

**THE UNIVERSITY OF TEXAS SYSTEM
SHORT INTERMEDIATE TERM FUND**

FINANCIAL STATEMENTS

Years Ended August 31, 2003 and 2002

THE UNIVERSITY OF TEXAS SYSTEM SHORT INTERMEDIATE TERM FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

Our discussion and analysis of The University of Texas System Short Intermediate Term Fund's (Fund) financial performance provides an overview of its activities for the fiscal year ended August 31, 2003. This discussion was prepared by The University of Texas Investment Management Company "UTIMCO" and should be read in conjunction with the Fund's financial statements and notes. The Fund is an internal UT System mutual fund for the pooled investment of UT System institutional operating funds with an investment horizon of greater than one year. The Texas Constitution and various state statutes designate The University of Texas System Board of Regents (UT Board) as the fiduciary for the management of certain public endowment and operating funds. The UT Board has entered into an Investment Management Services Agreement delegating investment management responsibility for all investments to UTIMCO.

The purpose of the MD&A is to provide an objective and easily readable analysis of the Fund's financial statements based upon currently known facts, decisions or conditions.

Financial Highlights

- The Fund's net assets were \$1,435.3 million at August 31, 2003 compared to \$1,435.9 million at August 31, 2002.
- Investment income totaled \$53.0 million for the year ended August 31, 2003, compared to \$68.0 million for the year ended August 31, 2002.
- The Fund posted a net investment return of 1.64% for the fiscal year ended August 31, 2003, compared to a net investment return of 3.75% for the prior fiscal year.

Market Commentary

The Fund entered fiscal year 2003 positioned for a broad-based economic recovery. With the continuing support of monetary and fiscal stimulus flowing through the economic system (courtesy of Federal Reserve interest rate cuts and Federal Government tax relief), the Fund was positioned for a general rise in market interest rates as both the consumer and corporate sector were poised for a sustained rebound. However, with the developing strains of the Iraq War, and with the subsequent fears of potential deflation spurring investor uncertainty, market interest rates remained in a broad-based decline throughout most of the year. Although its overall positioning hindered results somewhat, the Fund was able to maintain its dedicated status of preserving investor capital and outperform money market interest rates, even in the most turbulent of market environments.

Use of Financial Statements and Notes

The Fund financial statements were prepared in accordance with standards issued by the Governmental Accounting Standards Board (GASB). Three financial statements are required under GASB: the Statement of Net Assets, the Statement of Operations and Changes in Net Assets, and

THE UNIVERSITY OF TEXAS SYSTEM SHORT INTERMEDIATE TERM FUND

the Statement of Cash Flows. We have also included as part of the basic financial statements the Schedule of Investment in Securities.

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

Statement of Net Assets

The Statement of Net Assets presents assets, liabilities, and net assets of the Fund as of the end of the fiscal year. This statement, along with all of the Fund's financial statements, is prepared using the accrual basis of accounting, whereby Fund investment income is recognized when earned and Fund expenses are recognized when incurred.

The Fund emphasizes moderate liquidity and safety of principal through investment in high grade fixed income and floating rate obligations. The Fund's investments are diversified among eligible asset classes and issuers (excluding the U.S. Government) as defined in the Fund's investment policy. The Fund carries an AAA_F credit rating and a bond volatility risk rating of S₂ from Standard & Poor's Inc (S&P). AAA is the highest quality rating issued by S&P. An S₂ rating indicates low to moderate market risk exposure.

The Fund's investment policy mitigates interest rate risk by limiting its portfolio duration to a range of 0.5 years to 4 years. Duration estimates the impact small changes in interest rates will have on the value of the portfolio. At August 31, 2003, the option adjusted duration of the portfolio was 1.67 years. Simplistically, if there is a 1.00% increase (decrease) in yields, the value of the portfolio would (decrease) increase by 1.67%.

Net assets consist of participant contributions and net accumulated realized and unrealized gains and losses on investments.

Statement of Operations and Changes in Net Assets

Changes in net assets as presented on the Statement of Operations and Changes in Net Assets are based on activity of the Fund. The purpose of this statement is to present the results of operations, the changes in value of the investments of the Fund, the net participant contributions, and the distributions to participants.

The Fund earned realized and unrealized investment losses of \$27.1 million during the year compared to realized and unrealized losses of \$7.7 million for the year ended August 31, 2002. Expenses totaled \$0.7 million for both fiscal year 2003 and 2002.

The net increase in net assets resulting from operations was \$25.2 million and \$59.6 million, respectively, for the years ended August 31, 2003 and 2002.

Distributions to participants totaled \$52.3 million and \$67.3 million for the years ended August 31, 2003 and 2002, respectively. Fund income is either reinvested or distributed to the participating institutions monthly at their election.

THE UNIVERSITY OF TEXAS SYSTEM SHORT INTERMEDIATE TERM FUND

The Fund's primary investment objective is to provide both (1) income and (2) capital appreciation when consistent with income generation, reasonable preservation of capital and the maintenance of adequate Fund liquidity.

Statement of Cash Flows

The Statement of Cash Flows provides relevant information about the cash receipts and cash payments of the Fund for the periods.

Purchases of investment securities totaled \$2,019.0 million and \$591.9 million, respectively, for the fiscal years ended August 31, 2003 and 2002. Proceeds from the sale and maturities of investment securities totaled \$2,098.4 million and \$663.8 million, respectively for the fiscal years ended August 31, 2003 and 2002.

Schedule of Investment in Securities

The Schedule of Investment in Securities provides information about the securities held by the Fund as of August 31, 2003.

Contacting UTIMCO

The above financial highlights are designed to provide a general overview of the Fund's investment results and insight into the following financial statements. Additional information may be found on our website and inquiries may be directed to UTIMCO via www.utimco.org.

Report of Independent Auditors

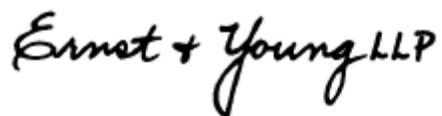
The Board of Regents of The University of Texas System
The Board of Directors of The University of Texas Investment Management
Company
Austin, Texas

We have audited the accompanying statement of net assets of The University of Texas System Short Intermediate Term Fund (the "Fund"), including the schedule of investment in securities as of August 31, 2003, and the related statements of operations, changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements (excluding a statement of cash flows) of The University of Texas System Short Intermediate Term Fund for the year ended August 31, 2002, were audited by other auditors whose report dated October 18, 2002, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Management's discussion and analysis on pages 1 through 3 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In our opinion, the 2003 financial statements, referred to above present fairly, in all material respects, the financial position of The University of Texas System Short Intermediate Term Fund as of August 31, 2003, the results of its operations, its cash flows, and changes in its net assets for the year then ended, in conformity with accounting principles generally accepted in the United States.

 Ernst & Young LLP

October 17, 2003

**THE UNIVERSITY OF TEXAS SYSTEM
SHORT INTERMEDIATE TERM FUND**

Statements of Net Assets

August 31, 2003 and 2002

(Dollars in thousands, except per unit amounts)

	<u>2003</u>	<u>2002</u>
Assets		
Investment in Securities, at Fair Value (Cost \$1,643,790 and \$1,416,219, respectively)	\$ 1,633,180	\$ 1,425,660
Accrued Income Receivable	<u>6,353</u>	<u>14,907</u>
Total Assets	<u>1,639,533</u>	<u>1,440,567</u>
Liabilities		
Investment Securities Purchased	201,386	-
Income Distributions Payable to Participants	2,814	4,685
Other Payables and Accrued Expenses	<u>6</u>	<u>6</u>
Total Liabilities	<u>204,206</u>	<u>4,691</u>
Net Assets	<u>\$ 1,435,327</u>	<u>\$ 1,435,876</u>
Supplementary Disclosure:		
Net Assets Consist Of:		
Participant Contributions (Net of withdrawals)	\$ 1,440,828	\$ 1,414,203
Accumulated Undistributed Net Realized Gain on Investments	5,109	12,232
Net Unrealized Appreciation (Depreciation)	<u>(10,610)</u>	<u>9,441</u>
Net Assets for 144,736,640 and 142,184,975 units, respectively	<u>\$ 1,435,327</u>	<u>\$ 1,435,876</u>
Net Asset Value Per Unit	<u>\$ 9.917</u>	<u>\$ 10.099</u>

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

**THE UNIVERSITY OF TEXAS SYSTEM
SHORT INTERMEDIATE TERM FUND**

Statements of Operations and Changes in Net Assets

Years Ended August 31, 2003 and 2002

(Dollars in thousands)

	<u>2003</u>	<u>2002</u>
Investment Income		
Interest	\$ 52,263	\$ 67,551
Commitment Fees	741	433
Total Investment Income	<u>53,004</u>	<u>67,984</u>
Expenses		
UTIMCO Management Fee	603	580
Custodial Fees and Expenses	74	76
Other Expenses	36	38
Total Expenses	<u>713</u>	<u>694</u>
Net Investment Income	<u>52,291</u>	<u>67,290</u>
Realized and Unrealized Gain (Loss) on Investments		
Net Realized Loss on Investment Securities	(7,078)	(10,756)
Net Unrealized Appreciation (Depreciation) on Investment Securities	<u>(20,051)</u>	<u>3,079</u>
Net Loss on Investments	<u>(27,129)</u>	<u>(7,677)</u>
Net Increase in Net Assets Resulting from Operations	\$ 25,162	\$ 59,613
Net Assets		
Beginning of Period	1,435,876	1,704,605
Participant Contributions (including reinvestments of \$46,898 and \$52,156 for years ended August 31, 2003 and 2002, respectively)	351,580	286,948
Participant Withdrawals	(325,000)	(548,000)
Distributions of Net Investment Income to Participants	<u>(52,291)</u>	<u>(67,290)</u>
End of Period	<u>\$ 1,435,327</u>	<u>\$ 1,435,876</u>
Ratios and Supplemental Data		
Ratio of Expenses to Average Net Assets	0.05%	0.04%
Ratio of Net Investment Income Distributed to Average Net Assets	3.44%	4.24%

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

**THE UNIVERSITY OF TEXAS SYSTEM
SHORT INTERMEDIATE TERM FUND**

Statements of Cash Flows

Years Ended August 31, 2003 and 2002

(in thousands)

	2003	2002 (unaudited)
	<hr/>	<hr/>
Cash Flows From Operating Activities:		
Cash received on interest	\$ 60,803	\$ 69,794
Cash received on commitment fees	755	433
Cash payments to UTIMCO for management fees	(603)	(580)
Cash payments to service providers	(110)	(115)
Purchase of investment securities	(2,019,001)	(591,870)
Proceeds from sale and maturities of investment securities	2,098,410	663,787
	<hr/>	<hr/>
Net Cash Provided By Operating Activities	140,254	141,449
	<hr/>	<hr/>
Cash Flows from Financing Activities:		
Contributions from participants	351,580	286,948
Withdrawals by participants	(325,000)	(548,000)
Distributions to participants	(54,160)	(70,104)
	<hr/>	<hr/>
Net Cash Used in Financing Activities	(27,580)	(331,156)
	<hr/>	<hr/>
Net increase (decrease) in cash and cash equivalents	112,674	(189,707)
Cash and cash equivalents at beginning of year	454,286	643,993
	<hr/>	<hr/>
Cash and cash equivalents at end of year	\$ 566,960	\$ 454,286
	<hr/>	<hr/>
Reconciliation of net increase in net assets provided by operating activities:		
Net increase in net assets	\$ 25,162	\$ 59,613
Adjustments to reconcile net increase in net assets to net cash provided by operating activities:		
Unrealized losses (gains) on investments	20,051	(3,079)
Cost of investment securities purchased	(2,220,387)	(591,870)
Cost of investment securities sold	2,105,488	674,543
Decrease in accrued income receivable	8,554	2,243
Increase in investment securities purchased payable	201,386	-
Decrease in other payables and accrued expenses	-	(1)
	<hr/>	<hr/>
Net Cash Provided by Operating Activities	\$ 140,254	\$ 141,449
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The accompanying notes are an integral part of these financial statements.

**THE UNIVERSITY OF TEXAS SYSTEM
SHORT INTERMEDIATE TERM FUND**

Schedule of Investment in Securities

August 31, 2003

(Dollars in thousands)

Description	Coupon	Maturity	Par Value	Value	Cost
Cash and Cash Equivalents					
Dreyfus Institutional Pfd Money Market			\$ 566,960	\$ 566,960	\$ 566,960
U.S. Treasury Securities					
U.S. Treasury Notes	3.625%	03/31/2004	150,000	152,250	151,868
U.S. Treasury Notes	3.375%	04/30/2004	75,000	76,125	76,453
U.S. Treasury Notes	7.250%	08/15/2004	75,000	79,266	82,406
U.S. Treasury Notes	1.625%	03/31/2005	21,750	21,743	21,759
U.S. Treasury Notes	3.000%	02/15/2008	47,750	47,258	49,052
Total U.S. Treasury Securities			<u>369,500</u>	<u>376,642</u>	<u>381,538</u>
U.S. Agency Bonds					
Federal Home Loan Mortgage Corp Debs	3.250%	11/15/2004	100,000	102,120	103,012
Federal Nat'l Mtg Association Debs	1.875%	12/15/2004	100,000	100,316	100,383
Federal Farm Credit Bks Cons Med Term Notes	2.125%	08/15/2005	250,000	249,635	252,323
Total U.S. Agency Bonds			<u>450,000</u>	<u>452,071</u>	<u>455,718</u>
U.S. Agency Mortgage Backed Bonds					
Fannie Mae Pool	7.000%	09/0/2014	16,832	17,880	17,836
Commitment to Purchase Fannie Mae Pool	5.000%	06/01/2033	207,000	199,852	200,984
Total U.S. Agency Mortgage Backed Bonds			<u>223,832</u>	<u>217,732</u>	<u>218,820</u>
Mortgage Backed CMOS					
FHMLC Multiclass Mortgage	7.000%	03/15/2010	19,502	19,775	20,754
Total Mortgage Backed CMOS			<u>19,502</u>	<u>19,775</u>	<u>20,754</u>
Total Investment in Securities			<u>\$ 1,629,794</u>	<u>\$ 1,633,180</u>	<u>\$ 1,643,790</u>

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

**THE UNIVERSITY OF TEXAS SYSTEM
SHORT INTERMEDIATE TERM FUND**

Notes to Financial Statements

Note 1 – Organization and Basis of Presentation

The University of Texas System Short Intermediate Term Fund (Fund) is a short intermediate term pooled investment fund established by The University of Texas System Board of Regents (Board of Regents) for the collective investment of operating funds and other short and intermediate term funds held by The University of Texas System Administration and the fifteen component institutions of The University of Texas System. The Fund carries an AAA_f credit quality rating and a bond fund volatility rating of S₂ from Standard & Poor's, Inc. (S&P). AAA is the highest credit quality rating issued by S&P. An S₂ rating indicates low to moderate market risk exposure. The day-to-day operational responsibilities of the Fund are delegated to The University of Texas Investment Management Company (UTIMCO), pursuant to an Investment Management Services Agreement with the Board of Regents.

The Fund uses the accrual method of accounting, recognizing income when such items are earned and expenses when such items are incurred. The Fund is subject to the pronouncements of the Governmental Accounting Standards Board (GASB) and accounts for its activities as a proprietary enterprise fund. The Fund also applies all applicable pronouncements of the Financial Accounting Standards Board that do not conflict with pronouncements of the GASB.

The annual combined financial statements of The University of Texas System are prepared in accordance with Texas Comptroller of Public Accounts' Annual Financial Reporting Requirements and include information related to the Fund. The accompanying financial statements may differ in presentation from the Texas Comptroller of Public Accounts' Annual Financial Reporting Requirements.

Note 2 - Significant Accounting Policies

- (A) Investment Policy - The Fund invests in high grade fixed income obligations as provided for in the Fund's Investment Policy statement. Limiting the duration of the Fund to a range of one-half to four years controls interest rate risk. The effective duration of any eligible investment should not exceed ten years.
- (B) Security Valuation - Investments are valued on the basis of market valuations provided by Merrill Lynch Securities Pricing Services and various other independent pricing services.

THE UNIVERSITY OF TEXAS SYSTEM
SHORT INTERMEDIATE TERM FUND

Notes to Financial Statements (cont.)

- (C) Investment Income - Interest income is accrued as earned. Premium and discounts on bonds are not amortized.
- (D) Security Transactions - Security transactions are accounted for on a trade date basis. Gains and losses on securities sold are determined on the basis of average cost. A loss is recognized if there is impairment in the value of the security that is determined to be other than temporary.
- (E) Federal Income Taxes - The Fund is not subject to federal income tax.
- (F) Fund Valuation - Valuation of the Fund's units occurs weekly and at month-end. Unit values are determined by dividing the value of the Fund's net assets by the number of units outstanding on the valuation date.
- (G) Distributions to Participants - Accrued net investment income is allocated to participants each valuation period. Income is distributed to participants at the beginning of each month.
- (H) Purchases and Redemption of Units - The value of participating units, upon admission to or withdrawal from the Fund, is based upon the market value of net assets held as of the valuation date. There are no transaction costs incurred by participants to purchase or redeem units.
- (I) Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.
- (J) Cash and Cash Equivalents – Cash and cash equivalents consist of money market funds, and are an integral part of the Fund's investment strategy and activities. Thus, cash and cash equivalents are included in the investment in securities balance on the statement of net assets.
- (K) Recently Issued Accounting Standards – In March 2003, GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures – An Amendment of GASB Statement No. 3*, which modifies and expands disclosures regarding deposits and investments. This statement is not effective for the Fund until the fiscal year ending

**THE UNIVERSITY OF TEXAS SYSTEM
SHORT INTERMEDIATE TERM FUND**

Notes to Financial Statements (cont.)

August 31, 2005. Management does not anticipate that the implementation of the new statement will have a material impact on the Fund's financial statement balances.

- (L) Reclassifications – Certain items in the 2002 financial statements have been reclassified to conform with 2003 classification.

Note 3 - Investment Risk

The Fund's investments have been categorized as defined by GASB Statement No. 3, Deposits with Financial Institutions, Investments (including Repurchase Agreements) and Reverse Repurchase Agreements, to give an indication of the level of credit risk assumed by the Fund at August 31, 2003. Investments in U.S. Treasury Securities, U.S. Agency Bonds, and Mortgage Backed Collateralized Mortgage Obligations have been categorized as category 1, as investments that are insured or registered investments held by the Fund or its agent in the Fund's name. Investments classified as cash and cash equivalents are not categorized because they are not evidenced by securities that exist in physical or book entry form.

Note 4 - Note Purchase Commitment

The Fund has entered into a note purchase commitment with the Board of Regents of The University of Texas System Revenue Financing System that commits the Fund to acquire up to \$750 million of revenue financing system notes in the event of a failed remarketing of these notes. If the net asset value of the Fund declines below \$1,225 million and is expected to remain below this amount for thirty days, the Fund's commitment will be \$250 million. If the net asset value of the Fund declines below \$875 million and is expected to remain below this amount for thirty days, the Fund's commitment will be \$150 million.

During 2001, the Fund entered into an additional commitment in connection with the Board of Regents of The University of Texas System Revenue Financing System Refunding Bonds, Series 2001A. As of August 31, 2003, the Fund is committed to a maximum bond purchase commitment of \$58.1 million in the event of a failed remarketing of the Series 2001A bonds. The commitment amount as of August 31, 2002, was \$71.4 million. The amount of commitment is expected to decrease annually based on amortization of the Series 2001A bonds.

**THE UNIVERSITY OF TEXAS SYSTEM
SHORT INTERMEDIATE TERM FUND**

Notes to Financial Statements (cont.)

The commitment fees earned by the Fund were \$741,438 and \$433,176, respectively, for the years ended August 31, 2003 and 2002.

Note 5 - Fees and Expenses

The Fund is assessed an investment management fee by The University of Texas Investment Management Company. For the years ended August 31, 2003 and 2002, the fee was \$603,402 and \$580,393, respectively.

Custodial fees and expenses are assessed by the financial institution which holds the Fund's assets. Fees are based on the market value of the Fund and transaction activity in accordance with the contractual agreement with the institution. Additional fees are assessed for performance measurement and on-line communication services per the contractual agreement.

The Fund incurs other fees related to its operations consisting of audit fees, printing and graphic expenses, consultation fees and rating fees.