Tobacco Settlement Endowment Trust Fund

Financial Statements

June 30, 2013 and 2012
(With Independent Auditors' Report Thereon)

FINLEY & COOK
CERTIFIED PUBLIC ACCOUNTANTS

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

FINANCIAL STATEMENTS

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INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and the permanent fund of the Tobacco Settlement Endowment Trust Fund (the "Fund"), which is a component unit of the State of Oklahoma, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

(Continued)

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INDEPENDENT AUDITORS' REPORT, CONTINUED

Opinions

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, 2013 and 2012, and the respective changes in financial position for the years then ended in accordance with accounting principles generally accepted in the United States.

Emphasis of Matters

Component-Unit-Only Financial Statements

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, 2013 and 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States. Our opinion is not modified with respect to this matter.

Change in Accounting Principle

As discussed in Note 1 to the financial statements, in 2013 the Fund adopted new accounting guidance, Statement No. 63 of the Governmental Accounting Standards Board, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States require that the management's discussion and analysis on pages I-1 through I-14 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.

(Continued)

INDEPENDENT AUDITORS' REPORT, CONTINUED

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2013, 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* in considering the Fund's internal control over financial reporting and compliance.

Finley & Cook, PLLC

Shawnee, Oklahoma
September 30, 2013

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

June 30, 2013 and 2012

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, 2013 and 2012. 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 ended 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 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. At their November 14, 2012, meeting, the Board of Investors defined the corpus of the Fund as the custodial market value of the Fund as of June 30, less any previous certified earnings (current year and previous years' certified earnings that remain invested) within the Fund at June 30, 2013.

At their August 21, 2013, meeting, the Board of Investors certified $35,068,801, reserving $4,857,493 for possible audit adjustments. The estimated earnings available for certification for the period ended June 30, 2013, were $39,926,294. It is anticipated that the Board of Investors will certify an additional amount at their November 13, 2013, meeting, increasing the total certification 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 position 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 Position

The statements of net position provide an indication of the Fund's financial condition at the end of the 2013, 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 Position

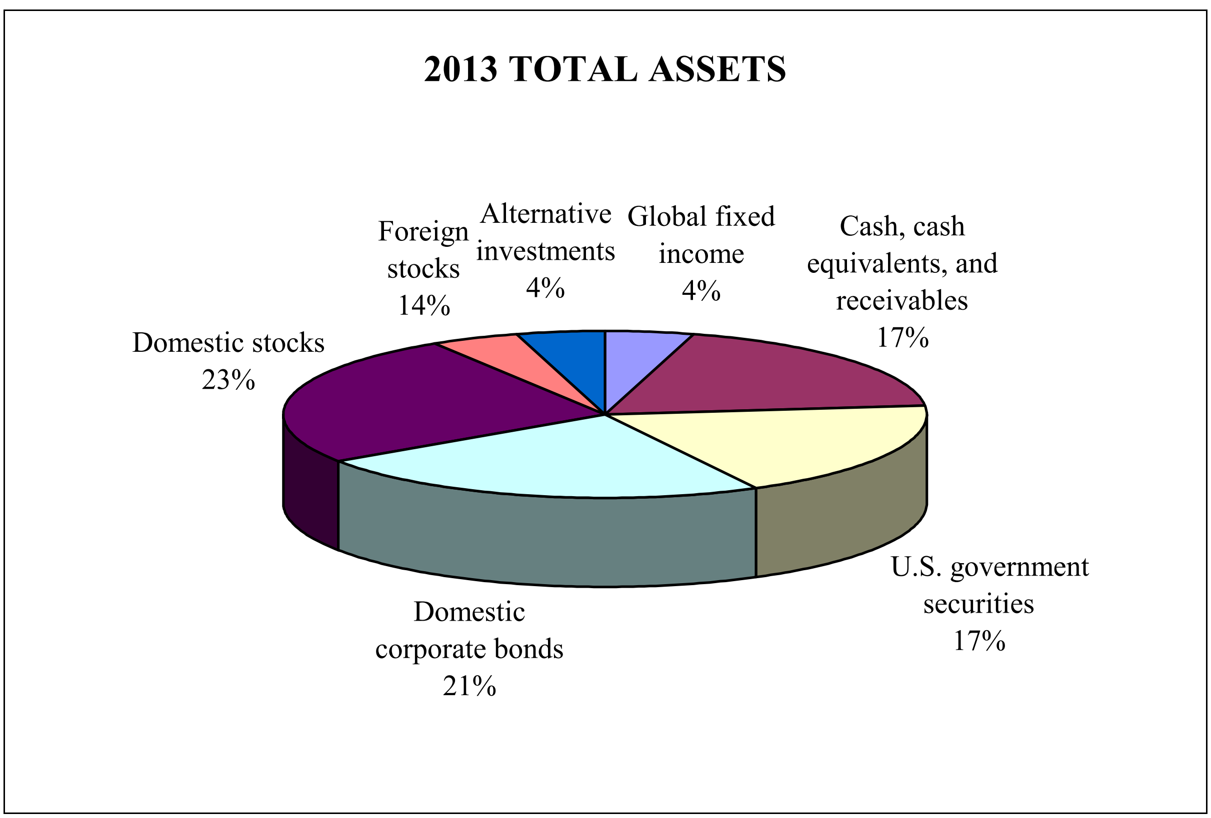
	2013	2012	2011
Assets			
Current assets	$ 162,403,184	79,651,734	128,808,922
Investments, at fair value	789,995,839	672,315,506	591,989,512
Capital assets	42,201	58,589	60,243
Total assets	952,441,224	752,025,829	720,858,677
Liabilities			
Current liabilities	16,151,201	12,124,274	13,189,743
Liability under securities lending	106,599,991	34,157,133	45,517,652
Noncurrent liabilities	73,622	62,983	44,419
Total liabilities	122,824,814	46,344,390	58,751,814
Net Assets			
Net investment in capital assets	42,201	58,589	60,243
Restricted for investment	729,689,075	613,868,427	632,837,824
Unrestricted	99,885,134	91,754,423	29,208,796
Total net position	$ 829,616,410	705,681,439	662,106,863

FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Net Position, Continued

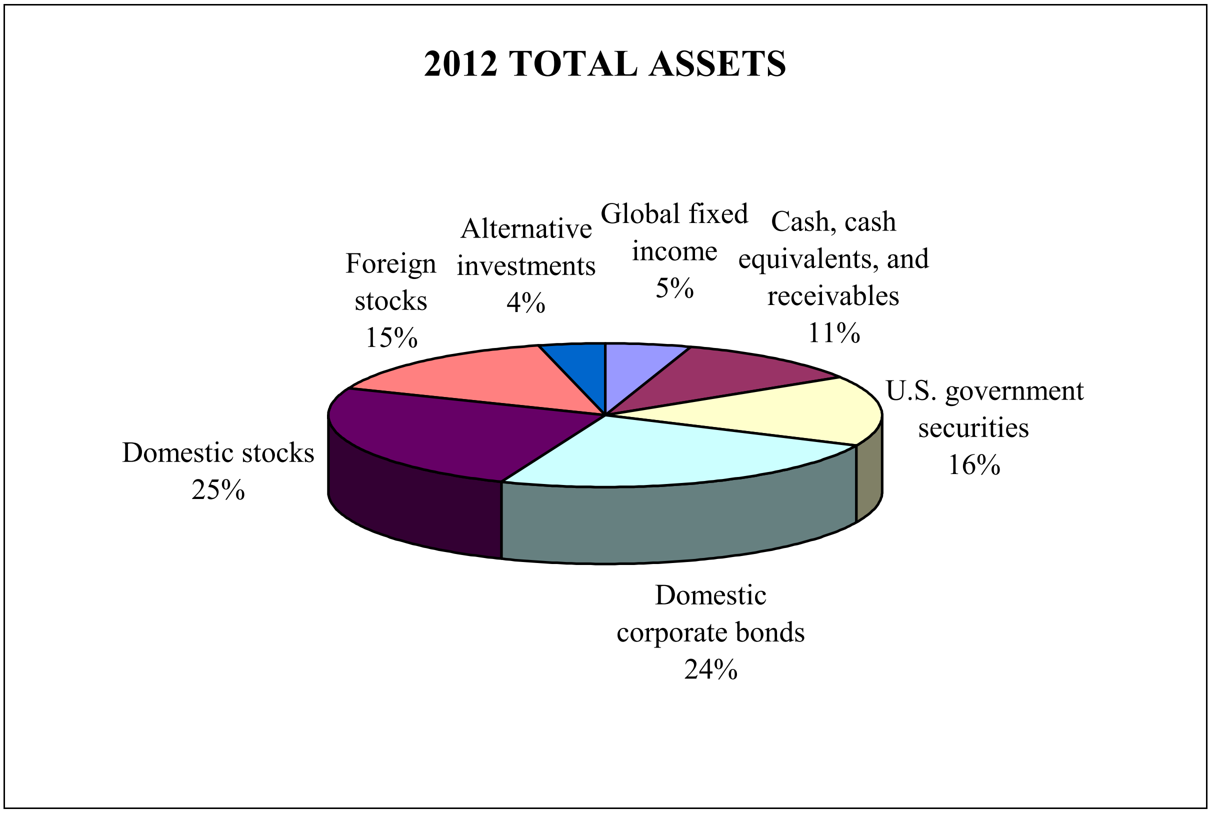
The Fund's total net position increased $123.9 million during the year, as the Fund invested an additional $85.0 million in settlement receipts, recognized $69.0 million as net investment income, and expended $32.6 million on programs and operations. Total investments increased from $672.3 million at the beginning of the year to $790.0 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 $46.9 million from the net appreciation of the fair value of the portfolio and earned $22.0 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 $106.6 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.



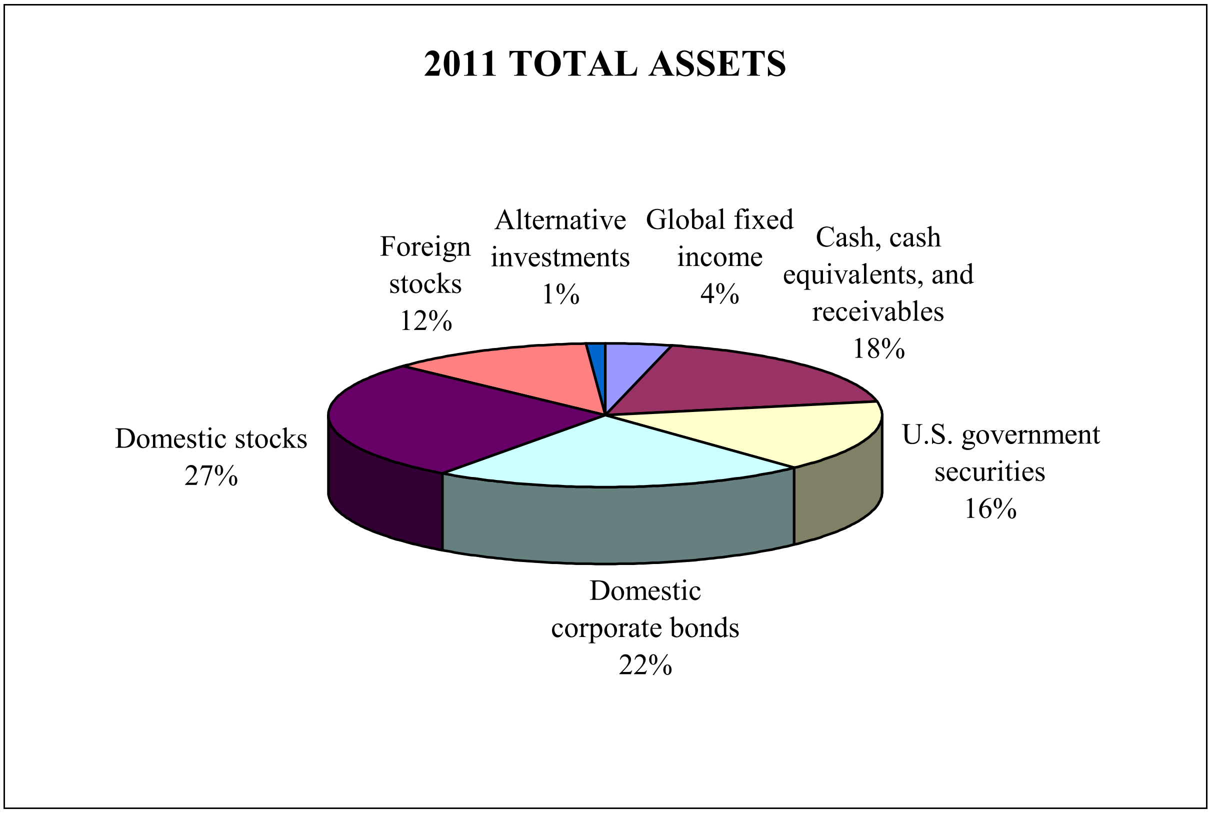
FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Net Position, Continued



FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Net Position, 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

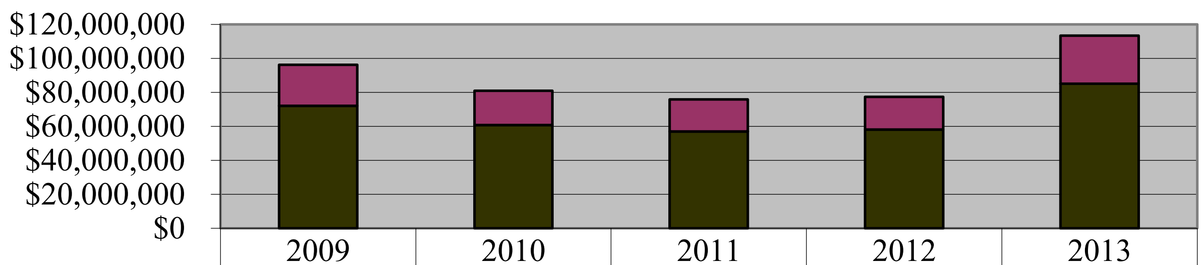
		2013	2012	2011
Investment income:				
Interest and dividend income	$	25,867,677	21,098,140	20,833,415
Securities lending income		84,424	63,106	57,184
Net appreciation (depreciation) in fair value of investments:				
Net unrealized gains and losses		30,751,892	(16,818,932)	56,492,135
Net realized gains and losses		16,183,796	7,029,702	17,324,049
		46,935,688	(9,789,230)	73,816,184
Total investment income		72,887,789	11,372,016	94,706,783
Investment expenses		(3,846,879)	(2,466,949)	(2,218,818)
Net investment income		69,040,910	8,905,067	92,487,965
Other income:				
Contract income		2,445,750	6,760,907	4,759,951
Miscellaneous income		11,451	36,714	22,877
Total other income		2,457,201	6,797,621	4,782,828
Expenses:				
Program		30,963,704	28,748,606	17,210,573
Operating		1,656,741	1,442,454	1,124,707
Total expenses		32,620,445	30,191,060	18,335,280
Changes in net position before settlement receipts		38,877,666	(14,488,372)	78,935,513
Contribution to fund principal:				
Settlement receipts		85,057,305	58,062,948	56,954,970
Changes in net position		123,934,971	43,574,576	135,890,483
Net position, beginning of year		705,681,439	662,106,863	526,216,380
Net position, end of year	$	829,616,410	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, 2013 and 2012, 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 $26,994,357 from 2012.

OKLAHOMA TOBACCO SETTLEMENT RECEIPTS



	2009	2010	2011	2012	2013
Balance to State	$24,044,386	$20,237,942	$18,984,991	$19,354,316	$28,352,435
Fund Deposit	$72,133,158	$60,713,827	$56,954,970	$58,062,948	$85,057,305

The major reason for the increase in settlement receipts over 2012 was the settlement of disputed amounts in April 2013. In prior years, the State had not received all monies, as disputed amounts were not distributed. As discussed in Note 11, this was resolved during 2013. Approximately $27,000,000 of the increase was due to this dispute being resolved.

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.

As settlement receipts were deposited and invested and the portfolio was diversified during the fiscal year ended June 30, 2013, net investment income increased by $60.1 million. Interest and dividend income increased $4.8 million, while the net appreciation of investment in the Fund's portfolio increased $56.7 million. Fees paid to investment managers, consultants, and custodians increased $1.4 million.

FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Activities—Income and Expenses, Continued

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 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, those with multiple funding partners, short-term grants, and those that address the Board of Directors' strategic goals.

During the fiscal year ended June 30, 2013, the Board of Directors increased program funding by more than \$6.5 million, using a combination of certified earnings, carryover, and income from other state agencies.

Prevention

In FY2013, 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 or okhelpline.com) 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 Employees Group Insurance Division (EGID), and the Oklahoma Health Care Authority (OHCA). In FY2013 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 Oklahoma 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 FY2013. The agreement with the EGID provides additional Helpline services for HealthChoice insurance beneficiaries. Revenue from this agreement is based on utilization. Total revenue from this agreement was approximately \$130,000 for FY2013. Funds from these agreements are restricted for the purpose of the Helpline, evaluation, and an administrative fee.

FINANCIAL HIGHLIGHTS, CONTINUED

Statements of Activities—Income and Expenses, Continued

Prevention, Continued

In FY2013, 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 $287,000.

In FY2013, 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 for each of the last two years (FY2013 and FY2012).

During FY2013, 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 FY2013, 50 counties and 1 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 OSDH, 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 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 3 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. In FY2012, 14 communities received grant awards. In FY2013, 21 communities and 26 school districts received grant awards.

Three Cessation Systems Initiative (CSI) grantees entered their fifth full year of grant funding in FY2013. Under the CSI program, the OCHA, the Oklahoma Hospital Association, and the Oklahoma Department of Mental Health and Substance Abuse Services work to implement a best practice intervention to address tobacco among hospitalized patients, Medicaid beneficiaries, and to infuse tobacco dependence treatment into routine mental health and substance abuse treatment programs.

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 (SCC) 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. FY2013 was the first full year of funding for the SCC at $5.5 million per year.

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. The FY2013 budget was $1.3 million.

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 5½ 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." In FY2013, one new proposal, from the Physician Manpower Training Commission (PMTC), was funded. The PMTC grant provides a federal match to TSET funding to help physicians pay up to $160,000 in student loans, after establishing a practice in a rural and underserved area of the state. Three unsolicited grants, which were funded in FY2012, continued their efforts: 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.

Conference Sponsorships

In 2010, the Board of Directors established a Conference Sponsorships process whereby organizations could apply for sponsorship funds for trainings and conferences that are statewide and address the Board of Directors' strategic plan, or any area related to the constitutional mission. The original budget for conference sponsorships was $25,000. The budget was increased to $50,000 in FY2012 and FY2013.

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

	2013	2012	2011
Assets:			
Cash and cash equivalents	$ 158,232,019	75,465,761	121,192,268
Interest and dividends receivable	3,956,231	4,119,127	4,098,983
Contract receivable	204,424	62,441	3,512,090
Securities lending receivable	10,510	4,405	5,581
Investments at fair value	789,995,839	672,315,506	591,989,512
Total assets	$ 952,399,023	751,967,240	720,798,434
Liabilities:			
Net payable to brokers	$ 6,967,044	1,641,621	10,156,258
Accounts payable	9,135,076	10,440,664	3,003,873
Liability under securities lending	106,599,991	34,157,133	45,517,652
Total liabilities	122,702,111	46,239,418	58,677,783
Fund Balances:			
Nonspendable	729,689,075	613,868,427	632,837,824
Assigned	60,952,331	66,135,396	2,928,283
Unassigned	39,055,506	25,723,999	26,354,544
Total fund balances	829,696,912	705,727,822	662,120,651
Total liabilities and fund balances	$ 952,399,023	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

	2013	2012	2011
Revenues:			
Restricted:			
Net appreciation (depreciation) in fair value of investments:			
Net unrealized gains and losses	$ 30,751,892	(16,818,932)	56,492,135
Net realized gains and losses	16,183,796	7,029,702	17,324,049
	46,935,688	(9,789,230)	73,816,184
Settlement receipts	85,057,305	58,062,948	56,954,970
Miscellaneous income	11,451	36,714	22,877
Total restricted revenues	132,004,444	48,310,432	130,794,031
Interest and dividend income	25,867,677	21,098,140	20,833,415
Securities lending income	84,424	63,106	57,184
Contract income	2,445,750	6,760,907	4,759,951
Total revenues	160,402,295	76,232,585	156,444,581
Expenditures:			
Personnel and administrative	1,397,400	1,152,795	905,730
Health communication and program promotion	5,747,213	8,395,475	6,142,397
Community programs	7,566,619	7,449,037	4,421,081
Counseling	5,747,656	5,538,420	4,342,659
Evaluation services	872,447	794,649	596,887
Research	11,029,769	6,571,025	1,707,549
Investment management fees	3,846,879	2,466,949	2,218,818
Equipment	-	20,422	13,424
Other	225,222	236,642	188,517
Total expenditures	36,433,205	32,625,414	20,537,062
Net changes in fund balances	123,969,090	43,607,171	135,907,519
Fund balances, beginning of year	705,727,822	662,120,651	526,213,132
Fund balances, end of year	$ 829,696,912	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 Lisa Murray, 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 POSITION

June 30,		*2013*	*2012*
Assets			
Cash and cash equivalents:			
Unrestricted cash	$	51,632,028	41,308,628
Restricted cash:			
Securities lending collateral		106,599,991	34,157,133
Total cash and cash equivalents		158,232,019	75,465,761
Receivables:			
Interest and dividends		3,956,231	4,119,127
Contract receivable		204,424	62,441
Securities lending receivable		10,510	4,405
Total receivables		4,171,165	4,185,973
Investments, at fair value:			
U.S. government securities		158,688,335	122,403,411
Foreign government securities		21,253,881	16,885,248
Domestic corporate bonds		199,125,587	183,222,648
Foreign corporate bonds		18,023,855	19,759,097
Domestic stocks		221,105,647	191,002,585
Foreign stocks		130,266,536	111,726,819
Alternative investments		41,531,998	27,315,698
Total investments, at fair value		789,995,839	672,315,506
Capital assets, net of accumulated depreciation of $98,734 and $82,346 as of June 30, 2013 and 2012, respectively.		42,201	58,589
Total assets		952,441,224	752,025,829

(Continued)

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

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

STATEMENTS OF NET POSITION, CONTINUED

June 30,	*2013*	*2012*
Liabilities		
Net payable to brokers	6,967,044	1,641,621
Accounts payable	9,135,076	10,440,664
Liability under securities lending	106,599,991	34,157,133
Compensated absences:		
Payable within 1 year	49,081	41,989
Payable after 1 year	73,622	62,983
Total liabilities	122,824,814	46,344,390
Net Position		
Net investment in capital assets	42,201	58,589
Restricted for investment	729,689,075	613,868,427
Unrestricted	99,885,134	91,754,423
Total net position	$ 829,616,410	705,681,439

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

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

STATEMENTS OF ACTIVITIES

Years Ended June 30,	*2013*	*2012*
Expenses:		
Program:		
Health communication and program promotion	$ 5,747,213	8,395,475
Community programs	7,566,619	7,449,037
Counseling	5,747,656	5,538,420
Evaluation services	872,447	794,649
Research	11,029,769	6,571,025
Total program expenses	30,963,704	28,748,606
Operating:		
Personnel and administrative	1,415,131	1,183,736
Other	225,222	241,425
Depreciation	16,388	17,293
Total operating expenses	1,656,741	1,442,454
Total expenses	32,620,445	30,191,060
Investment income:		
Interest income	13,876,853	14,949,711
Dividend income	11,990,824	6,148,429
Securities lending income	84,424	63,106
Net appreciation (depreciation) in fair value of investments:		
Net unrealized gains and losses	30,751,892	(16,818,932)
Net realized gains and losses	16,183,796	7,029,702
	46,935,688	(9,789,230)
Total investment income	72,887,789	11,372,016
Investment expenses	(3,846,879)	(2,466,949)
Net investment income	69,040,910	8,905,067

(Continued)

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

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

STATEMENTS OF ACTIVITIES, CONTINUED

Years Ended June 30,	*2013*	*2012*
Other income:		
Contract income	2,445,750	6,760,907
Miscellaneous income	11,451	36,714
Total other income	2,457,201	6,797,621
Changes in net assets, before settlement receipts	38,877,666	(14,488,372)
Contribution to fund principal:		
Settlement receipts	85,057,305	58,062,948
Changes in net position	123,934,971	43,574,576
Net position, beginning of year	705,681,439	662,106,863
Net position, end of year	$ 829,616,410	705,681,439

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

TOBACCO SETTLEMENT ENDOWMENT TRUST FUND

BALANCE SHEETS—PERMANENT FUND

June 30,	*2013*	*2012*
Assets		
Cash and cash equivalents:		
Unrestricted cash	$ 51,632,028	41,308,628
Restricted cash:		
Securities lending collateral	106,599,991	34,157,133
Total cash and cash equivalents	158,232,019	75,465,761
Receivables:		
Interest and dividends	3,956,231	4,119,127
Contract receivable	204,424	62,441
Securities lending receivable	10,510	4,405
Total receivables	4,171,165	4,185,973
Investments, at fair value:		
U.S. government securities	158,688,335	122,403,411
Foreign government securities	21,253,881	16,885,248
Domestic corporate bonds	199,125,587	183,222,648
Foreign corporate bonds	18,023,855	19,759,097
Domestic stocks	221,105,647	191,002,585
Foreign stocks	130,266,536	111,726,819
Alternative investments	41,531,998	27,315,698
Total investments, at fair value	789,995,839	672,315,506
Total assets	$ 952,399,023	751,967,240
Liabilities and Fund Balances		
Liabilities:		
Net payable to brokers	$ 6,967,044	1,641,621
Accounts payable	9,135,076	10,440,664
Liability under securities lending	106,599,991	34,157,133
Total liabilities	122,702,111	46,239,418
Fund balances:		
Nonspendable	729,689,075	613,868,427
Assigned	60,952,331	66,135,396
Unassigned	39,055,506	25,723,999
Total fund balances	829,696,912	705,727,822
Total liabilities and fund balances	$ 952,399,023	751,967,240

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 POSITION

June 30,	*2013*	*2012*
Total fund balances, per the balance sheets—permanent fund	$ 829,696,912	705,727,822
Amounts reported in the statements of net position are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the fund.	42,201	58,589
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	(122,703)	(104,972)
Net position, per the statements of net position	$ 829,616,410	705,681,439

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,	*2013*	*2012*
Revenues:		
Restricted:		
Net appreciation (depreciation) in fair value of investments:		
Net unrealized gains and losses	$ 30,751,892	(16,818,932)
Net realized gains and losses	16,183,796	7,029,702
	46,935,688	(9,789,230)
Settlement receipts	85,057,305	58,062,948
Miscellaneous income	11,451	36,714
Total restricted revenues	132,004,444	48,310,432
Interest income	13,876,853	14,949,711
Dividend income	11,990,824	6,148,429
Securities lending income	84,424	63,106
Contract income	2,445,750	6,760,907
Total revenues	160,402,295	76,232,585
Expenditures:		
Personnel and administrative	1,397,400	1,152,795
Health communication and program promotion	5,747,213	8,395,475
Community programs	7,566,619	7,449,037
Counseling	5,747,656	5,538,420
Evaluation services	872,447	794,649
Research	11,029,769	6,571,025
Investment management fees	3,846,879	2,466,949
Equipment	-	20,422
Other	225,222	236,642
Total expenditures	36,433,205	32,625,414
Net changes in fund balances	123,969,090	43,607,171
Fund balances, beginning of year	705,727,822	662,120,651
Fund balances, end of year	$ 829,696,912	705,727,822

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,	*2013*	*2012*
Net changes in fund balances, per the statements of revenues, expenditures, and changes in fund balances—permanent fund	$ 123,969,090	43,607,171
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 depreciation in the current period.	(16,388)	(1,654)
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.	(17,731)	(30,941)
Changes in net position, per the statements of activities	$ 123,934,971	43,574,576

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 position 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.

See Independent Auditors' Report.

(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	
	2013	2012
Securities loaned		
U.S. government securities	$ 21,523,140	22,884,703
U.S. corporate bonds	12,303,773	2,732,921
U.S. equity	70,435,875	8,542,294
Total securities loaned	$ 104,262,788	34,159,918
Cash collateral maintained for securities loaned	$ 106,599,991	34,157,133
Percentage of cash collateral to securities loaned as of June 30	102.24%	99.99%

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, 2013 and 2012, all collateral was presented as cash in U.S. currency. The total value of the collateral held at June 30, 2013, was $2,337,203 more than the current fair value of the securities loaned. The total value of the collateral held at June 30, 2012, was $(2,785) less 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.

See Independent Auditors' Report.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Securities Lending, Continued

The cash collateral ratio to securities loaned as of June 30, 2013, is 102.24%. The cash collateral ratio to securities loaned as of June 30, 2012, was below 102%, primarily due to a position in a $1,000,000 unsecured Lehman Brothers note held in the cash collateral pool. Lehman Brothers filed for bankruptcy protection on September 15, 2008.

The first distribution from the bankruptcy 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, 34% 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).

Securities lending income included as certified earnings was $84,424 and $63,106 for the fiscal years ended June 30, 2013 and 2012, 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.

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.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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. The Fund adopted GASB 63 effective July 1, 2012. The adoption of the statement required the Fund to adopt the term "net position" as required. In addition, as required by GASB 63, the Fund determined that as of June 30, 2013 and 2012, there were no items of deferred outflows of resources or deferred inflows of resources, as presently defined, to be reported.

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. The Fund has not determined the effects, if any, of implementing GASB 65.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Recent Accounting Pronouncements, Continued

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. The Fund has not determined the effects, if any, of implementing GASB 68.

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 2012 amounts have been reclassified to be comparable with the 2013 presentation.

Date of Management's Review of Subsequent Events

Management has evaluated subsequent events through September 30, 2013, the date which the financial statements were available to be issued, and determined that no subsequent events have occurred which require adjustment to or disclosure in the financial statements.

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS

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

		2013	2012
Cash on deposit with the State	$	12,765,317	14,986,643
Foreign currency		941,751	443,489
Collateral from securities lending—restricted cash		106,599,991	34,157,133
Certificates of deposit		8,824,901	8,411,334
Money market mutual fund		29,100,059	17,467,162
	$	158,232,019	75,465,761

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 a 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 the 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.

(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:

	2013		
	Fair Value *(Expressed in thousands)*		Moody Rating
U.S. government agencies (held in U.S. currency):			
U.S. Treasury bonds	$	78,169	(1)
U.S. Treasury notes		21,089	(1)
U.S. Treasury bills		16,000	(1)
Federal Home Loan Bank		1,962	AA+
Federal Home Loan Mortgage Corp.		3,997	AGY
Federal National Mortgage Corp.		20,896	AGY
Government National Mortgage Association		4,633	AGY
Other		10,271	AGY
Other		827	A2
Other		844	Not Rated
		158,688	
Corporate bonds (held in U.S. currency):			
Domestic bonds		5,415	A1
Domestic bonds		7,902	A2
Domestic bonds		12,369	A3
Domestic bonds		1,088	AA1
Domestic bonds		1,842	AA2
Domestic bonds		5,725	AA3
Domestic bonds		14,851	AAA
Domestic bonds		20,293	B1
Domestic bonds		11,840	B2
Domestic bonds		15,170	B3
Domestic bonds		7,195	BA1
Domestic bonds		8,323	BA2

(Continued)

(2) CASH AND INVESTMENTS, CONTINUED

Credit Risk, Continued

	2013	
	Fair Value (Expressed in thousands)	Moody Rating
Corporate bonds (held in U.S. currency), Continued:		
Domestic bonds	21,386	BA3
Domestic bonds	11,824	BAA1
Domestic bonds	13,603	BAA2
Domestic bonds	9,213	BAA3
Domestic bonds	152	C
Domestic bonds	368	CA
Domestic bonds	3,646	CAA1
Domestic bonds	2,707	CAA2
Domestic bonds	4,497	CAA3
Domestic bonds	19,717	Not Rated
	199,126	
Corporate bonds (held in foreign currency):		
Domestic bonds	135	A
Domestic bonds	378	B1
Domestic bonds	136	BAA1
Domestic bonds	857	BAA2
	1,506	
Foreign corporate bonds (held in U.S. currency):		
Foreign bonds	2,655	A2
Foreign bonds	517	B1
Foreign bonds	2,790	B2
Foreign bonds	749	B3
Foreign bonds	739	BA1
Foreign bonds	2,506	BA3
Foreign bonds	934	BAA1
Foreign bonds	269	CA
	11,159	

(Continued)

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Credit Risk, Continued

	2013	
	Fair Value *(Expressed in thousands)*	Moody Rating
Foreign corporate bonds (held in foreign currency):		
Foreign bonds	232	A2
Foreign bonds	135	B1
Foreign bonds	1,015	B2
Foreign bonds	139	(P)B2
Foreign bonds	565	B3
Foreign bonds	166	BA2
Foreign bonds	147	BA3
Foreign bonds	263	BAA1
Foreign bonds	172	BAA2
Foreign bonds	373	BAA3
Foreign bonds	19	CA2
Foreign bonds	950	CAA1
Foreign bonds	1,183	Not rated
	5,359	
Foreign government bonds (held in U.S. currency):		
Foreign government bonds	849	B2
Foreign government bonds	850	BAA1
Foreign government bonds	465	BAA3
	2,164	

(Continued)

(2) CASH AND INVESTMENTS, CONTINUED

Credit Risk, Continued

	2013	
	Fair Value *(Expressed in thousands)*	Moody Rating
Foreign government bonds (held in foreign currency):		
Foreign government bonds	2,125	AA1U
Foreign government bonds	10,056	AAAU
Foreign government bonds	3,778	BAA1
Foreign government bonds	1,041	BAA2
Foreign government bonds	1,611	BAA3
Foreign government bonds	479	Not rated
	19,090	
Total fair value of credit risk	$ 397,092	

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

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Credit Risk, Continued

	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)

(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.

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 position at June 30, 2013 or 2012.

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.

	2013	
	Fair Value *(Expressed in thousands)*	Effective Duration Years
U.S. government securities (government guaranteed):		
U.S. Treasury bonds	$ 21,089	18.89
U.S. Treasury notes	78,169	4.64
U.S. Treasury bills	16,000	0.06
Federal Home Loan Bank	1,962	4.51
Federal National Mortgage Association—FHR	609	1.90
Federal National Mortgage Association—FNR	7,150	4.54
Government National Mortgage Association	4,633	7.41
FNA	1,258	1.96
GNR	1,253	3.29
Other	1,672	6.22
Foreign government securities:		
Foreign government bonds (held in U.S. currency)	2,164	5.92
Foreign government bonds (held in foreign currency)	19,090	5.63
Mortgage-backed securities:		
Federal Home Loan Mortgage Corp.	3,997	4.59
Federal National Mortgage Corp.	20,896	5.20
Corporate bonds:		
Domestic bonds (held in U.S. currency)	199,126	3.92
Domestic bonds (held in foreign currency)	1,506	4.62
Foreign bonds (held in U.S. currency)	11,159	3.66
Foreign bonds (held in foreign currency)	5,359	3.88
Total fixed income	$ 397,092	

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Interest Rate Risk, Continued

	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

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 position through its asset allocation policy. Investment in foreign equities and fixed income is shown by monetary unit to indicate possible foreign currency risk.

	2013	
	Fair Value *(Expressed in thousands)*	Type
Foreign currency:		
Australian dollar	$ 2,848	Equity
Bermuda dollar	5,760	Equity
Bermuda dollar	805	Fixed income
Brazilian real	1,520	Fixed income
British pound sterling	25,763	Equity
British pound sterling	5,103	Fixed income
British pound sterling	62	Foreign currency
Canadian dollar	8,107	Equity
Canadian dollar	2,343	Fixed income
Cayman dollar	46	Equity
Cayman dollar	304	Fixed income
Euro	35,597	Equity
Euro	21,638	Fixed income
Euro	671	Foreign currency
Hong Kong dollar	4,595	Equity
Indonesian Rupian	2,071	Equity
Israeli New Sheqel	2,394	Equity
Japanese Yen	16,801	Equity
Jersey	3,740	Equity
Malaysian ringgit	17	Foreign currency

(Continued)

(2) CASH AND INVESTMENTS, CONTINUED

Foreign Currency Risk, Continued

	2013	
	Fair Value *(Expressed in thousands)*	Type
Foreign currency, Continued:		
Mexican nuevo peso	1,702	Equity
Mexican nuevo peso	2,579	Fixed income
Mexican nuevo peso	86	Foreign currency
Netherlands Antillean guilder	1,146	Equity
Norwegian krone	3,888	Equity
Russian ruble	1,739	Equity
Singapore dollar	102	Equity
South Korean won	3,651	Equity
Swedish Krona	993	Equity
Swiss franc	6,940	Equity
Thai baht	2,383	Equity
Turkish lira	1,611	Fixed income
South African Rand	1,211	Fixed income
South African Rand	106	Foreign Currency
	$ 168,322	

See Independent Auditors' Report.

(2) CASH AND INVESTMENTS, CONTINUED

Foreign Currency Risk, Continued

	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.

(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, 2013 and 2012. 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, 2013		
	Expiration Date	Long/Short	Notional/ Fair Value *(Expressed in thousands)*
U.S. 5-year note	September 2013	Short	$ (3,389)
U.S. 10-year note	September 2013	Short	(2,405)
Long GILT futures	September 2013	Long	2,037
Euro BOBL futures	September 2013	Long	7,812
U.S. long bond	September 2013	Short	(2,309)
Euro 90-day note	March 2015	Long	21,570
			$ 23,316

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

(3) DERIVATIVES, CONTINUED

Foreign Currency Forward Contracts

	June 30, 2013	June 30, 2012
	(Expressed in thousands)	
Pending receivable	$ 39,063	41,258
Pending payable	(39,035)	(40,773)
Foreign currency forward contract asset	$ 28	485

As of June 30, 2013, the foreign currency forward contracts expire in August 2013. During the years ended June 30, 2013 and 2012, realized (losses) gains on foreign currency contracts were approximately $(388,000) and $706,000, respectively.

The Fund invests in mortgage-backed securities, which are reported at fair value in the statements of net position 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 were with limited partnerships as follows:

2013			
Company	Fair Value (Determined using NAV)	Unfunded Commitment	Purpose
SJC Offshore (Frontpoint)	$ 10,591,460	2,443,410	Investments consist of senior secured direct loans to corporate entities that meet certain criteria.
SJC Offshore II (Frontpoint)	1,515,586	13,500,000	Investments consist of senior secured direct loans to corporate entities that meet certain criteria.
Medley Opportunity Fund II L.P.	19,245,345	22,037,545	Investments consist of senior secured direct loans to corporate entities that meet certain criteria.
AEW Core Property Trust, Inc.	10,179,607	-	Real estate investment trust
Total alternative investments	$ 41,531,998	37,980,955	

See Independent Auditors' Report.

(4) ALTERNATIVE INVESTMENTS, CONTINUED

	2012		
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, 2012	Additions	Disposals	Balance at June 30, 2013
Depreciable capital assets:				
Office equipment and furnishings	$ 140,935	-	-	140,935
Accumulated depreciation:				
Office equipment and furnishings	(82,346)	(16,388)	-	(98,734)
Capital assets, net	$ 58,589	(16,388)	-	42,201

	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)
Capital assets, net	$ 60,243	(1,654)	-	58,589

See Independent Auditors' Report.

(6) CHANGES IN COMPENSATED ABSENCES

Compensated absence activity was as follows:

	Balance at June 30, 2012	Additions	Reductions	Balance at June 30, 2013	Amounts due within 1 year
Compensated absences	$ 104,972	56,894	(39,163)	122,703	49,081

	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

(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 was reflected as assigned to be certified earnings. Of this reserve, $7,620,259 was certified in the November 2012 board meeting to bring the shortage in the total certification up to 5% of the corpus, thus reducing the reserve balance to $35,278,588.

(7) AVAILABLE EARNINGS AND FUND BALANCES, CONTINUED

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 the assigned fund balance, the Fund's Board of Directors and Board of Investors have authority to assign funds for specific purposes.

  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.

(7) AVAILABLE EARNINGS AND FUND BALANCES, CONTINUED

Fund Balances, Continued

- Assigned Fund Balance, Continued

  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: The 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.

(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:

	2013				
	Nonspendable	Assigned Available for Expenditure but Uncertified	Assigned Available for Expenditure and Certified	Unassigned	Total
Balance at June 30, 2012	$ 613,868,427	42,898,847	23,236,549	25,723,999	705,727,822
Transfer—2012—5% cap	-	(7,620,259)	7,620,259	-	-
Settlement receipts	85,057,305	-	-	-	85,057,305
Net unrealized gains on investments	30,751,892	-	-	-	30,751,892
Miscellaneous income	11,451	-	-	-	11,451
Contract income	-	-	-	2,445,750	2,445,750
Expendable earnings, including net realized gains on investments	-	-	-	38,289,018	38,289,018
Program and operating expenses	-	-	-	(32,586,326)	(32,586,326)
Transfer—estimate of certified earnings for 2013	-	-	(4,416,577)	4,416,577	-
Transfer—estimate of 2013 5% cap	-	(766,488)	-	766,488	-
Balance at June 30, 2013	$ 729,689,075	34,512,100	26,440,231	39,055,506	829,696,912

See Independent Auditors' Report.

(7) AVAILABLE EARNINGS AND FUND BALANCES, CONTINUED

Fund Balances, Continued

	2012				
	Nonspendable	Assigned Available for Expenditure 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 certification for the period ended June 30, 2013, was $38,289,018, which is below 5% of the corpus of the Fund. At their August 21, 2013, meeting, the Board of Investors certified $35,068,801, reserving a portion of the amount available for certification for possible audit adjustments. It is anticipated that the Board of Investors will certify an additional amount at their November 2013 meeting, increasing the total certification to 5% of the corpus of the Fund. At their November 14, 2012, meeting, the Board of Investors defined the corpus of the Fund as the custodial market value of the Fund as of June 30, less any previous certified earnings (current year and previous years' certified earnings that remain invested) within the Fund at June 30, 2013.

See Independent Auditors' Report.

(7) AVAILABLE EARNINGS AND FUND BALANCES, CONTINUED

Fund Balances, Continued

The transfers of fund balances during 2013 and 2012 as noted in the above reconciliation are as follows:

2013

- In November 2012, the Board of Investors increased its previous certification by $7,620,259 to equal 5% of the cap.
- The transfer of $4,416,577 was to adjust the unassigned balance to the estimate of certified earnings at June 30, 2013, before the 5% cap adjustment.
- The $766,488 is a transfer to estimate the 5% cap adjustment for 2013.

2012

- 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 2013	
State Employees	The Fund
All Salaries	All Salaries
3.5%	16.5%

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

The Fund's contributions to the Retirement Plan for the years ended June 30, 2013, 2012, and 2011, were $129,208, $103,380, and $70,367, respectively, and were equal to its required contributions for each year.

(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 annually subject to certain limits.

See Independent Auditors' Report.

(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, 2013 and 2012. 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.

See Independent Auditors' Report.

(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.

(11) COMMITMENTS AND CONTINGENCIES, CONTINUED

Settlement Receipts

Previously reported pending litigation was resolved in April 2013, increasing the State's tobacco settlement receipts over the previous year. The State was exposed to the potential loss of more than $700 million for the years 2003 through 2012 for which it had received payment, including a portion that had been deposited in a disputed payments account. By joining the settlement, the funds it had already received were no longer in jeopardy and it received 54% of funds that the participating manufacturers had placed into a disputed payments account. As a result of the 2013 NPM Adjustment Arbitration Settlement, the State received additional tobacco settlement receipts in FY2013 and it will also receive additional funds in the future because, as part of the settlement, there will be no withholding from the State's Master Settlement Agreement (MSA) payment, which is expected to increase the State's future annual payments by an estimated additional $8 million to $10 million.

The dispute involved the diligent enforcement of the provisions within the MSA that required the State to adopt a Qualifying Statute. Participating manufacturers contended the State did not diligently enforce the provisions of its Qualifying Statute during calendar year 2003, and every year thereafter. While the provisions of the Qualifying Statute to be enforced appear relatively simple on the surface, enforcement proved to be a complex and difficult undertaking. An additional complication was the MSA's silence as to what was required for diligent enforcement.

As part of the settlement, the State agreed to take on additional responsibilities, many of which it was already performing. Major requirements of the settlement are that the State must enforce its Complementary Statute against contraband tobacco products and pay a per-stick amount for cigarette sales which have been taxed and stamped. Enforcement of the settlement is expected to require some State statutory changes.

FINLEY & COOK
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' 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, in accordance with the 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, the financial statements of the governmental activities and the permanent fund of the Tobacco Settlement Endowment Trust Fund (the "Fund"), which is a part of the State of Oklahoma financial reporting entity, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated September 30, 2013. Our report includes an explanatory paragraph disclaiming an opinion on required supplementary information. Our report also includes an explanatory paragraph to emphasize the adoption of GASB Statement No. 63 by the Fund. In addition, 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 transactions of the Fund.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

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. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

(Continued)

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INDEPENDENT AUDITORS' 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

Internal Control Over Financial Reporting, Continued

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from 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*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Finley + Cook, PLLC

Shawnee, Oklahoma
September 30, 2013