Tobacco Settlement Endowment Trust Fund

Financial Statements

June 30, 2012 and 2011
(With Independent Auditors' Report Thereon)

FINLEY & COOK
CERTIFIED PUBLIC ACCOUNTANTS

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

FINANCIAL STATEMENTS

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FINLEY & COOK
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

Board of Directors and
Board of Investors
Tobacco Settlement Endowment Trust Fund

We have audited the accompanying financial statements of the governmental activities and the permanent fund of the Tobacco Settlement Endowment Trust Fund (the "Fund") as of and for the years ended June 30, 2012 and 2011, which collectively comprise the Fund's basic financial statements as listed in the table of contents. The Fund is a part of the reporting entity of the State of Oklahoma. These financial statements are the responsibility of the Fund's management. Our responsibility is to express opinions on these financial statements based on our audits.

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

As discussed in Note 1, the financial statements of the Fund, a permanent fund of the State of Oklahoma, are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and governmental funds of the State of Oklahoma that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position of the State of Oklahoma as of June 30, 2012 and 2011, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the permanent fund of the Fund as of June 30, 2012 and 2011, and the respective changes in financial position for the years then ended in conformity with accounting principles generally accepted in the United States.

1421 East 45th Street • Shawnee, OK 74804
P: 405.878.7300 • www.finley-cook.com • F: 405.395.3300

INDEPENDENT AUDITORS' REPORT, CONTINUED

In accordance with *Government Auditing Standards*, we have also issued our report dated September 26, 2012, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States require that the Management's Discussion and Analysis on pages I-1 through I-15 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Finley + Cook, PLLC

Shawnee, Oklahoma
September 26, 2012

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

June 30, 2012 and 2011

The Management's Discussion and Analysis (MD&A) of the Tobacco Settlement Endowment Trust Fund (the "Fund") provides an overview and overall review of the Fund's financial activities for the fiscal years ended June 30, 2012 and 2011. The intent of the MD&A is to look at the Fund's financial performance as a whole. It should, therefore, be read in conjunction with the Fund's financial statements and the notes thereto.

The Fund was established pursuant to the Constitution of the State of Oklahoma. The Fund's principal was established with funds received by the State of Oklahoma (the "State") on or after July 1, 2001, pursuant to any settlement with or judgment against any tobacco companies. The principal funds are invested, and the earnings (see Note 7) may be expended for operations; tobacco prevention and cessation programs; research and treatment efforts in Oklahoma to prevent and combat cancer and other tobacco-related diseases; and programs to maintain or improve the health of Oklahomans or to enhance health care services provided to Oklahomans, with a particular emphasis on children and senior adults.

A Board of Investors was created to manage the investment of the Fund and to annually certify the earnings that are available for program expenditures. A Board of Directors was created to oversee the Fund's operating and program expenditures.

Through the joint effort of both Boards in 2011, the Board of Investors requested an official Attorney General Opinion regarding conflicting language between Article X of the Constitution and the statutory language in Title 62, Section 2307 in defining earnings available for certification by the Board of Investors. An opinion was issued by the Attorney General on August 31, 2011, stating that earnings for the annual certification by the Board of Investors includes, but is not limited to, interest, dividends, and realized capital gains from investments, minus costs and expenses of the investments, and minus any losses realized by the Fund.

Since this method is reflective of the constitutional language and the Board of Investors has historically used the definition within the statutory language to certify earnings, additional earnings were certified by the Board of Investors for the year ending June 30, 2011, inclusive of net realized gains. The recalculation according to the Attorney General's opinion resulted in $36,023,061 being certified by the Board of Investors at their meeting on November 17, 2011.

At this joint meeting of both the Board of Investors and the Board of Directors, there was discussion of a possible action on the earnings previously certified between FY2001 and FY2010. It was determined that an additional $42,898,847 would have been certified during this period had the Board of Investors calculated available earnings under the constitutional language. Upon the request of the Board of Directors, the Board of Investors voted to hold the $42,898,847 in reserve to be certified when future earnings calculations were below 5% of the corpus of the Trust Fund.

In consideration of this, the Board of Directors approved the execution of a settlement agreement and release of all claims signed on February 16, 2012. This reserve is to be invested in the same manner as the Fund. According to the agreement, some or all of the reserve funds are to be available for spending when the current year earnings calculation is below 5% of the corpus of the Fund. The certification of reserve funds is limited to the 5% cap inclusive of the initial calculation based upon the constitutional language. This agreement is in effect until the total amount of the reserve has been certified by the Board of Investors.

The amount of earnings available for certification for the period ending June 30, 2012, was $26,958,475 which is below 5% of the corpus of the Fund. At their August 22, 2012, meeting, the Board of Investors certified $26,758,475, reserving $200,000 for possible audit adjustments. It is anticipated that the Board will certify an additional amount at their November 2012 meeting, increasing the total certification to 5% of the corpus of the Fund. It is anticipated that the Board of Investors will certify an additional amount at their November 2012 meeting, increasing the total certification to 5% of the corpus of the Fund, inclusive of an appropriate calculation method.

At the time the Board of Investors certifies the additional earnings, clarification will be obtained as to the exact meaning as to 5% of the corpus of the Fund.

USING THIS ANNUAL REPORT

The basic financial statements presented in the annual report include both government-wide and fund financial statements.

Government-Wide Statements: The government-wide financial statements include the statements of net assets and the statements of activities. These statements display information about the Fund as a whole. The government-wide financial statements of the Fund are presented on a full accrual economic resource basis, which includes all assets and liabilities whether current or noncurrent. These statements provide both short-term and long-term information about the Fund's overall financial status.

Fund Statements: The fund financial statements include the governmental fund's balance sheets and the statements of revenues, expenditures, and changes in fund balance. In the fund financial statements, the revenues and expenditures of the Fund are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Under these accounting methods, revenues and assets are recognized when they become both measurable and available, and expenditures and liabilities are recognized when obligations are incurred as a result of the receipt of goods or services.

Financial Highlights

Statements of Net Assets

The statements of net assets provide an indication of the Fund's financial condition at the end of the 2012 and 2011 fiscal years; the statements report all assets and liabilities using the accrual basis of accounting.

Tobacco Settlement Endowment Trust Fund
Statements of Net Assets

	2012	2011
Assets		
Current assets	$ 79,651,734	128,808,922
Investments, at fair value	672,315,506	591,989,512
Capital assets	58,589	60,243
Total assets	752,025,829	720,858,677
Liabilities		
Current liabilities	12,124,274	13,189,743
Liability under securities lending	34,157,133	45,517,652
Noncurrent liabilities	62,983	44,419
Total liabilities	46,344,390	58,751,814
Net Assets		
Invested in capital assets	58,589	60,243
Restricted for investment	613,868,427	632,837,824
Unrestricted	91,754,423	29,208,796
Total net assets	$ 705,681,439	662,106,863

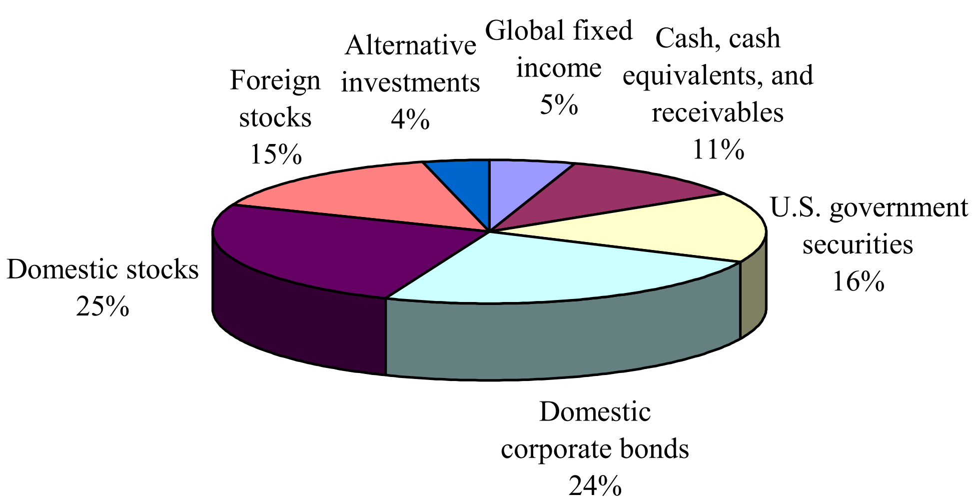
FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Net Assets, Continued

The Fund's total net assets increased $43.6 million during the year, as the Fund invested an additional $58.1 million in settlement receipts, recognized a gain of $8.9 million as net investment income, and expended $30.2 million on programs and operations. Total investments increased from $591.9 million at the beginning of the year to $672.3 million as of year-end, as the Board of Investors invested cash and cash equivalents held at the beginning of the year and additional settlement receipts were deposited during the year. The Fund recognized $9.8 million from the net depreciation of the fair value of the portfolio and earned $18.6 million in interest and dividends, net of investment management fees. The Fund's investment policy establishes investment goals and objectives and provides specific investment guidelines for investment managers, including a prohibition from investing in securities issued by companies engaged in the manufacture of tobacco products.

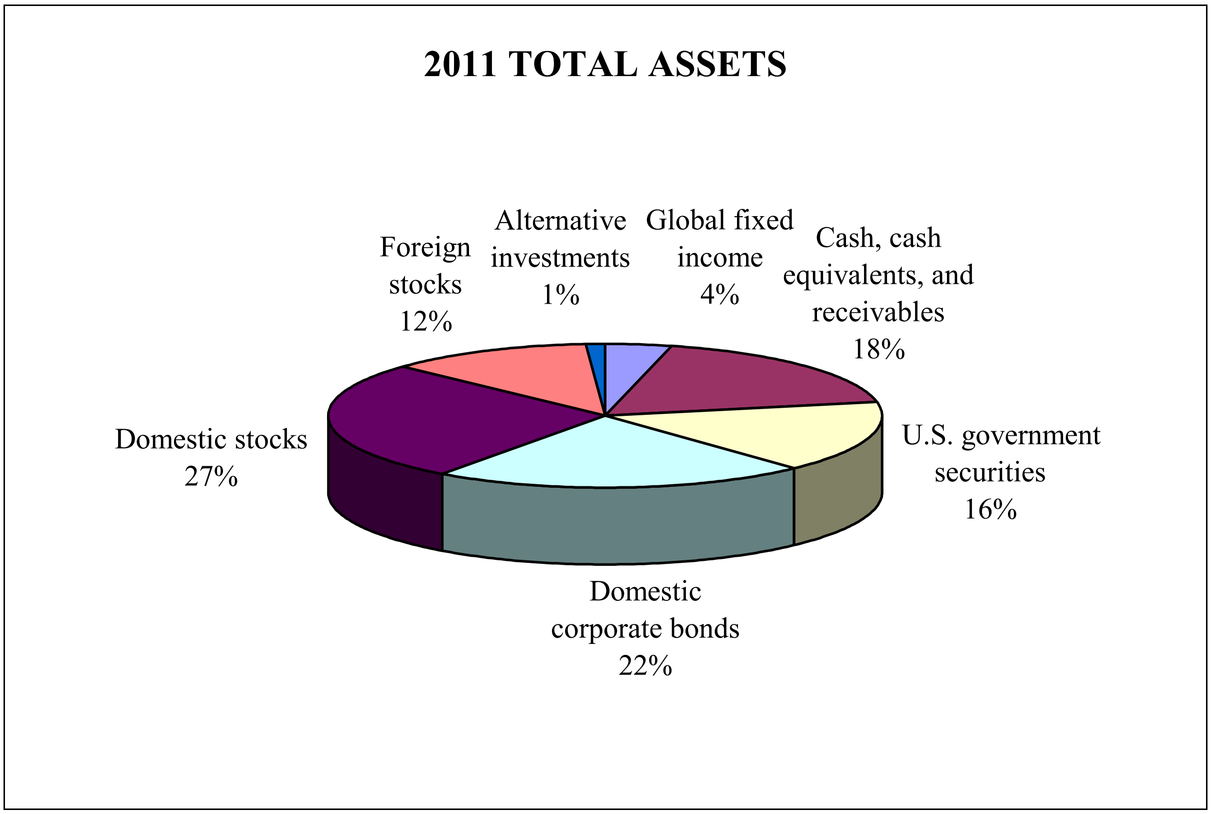
Cash balances also include restricted cash of approximately $34.2 million, which represents cash collateral presented to the Fund by security borrowers through the Board of Investors' securities lending effort. Use of this cash is restricted unless the borrowers were to default in the return of the securities borrowed.

2012 TOTAL ASSETS



FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Net Assets, Continued



FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Activities—Income and Expenses

The statements of activities report all of the income and expenses during the time periods indicated.

Tobacco Settlement Endowment Trust Fund
Statements of Activities

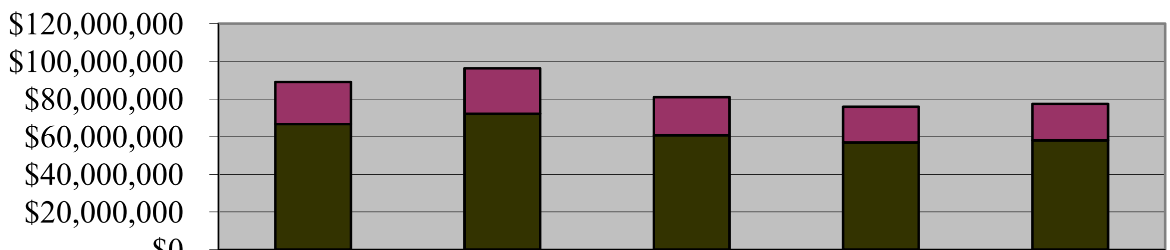
	2012	2011
Investment income:		
Interest and dividend income	$ 21,098,140	20,833,415
Securities lending income	63,106	57,184
Net (depreciation) appreciation in fair value of investments:		
Net unrealized (losses) gains	(16,818,932)	56,492,135
Net realized gains and losses	7,029,702	17,324,049
	(9,789,230)	73,816,184
Total investment income	11,372,016	94,706,783
Investment expenses	(2,466,949)	(2,218,818)
Net investment income	8,905,067	92,487,965
Other income:		
Contract income	6,760,907	4,759,951
Miscellaneous income	36,714	22,877
Total other income	6,797,621	4,782,828
Expenses:		
Program	28,748,606	17,210,573
Operating	1,442,454	1,124,707
Total expenses	30,191,060	18,335,280
(Decrease) increase in net assets before settlement receipts	(14,488,372)	78,935,513
Contribution to fund principal:		
Settlement receipts	58,062,948	56,954,970
Increase in net assets	43,574,576	135,890,483
Net assets, beginning of year	662,106,863	526,216,380
Net assets, end of year	$ 705,681,439	662,106,863

FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Activities—Income and Expenses, Continued

Revenues continue to be dominated by settlement receipts which are restricted for investment purposes. During the fiscal years ended June 30, 2012 and 2011, 75% of settlement receipts paid to the State were deposited by the State into the Fund. The percentage of the State's settlement receipts to be received by the Fund increased by 5% annually until it reached 75% during the fiscal year ended June 30, 2007, where it remains. As reflected below, settlement receipts deposited by the Fund increased by $1,107,978 from 2011.

OKLAHOMA TOBACCO SETTLEMENT RECEIPTS



	2008	2009	2010	2011	2012
Balance to State	$22,242,153	$24,044,386	$20,237,942	$18,984,991	$19,354,316
Fund Deposit	$66,726,460	$72,133,158	$60,713,827	$56,954,970	$58,062,948

Balance to State Fund Deposit

There are no guarantees regarding the State's continued receipt of funds in the settlement of claims against the tobacco companies. The amount received by the State can be attributed to several factors. An independent auditor calculates and determines the amount of all payments based in part on the market share of tobacco consumption.

Previous studies of tobacco consumption reported by the National Association of Attorneys General showed a continued long-term decline in cigarette sales in the United States since the state Attorneys General negotiated the Tobacco Master Settlement Agreement in 1998. A downward trend in consumption was reported through 2005. The Centers for Disease Control and Prevention (CDC) states that recent research indicates that the more spent on comprehensive tobacco control programs, the greater the reduction in smoking. However, recent surveys indicate that the rate of decline may have stalled in youth and adults, due in large part to the fact that only three states are funding tobacco prevention programs at the minimum levels recommended by the CDC.

FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Activities—Income and Expenses, Continued

Since 1998, increasing numbers of new tobacco manufacturers not participating in the Tobacco Master Settlement Agreement have entered the market. These new tobacco manufacturers impact the market share of the participating manufacturers and this, in turn, reduces the amount of the settlement payments to the states. As shown below, a significant amount of the payment calculation has not been received by the settling states and has been deposited in disputed accounts.

	FY–2012				FY–2011			
	Final Calculation	%	Deposit to Trust—75%	%	Final Calculation	%	Deposit to Trust—75%	%
Independent Auditor's Oklahoma Final Calculation	$ 87,257,753	100.00%	65,443,315	100.00%	$ 87,572,445	100.00%	65,679,334	100.00%
Received	77,417,264	88.72%	58,062,948	88.72%	75,939,961	86.72%	56,954,970	86.72%
Amount Not Received	$ 9,840,489	11.28%	7,380,367	11.28%	$ 11,632,484	13.28%	8,724,364	13.28%

	FY–2010				FY–2009			
	Final Calculation	%	Deposit to Trust—75%	%	Final Calculation	%	Deposit to Trust—75%	%
Independent Auditor's Oklahoma Final Calculation	$ 89,012,841	100.00%	66,759,631	100.00%	$101,662,042	100.00%	76,246,532	100.00%
Received	80,951,769	90.94%	60,713,827	90.94%	96,177,544	94.61%	72,133,158	94.61%
Amount Not Received	$ 8,061,072	9.06%	6,045,804	9.06%	$ 5,484,498	5.39%	4,113,374	5.39%

FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Activities—Income and Expenses, Continued

A participating manufacturer who disputes the final calculation may pay the disputed amount into the disputed payments accounts to avoid any accrual of interest until the issue is resolved. These participating manufacturers maintain that they are entitled to withhold, whether by means of offset or otherwise, from their 2012 payment or to place in the disputed payments account the amount attributable to the nonparticipating manufacturer's adjustment for the year disputed. The settling states do not agree with this position, and litigation is pending in these matters.

As settlement receipts were deposited and invested and the portfolio was diversified during the fiscal year ended June 30, 2012, net investment income decreased by $83.6 million. Interest and dividend income increased $265 thousand, while the net appreciation of investment in the Fund's portfolio decreased $83.6 million. Fees paid to investment managers, consultants, and custodians increased $248 thousand.

As previously noted, the Fund's principal is restricted for investment purposes only. According to a recent Attorney General's opinion, interest, dividends, and realized capital gains from investments minus costs and expenses of the investments, and minus any losses realized by the Fund may be expended for operations; tobacco use prevention and cessation programs; research and treatment efforts in Oklahoma to prevent and combat cancer and other tobacco-related diseases; and other programs to improve the health and wellbeing of Oklahomans, with a particular emphasis on children and senior adults.

The Board of Directors adopted a strategic plan to maximize the impact of the limited earnings available in the early years of the agency by focusing on reducing tobacco use in Oklahoma. In 2010, the Board of Directors updated the strategic plan to emphasize three primary areas of funding: Prevention, Research, and Emerging Opportunities. Prevention programs focus on reducing cancer and cardiovascular disease, Oklahoma's leading causes of death, through comprehensive programs addressing the three leading causes of each: tobacco use, physical inactivity, and poor nutrition. Research focuses on cancer and tobacco-related diseases. Emerging Opportunities are short-term grants to organizations proposing innovative and evidence-based approaches to transform and improve health in Oklahoma. Preference is given to proposals that impact large populations, organizations, or systems, and those that address the board's strategic goals.

During the fiscal year ended June 30, 2012, the Board of Directors increased program funding by more than $11.5 million, using a combination of certified earnings, carryover, and income from other state agencies.

FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Activities—Income and Expenses, Continued

Prevention

In FY2012, the Board of Directors continued an agreement in the amount of $5 million with Alere Wellbeing, Inc., provider of the telephone- and web-based Oklahoma Tobacco Helpline (1-800-QUIT NOW) services to all Oklahomans with a desire to quit tobacco use. The Helpline is collaboratively funded by the Fund, the Oklahoma State Department of Health (OSDH), Centers for Disease Control and Prevention (CDC), the Oklahoma State and Education Employees Group Insurance Board (OSEEGIB), and the Oklahoma Health Care Authority (OHCA). In FY2012 Alere Wellbeing, Inc. also continued to employ Oklahoma workers as "Quit Coaches" to assist tobacco users in 27 states and over 400 commercial clients. The first workers were hired in FY2010.

The Board of Directors continued two agreements with state agencies for Helpline services, evaluation, and administrative services. The agreement with the OSDH was for $750,000 in FY2012. The agreement with the OSEEGIB provides additional Helpline services for HealthChoice insurance beneficiaries. Revenue from this agreement is based on utilization. Total revenue from this agreement was approximately $202,000 for FY2012. Funds from these agreements are restricted for the purpose of the Helpline, evaluation, and an administrative fee.

In FY2012 a new agreement was created with the OHCA to provide federal matching funds, restricted for Helpline services to beneficiaries of the SoonerCare Medicaid plan and Insure Oklahoma participants. Revenue from this agreement was $274,000.

In FY2012, the Board of Directors also expanded health communications funding to continue the "*Tobacco Stops With Me*" and "*Shape Your Future*" campaigns to encourage Oklahomans to eat better, move more, and be tobacco-free. Media products also promote the Oklahoma Tobacco Helpline to Oklahomans, with a special emphasis on women in the state's SoonerCare Medicaid program. Through a continuing agreement with the OHCA, federal matching funds for the "*SoonerQuit for Women*" campaign were $300,000 in each of the last two years (FY2012 and FY2011).

FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Activities—Income and Expenses, Continued

Prevention, Continued

During FY2012, the Board of Directors also continued funding for comprehensive community-based programs across the state of Oklahoma to implement programs to prevent initiation to tobacco products among youth, to promote quitting among youth and adults, to reduce exposure to secondhand smoke, and to reduce tobacco-related health disparities. Through FY2012, 51 counties and one tribal nation were served under the comprehensive community grants program. In July 2011, 15 five-year "Communities of Excellence in Nutrition and Fitness" grants were awarded to plan interventions to increase physical activity and healthy nutrition within 21 counties. To support the new initiative, the Board of Directors also continued agreements with the Oklahoma State Department of Health, Center for the Advancement of Wellness, to provide training and technical assistance to grantees. In addition, another agreement, with the Oklahoma State University Department of Nutrition Sciences for evaluation of the program, was continued.

In FY2012, the Board of Directors expanded the agreement with the Oklahoma State Department of Health (OSDH) to provide incentive grants to communities to encourage them to become Certified Healthy Communities. The original agreement provided $3.5 million to be utilized by the Fund over the course of three years. The agreement was expanded in FY2012 to provide incentive grants to school districts to encourage their school sites to become Certified Healthy Schools. The total of both agreements was $8.5 million.

Three Cessation Systems Initiative (CSI) grantees entered their third full year of grant funding in FY2012. Under the CSI program, the Oklahoma Insurance Department, the Oklahoma Hospital Association, and the Oklahoma Department of Mental Health and Substance Abuse Services work to promote coverage for tobacco dependence treatment among private insurers, to implement a best practice intervention to address tobacco among hospitalized patients, and to infuse tobacco dependence treatment into routine mental health and substance abuse treatment programs.

Several multi-year agreements reached the end of their grant cycles in FY2012. Grants to Communication Services for the Deaf for tobacco prevention among the deaf and hard of hearing, Oklahoma State University for tobacco prevention among college students, and the Indian Health Care Resource Center for tobacco prevention and nutrition and fitness in 12 Tulsa area schools were completed. A fourth grant, with the Oklahoma Department of Mental Health and Substance Abuse Services in partnership with the ABLE Commission, was terminated by mutual agreement when the program was fully funded by the federal Food and Drug Administration (FDA) in October 2011.

FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Activities—Income and Expenses, Continued

Research

In FY2012 the Board of Directors committed $30.25 million to the Peggy and Charles Stephenson Cancer Center to create the TSET Cancer Research Program, expanding access to Phase I Clinical Trials and leveraging additional dollars to recruit scientists as TSET Cancer Research Scholars. The Board of Directors also approved a second five-year agreement to continue the work of the Oklahoma Tobacco Research Center (OTRC) to fund research projects and recruit scientists and TSET Research Scholars to reduce cancer and other tobacco-related diseases in Oklahoma.

In FY2012 the Board of Directors also expanded funding for the Oklahoma Center for Adult Stem Cell Research (OCASCR), which was established in FY2010 with an initial $500,000 investment. OCASCR is governed by the research directors of the Oklahoma Medical Research Foundation, the University of Oklahoma, and Oklahoma State University, with the Oklahoma Medical Research Foundation serving as the fiscal agent. The original agreement for $5.5 million over five and one-half years was amended to increase the budgets for FY2012–FY2015 to $2 million per year.

Emerging Opportunities

The "Unsolicited Proposals" program provides an opportunity for organizations to proactively submit a proposal related to any of the program areas listed in the constitutional amendment that created the Fund, instead of reactively applying for funding in response to a "Request for Proposals." Three new unsolicited grants were funded in FY2012: the Oklahoma after School Network, the Oklahoma State University Dining Services, and the Oklahoma Child Care Association. The grants are designed to create afterschool standards (including tobacco prevention, nutrition, and fitness), menu labeling, and improved nutrition among college students, and address tobacco, nutrition, and fitness within child care centers, respectively.

FUND HIGHLIGHTS

Governmental Fund—Balance Sheets

The Fund is classified as a permanent fund, as the principal funds are restricted by law for investment purposes only. The earnings may be expended for operations; tobacco prevention and cessation programs; research and treatment efforts in Oklahoma to prevent and combat cancer and other tobacco-related diseases; and other programs to maintain or improve the health of Oklahomans or to enhance health care services provided to Oklahomans, with a particular emphasis on children and senior adults. Accordingly, the fund balance at year-end includes balances which are nonspendable (restricted for investment purposes) and balances which are assigned and unassigned that are expendable for operations and programs of the Fund.

Tobacco Settlement Endowment Trust Fund
Balance Sheets—Permanent Fund

	2012	2011
Assets:		
Cash and cash equivalents	$ 75,465,761	121,192,268
Interest and dividends receivable	4,119,127	4,098,983
Contract receivable	62,441	3,512,090
Securities lending receivable	4,405	5,581
Investments at fair value	672,315,506	591,989,512
Total assets	$ 751,967,240	720,798,434
Liabilities:		
Net payable to brokers	$ 1,641,621	10,156,258
Accounts payable	10,440,664	3,003,873
Liability under securities lending	34,157,133	45,517,652
Total liabilities	46,239,418	58,677,783
Fund Balances:		
Nonspendable	613,868,427	632,837,824
Assigned	66,135,396	2,928,283
Unassigned	25,723,999	26,354,544
Total fund balances	705,727,822	662,120,651
Total liabilities and fund balances	$ 751,967,240	720,798,434

FUND HIGHLIGHTS, CONTINUED

Governmental Fund—Revenues, Expenditures, and Changes in Fund Balances

Tobacco Settlement Endowment Trust Fund
Revenues, Expenditures, and Changes in Fund Balances—Permanent Fund

	2012	2011
Revenues:		
Restricted:		
Net (depreciation) appreciation in fair value of investments:		
Net unrealized (losses) gains	$ (16,818,932)	56,492,135
Net realized gains and losses	7,029,702	17,324,049
	(9,789,230)	73,816,184
Settlement receipts	58,062,948	56,954,970
Miscellaneous income	36,714	22,877
Total restricted revenues	48,310,432	130,794,031
Interest and dividend income	21,098,140	20,833,415
Securities lending income	63,106	57,184
Contract income	6,760,907	4,759,951
Total revenues	76,232,585	156,444,581
Expenditures:		
Personnel and administrative	1,152,795	905,730
Health communication and program promotion	12,069,519	6,142,397
Community programs	6,120,282	4,421,081
Evaluation services	720,654	596,887
Counseling	5,538,420	4,342,659
Research	4,299,731	1,707,549
Investment management fees	2,466,949	2,218,818
Equipment	20,422	13,424
Other	236,642	188,517
Total expenditures	32,625,414	20,537,062
Net changes in fund balances	43,607,171	135,907,519
Fund balances, beginning of year	662,120,651	526,213,132
Fund balances, end of year	$ 705,727,822	662,120,651

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Fund's finances for all those with an interest. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Ms. Georgiana Stephens, Deputy Chief Investment Officer, Office of the Oklahoma State Treasurer, 2300 North Lincoln Boulevard, Room 217, Oklahoma City, Oklahoma 73105-4895.

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

STATEMENTS OF NET ASSETS

June 30,		*2012*	*2011*
Assets			
Cash and cash equivalents:			
Unrestricted cash	$	41,308,628	75,674,616
Restricted cash:			
Securities lending collateral		34,157,133	45,517,652
Total cash and cash equivalents		75,465,761	121,192,268
Receivables:			
Interest and dividends		4,119,127	4,098,983
Contract receivable		62,441	3,512,090
Securities lending receivable		4,405	5,581
Total receivables		4,185,973	7,616,654
Investments, at fair value:			
U.S. government securities		122,403,411	112,670,635
Foreign government securities		16,885,248	12,418,904
Domestic corporate bonds		183,222,648	156,083,735
Foreign corporate bonds		19,759,097	20,675,354
Domestic stocks		191,002,585	192,144,280
Foreign stocks		111,726,819	90,004,100
Alternative investments		27,315,698	7,992,504
Total investments, at fair value		672,315,506	591,989,512
Capital assets, net of accumulated depreciation of $82,346 and $65,053 as of June 30, 2012 and 2011, respectively.		58,589	60,243
Total assets		752,025,829	720,858,677

(Continued)

See Independent Auditors' Report.
See accompanying notes to financial statements.

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

STATEMENTS OF NET ASSETS, CONTINUED

June 30,	*2012*	*2011*
Liabilities		
Net payable to brokers	1,641,621	10,156,257
Accounts payable	10,440,664	3,003,873
Liability under securities lending	34,157,133	45,517,652
Compensated absences:		
Payable within 1 year	41,989	29,613
Payable after 1 year	62,983	44,419
Total liabilities	46,344,390	58,751,814
Net Assets		
Invested in capital assets	58,589	60,243
Restricted for investment	613,868,427	632,837,824
Unrestricted	91,754,423	29,208,796
Total net assets	$ 705,681,439	662,106,863

See Independent Auditors' Report.
See accompanying notes to financial statements.

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

STATEMENTS OF ACTIVITIES

Years Ended June 30,		*2012*	*2011*
Expenses:			
Program:			
Health communication and program promotion	$	12,069,519	6,142,397
Community programs		6,120,282	4,421,081
Counseling		5,538,420	4,342,659
Evaluation services		720,654	596,887
Research		4,299,731	1,707,549
Total program expenses		28,748,606	17,210,573
Operating:			
Personnel and administrative		1,183,736	921,986
Other		241,425	176,973
Depreciation		17,293	25,748
Total operating expenses		1,442,454	1,124,707
Total expenses		30,191,060	18,335,280
Investment income:			
Interest income		14,949,711	15,315,496
Dividend income		6,148,429	5,517,919
Securities lending income		63,106	57,184
Net (depreciation) appreciation in fair value of investments:			
Net unrealized (losses) gains		(16,818,932)	56,492,135
Net realized gains and losses		7,029,702	17,324,049
		(9,789,230)	73,816,184
Total investment income		11,372,016	94,706,783
Investment expenses		(2,466,949)	(2,218,818)
Net investment income		8,905,067	92,487,965

(Continued)

See Independent Auditors' Report.
See accompanying notes to financial statements.

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

STATEMENTS OF ACTIVITIES, CONTINUED

Years Ended June 30,	*2012*	*2011*
Other income:		
Contract income	6,760,907	4,759,951
Miscellaneous income	36,714	22,877
Total other income	6,797,621	4,782,828
Changes in net assets, before settlement receipts	(14,488,372)	78,935,513
Contribution to fund principal:		
Settlement receipts	58,062,948	56,954,970
Changes in net assets	43,574,576	135,890,483
Net assets, beginning of year	662,106,863	526,216,380
Net assets, end of year	$ 705,681,439	662,106,863

See Independent Auditors’ Report.
See accompanying notes to financial statements.

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

BALANCE SHEETS—PERMANENT FUND

June 30,	*2012*	*2011*
Assets		
Cash and cash equivalents:		
Unrestricted cash	$ 41,308,628	75,674,616
Restricted cash:		
Securities lending collateral	34,157,133	45,517,652
Total cash and cash equivalents	75,465,761	121,192,268
Receivables:		
Interest and dividends	4,119,127	4,098,983
Contract receivable	62,441	3,512,090
Securities lending receivable	4,405	5,581
Total receivables	4,185,973	7,616,654
Investments, at fair value:		
U.S. government securities	122,403,411	112,670,635
Foreign government securities	16,885,248	12,418,904
Domestic corporate bonds	183,222,648	156,083,735
Foreign corporate bonds	19,759,097	20,675,354
Domestic stocks	191,002,585	192,144,280
Foreign stocks	111,726,819	90,004,100
Alternative investments	27,315,698	7,992,504
Total investments, at fair value	672,315,506	591,989,512
Total assets	$ 751,967,240	720,798,434
Liabilities and Fund Balances		
Liabilities:		
Net payable to brokers	$ 1,641,621	10,156,258
Accounts payable	10,440,664	3,003,873
Liability under securities lending	34,157,133	45,517,652
Total liabilities	46,239,418	58,677,783
Fund balances:		
Nonspendable	613,868,427	632,837,824
Assigned	66,135,396	2,928,283
Unassigned	25,723,999	26,354,544
Total fund balances	705,727,822	662,120,651
Total liabilities and fund balances	$ 751,967,240	720,798,434

See Independent Auditors' Report.
See accompanying notes to financial statements.

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

RECONCILIATION OF THE BALANCE SHEETS—PERMANENT FUND TO THE STATEMENTS OF NET ASSETS

June 30,	*2012*	*2011*
Total fund balances, per the balance sheets—permanent fund	$ 705,727,822	662,120,651
Amounts reported in the statements of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the fund.	58,589	60,244
Some liabilities are not due and payable in the current period and therefore are not reported in the fund. Those liabilities consist of:		
Compensated absences	(104,972)	(74,032)
Net assets, per the statements of net assets	$ 705,681,439	662,106,863

See Independent Auditors' Report.
See accompanying notes to financial statements.

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

STATEMENTS OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES—PERMANENT FUND

Years Ended June 30,	*2012*	*2011*
Revenues:		
Restricted:		
Net (depreciation) appreciation in fair value of investments:		
Net unrealized (losses) gains	$ (16,818,932)	56,492,135
Net realized gains and losses	7,029,702	17,324,049
	(9,789,230)	73,816,184
Settlement receipts	58,062,948	56,954,970
Miscellaneous income	36,714	22,877
Total restricted revenues	48,310,432	130,794,031
Interest income	14,949,711	15,315,496
Dividend income	6,148,429	5,517,919
Securities lending income	63,106	57,184
Contract income	6,760,907	4,759,951
Total revenues	76,232,585	156,444,581
Expenditures:		
Personnel and administrative	1,152,795	905,730
Health communication and program promotion	12,069,519	6,142,397
Community programs	6,120,282	4,421,081
Counseling	5,538,420	4,342,659
Evaluation services	720,654	596,887
Research	4,299,731	1,707,549
Investment management fees	2,466,949	2,218,818
Equipment	20,422	13,424
Other	236,642	188,517
Total expenditures	32,625,414	20,537,062
Net changes in fund balances	43,607,171	135,907,519
Fund balances, beginning of year	662,120,651	526,213,132
Fund balances, end of year	$ 705,727,822	662,120,651

See Independent Auditors' Report.
See accompanying notes to financial statements.

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

RECONCILIATION OF THE STATEMENTS OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES—PERMANENT FUND TO THE STATEMENTS OF ACTIVITIES

Years Ended June 30,	*2012*	*2011*
Net changes in fund balances, per the statements of revenues, expenditures, and changes in fund balances—permanent fund	$ 43,607,171	135,907,519
Amounts reported in the statements of activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the statements of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays were (less than) greater than depreciation in the current period.	(1,654)	(781)
Some expenses reported in the statements of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. This amount represents the amount by which unused compensated absences increased over the amount in the prior year.	(30,941)	(16,255)
Changes in net assets, per the statements of activities	$ 43,574,576	135,890,483

See Independent Auditors' Report.
See accompanying notes to financial statements.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Tobacco Settlement Endowment Trust Fund (the "Fund") was established pursuant to the Constitution of the State of Oklahoma. The Fund principal was established with funds received by the State of Oklahoma (the "State") on or after July 1, 2001, pursuant to any settlement with or judgment against any tobacco companies. Fifty percent (50%) of all such receipts was deposited into the Fund during the fiscal year ended June 30, 2002. That percentage increased by 5% annually until it reached 75% during the fiscal year ending June 30, 2007, where it remains. However, there are no guarantees regarding the State's continued receipt of funds in settlement of claims against tobacco companies. The principal funds are invested, and the earnings (see Note 7) may be expended for operations; tobacco prevention and cessation programs; research and treatment efforts in Oklahoma to prevent and combat cancer and other tobacco-related diseases; and other programs to maintain or improve the health of Oklahomans or to enhance health care services provided to Oklahomans, with a particular emphasis on children and senior adults.

Pursuant to the Constitution of the State of Oklahoma, the Board of Investors was created to manage the investment of the principal of the Fund and to annually certify the earnings that are available for program expenditures. The Board of Directors was created to oversee Fund operating and program expenditures. The Fund is a part of the State's financial reporting entity and is included in the State's Comprehensive Annual Financial Report as a permanent fund and a governmental entity.

The financial statements of the Fund are intended to present the financial position and changes in financial position of only that portion of the governmental activities and governmental funds of the State that is attributable to the transactions of the Fund, and not those of the entire State.

Basis of Presentation, Measurement Focus, and Basis of Accounting

The financial statements have been prepared in accordance with Governmental Accounting Standards Board Statement No. 34 (GASB 34).

Government-Wide Financial Statements—The statements of net assets and the statements of activities are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Investment purchases and sales are recorded as of their trade dates. Settlement receipts are recognized as revenue when they are received by the State and their use is restricted as noted above.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Basis of Presentation, Measurement Focus, and Basis of Accounting, Continued

Governmental Fund Financial Statements—As a permanent fund, the Fund is reported in the governmental fund financial statements using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Since the Fund predominantly accounts for financial resources, revenue recognition is generally consistent between the accrual and modified accrual basis of accounting. Settlement receipts are recognized as revenue when they are received by the State and their use is restricted as noted above.

Investment purchases and sales are recorded as of their trade dates. Expenditures generally are recorded when a liability is incurred.

Since the governmental fund financial statements are presented on a different measurement focus and basis of accounting than the government-wide financial statements, reconciliations are presented which briefly explain the adjustments necessary to reconcile the fund and the government-wide presentations.

Investments

The Fund is authorized to invest in eligible investments as approved by the Board of Investors and set forth in its investment policy.

Fund investments are reported at fair value, except for alternative investments (which are reported at net asset value (NAV), which approximates fair value) and SEC-registered money market mutual funds (which are reported as cash equivalents and reported at cost, which approximates fair value). Debt and equity securities are reported at fair value, as determined by the Fund's custodial agent, using pricing services or prices quoted by independent brokers based on the latest reported sales prices at current exchange rates for securities traded on national or international exchanges.

The Fund invests in various traditional financial instruments that fall under the broad definition of derivatives. The Fund's derivatives may include U.S. Treasury strips, collateralized mortgage obligations, asset-backed securities, forward-based derivatives, option-based derivatives, and variable-rate instruments. These investments do not increase investment risk beyond allowable limits specified in the Fund's investment policy.

Net investment income includes net appreciation (depreciation) in the fair value of investments, interest income, dividend income, securities lending income, and investment expenses, which includes investment management and custodial fees and all other significant investment-related costs.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Securities Lending

The investment policy authorizes the Board of Investors to contract with their custodian to act as their securities lending agent. The policy requires the securities lending agent to provide indemnification against borrower default, have written agreements with each borrower, not loan securities until acceptable collateral is received and monitor that collateral on a daily basis, and review and monitor the approved borrowers to minimize risk.

The fair values of securities loaned and cash collateral maintained for those securities at June 30 were:

	Fair Value 2012	Fair Value 2011
Securities loaned		
U.S. government securities	$ 22,884,703	1,339,504
U.S. corporate bonds	2,732,921	16,223,799
U.S. equity	8,542,294	27,617,287
Total securities loaned	$ 34,159,918	45,180,590
Cash collateral maintained for securities loaned	$ 34,157,133	45,517,652
Percentage of cash collateral to securities loaned as of June 30	99.99%	100.75%

Borrowers are required to deliver collateral for each loan with a fair value equal to 102% of the current fair value of the loaned securities. Collateral delivered in non-U.S. currency is required to be equal to 105% of the fair value of the securities loaned; however, at June 30, 2012 and 2011, all collateral was presented as cash in U.S. currency. The total value of the collateral held at June 30, 2012, was $(2,785) less than the current fair value of the securities loaned. The total value of the collateral held at June 30, 2011, was $337,062 more than the current fair value of the securities loaned. Cash collateral is invested in a short-term investment pool and is included as an asset on the balance sheet, with an offsetting liability for the return of the collateral.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Securities Lending, Continued

The cash collateral ratio to securities loaned as of June 30, 2012 and 2011, was below 102% primarily due to a position in a $1,000,000 unsecured Lehman Brothers note held in the cash collateral pool. The Investment Policy Statement and the executed Securities Lending Agreement and Guaranty require collateral at 102% of the market value of the securities loaned at the time of the transaction. Lehman Brothers filed for bankruptcy protection on September 15, 2008. The loss estimated by BNY Mellon, the securities lending agent, at June 30, 2012, on this security was $443,459. The security matured on November 24, 2008. The Chairman of the Board of Investors was notified by BNY Mellon shortly after the bankruptcy notice and negotiated a support agreement in the absorption of realized losses on the Lehman security through the bankruptcy proceedings. BNY Mellon began in January 2009 to accrue its 30% split of securities lending income earned into an escrow account.

In April 2012, an update of the Lehman bankruptcy was received from the custodian. Lehman's bankruptcy plan was adopted on December 6, 2011. Distributions for this bankruptcy are expected to occur semi-annually over the next two years. The first distribution was applied on April 17, 2012, as a reduction to the amortized cost of the Lehman security. The lending agent also indicated an opportunity for recovery in the sale of a portion of the position due to the monetization of the assets within the Lehman estate. Thus, thirty four percent of the security was sold on May 3, 2012. The calculated support from the lending agent was also applied against the amortized cost resulting in an estimated unrealized loss of $443,459 at June 30, 2012.

During September 2012, the remainder of the Lehman Brothers security was sold. As a result of the sale, the Fund's portion of the realized loss was approximately $487,000. This loss is not reflected in the financial statements.

Securities lending income included as certified earnings was $63,106 and $57,184 for the fiscal years ended June 30, 2012 and 2011, respectively.

Capital Assets

Office equipment and furnishings which have an expected useful life of more than 1 year are recorded as capital assets. Capital assets are recorded at cost when purchased. Depreciation is recorded on capital assets in the government-wide financial statements. Depreciation is calculated on a straight-line basis over a 4- to 12-year period.

No provision for depreciation is recorded in the governmental fund financial statements, as expenditures for capital assets are recorded as period costs when the capital assets are purchased.

See Independent Auditors' Report.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Compensated Absences

Employees earn annual vacation leave at the rate of 10 hours per month for the first 5 years of service, 12 hours per month for service of over 5 years to 10 years, 13.33 hours per month for service of over 10 years to 20 years, and 16.67 hours per month for over 20 years of service. Unused annual leave may be accumulated to a maximum of 480 hours. All accrued annual leave is payable upon termination, resignation, retirement, or death. The governmental fund financial statements record expenditures when employees are paid for leave. The government-wide financial statements present the cost of accumulated vacation leave as a liability. The liability is valued based on the current rate of pay.

Advertising Costs

All costs associated with advertising are expensed as incurred.

Recent Accounting Pronouncements

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* (GASB 63). The objective of GASB 63 is to provide guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position and related disclosures. The pronouncement will improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Recent Accounting Pronouncements, Continued

In March 2012, GASB issued Statement No. 65*, Items Previously Reported as Assets and Liabilities* (GASB 65). The objective of GASB 65 is to establish accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets or liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions* (GASB 68). The primary objective of GASB 68 is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. GASB 68 establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. This statement is effective for financial statements for periods beginning after June 15, 2014.

Annual Budget-to-Actual Comparison

The Fund is not required to prepare an annual budget. Therefore, an annual budget-to-actual comparison as required by GASB 34 is not presented.

Reclassification of Prior Year Amounts

Certain amounts for 2011 have been reclassified to be comparable with the 2012 presentation.

Date of Management's Review of Subsequent Events

Management has evaluated subsequent events through September 26, 2012, the date which the financial statements were available to be issued, and determined that no subsequent events have occurred that require adjustment to or disclosure in the financial statements.

(2) CASH AND INVESTMENTS

At June 30, cash and cash equivalents were composed of the following:

	2012	2011
Cash on deposit with the State	$ 14,986,643	1,029,944
Foreign currency	443,489	830,449
Collateral from securities lending—restricted cash	34,157,133	45,517,652
Certificates of deposit	8,411,334	6,405,880
Money market mutual fund	17,467,162	67,408,343
	$ 75,465,761	121,192,268

Restricted Cash

Cash collateral from securities lending activity is identified as restricted cash as it cannot be used by the Fund unless there is default in the return of the securities loaned.

Custodial Credit Risk

Custodial credit risk is the risk that in the event of the failure of counterparty, the Fund will not be able to recover the value of its investments. Deposits are exposed to custodial credit risk if they are uninsured and uncollateralized. Investment securities are exposed to custodial credit risk if they are uninsured, are not registered in the name of the Fund, and are held by counterparty or the counterparty's trust department but not in the name of the Fund. The investment policy requires that all deposits be invested in a fully collateralized interest-bearing account. Policy also provides that investment collateral be held by a third-party custodian with whom the Fund has a current custodial agreement in the Fund's name.

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Credit Risk

Fixed income securities are subject to credit risk. A bond's credit quality rating is one method of assessing the ability of the issuer to meet its obligation. Exposure to credit risk as of June 30 was as follows:

	2012	
	Fair Value *(Expressed in thousands)*	Moody Rating
U.S. government agencies (held in U.S. currency):		
U.S. Treasury bonds	$ 14,664	(1)
U.S. Treasury notes	56,886	(1)
U.S. Treasury Bills	10,800	(1)
Federal Home Loan Bank	998	AA
Federal Home Loan Mortgage Corp.	6,504	AGY
Federal National Mortgage Corp.	28,885	AGY
Government National Mortgage Association	258	AGY
Other	2,144	A
Other	331	AAA
Other	933	Not Rated
	122,403	
Corporate bonds (held in U.S. currency):		
Domestic bonds	21,609	A
Domestic bonds	6,096	AA
Domestic bonds	20,442	AAA
Domestic bonds	39,638	B
Domestic bonds	25,064	BA
Domestic bonds	35,413	BAA
Domestic bonds	111	C
Domestic bonds	154	CA
Domestic bonds	11,987	CAA
Domestic bonds	21,445	Other
	181,959	

(Continued)

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Credit Risk, Continued

	2012	
	Fair Value *(Expressed in thousands)*	Moody Rating
Corporate bonds (held in Foreign currency):		
Domestic bonds	119	A
Domestic bonds	891	BAA
Domestic bonds	254	CAA
	1,264	
Foreign corporate bonds (held in U.S. currency):		
Foreign bonds	3,901	A
Foreign bonds	1,105	AA
Foreign bonds	171	AAA
Foreign bonds	5,437	B
Foreign bonds	3,438	BA
Foreign bonds	1,504	BAA
Foreign bonds	117	CA
Foreign bonds	606	CAA
	16,279	
Foreign corporate bonds (held in foreign currency):		
Foreign bonds	225	A
Foreign bonds	792	B
Foreign bonds	625	BA
Foreign bonds	656	BAA
Foreign bonds	394	CAA
Foreign bonds	788	Not rated
	3,480	

(Continued)

(2) CASH AND INVESTMENTS, CONTINUED

Credit Risk, Continued

	2012	
	Fair Value *(Expressed in thousands)*	Moody Rating
Foreign government bonds (held in U.S. currency):		
Foreign government bonds	1,420	B
Foreign government bonds	474	BA
Foreign government bonds	2,628	BAA
	4,522	
Foreign government bonds (held in foreign currency):		
Foreign government bonds	877	A
Foreign government bonds	8,517	AAA
Foreign government bonds	2,969	BAA
	12,363	
Total fair value of credit risk	$ 342,270	

(1) Backed by full faith and credit of the U.S. government.

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Credit Risk, Continued

	2011	
	Fair Value *(Expressed in thousands)*	Moody Rating
U.S. government agencies (held in U.S. currency):		
U.S. Treasury bonds	$ 10,984	(1)
U.S. Treasury notes	66,472	(1)
Federal Home Loan Mortgage Corp.	4,555	AAA
Federal National Mortgage Corp.	26,916	AAA
Government National Mortgage Association	321	AAA
Other	522	AAA
Other	2,900	A
	112,670	
Corporate bonds (held in U.S. currency):		
Domestic bonds	25,068	A
Domestic bonds	9,965	AA
Domestic bonds	17,616	AAA
Domestic bonds	46,375	B
Domestic bonds	19,685	BA
Domestic bonds	14,222	BAA
Domestic bonds	734	BB
Domestic bonds	466	BBB
Domestic bonds	49	C
Domestic bonds	239	CA
Domestic bonds	12,142	CAA
Domestic bonds	49	CC
Domestic bonds	2,871	CCC
Domestic bonds	479	D
Domestic bonds	6,124	Other
	156,084	

(Continued)

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Credit Risk, Continued

	2011	
	Fair Value *(Expressed in thousands)*	Moody Rating
Foreign corporate bonds (held in U.S. currency):		
Foreign bonds	1,900	A
Foreign bonds	814	AA
Foreign bonds	6,612	B
Foreign bonds	2,094	BA
Foreign bonds	651	BB
Foreign bonds	315	Other
	12,386	
Foreign corporate bonds (held in foreign currency):		
Foreign bonds	1,863	A
Foreign bonds	1,098	AA
Foreign bonds	1,318	B
Foreign bonds	599	BA
Foreign bonds	2,247	BAA
Foreign bonds	123	BB
Foreign bonds	140	BBB
Foreign bonds	20	C
Foreign bonds	683	CAA
Foreign bonds	198	CCC
	8,289	

(Continued)

(2) CASH AND INVESTMENTS, CONTINUED

Credit Risk, Continued

	2011	
	Fair Value *(Expressed in thousands)*	Moody Rating
Foreign government bonds (held in U.S. currency):		
Foreign government bonds	244	AA
Foreign government bonds	207	B
Foreign government bonds	223	BA
Foreign government bonds	1,628	BAA
	2,302	
Foreign government bonds (held in foreign currency):		
Foreign government bonds	916	A
Foreign government bonds	6,046	AAA
Foreign government bonds	2,968	BAA
Foreign government bonds	187	CC
	10,117	
Total fair value of credit risk	$ 301,848	

(1) Backed by full faith and credit of the U.S. government.

Concentration of Credit Risk

The Fund limits its exposure to concentration of credit risk through its investment policy and asset allocation policy. Within asset classes, individual securities are limited to not more than 6% of the investment manager's portfolio; however, securities of one issuer could be represented in more than one asset class. No investments in any one organization, excluding those guaranteed by the U.S. government, represented 5% or more of the Fund's net assets at June 30, 2012 or 2011.

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Mortgage-backed securities are highly sensitive to interest rate changes. The investment policy manages interest rate risk by limiting the effective duration of an actively managed fixed-income portfolio. Excluding U.S. government guaranteed securities, effective duration is not to exceed 7 years.

	2012	
	Fair Value *(Expressed in thousands)*	Effective Duration Years
U.S. government securities (government guaranteed):		
U.S. Treasury bonds	$ 13,642	14.92
U.S. Treasury notes	57,908	4.87
U.S. Treasury bills	10,800	0.08
Federal Home Loan Bank	998	2.87
Federal National Mortgage Association—FHR	941	2.20
Federal National Mortgage Association—FNR	1,142	4.24
Government National Mortgage Association	258	1.47
Student Loan Marketing Association	331	3.04
Veterans Administration	78	4.29
Other	3,077	9.20
Foreign government securities:		
Foreign government bonds (held in U.S. currency)	4,522	5.33
Foreign government bonds (held in foreign currency)	12,363	4.98
Mortgage-backed securities:		
Federal Home Loan Mortgage Corp.	5,563	3.30
Federal National Mortgage Corp.	27,743	2.38
Corporate bonds:		
Domestic bonds (held in U.S. currency)	181,882	3.89
Domestic bonds (held in foreign currency)	1,263	4.90
Foreign bonds (held in U.S. currency)	16,279	3.18
Foreign bonds (held in foreign currency)	3,480	3.49
Total fixed income	$ 342,270	

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Interest Rate Risk, Continued

	2011	
	Fair Value (Expressed in thousands)	Effective Duration Years
U.S. government securities (government guaranteed):		
U.S. Treasury bonds	$ 10,984	17.35
U.S. Treasury notes	66,472	4.49
Government National Mortgage Association	321	3.79
Other	3,422	8.52
Foreign government securities:		
Foreign government bonds (held in U.S. currency)	2,302	6.32
Foreign government bonds (held in foreign currency)	10,117	5.31
Mortgage-backed securities:		
Federal Home Loan Mortgage Corp.	4,555	1.68
Federal National Mortgage Corp.	26,916	5.18
Corporate bonds:		
Domestic bonds (held in U.S. currency)	156,084	4.71
Foreign bonds (held in U.S. currency)	12,386	4.22
Foreign bonds (held in foreign currency)	8,289	4.42
Total fixed income	$ 301,848	

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The investment policy limits foreign equity investments to 10% of total net assets through its asset allocation policy. Investment in foreign equities and fixed income is shown by monetary unit to indicate possible foreign currency risk.

	2012	
	Fair Value *(Expressed in thousands)*	Type
Foreign currency:		
Argentine peso	$ 343	Fixed income
Australian dollar	5,330	Equity
Bermuda dollar	1,828	Equity
Bermuda dollar	939	Fixed income
Brazilian real	4,339	Equity
Brazilian real	1,736	Fixed income
British pound sterling	28,835	Equity
British pound sterling	4,237	Fixed income
British pound sterling	142	Foreign currency
Canadian dollar	5,342	Equity
Canadian dollar	2,633	Fixed income
Cayman dollar	78	Equity
Cayman dollar	129	Fixed income
Columbian peso	477	Fixed income
Euro	19,903	Equity
Euro	20,176	Fixed income
Euro	309	Foreign currency
Hong Kong dollar	6,376	Equity
Malaysian ringgit	1,340	Fixed income
Malaysian ringgit	1	Foreign currency
Mexican nuevo peso	1,242	Fixed income
Mexican nuevo peso	85	Foreign currency

(Continued)

(2) CASH AND INVESTMENTS, CONTINUED

Foreign Currency Risk, Continued

	2012	
	Fair Value *(Expressed in thousands)*	Type
Foreign currency, Continued:		
Netherlands Antillean guilder	1,129	Equity
New Israeli shekel	3,321	Equity
Norwegian krone	2,942	Equity
Panamanian balboa	1,938	Equity
Panamanian balboa	320	Fixed income
Peruvian nuevo sol	1,036	Fixed income
Russian ruble	880	Equity
Russian ruble	786	Fixed income
Singapore dollar	109	Equity
South Korean won	5,026	Equity
Swiss franc	6,353	Equity
Swiss franc	433	Fixed income
Thai baht	2,177	Equity
Turkish lira	474	Fixed income
Venezuelan Bolivar fuerte	1,077	Fixed income
Yen	13,877	Equity
Yuan/Renminbi	2,380	Equity
	$ 150,078	

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Foreign Currency Risk, Continued

	2011	
	Fair Value *(Expressed in thousands)*	Type
Foreign currency:		
Argentine peso	$ 53	Fixed income
Australian dollar	1,094	Equity
Bermuda dollar	842	Fixed income
Brazilian real	5,613	Equity
Brazilian real	1,554	Fixed income
Brazilian real	1	Foreign currency
British pound sterling	13,925	Equity
British pound sterling	3,219	Fixed income
British pound sterling	263	Foreign currency
Canadian dollar	3,502	Equity
Canadian dollar	2,240	Fixed income
Cayman dollar	727	Equity
Cayman dollar	1,222	Fixed income
Columbian peso	258	Fixed income
Euro	29,402	Equity
Euro	18,819	Fixed income
Euro	494	Foreign currency
Hong Kong dollar	7,074	Equity
Israeli shekel	1,205	Equity
Korean won	3,429	Equity
Malaysian ringgit	916	Fixed income
Malaysian ringgit	9	Foreign currency
Mexican nuevo peso	1,242	Fixed income
Mexican nuevo peso	47	Foreign currency

(Continued)

(2) CASH AND INVESTMENTS, CONTINUED

Foreign Currency Risk, Continued

	2011	
	Fair Value *(Expressed in thousands)*	Type
Foreign currency, Continued:		
Peruvian nuevo sol	473	Fixed income
Peruvian nuevo sol	16	Foreign currency
Russian ruble	1,830	Equity
Russian ruble	708	Fixed income
Singapore dollar	2,227	Equity
South African rand	1,970	Equity
Swedish krona	1,285	Equity
Swiss franc	5,324	Equity
Swiss franc	567	Fixed income
Thai baht	904	Equity
Turkish lira	223	Fixed income
Venezuelan Bolivar fuerte	154	Fixed income
Yen	10,493	Equity
	123,324	
Other—securities held in U.S. dollars	605	
	$ 123,929	

See Independent Auditors' Report.

(3) DERIVATIVES

Derivative instruments are financial contracts whose values depend on the values of one or more underlying assets, reference rates, or financial indexes. They include futures contracts, swap contracts, options contracts, and forward foreign currency exchange. The Fund's derivatives policy identifies and allows common derivative investments and strategies which are consistent with applicable law and the Investment Policy Statement and requires investment managers to petition for the inclusion of additional derivative instruments and strategies. The guidelines also require investment managers to follow certain controls and documentation and risk management procedures. The Fund enters into these certain derivative instruments primarily to enhance the performance and reduce the volatility of its portfolio. It enters futures contracts to gain or hedge exposure to certain markets and to manage interest rate risk and uses forward foreign exchange contracts primarily to hedge foreign currency exposure. The tables below summarize the various contracts in the portfolio as of June 30, 2012 and 2011. The notional values associated with the futures contracts are generally not recorded in the financial statements, as they represent the obligation to purchase the futures contracts. Unrealized gains or losses are recognized daily by the investment manager and have been reflected in the Fund's financial statements. Interest risks associated with these investments are included in the interest rate risk disclosures. The Fund does not anticipate additional significant market risk from the futures or currency contracts.

Futures Contracts

	June 30, 2012		
	2012 Expiration Date	Long/Short	Notional/ Fair Value *(Expressed in thousands)*
U.S. 5-Year Note	September	Short	$ 5,827
U.S. 10-Year Note	September	Short	3,735
			$ 9,562

	June 30, 2011		
	2011 Expiration Date	Long/Short	Notional/ Fair Value *(Expressed in thousands)*
U.S. 5-Year Note	September	Short	$ 11,562
Euro-Bund Future	September	Short	2,729
U.S. 10-Year Note	September	Short	2,569
			$ 16,860

See Independent Auditors' Report.

(3) DERIVATIVES, CONTINUED

Foreign Currency Forward Contracts

	June 30, 2012	June 30, 2011
	(Expressed in thousands)	
Pending receivable	$ 41,258	30,428
Pending payable	(40,773)	(30,430)
Foreign currency forward contract asset (liability)	$ 485	(2)

As of June 30, 2012, the foreign currency forward contracts expire in August 2012. During the years ended June 30, 2012 and 2011, realized gains on foreign currency contracts were approximately $706,000 and $93,000, respectively.

The Fund invests in mortgage-backed securities, which are reported at fair value in the statements of net assets and the balance sheets and are based on the cash flows from interest and principal payments by the underlying mortgages. As a result, they are sensitive to prepayments by mortgagees, which are likely in declining interest rate environments, thereby reducing the values of these securities. The Fund invests in mortgage-backed securities to diversify the portfolio and increase the return while minimizing the extent of risk. Details regarding interest rate risks for these investments are included under the interest rate risk disclosures.

(4) ALTERNATIVE INVESTMENTS

Alternative investments as of June 30, 2012, were with limited partnerships as follows:

Company	Fair Value (Determined using NAV)	Unfunded Commitment	Purpose
FrontPoint Partners L.P.	$ 7,413,039	5,968,202	Investments consist of senior secured direct loans to corporate entities that meet certain criteria.
Medley Opportunity Fund II L.P.	19,902,659	10,610,957	Investments consist of senior secured direct loans to corporate entities that meet certain criteria.
Total alternative investments	$ 27,315,698	16,579,159	

Alternative investments are carried at the NAV of the fund as provided by the administrator or general partner. The Fund uses the NAV to determine the fair value for all alternative investments which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have attributes of an investment company. Management evaluates the values provided based on a number of factors, including obtaining an understanding of the fund's underlying investments, strategy, positions and valuation methodologies, obtaining audited financial statements, obtaining verification of transactions at or near year end, and comparing information provided by the fund administrator or general partner to other available information such as sector data and indexes. Because alternative investments are not readily marketable, their NAV is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. Such a difference could be material. Discretionary redemption of the investment in the limited partnerships by the Fund is not permitted.

(5) CAPITAL ASSETS

The following is a summary of changes in capital assets:

	Balance at June 30, 2011	Additions	Disposals	Balance at June 30, 2012
Depreciable capital assets:				
Office equipment and furnishings	$ 125,296	15,639	-	140,935
Accumulated depreciation:				
Office equipment and furnishings	(65,053)	(17,293)	-	(82,346)
Net capital assets	$ 60,243	(1,654)	-	58,589

	Balance at June 30, 2010	Additions	Disposals	Balance at June 30, 2011
Depreciable capital assets:				
Office equipment and furnishings	$ 100,329	24,967	-	125,296
Accumulated depreciation:				
Office equipment and furnishings	(39,305)	(25,748)	-	(65,053)
Net capital assets	$ 61,024	(781)	-	60,243

(6) CHANGES IN COMPENSATED ABSENCES

Compensated absence activity was as follows:

	Balance at June 30, 2011	Additions	Reductions	Balance at June 30, 2012	Amounts due within 1 year
Compensated absences	$ 74,032	51,530	(20,590)	104,972	41,989

	Balance at June 30, 2010	Additions	Reductions	Balance at June 30, 2011	Amounts due within 1 year
Compensated absences	$ 57,776	36,765	(20,509)	74,032	29,613

See Independent Auditors' Report.

(7) AVAILABLE EARNINGS AND FUND BALANCES

Available Earnings

Annual earnings available for expenditure were previously considered to be dividends and interest, less fees to manage the Fund. However, Attorney General Opinion 2011-11 (AG Opinion 2011-11), which was issued in August 2011, states that earnings are equal to the income generated from the Fund, including but not limited to interest, dividends, and realized capital gains from investments, minus the costs and expenses of investment and minus any losses realized by the Fund. As a result of the AG Opinion 2011-11, the Board of Investors and the Board of Directors reached an agreement in February 2012 that $42,898,847 of earnings (July 1, 2001, through June 30, 2010) as defined by AG Opinion 2011-11 would be available for certification in addition to any current year earnings in years in which current year earnings to be certified were less than 5% of the corpus of the Fund. The $42,898,847 is reflected as assigned to be certified earnings. In addition, $17,351,280 of 2011 earnings, as newly defined, were also certified as available for expenditure.

Fund Balances

Fund balance refers to the difference between assets and liabilities in the governmental funds balance sheet. Fund balance, as defined in GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, as applicable to the Fund, consists of the following three categories:

- Nonspendable Fund Balance: The nonspendable fund balance classification includes amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact. This would include items not expected to be converted to cash including inventories and prepaid amounts. It may also include the long-term amount of loans and receivables, as well as property acquired for resale and the corpus (principal) of a permanent fund.

  Nonspendable amounts are primarily composed of settlement receipts and the net unrealized appreciation or depreciation in the fair value of invested funds.

- Assigned Fund Balance: The assigned fund balance classification reflects amounts that are constrained by the Fund's intent to be used for specific purposes. For purposes of assigned fund balance, the Funds' Board of Directors and Board of Investors have authority to assign funds for specific purposes.

(7) AVAILABLE EARNINGS AND FUND BALANCES, CONTINUED

Fund Balances, Continued

- Assigned Fund Balance, Continued:

  Assigned by Board of Directors

  Prior to 2012, the Board of Directors had set aside 10% of the unassigned fund balance as a reserve to be used for future periods should annual earnings prove insufficient for operations. In November 2011, the Board of Directors chose to limit yearly expenditures of certified earnings to no more than 5% of the corpus of the Fund. Each year any unexpended certified earnings will be added to the reserve of prior year unspent certified earnings. In essence, unexpended amounts will be moved to assigned fund balances for future years' operations. All the unspent amounts have previously been certified by the Board of Investors.

  Assigned by Board of Investors

  As previously discussed, an additional $42,898,847 was reserved during 2012 in accordance with an agreement between the Board of Directors and the Board of Investors. According to the agreement, some or all of the reserve funds are to be available for spending when the current year earnings calculation is below 5% of the corpus of the Fund. When future earnings calculations are below 5% of the corpus of the Fund, the reserve will be reduced by the difference and certified for use. The certification of reserve funds is limited to the 5% cap inclusive of the initial calculation based upon the constitutional language. The agreement will remain in effect until the total amount of the reserve has been certified by the Board of Investors.

- Unassigned Fund Balance: Unassigned fund balance essentially consists of excess funds that have not been classified in the above fund balance categories.

  The unassigned fund balance consists of annual earnings that have been certified by the Board of Investors as available for expenditures for approved programs and operations, and contractual income less program and operational expenses.

It is the Fund's policy that expenditures which are incurred for purposes for which both unassigned and assigned fund balances are available, unassigned fund balances are considered to have been spent first.

The Board of Directors manages program and operating expenses that are expended from the assigned and unassigned fund balance. Contract income is the reimbursement of program expenses related to the Helpline and is considered a reduction to unassigned expenses. Operating expenses include salaries, travel, and other operating expenses of the Board of Investors and the Board of Directors. The maximum amount allowed for operating expenses is 15% of certified earnings in any fiscal year. Operating expenses do not include program expenses or investment management expenses.

See Independent Auditors' Report.

(7) AVAILABLE EARNINGS AND FUND BALANCES, CONTINUED

Fund Balances, Continued

A reconciliation of the nonspendable, assigned, and unassigned components of the fund balances as of June 30 is as follows:

	2012				
	Nonspendable	Assigned Available for Expenditures but Uncertified	Assigned Available for Expenditure and Certified	Unassigned	Total
Balance at June 30, 2011	$ 632,837,824	-	2,928,283	26,354,544	662,120,651
Settlement receipts	58,062,948	-	-	-	58,062,948
Net unrealized losses of investments	(16,818,932)	-	-	-	(16,818,932)
Miscellaneous income	36,714	-	-	-	36,714
Contract income	-	-	-	6,760,907	6,760,907
Expendable earnings, including realized gain on investments	-	-	-	25,723,999	25,723,999
Program and operating expenses	-	-	-	(30,158,465)	(30,158,465)
Transfer–AG Opinion 2011-11	(42,898,847)	42,898,847	-	-	-
Transfer–additional 2011 earnings	(17,324,049)	-	-	17,324,049	-
Transfer–revised 2011 earnings	(27,231)	-	-	27,231	-
Transfer–5% cap	-	-	-	-	-
Transfer–Board of Directors	-	-	20,308,266	(20,308,266)	-
Balance at June 30, 2012	$ 613,868,427	42,898,847	23,236,549	25,723,999	705,727,822

The amount of earnings available for certifications for the period ending June 30, 2012, was below 5% of the corpus of the Fund. At their August 22, 2012, meeting, the Board of Investors certified $26,758,475, reserving $200,000 for possible audit adjustments. It is anticipated that the Board will certify an additional amount at their November 2012 meeting, increasing the total certification to 5% of the corpus of the Fund. As noted previously, clarification will be obtained as to what amount will be used to determine the corpus of the Fund.

See Independent Auditors' Report.

(7) AVAILABLE EARNINGS AND FUND BALANCES, CONTINUED

Fund Balances, Continued

	2011			
	Nonspendable	Assigned	Unassigned	Total
Balance at June 30, 2010	$ 502,043,793	2,416,934	21,752,405	526,213,132
Settlement receipts	56,954,970	-	-	56,954,970
Net appreciation in fair value of investments	73,816,184	-	-	73,816,184
Miscellaneous income	22,877	-	-	22,877
Contract income	-	-	4,759,951	4,759,951
Expendable earnings	-	-	18,671,781	18,671,781
Program and operating expenses	-	-	(18,318,244)	(18,318,244)
Transfers	-	511,349	(511,349)	-
Balance at June 30, 2011	$ 632,837,824	2,928,283	26,354,544	662,120,651

The transfers of fund balances during 2012 as noted in the above reconciliation are as follows:

- AG Opinion 2011-11—This transfer results in a set-aside of $42,898,847 of earnings that were previously not considered earnings for the period from July 1, 2001, to June 30, 2010.
- Additional 2011 earnings—This transfer results from fiscal year 2011 realized gains being considered earnings in accordance with AG Opinion 2011-11.
- Revised 2011 earnings—This transfer results from previously certified earnings being revised to $18,699,012 from what was previously reported in 2011 of $18,671,781.
- 5% cap—The transfer is the result of the Board of Investors setting aside an agreed-upon amount to be made available to the Board of Directors if and when the overall earnings of the Fund is less than 5%. This occurred in 2012. An amount has not been certified or determined currently, as clarification is needed as to what amount is to be used in determining the 5% cap. It is expected that when the Board of Investors meets in November 2012, clarification will be obtained and additional amounts will be certified to using the 5% cap, as previously agreed.
- Board of Directors—The Board of Directors in November 2011 instituted a policy to spend no more than 5% of the Fund's earnings in any one year. As such, the amount of certified earnings to be spent in the upcoming year will be the unassigned fund balance. Any excess of prior years' unspent earnings will be moved to the assigned fund balance. The transfer of $20,308,266 is to reduce the unassigned fund balance to the maximum amount planned to be spent in the upcoming year. This amount will change when additional earnings are certified.

(8) PENSION PLAN

Plan Description

The Fund contributes to the Oklahoma Public Employees Retirement Plan (the "Retirement Plan"), a cost-sharing, multiple-employer public employee retirement system administered by the Oklahoma Public Employees Retirement System (the "System"). The Retirement Plan provides retirement, disability, and death benefits to plan members and beneficiaries. The benefit provisions are established and may be amended by the Oklahoma Legislature. Title 74 of the Oklahoma Statutes, Sections 901–943, as amended, assigns the authority for management and operation of the Retirement Plan to the Board of Trustees of the System. The System issues a publicly available annual financial report that includes financial statements and required supplementary information for the Retirement Plan. That annual report may be obtained by writing to the Oklahoma Public Employees Retirement System, 5801 N. Broadway Extension, Suite 400, Oklahoma City, Oklahoma 73118 or by calling 1-800-733-9008.

Funding Policy

Retirement Plan members and the Fund are required to contribute at a rate set by statute. The contribution requirements of Retirement Plan members and the Fund are established and may be amended by the Oklahoma Legislature. The contribution rates are as follows:

Fiscal Year 2012	
State Employees	The Fund
All Salaries	All Salaries
3.5%	16.5%

Fiscal Year 2011	
State Employees	The Fund
All Salaries	All Salaries
3.5%	15.5%

The Fund's contributions to the Retirement Plan for the years ended June 30, 2012, 2011, and 2010 were $103,380 and $70,367, and $63,730, respectively, and were equal to its required contributions for each year.

See Independent Auditors' Report.

(9) OKLAHOMA STATE EMPLOYEES DEFERRED COMPENSATION PLAN AND DEFERRED SAVINGS INCENTIVE PLAN

Deferred Compensation Plan

The State offers its employees a Deferred Compensation Plan as authorized by Section 457 of the Internal Revenue Code (IRC), as amended by the Tax Reform Act of 1986, and in accordance with the provisions of Sections 1701 through 1706 of Title 74 of the Oklahoma Statutes.

The supervisory authority for the management and operation of the Deferred Compensation Plan is the Board of Trustees of the Oklahoma Public Employees Retirement System (the "Board").

The Deferred Compensation Plan is available to all State employees, as well as any elected officials receiving a salary from the State. Participants may direct the investment of their contributions in available investment options offered by the Deferred Compensation Plan. The minimum contribution amount is the equivalent of $25 per month, and participants are immediately 100% vested in their respective accounts. All interest, dividends, and investment fees are allocated to participants' accounts.

Participants may defer until future years up to the lesser of 100% of their compensation as defined by Deferred Compensation Plan documents or the maximum amount allowed each year as determined by the Internal Revenue Service.

The Deferred Compensation Plan offers a catch-up program to participants, which allows them to defer annually for the 3 years prior to their year of retirement up to twice that plan year's deferral limit. The amount of additional contributions in excess of the normal maximum contributions to the Deferred Compensation Plan is also limited to contributions for years in which the participant was eligible but did not participate in the Deferred Compensation Plan or the difference between contributions made and the maximum allowable level. To be eligible for the catch-up program, the participant must be within 3 years of retirement with no reduced benefits.

Participants age 50 or older may make additional contributions of up to $5,000 annually subject to certain limits.

(9) OKLAHOMA STATE EMPLOYEES DEFERRED COMPENSATION PLAN AND DEFERRED SAVINGS INCENTIVE PLAN, CONTINUED

Deferred Compensation Plan, Continued

Deferred compensation benefits are paid to participants or beneficiaries upon termination, retirement, death, or unforeseeable emergency. Such benefits are based on a participant's account balance and are disbursed in a lump sum or periodic payments at the option of the participant or beneficiaries in accordance with the Deferred Compensation Plan's provisions.

Effective January 1, 1998, the Board established a Trust and a Trust Fund covering the Deferred Compensation Plan's assets, pursuant to federal legislation enacted in 1996, requiring public employers to establish such trusts for plans meeting the requirements of Section 457 of the IRC no later than January 1, 1999. Under the terms of the Trust, the corpus or income of the Trust Fund may be used only for the exclusive benefit of the Deferred Compensation Plan's participants and their beneficiaries. Prior to the establishment of the Trust, the Deferred Compensation Plan's assets were subject to the claims of general creditors of the State. The Board acts as trustee of the Trust. The participants' accounts are invested in accordance with the investment elections of the participants. The Board is accountable for all deferred compensation received, but has no duty to require any compensation to be deferred or to determine that the amounts received comply with the Deferred Compensation Plan or to determine that the Trust Fund is adequate to provide the benefits payable pursuant to the Deferred Compensation Plan.

Further information may be obtained from the Deferred Compensation Plan's audited financial statements for the years ended June 30, 2012 and 2011. The Fund believes that it has no liabilities with respect to the Deferred Compensation Plan.

Deferred Savings Incentive Plan

Effective January 1, 1998, the State established the Oklahoma State Employees Deferred Savings Incentive Plan (the "Savings Incentive Plan") as a money purchase pension plan pursuant to IRC Section 401(a). The Savings Incentive Plan and its related Trust are intended to meet the requirements of IRC Sections 401(a) and 501(a).

Any qualified participant who is a State employee that is an active participant in the Deferred Compensation Plan is eligible for a contribution of the amount determined by Oklahoma Legislature, currently the equivalent of $25 per month. Participation in the Savings Incentive Plan is automatic in the month of participation in the Deferred Compensation Plan and is not voluntary.

(9) OKLAHOMA STATE EMPLOYEES DEFERRED COMPENSATION PLAN AND DEFERRED SAVINGS INCENTIVE PLAN, CONTINUED

Deferred Savings Incentive Plan, Continued

Upon cessation of contributions to the Deferred Compensation Plan, termination of employment with the State, retirement, or death, a participant will no longer be eligible for contributions from the State into the Savings Incentive Plan. Participants are at all times 100% vested in their Savings Incentive Plan account. Participant contributions are not required or permitted. Qualified participants may make rollover contributions to the Savings Incentive Plan, provided such rollover contributions meet applicable requirements of the IRC. Plan participants may direct the investment of the contributions in available investment options offered by the Savings Incentive Plan. All interest, dividends, and investment fees are allocated to the participants' accounts.

Savings Incentive Plan benefits are paid to participants or beneficiaries upon termination, retirement, or death. Such benefits are based on a participant's account balance and are disbursed in a lump sum or periodic payments or may be rolled over to a qualified plan at the option of the participant or beneficiaries.

(10) OPERATING EXPENSES

The State constitutional amendment creating the Fund also provides for the payment of authorized administrative expenses of the Office of the State Treasurer and the Board of Directors. State statutes further specify that the State Treasurer shall provide any necessary staff support to the Board of Investors and may request funding for the cost of up to two full-time equivalent employees.

During 2007, State statutes were amended and specify that annual operating expenses shall not exceed 15% of certified earnings.

(11) COMMITMENTS AND CONTINGENCIES

Contracts

The Fund has entered into various contracts to assist in its program operations. The contracts are generally for a commitment of 1 year with options to renew.

See Independent Auditors' Report.

(11) COMMITMENTS AND CONTINGENCIES, CONTINUED

Settlement Receipts

As permitted by the Tobacco Master Settlement Agreement between the State and participating manufacturers, the participating manufacturers have disputed the amount due to the State based on the final calculation and have placed the disputed funds in an escrow account. For the years ended June 30, 2012 and 2011, the Fund's portion of the disputed final calculation was approximately $7,380,000 and $8,700,000, respectively. These amounts were deposited in the escrow account for each of the respective years.

FINLEY & COOK
CERTIFIED PUBLIC ACCOUNTANTS

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Directors and
Board of Investors
Tobacco Settlement Endowment Trust Fund

We have audited the financial statements of the governmental activities and the permanent fund of the Tobacco Settlement Endowment Trust Fund (the "Fund") as of and for the year ended June 30, 2012, which collectively comprise the Fund's financial statements and have issued our report thereon dated September 26, 2012. The Fund is a part of the reporting entity of the State of Oklahoma. Our report includes an explanatory paragraph to emphasize the fact that the financial statements include only that portion of the State of Oklahoma that is attributable to the transactions of the Fund and an explanatory paragraph disclaiming an opinion on required supplementary information. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Fund is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

(Continued)

1421 East 45th Street • Shawnee, OK 74804
P: 405.878.7300 • www.finley-cook.com • F: 405.395.3300

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*, CONTINUED

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended solely for the information and use of the management of the Fund, the Oklahoma State Treasurer's Office, and the State of Oklahoma Office of the Auditor and Inspector and is not intended to be and should not be used by anyone other than these specified parties.

Finley & Cook, PLLC

Shawnee, Oklahoma
September 26, 2012