Equity Performance Goal, perform the following steps: (i) subtract the difference between the dollar amount of the Threshold and Target Incentive Award Opportunities for the Participant (e.g., for the President and CEO, as illustrated in the above table, the difference is $226,800 ($283,500- $56,700)); (ii) divide 14 (the

percentile difference between the Threshold level of 40^{th} percentile and the attained level of 54^{th} percentile) by 20 (the percentile difference between the Threshold level and the Target level); (iii) multiply the amount determined in the preceding Step (i) by the percentage determined in the preceding Step (ii); (iv) add the amount determined in the preceding Step (iii) to the Threshold Incentive Award Opportunity for the Participant to get the actual award for the Participant attributable to each Performance Goal.

10. No award is given for an achievement percentile below Threshold, and no award above the Maximum award is given for an achievement percentile above the Maximum level. For example, if the 38^{th} percentile of the Entity Performance Goal has been achieved for the Performance Period, no award is given for that Performance Goal. If the 85^{th} percentile of the Entity Performance Goal has been achieved for the Performance Period, no award in excess of the Maximum Incentive Award Opportunity for that goal is given.

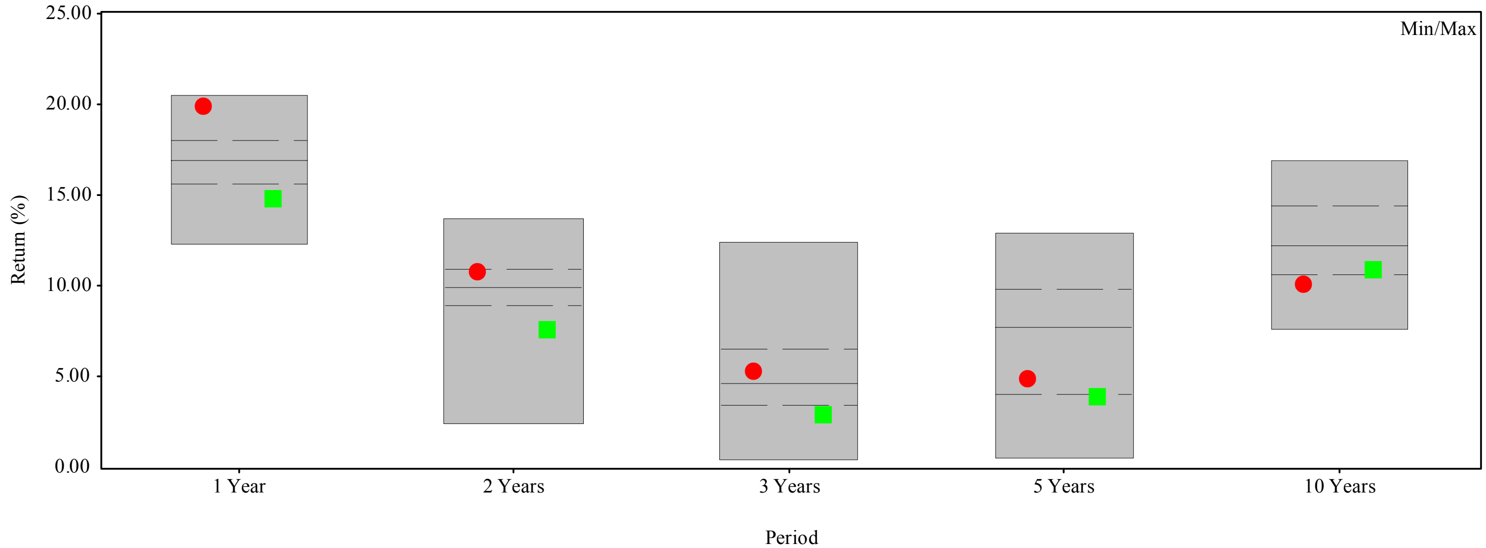
11. Add the awards determined in Step #8 and/or Step #9 above together to determine the total amount of the Participant's Performance Incentive Award for the Performance Period.

APPENDIX B
UTIMCO PEER GROUP

- Brown University
- California Institute of Technology
- Case Western Reserve University
- Columbia University
- Cornell University
- Dartmouth College
- Duke University
- Emory University
- Grinnell College
- Johns Hopkins University
- Massachusetts Institute of Technology
- New York University
- Northwestern University
- Ohio State University and Foundation
- Princeton University
- Purdue University
- Rice University
- Stanford University
- The Rockefeller University
- The Texas A&M University System and Foundations
- UNC at Chapel Hill and Foundations
- University of California
- University of Chicago
- University of Michigan
- University of Minnesota and Foundation
- University of Notre Dame
- University of Pennsylvania
- University of Pittsburgh
- University of Rochester
- University of Southern California
- University of Virginia
- University of Washington
- Vanderbilt University
- Washington University
- Wellesley College
- Williams College

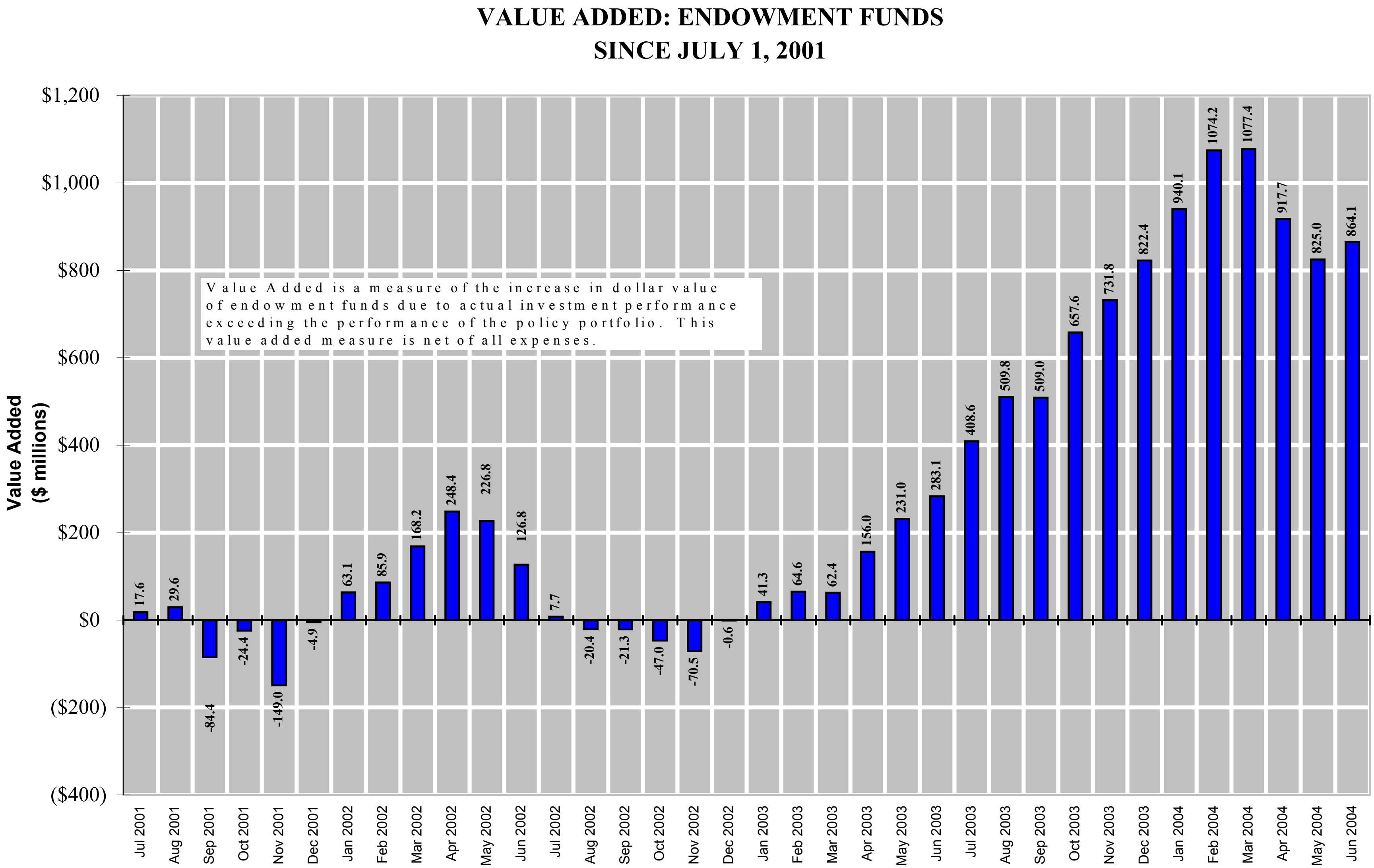
Source: Cambridge Associates. Represents University endowments (excluding Harvard, Yale and Total Endowment Assets) with total assets in excess of $1 billion as of fiscal year end June 2003.

UTIMCO COMPENSATION PLAN PEER GROUP UNIVERSE
Periods Ending June 30, 2004



	Return	(% tile)	Return	(% tile)	Return	(% tile)	Return	(% tile)	Return	(% tile)
Maximum	20.55		13.73		12.50		12.90		16.96	
25th Percentile	18.03		10.94		6.56		9.87		14.46	
Median	16.97		9.95		4.60		7.71		12.29	
75th Percentile	15.60		8.99		3.42		4.08		10.68	
Minimum	12.49		2.58		0.53		0.68		7.79	
# of Portfolios	36		36		36		32		27	
UT System Endowment Funds	20.06	6	10.94	25	5.48	41	5.00	70	10.24	90
Endowment Funds Policy Portfolio	14.95	82	7.72	95	3.02	84	4.07	76	11.07	72

The Compensation Plan Peer Group Universe is a peer group of 36 endowment funds greater than $1 Billion. The Compensation Plan Peer Group Universe shown above reflects final returns from 35 of the 36 reporting institutions and is therefore subject to change.


VALUE ADDED: ENDOWMENT FUNDS
SINCE JULY 1, 2001
Value Added ($ millions)
$1,200
$1,000
$800
$600
$400
$200
$0
($200)
($400)
Value Added is a measure of the increase in dollar value of endowment funds due to actual investment performance exceeding the performance of the policy portfolio. This value added measure is net of all expenses.
17.6
29.6
-84.4
-24.4
-149.0
-4.9
63.1
85.9
168.2
248.4
226.8
126.8
7.7
-20.4
-21.3
-47.0
-70.5
-0.6
41.3
64.6
62.4
156.0
231.0
283.1
408.6
509.8
509.0
657.6
731.8
822.4
940.1
1074.2
1077.4
917.7
825.0
864.1
Jul 2001
Aug 2001
Sep 2001
Oct 2001
Nov 2001
Dec 2001
Jan 2002
Feb 2002
Mar 2002
Apr 2002
May 2002
Jun 2002
Jul 2002
Aug 2002
Sep 2002
Oct 2002
Nov 2002
Dec 2002
Jan 2003
Feb 2003
Mar 2003
Apr 2003
May 2003
Jun 2003
Jul 2003
Aug 2003
Sep 2003
Oct 2003
Nov 2003
Dec 2003
Jan 2004
Feb 2004
Mar 2004
Apr 2004
May 2004
Jun 2004

Periods Ending 6/30/03	UT System Endowments Would Have Been This Much Larger at June 30, 2003 Endowments Larger than $1 billion 40th Percentile (NACUBO)	Endowments Larger than $1 billion 50th Percentile (NACUBO)	Endowments Larger than $1 billion 75th Percentile (NACUBO)
10 Years	$ 1,487,297,553	$ 1,872,047,727	$ 4,783,171,787
5 Years	1,435,730,414	1,672,504,051	3,524,187,557
3 Years	(170,566,302)	41,571,611	1,057,330,076
1 Year	41,925,692	176,161,115	330,404,146

The amounts shown above represent how much larger the UT System managed endowments would have been at June 30, 2003 had the UT endowments earned returns comparable to the 40th, 50th and 75th percentile returns of all endowments in the NACUBO universe greater than $1 billion. This scenario EXCLUDES Harvard, Yale and UT System in the determination of the 40th, 50th and 75th percentile returns.

7. U. T. Board of Regents: Approval of proposed Annual Budget and Management Fee Schedule for The University of Texas Investment Management Company (UTIMCO) and recommended cost study

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Business Affairs and the Associate Vice Chancellor for Finance that the U. T. Board of Regents approve the proposed Annual Budget as set forth on Page 13.1 and the Annual Fee and Allocation Schedule for the fiscal year ending August 31, 2005, as set forth on Page 13.2.

It is further recommended that the U. T. Board of Regents request the UTIMCO Board of Directors to determine how UTIMCO's cost structure compares to its peers, with a specific request that a study be performed by March 2005 to allow use of the study as a reference for review of the Fiscal Year 2006 UTIMCO Budget.

BACKGROUND INFORMATION

A proposed Annual Budget of $38.2 million was approved by the UTIMCO Board on July 15, 2004. The proposed Budget attached to this Item has been modified to slightly reduce salaries and wages. The proposed Budget is an increase of 9.85% from the Fiscal Year 2004 Budget.

Background materials prepared by UTIMCO President and Chief Executive Officer Bob Boldt are attached on Pages 13.3 - 13.7.

A Budget Report, prepared by the U. T. System Office of Finance and attached at Pages 13.8 - 13.24, reviews the proposed Annual Budget. The Executive Summary for the Report is on Page 13.9.

There is very little data available to determine how UTIMCO's cost structure compares to its peers. In the past, UTIMCO has referred to a study prepared by Cambridge Associates entitled "An Overview of Endowment Management Costs 2002", as support for its cost structure. While this study was helpful, it did not include all of UTIMCO's costs and it refers to data that is now dated. Therefore, it is recommended that a current and complete cost study be commissioned by the UTIMCO Board of Directors to address the following questions:

1. How do UTIMCO's Services Costs compare to its peers?

2. How do UTIMCO's Direct Costs to Funds compare to its peers?

3. How do UTIMCO's Total Costs compare to its peers? Total Costs would include the full cost of managing the investments including all of the costs in the UTIMCO budget, all management fees that are not included in the UTIMCO budget, and brokerage commissions.

4. How does the level and breadth of services provided by UTIMCO compare to its peers?

5. How do UTIMCO's costs compare to the costs associated with a purely passive investment implementation strategy?

The University of Texas Investment Management Company

2002 - 2005 Operating Budgets

	8/31/02 Budget	8/31/02 Actual	8/31/03 Budget	8/31/03 Actual	8/31/04 Budget	8/31/04 Projected	8/31/05 Budget	% Change from 2004 budget
UTIMCO Services								
Salaries and Wages + vac	2,703,427	2,287,533	3,854,426	3,102,883	4,141,188	3,804,867	4,780,040	15%
Bonus Compensation + int.	1,086,879	239,622	2,100,684	1,089,333	1,867,266	1,858,109	1,704,253	-9%
Total Compensation	3,790,306	2,527,155	5,955,110	4,192,216	6,008,455	5,662,976	6,484,293	7.92%
Total Payroll taxes	188,021	145,492	249,743	195,076	270,688	232,185	293,831	8.55%
403(b) Contributions	200,051	156,515	291,841	219,898	320,423	285,000	360,425	12%
Group Health,Dental,AD&D,Life,GroupLTD	166,472	150,085	246,344	201,090	322,430	293,025	437,787	36%
Employee Benefit Services	7,000	7,850	7,000	4,490	6,000	5,650	6,000	0%
Employee Benefits	373,523	314,450	545,186	425,478	648,854	583,675	804,212	23.94%
On-Line Data & Contract Services	522,500	304,635	512,500	417,995	558,800	584,150	636,729	14%
Recruiting and Relocation Expenses	8,000	94,038	372,000	359,917	25,000	18,500	141,000	464%
Travel	80,000	71,739	120,000	109,138	187,000	182,500	255,000	36%
Phone Equipment and Charges	82,000	49,530	79,500	41,990	72,000	48,785	46,000	-36%
Computer & Office Supplies	71,600	51,344	79,100	73,887	85,650	85,400	87,640	2%
Employee Education	20,000	13,034	72,000	14,424	56,500	36,450	54,700	-3%
Repairs/Maintenance	41,500	36,673	41,500	39,453	43,500	48,000	48,600	12%
BOD Meetings	20,000	18,623	47,500	29,811	49,050	38,700	40,750	-17%
Other Operating Expenses	115,300	16,675	47,500	25,554	23,500	30,700	21,500	-9%
Total General Operating	960,900	656,291	1,371,600	1,112,169	1,101,000	1,073,185	1,331,919	20.97%
Total Lease Expense	613,000	604,683	623,010	606,013	623,010	619,785	592,510	-4.90%
Investment Consultants	25,000	195	100,000	2,000	50,000	0	0	-100%
Legal Expenses	275,000	242,533	250,000	500,823	200,000	196,500	175,000	-13%
Compensation Consultant			0	45,200	25,000	65,000	25,000	0%
Accounting fees	10,000	6,630	10,000	6,870	10,000	9,500	9,500	-5%
Total Professional Fees	310,000	249,358	360,000	554,893	285,000	271,000	209,500	-26.49%
Property/Liability Package	10,875	12,182	13,399	15,009	18,282	17,500	17,500	-4%
Umbrella Policy	5,000	5,691	6,412	6,756	7,812	8,250	8,250	6%
Workers Compensation	7,300	10,910	11,543	14,109	16,722	17,500	17,500	5%
Business Auto	160	162	172	175	200	100	100	-50%
Commercial Bonding Policy	38,000	36,659	35,614	39,138	46,926	45,000	45,000	-4%
Prof. and D&O Liability	119,600	131,931	144,513	158,881	190,582	190,000	190,000	0%
Total Insurance	180,935	197,535	211,653	234,068	280,524	278,350	278,350	-0.77%
Depreciation of Equipment	281,592	271,692	286,200	286,176	294,243	286,297	456,000	54.97%
Total UTIMCO Services	$ 6,698,276	$ 4,966,655	$ 9,602,501	$ 7,606,089	$ 9,511,773	$ 9,007,453	$ 10,450,616	9.85%
		1,731,621		1,996,412		est. 504,320		
Direct Costs to Funds								
External Management Fees	12,788,316	10,968,493	13,344,491	10,699,801	9,525,099	13,168,545	15,043,557	58%
External Mgt. Fees-Performance Fees	7,400,111	3,899,937	6,771,540	4,467,459	8,423,640	9,548,200	8,460,603	0%
External Management Fees	20,188,427	14,868,430	20,116,031	12,314,265	17,948,739	22,716,745	23,504,160	30.95%
Custodian Fees and other direct costs	1,244,906	1,179,087	1,262,700	1,351,899	1,156,630	1,017,699	1,226,918	6%
Performance Measurement	321,338	231,413	268,163	261,625	400,000	478,075	685,710	71%
Risk Measurement	286,000	361,460	353,000	335,172	403,000	127,500	575,000	43%
Custodian and Analytical Costs	1,852,244	1,771,960	1,883,863	1,948,696	1,959,630	1,623,274	2,487,628	26.94%
Cambridge Fees	2,799,844	2,797,487	968,607	1,477,800	901,170	900,000	900,000	0%
Auditing	211,500	158,371	202,700	168,202	184,500	205,000	190,300	3%
Consulting		51,387	100,000	0	0		0	
Controls Assessment (Sarbanes Oxley)							95,000	
Printing	106,757	91,246	99,900	99,583	87,700	111,431	120,000	37%
Bank fees	4,000	7,289	9,000	7,605	9,000	10,670	9,000	0%
Rating agency fees	22,800	21,876	22,000	21,508	22,000	22,000	23,500	7%
Legal Fees	35,000	267,880	315,430	343,849	250,000	432,296	345,750	38%
Background Searches				1,540			18,900	
Other						3,180	2,000	
Other Directs Total	3,179,901	3,395,536	1,717,637	2,120,087	1,454,370	1,684,577	1,704,450	17.20%
Total Direct Costs to Funds	25,220,572	20,102,705	23,717,531	16,048,173	21,362,739	26,024,596	27,696,238	29.65%
		5,117,867		7,669,358		(4,661,857)		
Grand Total	31,918,848	25,069,360	33,320,032	23,654,262	30,874,512	35,032,049	38,146,854	23.55%
		6,849,488		9,665,770		(4,157,537)		

UTIMCO Budget ($)
Annual Fee and Allocation Schedule
For the fiscal year ending August 31, 2005

	The Permanent University Fund (PUF)	The Permanent Health Fund (PHF)	The University of Texas System Long Term Fund (LTF)	General Endowment Fund (GEF)	The University of Texas System Short Intermediate Term Fund (SITF)	Short Term Fund (STF)	Separately Invested Endowments and Charitable Trust Accounts	Total
UTIMCO Management Fee (1) (includes all operating expenses associated with the general management of the Funds)	**5,790,979**	**686,338**	**3,483,456**		**489,842**			**10,450,615**
Direct Expenses of the Fund:								
External Management Fees	9,874,557			5,169,000				15,043,557
External Management Fees-Performance	5,561,919			2,898,684				8,460,603
Other Direct Costs	2,166,240	22,050	112,450	1,768,687	122,651			4,192,078
Total Direct Expenses of the Fund	**17,602,717**	**22,050**	**112,450**	**9,836,371**	**122,651**		**0**	**27,696,239**
TOTAL UTIMCO Budget for the fiscal year ending August 31, 2005	**23,393,696**	**708,388**	**3,595,906**	**9,836,371**	**612,493**		**0**	**38,146,854**
Market Value of Funds Managed by UTIMCO as of 2/28/04 ($ millions)	**8,218.9**	**840.0**	**3,404.6**	**4,244.6** (3)	**1,106.2**	**2,231.3** (2)	**184.9**	**15,985.9**
<u>Percentage of Market Value</u>								
UTIMCO Services	0.070%	0.082%	0.102%	0.000%	0.044%	0.000%	0.000%	0.065%
Direct Expenses of the Fund	0.214%	0.003%	0.003%	0.232%	0.011%	0.000%	0.000%	0.173%
TOTAL	**0.285%**	**0.084%**	**0.106%**	**0.232%**	**0.055%**	**0.000%**	**0.000%**	**0.239%**

(1) Allocation Ratio: PUF-56%,PHF-7%,LTF-32%,SITF-5%
(2) Interest Income is net of fees and is not budgeted
(3) Pooled fund for the collective investment of the PHF and LTF

<u>UTIMCO Budget Analysis and Recommendation</u>

The Investment Management Services Agreement between the U. T. Board of Regents and UTIMCO requires that UTIMCO submit its annual budget and management fee schedule to the Board of Regents for approval. The Total Budget consists of UTIMCO's management fee, the UTIMCO Services Budget, plus the budget for the direct expenses to the Funds, the Direct Funds Budget.

As indicated above, the UTIMCO related budget for management of the endowment and operating funds is comprised of two distinct elements. The "UTIMCO Services Budget" provides for all expenses directly associated with UTIMCO operations including staff compensation and benefits, general operating expenses such as travel and computer equipment, office lease expenses, and professional fees including general legal and accounting expenses. The "Direct Funds Budget" provides for all expenses directly related to the external management of assets of the endowment and operating funds. These expenses include external management fees, custodian fees, analytical resources expenses, general consulting expenses (Cambridge Associates), and individual investment related legal and accounting expenses. The sum of the UTIMCO Services Budget and the Direct Funds Budget equals the Total Budget for the August 2005 fiscal year.

UTIMCO management has direct control of the UTIMCO Services budget and expenses. The Services budget is developed through a decentralized process with each Managing Director having some level of budgetary responsibility. Actual expense performance relative to the budget is a significant element of the qualitative performance compensation review for each Managing Director and Manager at UTIMCO.

In contrast, because the Direct Funds expenses are affected significantly by price changes in the capital markets and by the level of activity in external manager accounts operating under full discretion, UTIMCO management has only limited control of the Direct Funds budget and expenses. UTIMCO control is limited to selecting the types of external managers to be hired (active versus passive or partnership versus agency account, for example) and negotiation of contract terms. Although the performance of actual Direct Fund expenses relative to budget is not a part of qualitative incentive compensation considerations for UTIMCO management, because all Services and Direct Funds expenses reduce the net returns earned by the endowment and operating funds, UTIMCO management has clear incentive to manage Direct costs so as to maximize net investment returns. Note that this does not necessarily mean that attempting to minimize Direct (or Services) costs is the best approach. What is important both to UTIMCO management and the funds is <u>maximizing net returns</u>.

On July 15, 2004, the UTIMCO Board of Directors unanimously approved the proposed 2004-2005 Annual Budget and Management Fee Schedule. These recommended 2004-2005 Fiscal Year UTIMCO Services and Direct Fund budget totals are presented below:

Budget Comparisons	Fiscal Year 2004-2005 Budget	Fiscal Year 2003-2004 Budget	Increase (Decrease)	% Change
UTIMCO Services	$ 10,450,615	$ 9,511,773	$ 938,842	9.85%
Direct Fund	27,696,239	21,362,740	6,333,499	29.65%
Total	$ 38,146,854	$ 30,874,513	$ 7,272,341	23.55%
As a Percent of Average Asset Value				
UTIMCO Services	0.065%	0.074%	-0.009%	-12.20%
Direct Fund Expenses	0.173%	0.166%	0.008%	4.60%
Total	0.239%	0.239%	0.000%	0.000%

Although both the Services and Direct budgets are higher than last year's budgets in dollar terms, as a percentage of assets under management, the Services budget is significantly lower than the prior budget. The small increase in the Direct budget, measured as a percent of assets, is the result of countervailing effects: lower base fees negotiated in performance fee arrangements with external managers, offset by the movement of assets to higher potential return, but also higher base fee, managers. The net result is a more effective manager lineup at only a slight increase in expenses as a percent of assets.

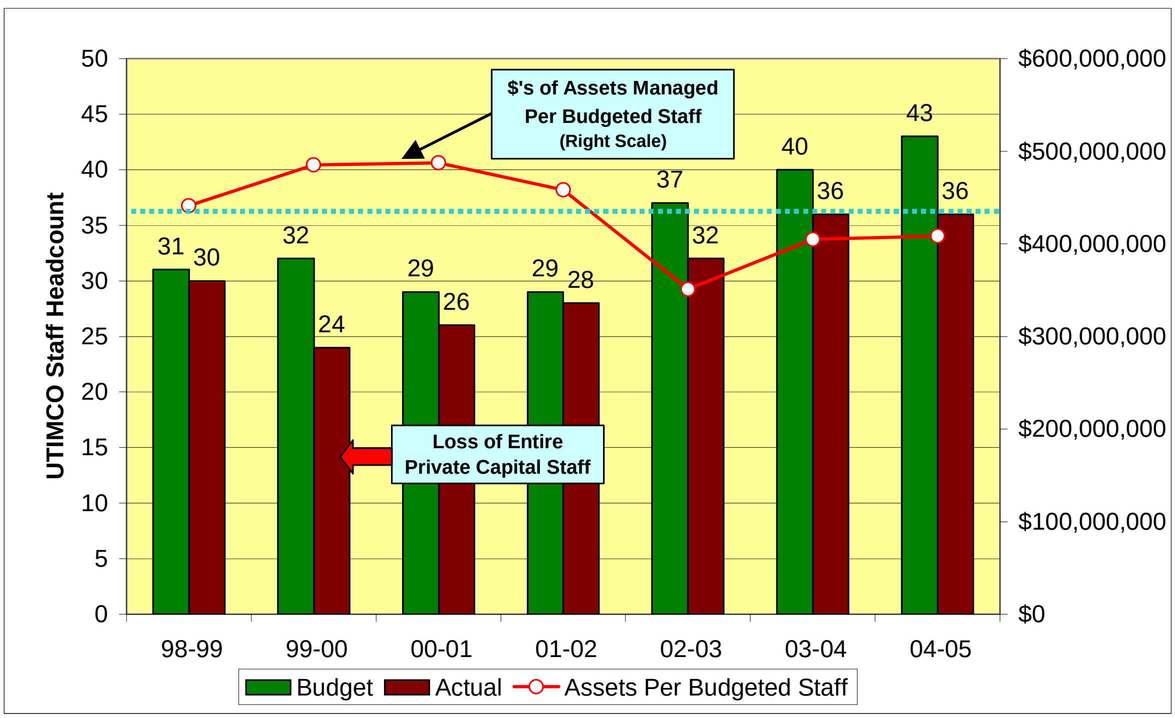
With this overview of the recommended budgets, the following sections focus on the UTIMCO Services and Direct budgets separately.

UTIMCO Services Budget

The primary items affecting the increase in the UTIMCO Services budget are salary increases for existing staff and new additions to the staff.

Salary Increases for Existing Staff: UTIMCO's compensation policy is to pay competitive base salaries. Competitive base salaries are defined to be salaries within a plus or minus 20% band centered on the market median salary for a similar position in an endowment fund or investment management organization. We obtain information on market median salaries for upper level accounting and administration and investment positions at UTIMCO from Mercer on a regular basis. Salary levels for other accounting and administrative positions are based on local competition in similar organizations. Mercer indicated that the increase in the market median salaries for competitive organizations over the past year was 3.7%. In setting salaries for this year, we began with 3.7% as our target, however the actual total increase was 4.07% for two primary reasons. First, we have several investment staff members who were below the market median. In fact, out of the 16 positions for which we have Mercer data on competitive salary levels, 11 are still below the market median despite larger increases this year to move those staff members closer to market median. On average among the senior staff, base salaries are at 96% of the market median despite the fact that we have a very talented and experienced staff. Most of these staff members should have above median salaries, so it is important to try to continue to move to higher levels which can only be done through above average increases. The Compensation Committee of the UTIMCO Board reviewed staff salaries and made several reductions that are reflected in the recommended Budget.

New Additions to Staff: The largest increase to the budget is due to the addition of 3.5 net new positions to the staff. The new positions recommended are a risk management and operations analyst, a client service specialist, and 1.5 new investment analyst positions. These new positions are essential to our plans to complete a competitive staff structure at UTIMCO. As you are aware, we have made major strides in rebuilding the staff following substantial staff defections in 2000 and 2001. Although the budgeted headcount has increased substantially since the ebb in 2000, current and projected assets managed per budgeted staff are very near the long term average indicated by the dashed line in the figure below; the projected figures for 2004-2005 are approximately equal to the 1998-1999 level:



The increase in staff count from 2000 is due to two factors: first, 2000 was an artificially low starting point, the staff was dangerously thin after the loss of the Private Capital team, necessitating a multimillion dollar payment to Cambridge Associates to monitor existing investments; and second, our current high return potential, specialist structure requires both a more experienced and larger team to monitor the more sophisticated investments we need to make to earn high value added returns. Our investment in staff will be repaid many times over in the form of enhanced returns.

Direct Fund Budget

The details of the Direct Fund budget are shown below:

Direct Funds Budget	Fiscal Year 2004-2005 Budget	Fiscal Year 2003-2004 Budget	Increase (Decrease)	% Change
External Management Fees	$15,043,557	$9,525,099	$5,518,458	57.94%
External Performance Fees	8,460,603	8,423,641	36,962	0.44%
Total External Management Fees	$23,504,160	$17,948,740	$5,555,420	30.95%
Custodian Fees	$1,226,918	$1,156,630	$70,288	6.08%
Performance Measurement	385,900	400,000	(14,100)	-3.53%
Analytical Tools	299,810	0	299,810	100.00%
Risk Measurement	575,000	403,000	172,000	42.68%
Total Custodian and Analytical Costs	$2,487,628	$1,959,630	$527,998	26.94%
Cambridge Associates Fee	900,000	901,170	(1,170)	-0.13%
Auditing	190,300	184,500	5,800	3.14%
Controls Assessment (Sarbanes-Oxley)	95,000	0	95,000	100.00%
Printing	120,000	87,700	32,300	36.83%
Bank Fees	9,000	9,000	0	0.00%
Rating Agency Fees	23,500	22,000	1,500	6.82%
Legal Fees	345,750	250,000	95,750	38.30%
Background Searches and Other Due Diligence	20,900	0	20,900	100.00%
Total Other Expenses	$1,704,450	$1,454,370	$250,080	17.20%
Total Direct Funds Expenses	$27,696,238	$21,362,740	$6,333,498	29.65%
As a Percent of Average Assets	0.173%	0.166%	0.008%	4.60%

As indicated earlier in the overview of the entire budget, the total Direct budget is expected to expand 29.7% on a dollar basis, but only 4.6% after adjusting for the substantial increase in average asset value of funds under management. More than $5.5 million of the $6.3 million total increase is due to higher projected external manager fees. As indicated earlier, this increase can be traced to three primary factors:

1. Since these external fees are paid almost exclusively to public markets managers, it is important to adjust for the increase in assets under management in public markets since the 2003-2004 budget. That increase is approximately 34%, which means that about 60% of the 58% overall increase in external manager fees, or about $3.2 million of the total $5.5 million increase, is due to an increase in asset values.
2. Within the public markets portfolio, assets were reallocated to higher return potential managers. We have moved funds from larger capitalization domestic managers to smaller capitalization specialists, from domestic equity managers to international equity managers, and within international markets, from developed markets managers to developing markets managers. In almost every case, higher return potential managers also charge higher base fees.

3. Partially offsetting these increases were our efforts to negotiate more attractive fee terms with existing managers. In general, we are moving to performance based fees which have a relatively low base fee, and have a value-added sharing feature for performance well above the manager's benchmark.

Other significant increases include expenditures for analytical tools and risk measurement. We now make extensive use of an analysis package called FactSet that is a very efficient software package that allows us to access a large quantity of public markets data. This data is used to track aggregate portfolio exposures by country, industry, size category, and many other categories to assist our decisions in risk control and tactical asset allocation.

Another large expected increase will be necessary to implement Sarbanes-Oxley. These additional expenses will be primarily fees for auditing work. Finally, we expect the increased activity in selecting and monitoring private equity and hedge fund investments to result in an increase in legal expenses directly related to particular individual investments.

Allocation of Expenses Across Funds

The final step in the budgeting process is to equitably allocate the budgeted expenses across the Funds. The UTIMCO Services budget has traditionally been allocated on the basis of a combination of relative asset value of the Funds and total staff time dedicated to the management of each Fund. Budgeted expenses for 2004-2005 were allocated as follows: Permanent University Fund 56%, Long Term Fund 32%, Permanent Health Fund 7%, and Short Intermediate Term Fund 5%. These allocations are very similar to prior fiscal year allocations.

Direct Funds expenses are charged primarily to the PUF and GEF on the basis of costs actually incurred. Only those Direct costs associated solely with the PHF, LTF, or the SITF are charged against those Funds.

FY 2005 UTIMCO BUDGET REPORT

The University of Texas System
Office of Finance

Prepared by:
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Jerry Modjeski - Senior Financial Analyst, Office of Finance

September 20, 2004

I. Executive Summary

The proposed UTIMCO budget for FY 2005 is $38.2 million, a 23.55% increase from the FY 2004 budget of $30.9 million. The $7.4 million increase from the FY 2004 budget is due primarily to a projected $5.5 million increase in External Management Fees, a $0.5 million increase in Custodian and Analytical Costs, a $960,000 increase in UTIMCO Services expenses (i.e. operations), a $100,000 increase in legal fees related to the funds, and approximately $100,000 related to compliance with Sarbanes-Oxley (see Exhibit A for the detailed budget).

Based on current estimates, UTIMCO expects to come in approximately $4.1 million over budget for FY 2004. This is entirely due to higher External Management fees for above-benchmark performance across multiple asset classes (year-to-date). The latest UTIMCO Services (i.e. operations) estimate for FY 2004 is approximately $500,000 under budget due primarily to unfilled positions.

	8/31/04		**8/31/05**	**Budget Increase**	**Budget Increase**
	Budget	**Estimated**	**Budget**	**(Decrease)**	**(Decrease)**
UTIMCO Services	$ 9,511,773	$ 9,007,453	$10,450,616	$ 938,843	9.85%
Direct Costs to Funds	$21,362,739	$26,024,596	$27,696,238	$6,333,499	29.65%
Total Budget	$30,874,512	$35,032,049	$38,245,854	$7,272,342	23.55%

The substantial increases in UTIMCO's proposed FY 2005 budget can be traced to a handful of factors that are discussed more fully in Section V entitled "Observations and Recommendations". The most important factors include:

- An additional $5.5 million of External Management Fees associated with 1) a greater than anticipated increase in funds under management; 2) a shift in several asset classes away from indexed funds towards more active managers; and 3) a change in the endowment fund asset allocation towards higher "Potential Value Added" asset classes.

- A $500,000 increase in Custodian and Analytical Costs due to a larger asset base, an increase in the proportion of international assets, and an upgrade of risk management and performance management software.

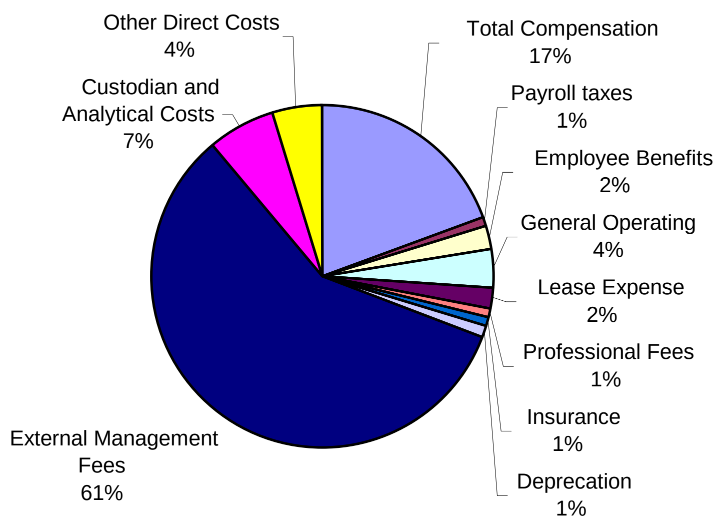
- Approximately $500,000 of costs associated with additional services that UTIMCO feels are necessary to enhance customer service. This includes two and one-half new staff positions, expanded data services on Bloomberg, additional travel expenses, and upgraded computer networking capabilities.

Section V contains observations and recommendations regarding the budget, the impact of the inclusion of the new proposed compensation program in the budget, the impact of a potential office relocation, and a recommendation regarding UTIMCO's Cash Reserve.

II. FY 2005 Budget Description

The budget is made up of two sections, UTIMCO Services and Direct Costs to Funds. The UTIMCO Services comprise 28% of the budget and consist mainly of Compensation and other employee-related operating expenses. The Direct Costs to Funds are 72% of the budget and consist of External Management Fees, Custodian and Analytical Costs, and Other Direct Costs.

FY 2005 UTIMCO Budget ($38.2 million)



For FY 2005, the proposed UTIMCO Services budget includes a step-up process. UTIMCO is using this process to associate the specific costs with each additional responsibility or scenario. See Exhibit B for the step-up budget, Exhibits C and D for detailed organization charts, and Exhibit E for a description of the proposed new positions.

1. **Baseline Budget -** The Baseline Budget is UTIMCO's minimum proposed budget. This includes an average 4.07% pay increase for existing staff, the use of some new UTIMCO Board-approved performance compensation program, maintaining the current office lease, and the addition of a Risk Manager/Operations Analyst. The cost of the baseline budget for FY 2005 is $37.2 million, or 21% greater than the FY 2004 budget.

2. **Additional Services Scenario -** Involves additional services that UTIMCO feels are necessary to enhance customer service. This scenario includes three new positions -- one Client Service Manager, one Compliance Accountant/Auditor, and one Non-Marketable Associate. Also included are expanded data services on Bloomberg, additional travel (primarily in Public Markets), upgraded computer networking capabilities, web-casting of board meetings, and the hiring of an Information Architect. The cost of the Additional Services is $857,300.

3. **Office Lease Alternative (Relocation) Scenario** – UTIMCO is exploring the possibility of moving its headquarters to less expensive space prior to the January 2006 expiration of its current

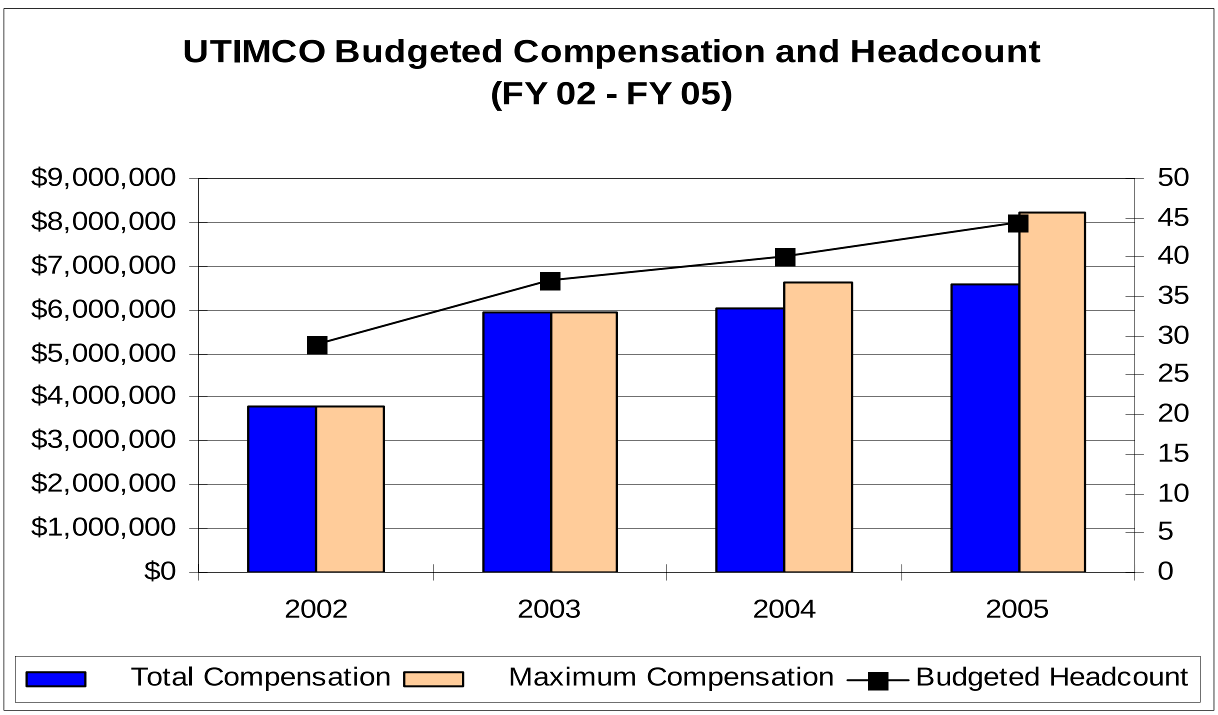
lease in Bank One. This scenario is budgeted at only $64,000 for FY 2005, which includes additional parking and the return of the lease deposit. There is also $100,000 of depreciation for new furniture costing a total of $450,000 (the remainder will be expensed in future years).

III. Comparison of FY 2005 Budget to FY 2004 Budget

UTIMCO Services Costs

The UTIMCO Services (i.e. operations) part of the budget has been increasing at a rapid rate over the last four years primarily due to additional personnel, the adoption of a performance-based compensation plan in FY 2003, the proposed adoption of a new performance-based compensation program in FY 2004 (included in the FY 2005 budget), and higher General Operating expenses.

The budget for Total Compensation, which includes Salaries and Wages and Bonus Compensation, has increased from $6.0 million in FY 2004 to $6.5 million in FY 2005. This represents an increase of 8%. The chart below also shows the corresponding increase in budgeted personnel over the past four years as compared to the increase in Total Compensation and Maximum Compensation (at 100% budgeted Bonus Compensation).



As the chart shows, UTIMCO's compensation has grown proportionately more than the growth in employees. Budgeted employees have grown by 53% since FY 2002, budgeted Total Compensation has grown by 71% over the same time period, while budgeted Maximum Compensation has grown by 116% (assuming full adoption of the proposed incentive compensation program effective 9/1/03). As UTIMCO points out in its budget report presented to the UTIMCO Board on July 15, 2004, the assets managed per budgeted staff has stayed relatively constant since FY 1999.

Until the FY 2004 budget, 100% of maximum potential Bonus Compensation was included in the budget. In FY 2004, with the concurrence of System staff, 75% of the maximum potential bonus was budgeted to reflect a more representative measure of what had been paid in the past. This fiscal year, UTIMCO is budgeting 50% of the maximum potential bonus. If 100% of the maximum potential bonus was used for budgeting purposes, the budgeted Total Compensation would have increased from $6.6 million in FY 2004 to $8.1 million in FY 2005, or 24%.

Employee Benefits increase from $648,854 in FY 2004 to $804,212 in FY 2005, or 24%. This is primarily due to the addition of 4.5 net new budgeted positions and an overall increase in the cost of insurance (consistent with U.T. System's projected increases in employee benefits costs for FY 2005).

General Operating Costs increase from $1.1 million in FY 2004 to a proposed $1.33 million in FY 2005, or 21%. This is primarily due to higher budgeted amounts for On-Line Data Services, Subscriptions, Travel, and Recruiting and Relocation expenses.

Total Professional Fees decrease from $285,000 in FY 2004 to a proposed $209,500 in FY 2005 or (26%). This is due to a decrease of $50,000 for Investment Consultants, and a decrease of $25,000 in Legal Expenses.

Total Depreciation increases from $294,243 in FY 2004 to a proposed $456,000 in FY 2005, or 55%. This increase is due to the potential purchase of office equipment related to the proposed office relocation and new lease arrangement.

Direct Cost to Funds

UTIMCO's Direct Costs to Funds budget (primarily External Management Fees[1]) for FY 2005 has increased by 30% versus the FY 2004 budget. The largest contributor of the increase is $5.5 million of External Management Fees that are incremental to the FY 2005 budget versus the FY 2004 budget. These additional costs are associated with a greater than anticipated increase in funds under management, a shift in several asset classes away from indexed funds towards more active managers, and a change in the endowment fund asset allocation towards higher "Potential Value Added" asset classes. The table on the next page shows that, even with higher External Management Fees budgeted for FY 2005, UTIMCO's Total Budget as a percentage of funds under management has not changed significantly since FY 2003.

[1] External Management Fees do not include Partnership fees and certain Hedge and Commingled Funds fees. While these fees are significant, they are netted against any returns before being reported.

	FY 2002	FY 2003	FY 2004	FY 2005[2]
Total Budget as a percent of total funds under management	0.22%	0.25%	0.24%	0.24%
External Management fees as a percent of endowment funds	0.18%	0.20%	0.16%	0.19%

The table above shows budgeted fees only. Actual fees are a direct result of the external manager's funds under management ("Base Fees") and performance ("Performance Fees"). In other words, the fees actually paid are highly correlated to positive performance, as demonstrated by the budgeted and actual fees paid in FY 2003 and FY 2004 (as shown in Exhibit A). The FY 2003 External Management fees came in $5.0 million under budget due to less than expected/budgeted performance. The opposite has happened so far in FY 2004, where UTIMCO's external managers have, on average, outperformed their benchmarks through 7/31/04.

Custodial and Analytical Costs, which include Custodian Fees, Analytical Tools, Performance Measurement fees, and Risk Measurement fees, increase by 27%, from $1.96 million in FY 2004 to a proposed $2.49 million in FY 2005. Most of the increase is due to higher fees for upgraded risk measurement and analytical software tools. Custodian fees and Other Direct Costs increase from $1.15 million in FY 2004 to a proposed $1.23 million in FY 2005, or 6%, due to a larger asset base, greater transaction volume, and an increase in international assets.

Other Direct Costs increase from $1.45 million in FY 2004 to $1.70 million in FY 2005, or 17%. This increase is mostly attributable to an additional cost of $95,000 for Controls Assessment Fee (Sarbanes-Oxley) and an increase of another $95,000 for legal fees related to a greater need for legal review of external management agreements.

IV. Reserve Analysis

UTIMCO's Services (operating) budget is funded through the assessment of fees charged against the PUF, the LTF, the PHF, and the SITF. To the extent that its fee revenue (plus interest income) exceeds its total cash expenses, UTIMCO accumulates a budget surplus that it holds for cash management and emergency expenditure purposes. UTIMCO has established a target Cash Reserve[3] balance equal to one year's operating budget. That would imply a need for a Cash Reserve as of 9/1/04 of approximately $10.8 million. Coincidentally, UTIMCO is projected to have an actual Cash Reserve of approximately $10.8 million by the end of this fiscal year. In August, the Board of Regents amended the IMSA (contract) to direct UTIMCO to rebate $4 million back to the funds pro-rated based on how the funds were generated. It is expected that this rebate will take place in the first quarter of FY 2005.

Based on a history of growing Cash Reserves, the flexible nature of UTIMCO's fee structure, and the lack of extraordinary, unplanned expenditures, System staff (and the UTIMCO Working Group) recommend a much lower Cash Reserve policy than the current 12 months' target. Specifically, it is recommended that UTIMCO maintain a three month Cash Reserve. This policy would result in a Cash Reserve of approximately $2.7 million for FY 2005.

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[2] Based on market values as of 7/31/04.
[3] "Cash Reserve" equals cash on hand plus investments less accounts payable.

This recommendation is based on the following facts:

1. When adjusted for cash rebated to the investment funds, UTIMCO's Cash Reserve has never declined, on an annual basis. UTIMCO has consistently run an operating budget surplus and is projected to do so again in FY 2004.
2. The Board of Regents can assess an extraordinary one-time fee at any time. Unlike most businesses, UTIMCO manages a $15 billion pool of assets that can, with Regents' approval, be tapped to cover an extraordinary, unplanned expenditure.
3. UTIMCO's Cash Reserve calculation deducts accounts payable from the total. This means that the sum of UTIMCO's cash on hand plus investments is actually greater than the Cash Reserve. Assuming a 30-day accounts payable balance on average, UTIMCO could have an additional $875,000 or so of cash and/or investments in excess of its defined Cash Reserve. This methodology does not, however, include any unbudgeted bonus compensation which would be paid after the end of the fiscal year. UTIMCO has currently budgeted $1.5 million for bonuses in FY 2004.

   Please see Exhibit F for a detailed analysis of UTIMCO's Cash Reserve.

V. Observations and Recommendations

1. **UTIMCO staff continues to be very responsive** to information requests from System staff and has provided detailed information in support of the budget.

2. **The budget should be prepared earlier in the fiscal year to provide adequate time for review.** The IMSA (contract) has been amended to require a budget timeline that coincides with the System Administration process and states that the final draft budget be ready for review no later than June 1st of each year.

3. **UTIMCO's Services budget (i.e. operations) for FY 2005 is proposed to increase by $1.0 million, or 9.85%** (see Exhibit A for the detailed budget).

   - UTIMCO's Total Compensation budget for FY 2005 increases by 8%, or $475,000. This increase is the net result of an 16% increase in Salaries and Wages and a 9% decrease in Bonus Compensation. However, the decrease in Bonus Compensation is the result of budgeting only 50% of the maximum bonus in FY 2005 versus last year's practice of budgeting 75% of the maximum. Without that change, Total Compensation would have increased by approximately 20%.

     - The Bonus Compensation is based on the UTIMCO-Board approved performance compensation plan, not the current program. This new program has yet to be reviewed and approved by the Board of Regents.
     - UTIMCO has budgeted $188,000 for merit increases for existing staff representing a 4.56% base pay increase. This is consistent with the increase at System Administration when adjusted for promotions and equity increases.
     - Employee Benefits are budgeted to rise by 24%, which is slightly higher than System Administration's experience, adjusted for the 4.5 new positions in UTIMCO's budget.

- UTIMCO continues to implement a new organizational structure that has increased budgeted positions from 29 in FY 2002 to a budgeted staff of 44.5 for FY 2005.
- UTIMCO is asking for approximately $500,000 to fund salaries for a net 4.5 new positions (described in Exhibit E) in FY 2005. We support the addition of a full-time Client Services Manager and Sarbanes-Oxley compliance auditor based on current needs in those areas. However, we do not understand the need for the three new research and analysis positions in Public Markets and Non-Marketable Alternatives. It was our understanding that the FY 2004 budget represented "full staffing" for the new UTIMCO management model (please note that Exhibit E provides UTIMCO's supporting rationale for these new positions).
- UTIMCO also has a vacant Managing Director for Inflation Hedging position that is budgeted to be filled as of 1/1/05. This position has been open for two years. The cost for this position in FY 2005 is approximately $220,000 (including bonus).

- The budgeted General Operating expenses are proposed to increase by 21% or approximately $230,000. This increase is for two new Bloomberg terminals and additional services related to Bloomberg, as well as $116,000 for recruiting and relocation expenses. If approved, this would bring the total number of Bloomberg terminals at UTIMCO to nine.

- UTIMCO is evaluating the possibility of relocating its offices to less expensive downtown space prior to the January 2006 expiration of its current lease in Bank One. This scenario is budgeted at only $64,000 for FY 2005, which includes additional parking expenses and the return of the lease deposit. There is also $100,000 of depreciation for new furniture costing a total of $450,000 (the remainder would be expensed in future years). UTIMCO purchased new furniture for the Bank One space in FY 2001. Because of potential conflict of interest, no recommendation is provided. [4]

4. **UTIMCO's Direct Costs to Funds budget for FY 2005 is proposed to increase by $6.3 million, or 23.55%** (see Exhibit A for the detailed budget).

- An additional $5.5 million of External Management Fees are attributable to more funds under management, a shift in several asset classes away from indexed funds towards more active managers, and a change in the endowment fund asset allocation towards higher "Potential Value Added" asset classes. The relative contribution to the higher fees is unclear. The endowment fund balances are up about 11% over the past year which certainly contributes to some of the increase. The fact that UTIMCO is shifting assets away from relatively low fee accounts to more actively managed accounts (e.g. PIMCO Real Return; the Globeflex funds; the TCW funds) is also a factor.

- Custodian Fees and Other Direct Costs increase from $1.15 million in FY 2004 to a proposed $1.23 million in FY 2005, or 6%.

- Performance Measurement Fees, Analytical Tools, and Risk Measurement Fees increase by 36% from a combined $803,000 in FY 2004 to $1.26 million in FY 2005. We generally support this increase due to the fact that these funds are being used to upgrade UTIMCO's performance measurement and risk measurement systems.

[4] A direct relative of Philip Aldridge was hired, effective 9/7/04, as the property manager at the Bank One building where UTIMCO is currently located.

- Other Direct Costs increase from $1.45 million in FY 2004 to $1.70 million in FY 2005, or 17%. This increase is mostly attributable to an additional cost of $95,000 for Controls Assessment Fee (a System-wide effort related to compliance with Sarbanes-Oxley) and an increase of another $95,000 for legal fees related to a greater need for legal review of external management agreements.

5. UTIMCO is forecasting a Cash Reserve balance at 8/31/04 of $10.8 million, which is equivalent to one year's operating budget. Based on a history of growing Cash Reserves, the flexible nature of UTIMCO's fee structure, and the lack of extraordinary, unplanned expenditures, **The IMSA defines anything in excess of a 3-month cash reserve balance as surplus, and provides flexibility in ways to handle any excess.**

6. **We would endorse the UTIMCO Working Group suggestion that a cost study be commissioned for UTIMCO.** There is very little data publicly available to determine how UTIMCO's cost structure compares to its peers. In last year's budget report, we referred to a study prepared by Cambridge Associates[5] and concluded that UTIMCO's "Total Costs" as defined by Cambridge were slightly higher than average and its "Accounting, IT, and Administrative Costs" were well above average. However, as we cited last year, these higher costs may well be justified by the level of service that UTIMCO provides its customers and the complexity of the more than 6,000 separate endowment accounts under management. We would also recommend that any cost study incorporate the impact of brokerage commissions, which are netted against asset returns and are not part of the budget. In lieu of a cost study performed by a third party, we are essentially benchmarking UTIMCO against itself.

[5] "An Overview of Endowment Management Costs 2002" prepared by Cambridge Associates, spring 2002.

Exhibit A

2002 - 2005 Operating Budgets

	8/31/02 Budget	8/31/02 Actual	8/31/03 Budget	8/31/03 Actual	8/31/04 Budget	8/31/04 Projected	8/31/05 Budget	% Change from 2004 budget
UTIMCO Services								
Salaries and Wages + vac	2,703,427	2,287,533	3,854,426	3,102,883	4,141,188	3,804,867	4,780,040	15%
Bonus Compensation + int.	1,086,879	239,622	2,100,684	1,089,333	1,867,266	1,858,109	1,704,253	-9%
Total Compensation	3,790,306	2,527,155	5,955,110	4,192,216	6,008,455	5,662,976	6,484,293	7.92%
Total Payroll taxes	188,021	145,492	249,743	195,076	270,688	232,185	293,831	8.55%
403(b) Contributions	200,051	156,515	291,841	219,898	320,423	285,000	360,425	12%
Group Health,Dental,AD&D,Life,GroupLTD	166,472	150,085	246,344	201,090	322,430	293,025	437,787	36%
Employee Benefit Services	7,000	7,850	7,000	4,490	6,000	5,650	6,000	0%
Employee Benefits	373,523	314,450	545,186	425,478	648,854	583,675	804,212	23.94%
On-Line Data & Contract Services	522,500	304,635	512,500	417,995	558,800	584,150	636,729	14%
Recruiting and Relocation Expenses	8,000	94,038	372,000	359,917	25,000	18,500	141,000	464%
Travel	80,000	71,739	120,000	109,138	187,000	182,500	255,000	36%
Phone Equipment and Charges	82,000	49,530	79,500	41,990	72,000	48,785	46,000	-36%
Computer & Office Supplies	71,600	51,344	79,100	73,887	85,650	85,400	87,640	2%
Employee Education	20,000	13,034	72,000	14,424	56,500	36,450	54,700	-3%
Repairs/Maintenance	41,500	36,673	41,500	39,453	43,500	48,000	48,600	12%
BOD Meetings	20,000	18,623	47,500	29,811	49,050	38,700	40,750	-17%
Other Operating Expenses	115,300	16,675	47,500	25,554	23,500	30,700	21,500	-9%
Total General Operating	960,900	656,291	1,371,600	1,112,169	1,101,000	1,073,185	1,331,919	20.97%
Total Lease Expense	613,000	604,683	623,010	606,013	623,010	619,785	592,510	-4.90%
Investment Consultants	25,000	195	100,000	2,000	50,000	0	0	-100%
Legal Expenses	275,000	242,533	250,000	500,823	200,000	196,500	175,000	-13%
Compensation Consultant			0	45,200	25,000	65,000	25,000	0%
Accounting fees	10,000	6,630	10,000	6,870	10,000	9,500	9,500	-5%
Total Professional Fees	310,000	249,358	360,000	554,893	285,000	271,000	209,500	-26.49%
Property/Liability Package	10,875	12,182	13,399	15,009	18,282	17,500	17,500	-4%
Umbrella Policy	5,000	5,691	6,412	6,756	7,812	8,250	8,250	6%
Workers Compensation	7,300	10,910	11,543	14,109	16,722	17,500	17,500	5%
Business Auto	160	162	172	175	200	100	100	-50%
Commercial Bonding Policy	38,000	36,659	35,614	39,138	46,926	45,000	45,000	-4%
Prof. and D&O Liability	119,600	131,931	144,513	158,881	190,582	190,000	190,000	0%
Total Insurance	180,935	197,535	211,653	234,068	280,524	278,350	278,350	-0.77%
Depreciation of Equipment	281,592	271,692	286,200	286,176	294,243	286,297	456,000	54.97%
Total UTIMCO Services	$ 6,698,276	$ 4,966,655	$ 9,602,501	$ 7,606,089	$ 9,511,773	$ 9,007,453	$ 10,450,616	9.85%
		1,731,621		1,996,412		est. 504,320		
Direct Costs to Funds								
External Management Fees	12,788,316	10,968,493	13,344,491	10,699,801	9,525,099	13,168,545	15,043,557	58%
External Mgt. Fees-Performance Fees	7,400,111	3,899,937	6,771,540	4,467,459	8,423,640	9,548,200	8,460,603	0%
External Management Fees	20,188,427	14,868,430	20,116,031	12,314,265	17,948,739	22,716,745	23,504,160	30.95%
Custodian Fees and other direct costs	1,244,906	1,179,087	1,262,700	1,351,899	1,156,630	1,017,699	1,226,918	6%
Performance Measurement	321,338	231,413	268,163	261,625	400,000	478,075	685,710	71%
Risk Measurement	286,000	361,460	353,000	335,172	403,000	127,500	575,000	43%
Custodian and Analytical Costs	1,852,244	1,771,960	1,883,863	1,948,696	1,959,630	1,623,274	2,487,628	26.94%
Cambridge Fees	2,799,844	2,797,487	968,607	1,477,800	901,170	900,000	900,000	0%
Auditing	211,500	158,371	202,700	168,202	184,500	205,000	190,300	3%
Consulting		51,387	100,000	0	0		0	
Controls Assessment (Sarbanes Oxley)							95,000	
Printing	106,757	91,246	99,900	99,583	87,700	111,431	120,000	37%
Bank fees	4,000	7,289	9,000	7,605	9,000	10,670	9,000	0%
Rating agency fees	22,800	21,876	22,000	21,508	22,000	22,000	23,500	7%
Legal Fees	35,000	267,880	315,430	343,849	250,000	432,296	345,750	38%
Background Searches				1,540			18,900	
Other						3,180	2,000	
Other Directs Total	3,179,901	3,395,536	1,717,637	2,120,087	1,454,370	1,684,577	1,704,450	17.20%
Total Direct Costs to Funds	25,220,572	20,102,705	23,717,531	16,048,173	21,362,739	26,024,596	27,696,238	29.65%
		5,117,867		7,669,358		(4,661,857)		
Grand Total	31,918,848	25,069,360	33,320,032	23,654,262	30,874,512	35,032,049	38,146,854	23.55%
		6,849,488		9,665,770		(4,157,537)		

Exhibit B

2005 Operating Budget
Step-Up Budget Scenarios

UTIMCO Services	8/31/04	Baseline	Increase (Decrease)	%	Additional Services	Increase (Decrease)	%	Office Lease Alternative	Increase (Decrease)	%	All Inclusive 8/31/2005	Increase (Decrease)	%
Salaries and Wages	4,067,188	4,346,040	278,852	7%	360,000	360,000	9%				4,706,040	638,852	16%
Vacation Pay	74,000	74,000	0	0%							74,000	0	0%
Bonus Compensation	1,853,367	1,576,139	(277,228)	-15%	66,176	66,176	4%				1,642,314	(211,053)	-11%
Bonus Interest	13,900	61,939	48,039	346%							61,939	48,039	346%
Total Compensation	6,008,455	6,058,118	49,663	1%	426,176	426,176	7%	0	0	0%	6,484,294	475,839	7.92%
Payroll Taxes	229,945	247,831	17,886	8%	17,968	17,968	8%				265,799	35,854	16%
Payroll Taxes-Bonus	40,743	27,515	(13,228)	-32%	517	517	1%				28,032	(12,711)	-31%
Total Payroll Taxes	270,688	275,345	4,657	2%	18,485	18,485	7%	0	0	0%	293,831	23,143	8.55%
403(b) Contributions	320,423	341,916	21,493	7%	18,509	18,509	6%				360,425	40,002	12%
Group Health,Dental,AD&D,Life,GroupLTD	322,430	362,888	40,458	13%	74,898	74,898	23%				437,787	115,357	36%
Employee Benefit Services	6,000	6,000	0	0%							6,000	0	0%
Employee Benefits	648,854	710,804	61,950	10%	93,407	93,407	14%	0	0	0%	804,212	155,358	23.94%
On-Line Data Services	387,000	335,127	(51,873)	-13%	77,942	77,942	20%				413,069	26,069	7%
Other Contract Services	94,000	50,000	(44,000)	-47%	51,000	51,000	54%				101,000	7,000	7%
Computer Services Providers	10,000	10,320	320	3%							10,320	320	3%
Bank Fees	3,500	3,500	0	0%							3,500	0	0%
Software Consultants	3,500	1,250	(2,250)	-64%							1,250	(2,250)	-64%
Employee Education	56,500	54,700	(1,800)	-3%							54,700	(1,800)	-3%
Phone Equipment Expense	60,000	32,000	(28,000)	-47%							32,000	(28,000)	-47%
Phone Call Expense	12,000	14,000	2,000	17%							14,000	2,000	17%
Subscriptions	56,300	60,800	4,500	8%	42,290	42,290	75%				103,090	46,790	83%
Publications	7,150	7,150	0	0%							7,150	0	0%
Computer Hardware	2,500	2,500	0	0%	2,500	2,500	100%				5,000	2,500	100%
Computer Software/Supplies	10,000	10,000	0	0%							10,000	0	0%
Office Supplies/Other	42,000	40,000	(2,000)	-5%							40,000	(2,000)	-5%
Express Mail/Delivery Service	9,000	9,000	0	0%							9,000	0	0%
Dues/Memberships	7,500	8,990	1,490	20%							8,990	1,490	20%
Postage	6,500	6,500	0	0%							6,500	0	0%
Repairs/Maintenance	43,500	48,600	5,100	12%							48,600	5,100	12%
Meeting Expenses	3,150	3,250	100	3%							3,250	100	3%
Copy/Printing	1,000	1,000	0	0%							1,000	0	0%
BOD Meeting Expense	36,500	30,000	(6,500)	-18%							30,000	(6,500)	-18%
Travel	187,000	175,500	(11,500)	-6%	79,500	79,500	43%				255,000	68,000	36%
Travel-BOD Meetings	9,400	7,500	(1,900)	-20%							7,500	(1,900)	-20%
Recruiting and Relocation	25,000	141,000	116,000	464%							141,000	116,000	464%
Office Plants & Maintenance	5,000	5,000	0	0%							5,000	0	0%
Non-Recurring Moving Expenses	0	0	0	0%							0	0	0%
Miscellaneous	10,000	10,000	0	0%							10,000	0	0%
ADP Charges	8,000	8,000	0	0%							8,000	0	0%
Charitable Contributions	5,000	3,000	(2,000)	-40%							3,000	(2,000)	-40%
Total General Operating	1,101,000	1,078,687	(22,313)	-2%	253,232	253,232	23%	0	0	0%	1,331,919	230,919	20.97%
Parking Expense	54,000	65,000	11,000	20%				54,000			119,000	65,000	120%
Misc. Lease Expense	5,000	5,000	0	0%				(90,000)			(85,000)	(90,000)	-1800%
Property Lease	362,010	362,010	0	0%							362,010	0	0%
Lease-Operating	202,000	196,500	(5,500)	-3%							196,500	(5,500)	-3%
Total Lease Expense	623,010	628,510	5,500	1%	0	0	0%	(36,000)	0	0%	592,510	(30,500)	-4.90%
Investment Consultants	50,000	0	(50,000)	-100%							0	(50,000)	-100%
Legal Expenses	200,000	175,000	(25,000)	-13%							175,000	(25,000)	-13%
Compensation Consultants	25,000	25,000	0	0%							25,000	0	0%
Accounting fees	10,000	9,500	(500)	-5%							9,500	(500)	-5%
Total Professional Fees	285,000	209,500	(75,500)	-26%	0	0	0%	0	0	0%	209,500	(75,500)	-26.49%
Property/Liability Package	18,282	17,500	(782)	-4%							17,500	(782)	-4%
Umbrella Policy	7,812	8,250	438	6%							8,250	438	6%
Workers Compensation	16,722	17,500	778	5%							17,500	778	5%
Business Auto	200	100	(100)	-50%							100	(100)	-50%
Commercial Bonding Policy	46,926	45,000	(1,926)	-4%							45,000	(1,926)	-4%
Prof. and D&O Liability	190,582	190,000	(582)	0%							190,000	(582)	0%
Total Insurance	280,524	278,350	(2,174)	-1%	0	0	0%	0	0	0%	278,350	(2,174)	-0.77%
Purchase of Equipment/Depreciation	294,243	290,000	(4,243)	-1%	66,000	66,000	22%	100,000	100,000	34%	456,000	161,757	55%
Gain/Loss on disposal of Equipment	0	0	0	0%								0	0%
Total Deprecation	294,243	290,000	(4,243)	-1%	66,000	0	0%	100,000	100,000	34%	456,000	161,757	54.97%
Total Utimco Services	$ 9,511,773	$ 9,529,314	17,541	0%	$ 857,300	$ 857,300	9%	$ 64,000	$ 64,000	1%	$ 10,450,616	938,843	9.85%
Increase (Decrease)		$ 17,541			$ 857,300			$ 64,000			938,842		
% Change		0.18%			9.01%			0.67%			9.87%		

Direct Costs to Funds	8/31/04	Baseline	Increase (Decrease)	%	Add Additional Services	Increase (Decrease)	%	Office Lease Alternative	Increase (Decrease)	%	All Inclusive 8/31/2005	Increase (Decrease)	%
External Management Fees	9,525,099	15,043,557	5,518,458	58%							15,043,557	5,518,458	58%
External Management Fees (Core Fund)											0	0	
External Mgt. Fees-Performance Fees	8,423,640	8,460,603	36,963	0%							8,460,603	36,963	0%
External Management Fees	17,948,739	23,504,160	5,555,421	31%							23,504,160	5,555,421	30.95%
Custodian Fees and other direct costs	1,156,630	1,226,918	70,288	6%							1,226,918	70,288	6%
Analytical Tools	0	299,810									299,810	299,810	100%
Performance Measurement	400,000	385,900	(14,100)	-4%							385,900	(14,100)	-4%
Risk Measurement	403,000	575,000	172,000	43%							575,000	172,000	43%
Custodian and Analytical Costs	1,959,630	2,487,628	527,998	27%							2,487,628	527,998	26.94%
Cambridge Fees	901,170	900,000	(1,170)	0%							900,000	(1,170)	0%
Auditing	184,500	190,300	5,800	3%							190,300	5,800	3%
Controls Assessment (Sarbanes Oxley)	0	95,000	95,000								95,000	95,000	
Printing	87,700	120,000	32,300	37%							120,000	32,300	37%
Bank fees	9,000	9,000	0	0%							9,000	0	0%
Rating agency fees	22,000	23,500	1,500	7%							23,500	1,500	7%
Legal Fees	250,000	345,750	95,750	38%							345,750	95,750	38%
Background Searches	0	18,900	18,900								18,900	18,900	
Other	0	2,000	2,000								2,000	2,000	
Other Directs Total	1,454,370	1,704,450	250,080	17%							1,704,450	250,080	17.20%
Total Direct Costs to Funds	21,362,739	27,696,238	6,333,499	30%							27,696,238	6,333,499	29.65%
Grand Total	30,874,512	37,225,552	6,351,040	21%	857,300	857,300		64,000	64,000		38,146,854	7,272,342	23.55%

Baseline	Add Additional Services	Office Lease Alternative
Includes: 4.56% Pay Increases for Staff New Compensation Plan Stay in Current Office Lease Add Risk Mgmt / Operations Analyst	Includes: 2 1/2 New Positions Expanded Data Services Travel for New Positions Upgraded Computer Network Information Architect	Includes: Maximum Lease Obligation Costs ---Return of $90,000 Lease Deposit ---$450,000 of New Furniture ---Duplicate Parking

Appendix C

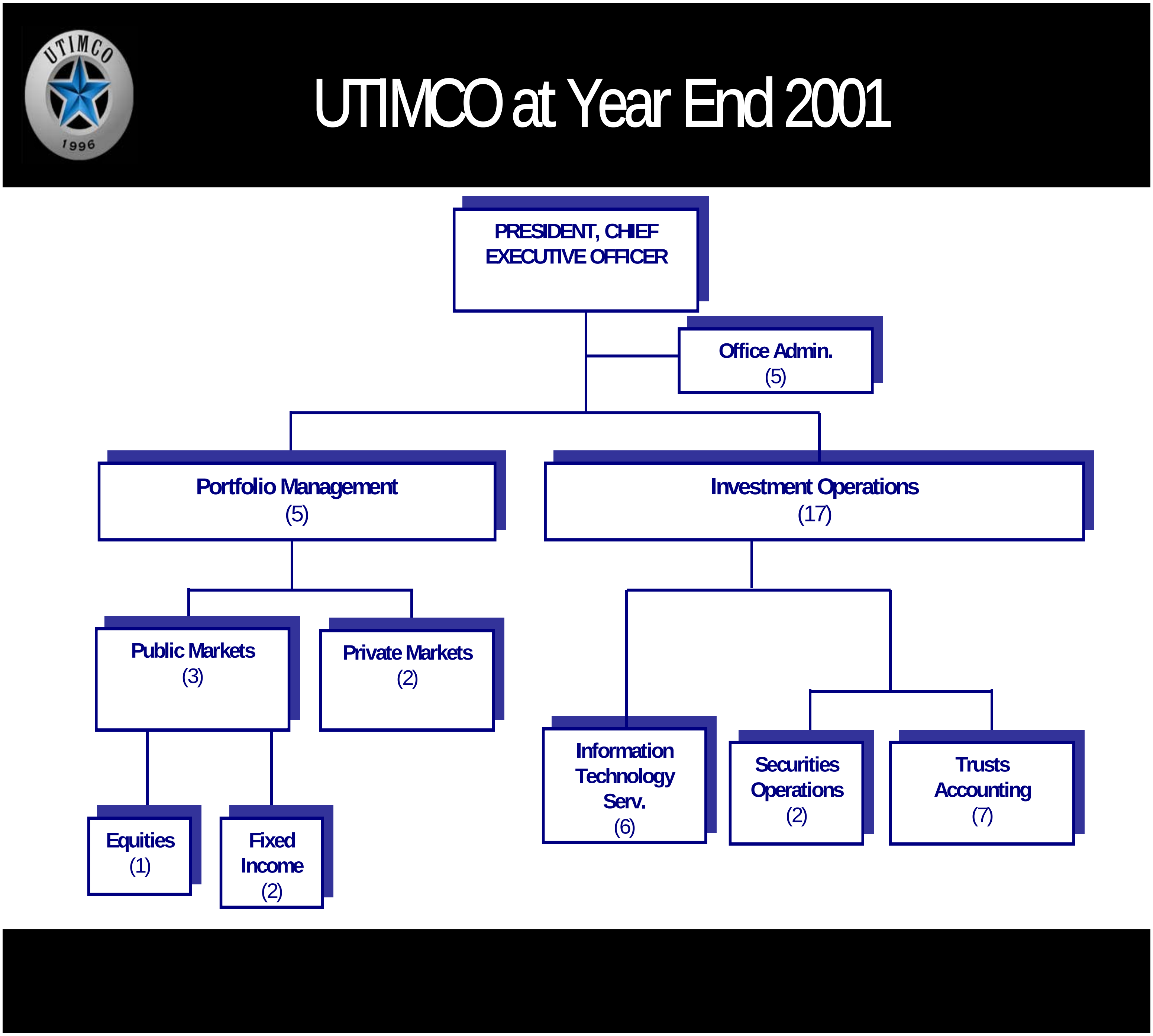
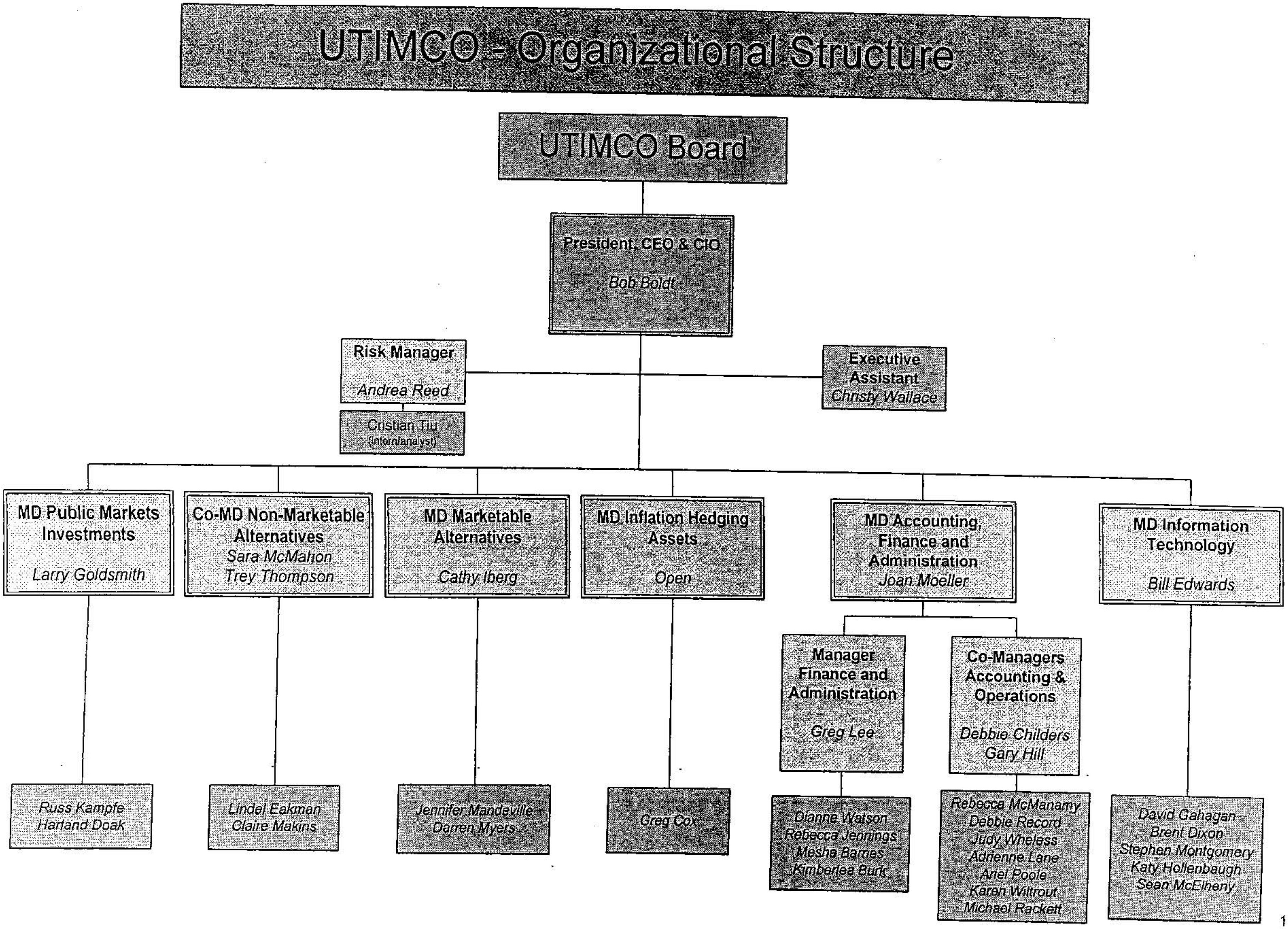

UTIMCO
1996
UTIMCO at Year End 2001
PRESIDENT, CHIEF EXECUTIVE OFFICER
Office Admin. (5)
Portfolio Management (5)
Investment Operations (17)
Public Markets (3)
Private Markets (2)
Equities (1)
Fixed Income (2)
Information Technology Serv. (6)
Securities Operations (2)
Trusts Accounting (7)

Exhibit D



[1] This is the UTIMCO Organization chart as it currently stands in FY 2004. The UTIMCO budget for FY 2005 proposes to add 4 ½ new positions as described in Exhibit E.

Exhibit E

Proposed New Positions
2005 Operating Budget

Baseline Budget

Risk Management / Operations Analyst – This position will work with both the Accounting/Operations and Risk Management departments. As the new investment risk management automated tools come online, it is critical that the data and information be consistent between the two systems. This position will ensure data integrity and work with both departments as these risk systems come online during the year. (This position only adds ½ position because it was a ½ budgeted position on last years budget.)

Additional Services

Client Service Manager – Provide much need client support in the field to the UT Components. Position will focus on investment matters and customer service to deliver timely information and presentations to UT components outside the Austin area.

Quantitative Analyst – Public Markets – Responsible for conducting analytical reviews of new internal active management strategies (public market) and coordination of risk/return analysis with risk management staff.

Manager – Research – Due Diligence – Public Markets - Staff person to research, filter, and analyze the enormous available information on external managers. The position will help review and investigate the universe of managers, evaluate detailed historical and operational information for new undiscovered talent, and perform related analytics.

Associate – Non Marketable Alternatives – This position would be capable of managing the investment process from initial review through due diligence to structuring to closing. This additional position will allow the Managing Directors time to focus on new deal generation. This additional position will give the department some extra capacity.
Accountant / Auditor – Compliance – This position will provide assistance with the implementation of Sarbanes-Oxley and provide day to day support for the risk assessment and compliance functions at UTIMCO. This position is a replacement for the Office Associate position being eliminated. (this is a re-classification of existing office staff)

Exhibit F

UTIMCO Reserve Analysis

I. Background

UTIMCO's budget is funded through the assessment of fees charged against the PUF, the LTF, the PHF, and the SITF. To the extent that its fee revenue (plus interest income) exceeds its total cash expenses, UTIMCO accumulates a budget surplus that it holds for cash management and emergency expenditure purposes. UTIMCO has established a target Cash Reserve balance equal to one year's operating budget. That would imply a need for a Cash Reserve as of 9/1/04 of approximately $10.8 million.

In 1996, UTIMCO was funded by the System with $400,000 in cash plus certain office equipment. By the end of its first fiscal year, UTIMCO had a Cash Reserve balance of approximately $1 million, of which, it rebated $435,900 back to the investment funds on a pro rata basis. Table 1 shows that the Cash Reserve amount has increased each year since 1996 to a projected balance of approximately $10.8 million as of 8/31/04. You'll note that the Cash Reserve did not reach the target policy level (one year's annual operating budget) until FY 2001. Other than the 1996 rebate and a $1.35 million rebate in FY 2001, all of the accumulated funds have been retained by UTIMCO.

Table 1 also highlights the fact that UTIMCO has consistently run a budget surplus, thereby adding to its Cash Reserve on an annual basis. Table 2 compares the Cash Reserve at the end of each fiscal year with the operating budget for the upcoming year. It then shows how many months of budgeted operating expenses are being held in Cash Reserve. As the numbers indicate, the Cash Reserve has been increasing every year when compared to the operating budget, except for FY 2001, which was impacted by the $1.35 million distribution.

The adequacy of the Cash Reserve was discussed with UTIMCO as part of the FY 2004 budget review. In those discussions, UTIMCO articulated several arguments in favor of maintaining a Cash Reserve equal to one year's operating budget:

1. UTIMCO's existing D&O insurance coverage was set, in part, based on the assumption that "additional reserves" would be available to cover actions against the Officers and Directors of UTIMCO.
2. A larger Cash Reserve reduces the likelihood that an unplanned withdrawal would need to be made from funds invested with a long-term allocation in mind.
3. Less than 100% of the performance bonuses are budgeted. If actual bonuses exceed the budgeted level, the excess would need to be paid out of the Cash Reserve.

II. The Case for Reducing the Cash Reserve

While recognizing UTIMCO's concerns, there is still a strong case to be made that UTIMCO's Cash Reserve policy requires it to maintain cash and investments well in excess of what is necessary. Consider the following:

1. When adjusted for cash rebated to the investment funds, UTIMCO's Cash Reserve has never declined, on an annual basis. UTIMCO has consistently run a budget surplus and is expected to continue to do so in FY 2004. Based on eight years of history, it is hard to envision an extraordinary, unplanned expenditure of a material nature that would be incurred by UTIMCO.
2. With Board of Regents' approval, UTIMCO can assess an extraordinary one-time fee at any time. Unlike most businesses, UTIMCO has a $16 billion pool of assets that can be tapped to cover unplanned expenditures.
3. UTIMCO's Cash Reserve calculation deducts accounts payable from the total. This means that the sum of UTIMCO's cash on hand plus investments is actually greater than the Cash Reserve. Assuming a 30-day payable balance on average, UTIMCO could have an additional $875,000 or so of cash and/or investments in excess of its defined Cash Reserve.

4. Unbudgeted performance compensation is relatively modest when compared to the total operating budget. A 100% (maximum) payout of UTIMCO's performance compensation for FY 2005 would add approximately $1.0 million to the operating budget – a sum that could be readily covered by a three-month reserve.

III. Conclusion

Based on a history of growing Cash Reserves, the flexible nature of UTIMCO's fee structure, and the lack of unplanned expenditures, we recommend a lower Cash Reserve policy than the current 12 months' target. Specifically, we believe that a three-month Cash Reserve should be more than adequate. This policy would result in a Cash Reserve of approximately $2.7 million for FY 2005 (plus accounts payable). We believe that this amount is more than adequate to manage UTIMCO's liquidity needs and to fund any unplanned or unbudgeted expenditures.

Table 1: UTIMCO Cash Reserve Analysis

	Cash Reserve**	Annual Operating Budget	Actual Operating Expenses	Budget Surplus (Deficit)
August 31, 1996	$ 610,379			
Rebated to Funds	$ (435,900)			
	$ 1,046,279			
December 31, 1996	$ 1,685,055	$ 4,752,147		
December 31, 1997	$ 2,229,534	$ 5,635,811	$ 4,671,095	$ 81,052
August 31, 1998	$ 2,634,418	$ 5,713,932	$ 2,929,793	$ 2,706,018
August 31, 1999	$ 3,606,195	$ 5,730,297	$ 5,079,734	$ 634,198
August 31, 2000	$ 5,117,129	$ 6,569,921	$ 4,656,180	$ 1,074,117
August 31, 2001	$ 4,463,550			
*Rebated to Funds	$ (1,350,000)			
Net Reserves	$ 5,813,550	$ 6,698,276	$ 4,508,611	$ 2,061,310
August 31, 2002	$ 7,806,894	$ 9,602,501	$ 4,966,657	$ 1,731,619
August 31, 2003	$ 10,110,253	$ 9,511,773	$ 7,606,088	$ 1,996,413
Estimated FY 2004 Budget Surplus to date				$ 504,320
			Total Surplus	$ 10,789,047

* In August, the U. T. Board of Regents directed UTIMCO to rebate $4 million back to the funds on a pro-rata basis. It is expected that this rebate will occur in the 1Q 05.

- Appears that Net Assets was used as the factor for calculating this rebate (rather than Cash Reserves).
- ** Cash on Hand + Investments - Accounts Payable

Table 2: UTIMCO Cash Reserve History

	Cash Reserve	Next Year's Operating Budget	Cash Reserves in Number of Months' Operating Budget
August 31, 1996	$ 610,379		
December 31, 1996	$ 1,685,055	$ 4,752,147	4.3
December 31, 1997	$ 2,229,534	$ 5,635,811	4.7
August 31, 1998	$ 2,634,418	$ 5,713,932	5.5
August 31, 1999	$ 3,606,195	$ 5,730,297	7.6
August 31, 2000	$ 5,117,129	$ 6,569,921	9.3
August 31, 2001	$ 4,463,550	$ 6,698,276	8.0
August 31, 2002	$ 7,806,894	$ 9,602,501	9.8
August 31, 2003	$ 10,110,253	$ 9,511,773	12.8
August 31, 2004 (est.)	$ 10,789,047	$ 10,757,906 (proposed)	12.0

* In August, the U. T. Board of Regents directed UTIMCO to rebate $4 million back to the funds on a pro-rate basis. It is expected that this rebate will occur in 1Q 05.

8. **U. T. Austin: Request for acceptance of and approval of the location of donated outdoor works of art - statues of Darrell K Royal and Joseph D. Jamail**

9. **U. T. Board of Regents: Presentation of certificate of appreciation to Vice Chancellor and General Counsel Godfrey**

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FOR
AUDIT, COMPLIANCE, AND MANAGEMENT REVIEW COMMITTEE

Committee Meeting: 9/28/2004
Austin

Robert A. Estrada, Chairman
Rita C. Clements
Judith L. Craven, M.D.
Woody L. Hunt
Cyndi Taylor Krier

1. U. T. System: Report on the State Auditor's Office financial statement audit for fiscal year ending August 31, 2004

REPORT

Mr. Kelton Green and Mr. Ron Franke, representatives from the State Auditor's Office, will report on their plan to perform financial audit procedures at several U. T. System institutions to express an opinion on the colleges and universities' financial information included in the State of Texas Comprehensive Annual Financial Report as of August 31, 2004. U. T. System represents approximately 60% of this total.

This information is being provided to assist the Audit, Compliance, and Management Review Committee in its oversight responsibility for the U. T. System financial statements.

2. U. T. System: Report on State Auditor's recommendations regarding protection of research data

REPORT

The State Auditor's Office recently concluded an audit of the protection of research data at three U. T. System institutions: U. T. Austin, U. T. Southwestern Medical Center - Dallas, and U. T. Health Science Center - San Antonio. The audit report was issued in June 2004 and includes several recommendations regarding the need for comprehensive information security programs for research data and improved network security. The report further states that, while issues were noted that increase the risk of loss of research data, no specific instances of research data loss or misuse were identified. The Executive Summary of the State Auditor's report, "An Audit Report on Protection of Research Data at Higher Education Institutions", is set forth on Pages 2 - 4.

Mr. Dan Updegrove, Vice President for Information Technology at U. T. Austin, Mr. Kirk Kirksey, Vice President for Information Resources at U. T. Southwestern Medical Center - Dallas, and Mr. Jerry York, Vice President and Chief Information Officer at U. T. Health Science Center - San Antonio will report on each institution's response to the State Auditor's report and on actions being taken to resolve the issues noted.

An Audit Report on

Protection of Research Data at Higher Education Institutions

SAO Report No. 04-035

June 2004

Overall Conclusion

Higher education institutions should do more to protect research data. Security of research data at the institutions we audited was inconsistent and sometimes inadequate. Although we identified instances in which research data was very well protected, we identified inconsistent security measures at each of the three institutions we audited that expose other research data to the risk of loss or misuse. This could significantly impede researchers' progress or, ultimately, result in the loss of research funding.

Background Information

We audited the protection of research data at the following institutions:

- The University of Texas at Austin (UT Austin)
- The University of Texas Southwestern Medical Center at Dallas (UT Southwestern)
- The University of Texas Health Science Center at San Antonio (UT Health Science Center)

These three institutions received more than $774 million in research funding and spent $571 million on research in fiscal year 2003. Research expenditures for Texas's public higher education institutions totaled nearly $2.2 billion during fiscal year 2003.

The institutions have ultimate responsibility for research data because they are the owners of this data and receive benefits from research such as patents, royalties, and associated funding for indirect costs. However, while institutions generally provide some degree of security to all users through perimeter firewalls or other types of network protection, they rely on decentralized departments and individual researchers to further protect research data.

Inadequate security can lead to the loss or misuse of research data, which could jeopardize institutions' reputations and their ability to achieve their missions. Although the following examples did not occur at institutions we audited, they demonstrate the importance of protecting research data:

- Not properly backing up research data has the potential to impede the progress of research. For example, Tropical Storm Allison caused the Baylor College of Medicine and the Medical School at The University of Texas Health Science Center at Houston to lose 10 years' worth of data on spinal cord injuries.
- Not securing workstations with antivirus software can leave workstations vulnerable to potential attacks, and inadequate security associated with a single workstation has the potential to have an impact on the institution's entire network. For example, in May 2004 the Sasser computer virus reportedly infected nearly one-third of the computers at The University of Texas M.D. Anderson Cancer Center and delayed some patient treatment. It is suspected that the virus entered the institution through a notebook computer.
- Because of their need for free exchange of information and open computing environments, higher education institutions in particular face a significant risk that intruders will be motivated to hack into their systems and use their extensive computing resources for unauthorized purposes. For example, hackers recently targeted and

This audit was conducted in accordance with <u>Texas Government Code</u>, Sections 321.0131 and 321.0132. For more information regarding this report, please contact Ron Franke, Audit Manager, at (512) 936-9500.

compromised TeraGrid, a network that institutions use to conduct and share research. Because of this attack, institutions that use TeraGrid took certain computers off line, which disrupted research for several days.

To minimize the risks associated with public disclosure, this report summarizes the issues we identified but does not reveal specific vulnerabilities. We provided the institutions we audited and The University of Texas System with confidential vulnerability assessments that included specific recommendations. We identified some practices being implemented at the institutions we audited that we feel are worth considering at other institutions. We have noted these as "best practices" in our report.

The institutions generally agreed with our recommendations. The institutions were already aware of the weaknesses we identified and had begun making progress and continue to make progress to address areas of concern. They have provided detailed plans for addressing their respective issues.

Key Points

Institutions should develop comprehensive information security programs for research data.

Not all of the institutions we audited have comprehensive security programs. Specifically, institutions do not always address the risk to research data in the information security policies, security risk assessments, and disaster recovery plans. Because researchers have limited guidance to follow when attempting to secure information resources, there are wide variations in security practices. In addition, none of the institutions we reviewed ensures that all users receive security awareness training to educate them on how to protect data.

Institutions should develop comprehensive protection at the user layer.

The research labs we reviewed receive varying levels of technical support. Individuals who manage information resources in these labs are researchers or instructors who may have varying levels of expertise in information security or for whom information security is not their primary responsibility. This has led to several weaknesses in data backups, antivirus software, security patches, user access, and passwords.

Institutions should develop comprehensive protection at the network and outer layers.

Each institution we audited must address specific weaknesses in its approach to network security and ensure that network equipment is properly protected. In addition, we identified unauthorized wireless access points at all of these institutions, which may expose the institutions' networks to the risk of intrusion.

Summary of Information Technology Review We focused on the security of research data on servers and workstations in individual research labs, as well as the management of central information resources that affect research. We conducted technical vulnerability scans, but we did not attempt to exploit the vulnerabilities we identified. We also conducted wireless leakage tests in selected areas. During our audit, we identified issues that increase the risk of loss of research data, but we did not identify any specific instances in which research data had been lost or misused. We did not review administrative systems or applications such as financial, accounting, or student information systems.

Summary of Objectives, Scope, and Methodology The objectives of the audit were to determine whether selected higher education institutions have (1) adequate controls for major research information systems to ensure that proprietary research information is sufficiently protected from loss or misuse, (2) access and security controls for the networks and information systems used for research, and (3) adequate physical security and disaster recovery plans to ensure that research information systems and data are not lost in the event of an emergency or disaster. The scope of the audit included reviewing selected research labs' workstations and servers that contain proprietary research data and the management of central information resources that affect research. The audit methodology consisted of interviewing staff, reviewing disaster recovery and information security plans and policies, inspecting major data centers and selected research labs, and conducting network and wireless scans to identify potential information system vulnerabilities. *iii*

3. **U. T. System: Approval of U. T. System Internal Audit Plan for Fiscal Year 2005**

RECOMMENDATION

It is recommended that the Audit, Compliance, and Management Review Committee approve the proposed U. T. System-wide Internal Audit Plan for Fiscal Year 2005 and recommend the Plan to the U. T. System Board of Regents for approval at the November 2004 meeting. A timeline and summary of the auditable areas are set forth on Pages 6 - 8. Development of the Internal Audit Plan is based on risk assessments performed at each institution. Implementation of the Plan will be coordinated with the institutional auditors.

BACKGROUND INFORMATION

Institutional Audit Plans, compiled by the internal audit departments after input and guidance from the System Audit Office and the institution's management and Internal Audit Committee, were submitted to all Internal Audit Committees and institutional presidents for review and comments.

The Chief Audit Executive provided feedback by conducting audit hearings with each institution. After the review process, each Internal Audit Committee formally approved its institution's Plan.

Annual Audit Plan – Approval Process

Board of Regents (November)

↑

Audit, Compliance, and Management Review Committee (September)

↑

Institutional Internal Audit Committees (August)
(includes Presidents)

↑

System Administration - Audit Plan Hearings (July & August)
Institutional Internal Audit Director meets with
the Director of Audits, a representative from Health Affairs or Academic Affairs,
and Business Affairs

↑

System Administration and Institutional Internal Audit Directors coordinate
the preparation of their risk-based audit plans (June & July)

Fiscal Year 2005 System-wide Audit Plan

Summary

The University of Texas System-wide Fiscal Year 2005 Internal Audit Plan (2005 Audit Plan) is a blueprint of the internal audit activities that will be performed by the internal audit function throughout The University of Texas System in FY 2005. Individual audit plans were prepared at each institution and approved by the institutional Internal Audit Committee.

The Director of Audits provided direction to the internal audit directors prior to the preparation of the audit plans and provided formal feedback through conducting "audit hearings" with each institution. The process of preparing the audit plans is risk based and ensures that activities with the greatest risk are audited.

The efforts of the internal audit function continue to expand into areas other than the performance of traditional audits. Examples of added services include: providing continued assistance in the System-wide Compliance Initiative, assisting in the Information Technology (IT) Vulnerability Initiative, providing information to the Board of Regents to assist them in their decision to voluntarily implement the "spirit" of the Sarbanes-Oxley Act of 2002, and performing consulting projects and special investigations at the request of management.

The 2005 Audit Plan illustrates an economic and efficient use of internal audit resources, and addresses the risks of The University of Texas System by planning activities as follows:

Area	**Audit Hours**	**% of Total Hours**
Key Financial and Operating Information	30,205	24%
Institutional Compliance Audits	11,616	9%
Information Technology Audits	23,604	18%
Core Business Processes	29,180	23%
Change in Management	5,850	5%
Follow-up	4,550	3%
Projects	22,661	18%
Total	127,666	100%

Prepared by: U. T. System Internal Audit Program
Consolidated by: U. T. System Audit Office
Date: September 2004

	Key Financial & Operating Information	Institutional Compliance	Information Technology	Core Business Processes	Change in Management	Follow-up	Projects	Total
U. T. System Administration	2,960	700	3,897	4,280	650	200	3,779	16,466
Large Institutions:								
U. T. Austin	4,090	2,450	3,150	1,550	1,080	400	4,500	17,220
U. T. Southwestern	3,050	1,000	2,700	4,050	650	400	2,150	14,000
U. T. Medical Branch at Galveston	3,360	1,075	3,000	3,700	700	750	2,076	14,661
U. T. HSC - Houston	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
U. T. HSC - San Antonio	1,960	720	980	1,250	300	450	1,280	6,940
U. T. MDA Cancer Center	2,330	1,190	3,437	6,980	240	400	1,750	16,327
subtotal	14,790	6,435	13,267	17,530	2,970	2,400	11,756	69,148
Mid-size Institutions:								
U. T. Arlington	1,920	600	600	1,160	200	300	266	5,046
U. T. Brownsville	1,350	200	550	550	400	250	624	3,924
U. T. Dallas	1,155	1,260	770	1,015	200	170	628	5,198
U. T. El Paso	2,470	550	950	1,250	820	530	1,350	7,920
U. T. Pan American	1,350	315	600	1,430	210	400	820	5,125
U. T. San Antonio	1,500	600	1,400	850	-	260	2,050	6,660
subtotal	9,745	3,525	4,870	6,255	1,830	1,910	5,738	33,873
Small Institutions:								
U. T. Permian Basin	500	170	130	270	160	40	100	1,370
U. T. Tyler	600	536	690	240	60	-	464	2,590
U. T. HC at Tyler	1,610	250	750	605	180	-	824	4,219
subtotal	2,710	956	1,570	1,115	400	40	1,388	8,179
TOTAL	**30,205**	**11,616**	**23,604**	**29,180**	**5,850**	**4,550**	**22,661**	**127,666**
Percentage of Total	**24%**	**9%**	**18%**	**23%**	**5%**	**3%**	**18%**	**100%**

N/A: The department has experienced 100% turnover and a new director and staff are expected to be in place in October. An audit plan will be developed upon the restaffing of the audit function.

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