

FUND ACCOUNTING TRAINING

Module 5

Endowment and Similar Funds – State and Annuity and Life Income Funds

The University of Texas System

OBJECTIVES



The University of Texas System has two state endowment funds:

- Permanent University Fund
- Permanent Health Fund

STATE ENDOWMENT FUNDS - PUF

History of the Permanent University Fund (PUF)

The University of Texas originated in 1839 when the Congress of the Republic ordered a site set aside for a university. That same year, 50 leagues of land were allocated for the establishment of two colleges or universities.

The *Constitution* of 1866 directed the legislature to put the university into operation. In 1871, the Agricultural and Mechanical College of Texas was established in Brazos county as a branch of the then nonexistent University of Texas. (It remained the Agricultural and Mechanical College until 1963 when it was changed to Texas A&M University.) It was not until 1881 that Austin was chosen as the site of the main campus. The University of Texas was formally opened in 1883.

STATE ENDOWMENT FUNDS - PUF (CONTINUED)

The *Constitution* of 1876 set aside 1 million acres of unappropriated public land in West Texas to fund The University of Texas. In 1883, the legislature appropriated an additional 1 million acres of West Texas land to the University. The land was to be sold and the proceeds used to make up the corpus of the PUF.

However, due to low interest rates on securities for which the proceeds were required to be invested, it was more profitable to lease the land rather than sell it. Oil was subsequently discovered on University land at oil well Santa Rita #1. These original oil proceeds were the first investments to the new State Endowment Fund, the PUF.

Pictured, Santa Rita #1 oil rig, now located on the U. T. Austin campus. “. . .the Santa Rita roared to life, sprayed oil over the top of the derrick, and covered a 250-yard area around the site.” from the *Handbook of Texas, Online*.



STATE ENDOWMENT FUNDS - PUF (CONTINUED)

- Assets: Assets of the PUF include receivables and restricted investments
- Liabilities: Include accounts payable, trade payable, A&M's PUF bonds payable, and securities lending activities.
- Net Assets: The PUF net assets are reported as a Restricted-Nonexpendable Endowment for the corpus and restricted-expendable for the appreciation.

The PUF is a unique endowment for the benefit of The University of Texas and Texas A&M University (TAMU) Systems. Dividends, interest, and gains/losses (difference between cost and selling price) on investments serve to change the net assets of the PUF. A portion of this income is then added to the AUF along with the surface income from the 2 million acres of PUF lands. Because of its uniqueness, this fund is reported as a separate fund group on U. T. System Administration's books only.

STATE ENDOWMENT FUNDS - PUF (CONTINUED)

Of the funds that flow into the AUF, one-third is distributed to the TAMU System and two-thirds remains within the U. T. System. U. T. System and the TAMU System may issue bonds totaling 20% and 10% respectively, of the total PUF book value for the construction and major renovation of plant facilities at institutions. PUF bond service is paid from each system's respective share of AUF income.

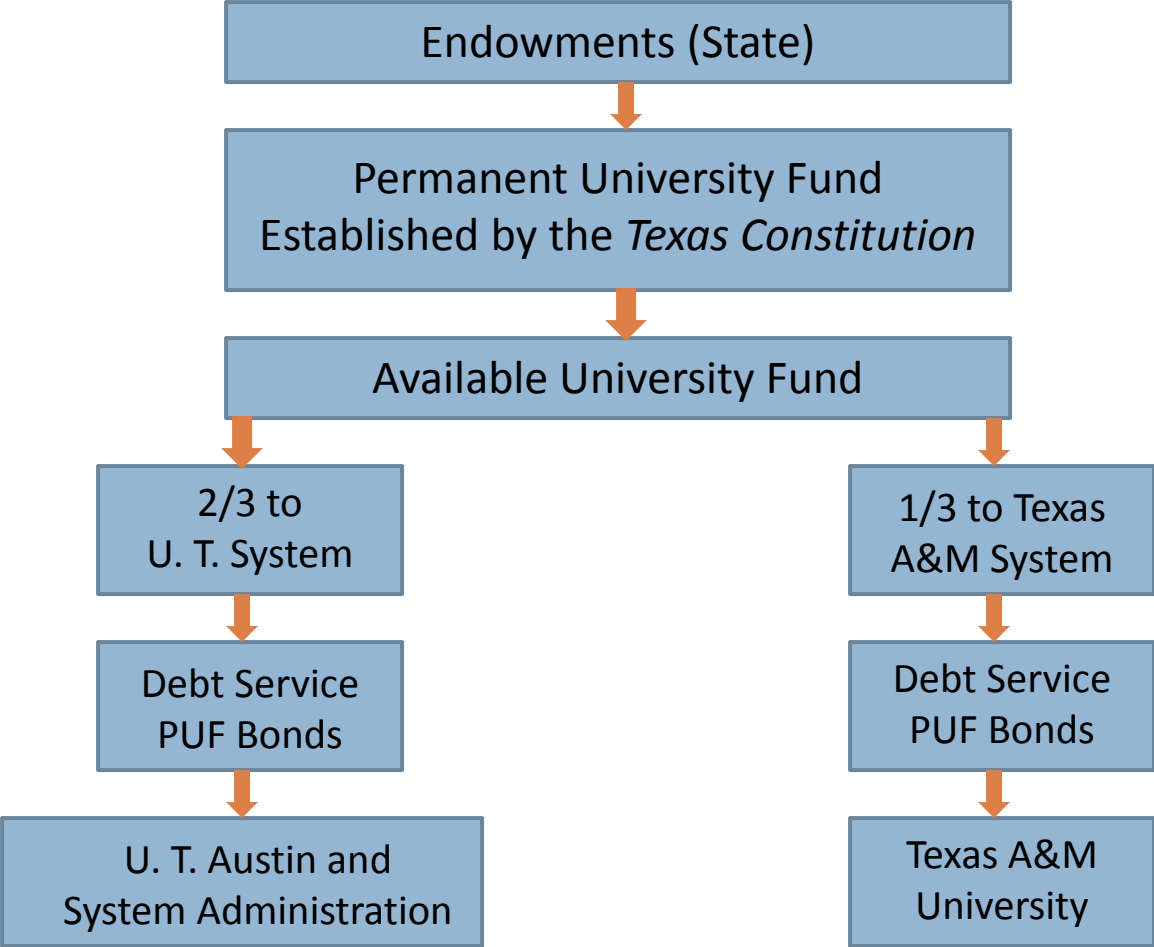
Distributions from the PUF to the AUF are allocated two-thirds and one-third for the benefit of the U. T. System and the TAMU System, respectively.

PUF distributions are expended by each university system to fund two major programs:

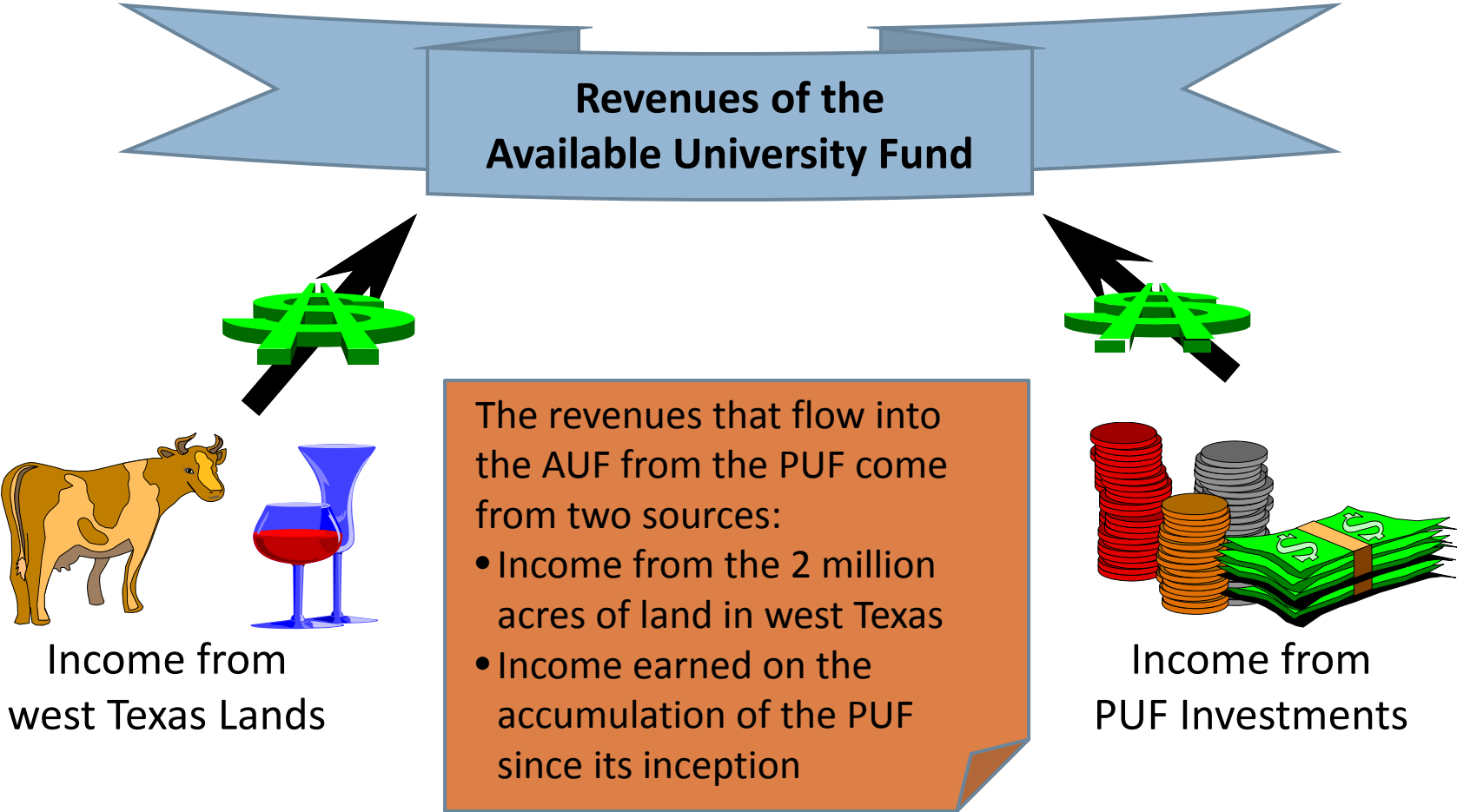
- Debt service on PUF bonds issued to fund capital expenditures
- Academic Excellence Programs at U. T. Austin and Texas A&M University.

A portion of the AUF funding is also used to fund the System Administration offices of both systems.

STATE ENDOWMENT FUNDS - PUF (CONTINUED)



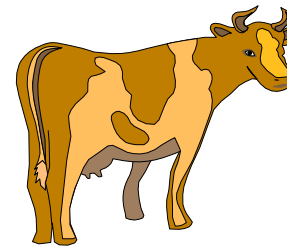
State Endowment Funds - PUF (Continued)



INCOME FROM WEST TEXAS LANDS

Examples of income from the 2 million acres of land in west Texas include:

- Grazing leases
- Surface easements
- Exploration permits
- Mineral lease assignment
- Royalties on winery



INCOME FROM PUF INVESTMENTS

Examples of income from PUF investments include:


- Interest on United States Bonds
- Interest on U.S. Government Obligations
- Interest on Corporate Bonds
- Stock Dividends
- Interest on Commercial Paper
- Interest on Municipal Bonds
- Income from Security Lending
- Capital Gain Distributions
- Capital Gains Resulting from Sales



PERMANENT HEALTH FUND



- On August 30, 1999, a second state endowment was created by the Legislature.
- The Permanent Health Fund (PHF) was created with approximately \$1 billion of settlement funds received from the tobacco lawsuit.
- All U. T. health institutions and U. T. El Paso had a permanent state endowment established with these funds for their institution.
- Earnings must be used for research or education related to tobacco use.



We are reviewing the fund groups that can be found on the Balance Sheet. In this section we will look at:

Annuity and Life Income Funds

ANNUITY AND LIFE INCOME FUNDS OBJECTIVES



- Acquire basic understanding of Annuity and Life Income Funds
- Understand differences between Annuity Funds and Life Income Funds

Institutions may receive funds under deferred giving agreements. These funds are deposited into a fund group entitled:

Annuity and Life Income Funds

ANNUITY AND LIFE INCOME FUNDS



The Annuity and Life Income Funds are received by an institution under deferred giving agreements. These are four types of deferred-giving agreements that qualify the donor for federal income tax benefits:

- Charitable gift annuity contracts
- Pooled life income funds
- Charitable remainder unitrusts
- Charitable remainder annuity trusts

ANNUITY AND LIFE INCOME FUNDS (CONTINUED)



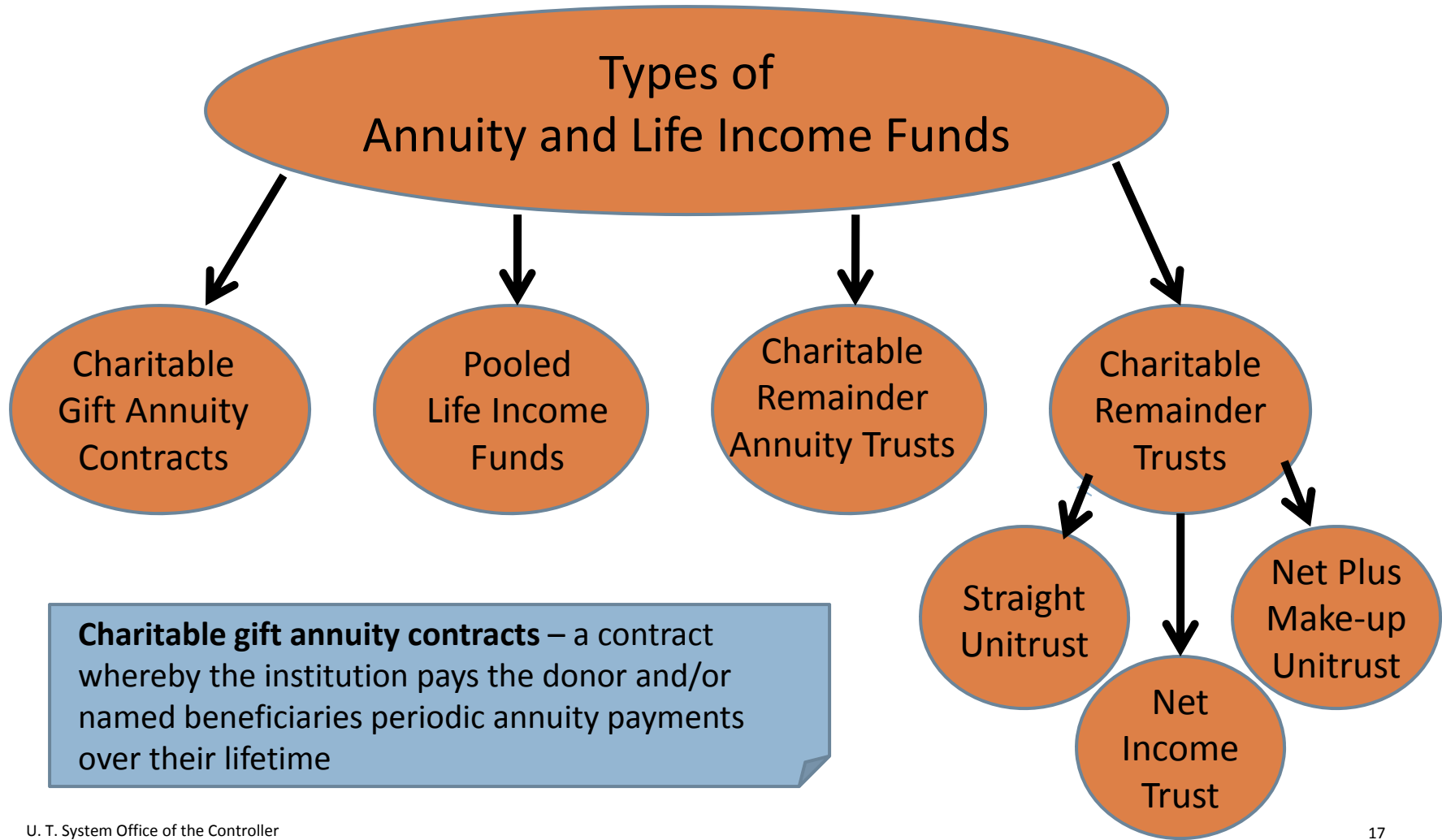
The Annuity and Life Income Funds provide payment to beneficiaries during their lifetimes or for a specific term. Institutions may use the remaining principal for other purposes, as defined by the donor(s), upon the death of the beneficiaries. Ultimately, these funds could either be expendable or used as an endowment for restricted or unrestricted purposes.

The difference between Annuity Funds and Life Income Funds is that Annuity Funds return a portion of the principal to the beneficiary and payments remain fixed over the life of the contract. Life Income Funds only return the income earned on the fund to the beneficiary and, therefore, may vary depending on market conditions.

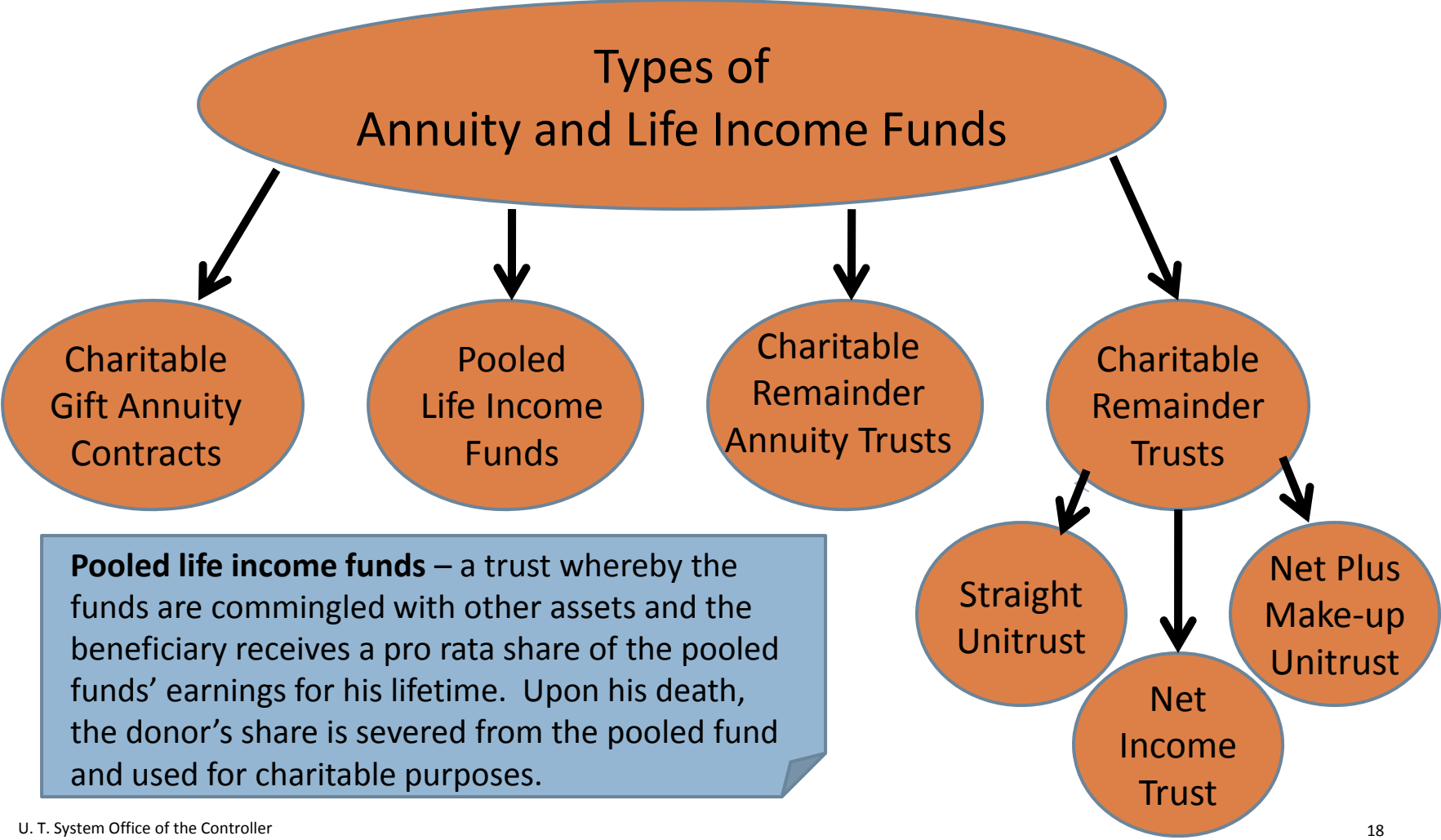
ANNUITY AND LIFE INCOME FUNDS (CONTINUED)

- Assets:** Due to the nature of Annuity and Life Income Funds, assets are generally comprised of noncurrent investments, which provide stability and steady income to the funds; however, there may also be cash and cash equivalents.
- Liabilities:** The amount actuarially estimated to be paid to the beneficiary is recognized as a liability.
- Net Assets:** Both Annuity Fund and Life Income Fund balances are reported as Restricted-nonexpendable on U. T. System's Balance Sheet for the corpus and Restricted Expendable for the appreciation.

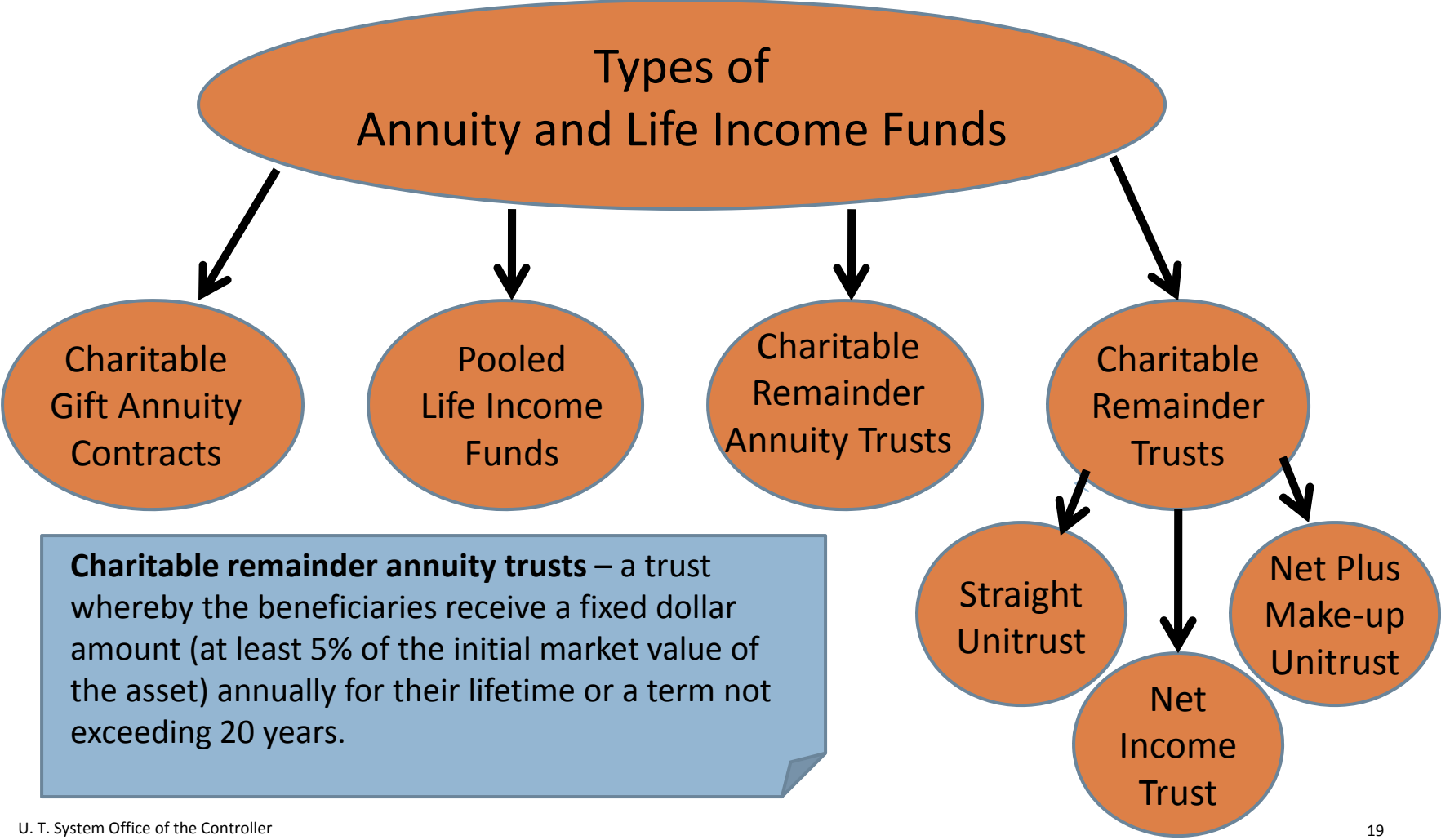
ANNUITY AND LIFE INCOME FUNDS (CONTINUED)



ANNUITY AND LIFE INCOME FUNDS (CONTINUED)



ANNUITY AND LIFE INCOME FUNDS (CONTINUED)

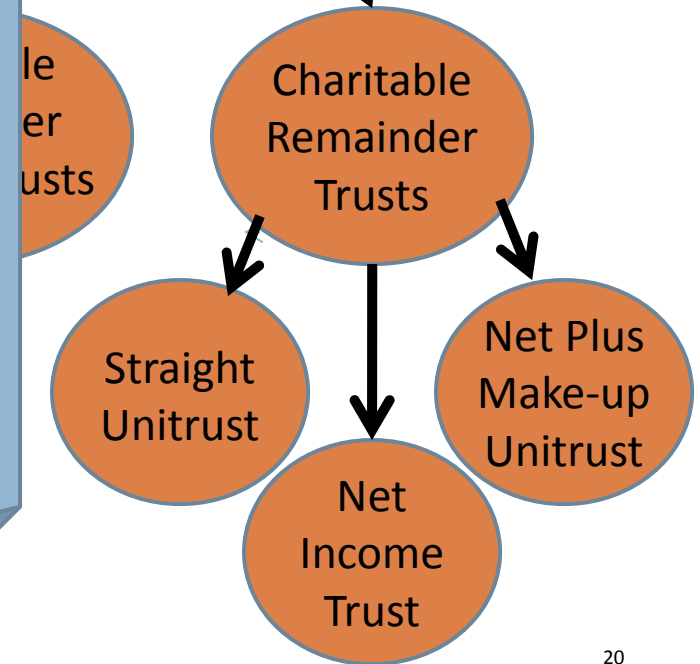


ANNUITY AND LIFE INCOME FUNDS (CONTINUED)

Types of Annuity and Life Income Funds

Charitable remainder unitrusts:

- Straight Unitrust – a stated percentage of the market value of trust assets is distributed at a fixed percentage (not less than 5%) annually regardless of income for a term not to exceed 20 years.
- Net Income Unitrust – similar to a straight unitrust except that payments to beneficiaries are limited to actual income earned by the trust not to exceed the percentage stated in the trust documents.
- Net-Plus-Makeup Unitrust – payments are limited to ordinary earned income but may exceed the stated percentage up to but not exceeding the amount required making up any accumulated deficiencies from prior years.



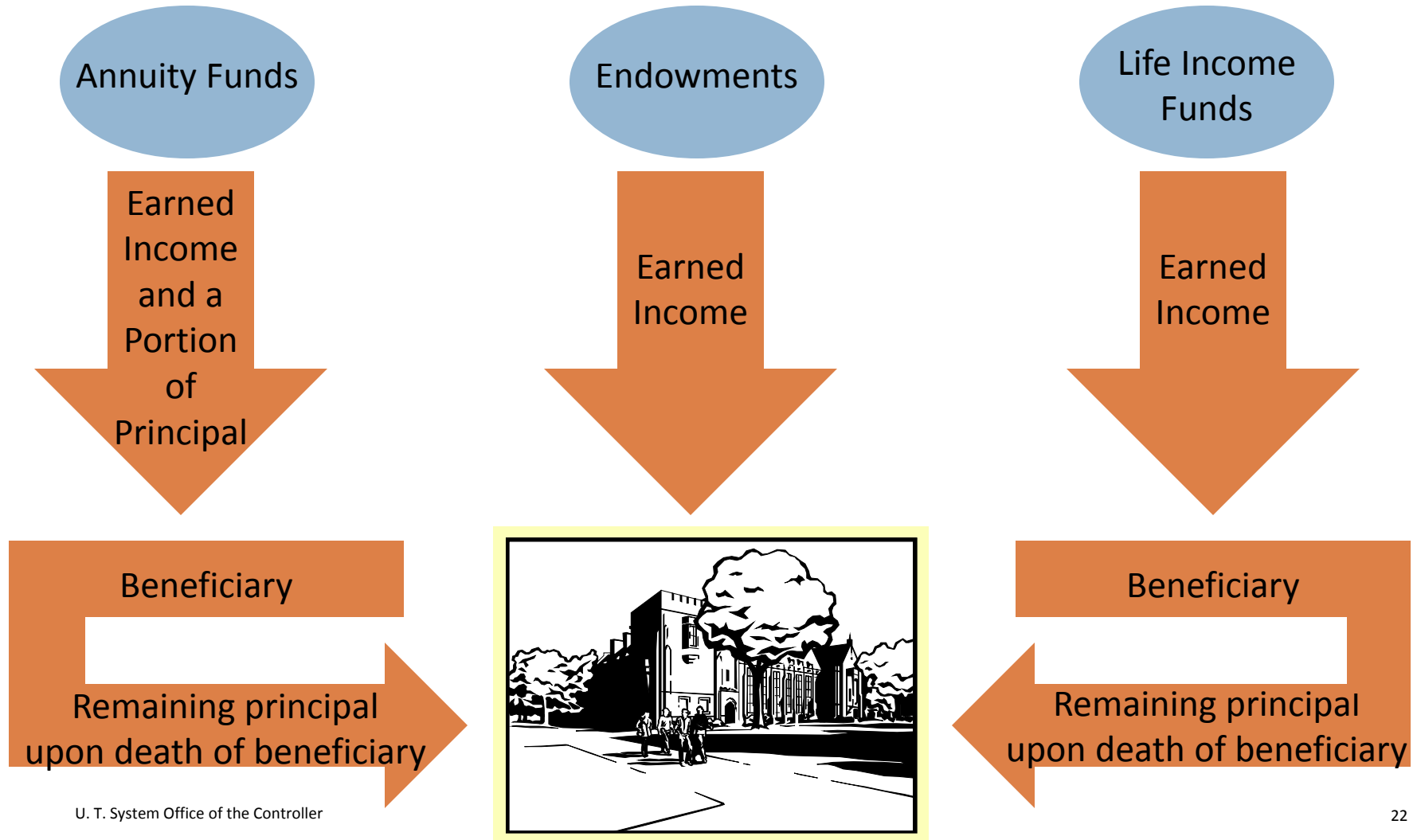
ANNUITY AND LIFE INCOME FUNDS (CONTINUED)



Annuity Funds are established through deferred giving contracts between the University and the donor. The principal is donated to the University and a portion of the principal and income is distributed to the beneficiaries over their lifetimes. Upon a beneficiary's death, the University uses the remaining funds.

Life Income Funds are also set up through deferred giving contracts. The principal is donated to the University and only income, or a portion thereof, is distributed to the beneficiary. Upon a beneficiary's death, the University may use the principal.

ANNUITY AND LIFE INCOME FUNDS (CONTINUED)



CONCLUSION



You have completed this module of the Fund Accounting Training. Exit the training by clicking the link below and access the next module.

<http://www.utsystem.edu/cont/training.html>