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Board of Directors · Chair's Message



On behalf of the Board of Directors I am pleased to present this second Annual Report showing how Oklahoma's tobacco settlement funds are being used to improve the health of Oklahomans.

The good news is that while most state governments have failed to keep their promise to use tobacco settlement funds to prevent and reduce tobacco use and improve health, Oklahomans have created a constitutionally protected endowment to assure that funds will be available for these purposes for generations to come.

The bad news is that tobacco use remains our state's leading cause of preventable death; and each year another 9,500 Oklahoma children become regular smokers. In addition the endowment's earnings are only a fraction of the amount needed annually to fund a statewide, comprehensive program to reduce tobacco use.

To succeed, we must strategically focus the endowment's initial earnings on implementing programs that have proven to be most effective in reducing tobacco use.

For this reason, with the earnings available in FY 2003, the Board of Directors established the Oklahoma Tobacco Helpline (1-866-PITCH-EM) to provide professional tobacco cessation counseling over the telephone at no charge to any Oklahoman with a desire to stop smoking or using other tobacco products. In FY 2004 additional programs will be funded including a youth prevention counter-marketing campaign, a public education campaign, and a community grants program. These programs are essential components of the comprehensive approach needed to reduce tobacco use in Oklahoma.

I look forward to our future progress as we continue to work collaboratively with the Board of Investors and expand our partnerships with numerous organizations and individuals throughout the state. Together, we will significantly improve the health and quality of life of all Oklahomans!

Susan Walters Bize

Board of Investors · Chair's Message



Dear Citizens,

The Oklahoma Tobacco Settlement Endowment Trust Fund is alive and well! The vision of the people of Oklahoma is being fulfilled.

Since voters approved a constitutional amendment in November 2000 to permanently set aside a growing portion of the state's share of the National Tobacco Settlement, the board I chair has consistently worked to safely invest the funds and draw as much earnings as possible for use in preventing and stopping tobacco use in Oklahoma.

Each year, the amount of money available for such programs has increased. That means more can be done to keep people from smoking that first cigarette and to get those who are addicted to quit and stay quit.

The beauty of Oklahoma's tobacco settlement endowment is that the funding is permanent. We will always have a majority of Oklahoma's share of the tobacco settlement invested for the benefit of the people.

I am appreciative of the positive spirit of cooperation that exists between the two boards created by the constitutional amendment. We have worked hand-in-hand to generate income and to make sure it is spent in a most effective way.

I look forward to even more success in the years to come!

Sincerely,

A handwritten signature in black ink that reads "Robert Butkin". The signature is written in a cursive, flowing style.

Robert A. Butkin, Oklahoma State Treasurer

Background

As a result of the 1998 Master Settlement Agreement between 46 states and the tobacco industry, the Oklahoma Tobacco Settlement Endowment Trust was established in 2000 through a voter-approved constitutional amendment.

According to the provisions of the constitutional amendment, the Board of Directors may direct only the investment earnings from the endowment to fund programs in the following areas:

- Clinical and basic research and treatment efforts in Oklahoma for the purpose of enhancing efforts to prevent and combat cancer and other tobacco-related diseases;
- Cost-effective tobacco prevention and cessation programs;
- Programs designed to maintain or improve the health of Oklahomans or to enhance the provision of health care services to Oklahomans, with particular emphasis on such programs for children;
- Programs and services for the benefit of the children of Oklahoma, with particular emphasis on common and higher education, before- and after-school programs, substance abuse prevention and treatment programs and services designed to improve the health and quality of life of children; and
- Programs designed to enhance the health and well-being of senior adults.

Earnings from the funds placed in the endowment are expected to grow gradually over time. This steady and growing flow of earnings provides an opportunity for the Board of Directors to strategically fund programs that will address Oklahoma's devastating tobacco use problem in the early years, and begin to fund additional health initiatives over time.

FY 2003 Highlights

Infrastructure

An Executive Director and Executive Administrative Assistant were hired and a small state agency was established, including the development and use of a “virtual infrastructure” to assure the provision of essential services such as procurement (Department of Central Services), personnel (Office of Personnel Management), financial management (Office of State Finance), legal services (Attorney General’s Office), communications (Office of the State Treasurer), and other support services.

Strategic Planning

The Board of Directors and staff engaged in a process to update the strategic plan that included a review of 1) program information previously submitted to the board by various community-based and state organizations, 2) best practices in strategic philanthropy and grantmaking processes among philanthropic organizations throughout the nation, and 3) research findings and best practices in tobacco use prevention and cessation interventions. A consultant was hired to assist the Board in establishing a governance model, short and long-term funding priorities, grantmaking approaches and guidelines, and grant review and selection processes.

Programs

With only \$700,000 in certified earnings available for programs in FY 2003, the Board of Directors authorized funding for the Oklahoma Tobacco Helpline, a professional telephone-based tobacco cessation counseling service, provided at no charge to all Oklahomans with a desire to quit smoking or using other tobacco products. Proactive telephone-based cessation counseling services have proven to be very successful in reaching large numbers of tobacco users with an effective program to help them successfully quit tobacco. Funding was also authorized for a limited media campaign necessary to promote the Helpline and an independent evaluation of the project. The Oklahoma Tobacco Helpline grant was awarded in June, 2003 and the Helpline began serving Oklahomans in August 2003.

Policies

The Board of Directors adopted a policy prohibiting grantees from accepting funding from or having an affiliation or contractual relationship with a tobacco company, any of its subsidiaries or parent company during the term of the grant from the Oklahoma Tobacco Settlement Endowment Trust.

FY 2003 Financials

Tobacco Industry Payments

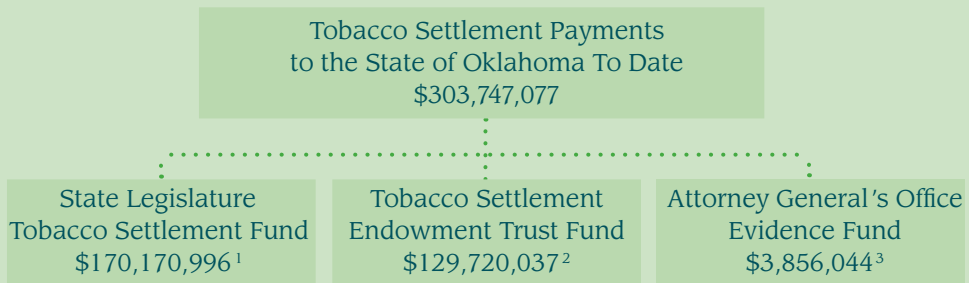
Fiscal Year	Amount
2000	\$86,521,018
2001	\$65,328,240
2002	\$75,872,921
2003	\$76,024,898
Total	\$303,747,077

Schedule of Deposits

Fiscal Year	Percent to Legislature	Percent to Endowment
2002	50%	50%
2003	45%	55%
2004	40%	60%
2005	35%	65%
2006	30%	70%
2007*	25%	75%

* and all subsequent years

Tobacco Settlement Payments to the State of Oklahoma June 6, 1999 - June 30, 2003



- 1 \$45.3 million of the \$170.1 million available to the State Legislature was placed in the general revenue fund prior to November 2000. The remaining \$124.8 million was placed in the state's Tobacco Settlement Fund and has been appropriated for various health and human services programs as detailed in the "Appropriations by the Oklahoma State Legislature from the Tobacco Settlement Fund" table on page 10. These funds are not part of the Endowment.
- 2 The \$129.7 million is the amount of the tobacco settlement payments that have been deposited in the Tobacco Settlement Endowment Trust Fund and invested by the Board of Investors. This includes an initial \$50 million in settlement funds that were directed to the Endowment's principal by the Oklahoma State Legislature during the 2001 legislative session. Only the earnings on these investments may be spent on programs.
- 3 By law, a small percentage of the settlement payments are directed to the Attorney General's Evidence Fund to be used for legal battles to pay for expert witnesses and other costs.

Legislative Appropriations

From the General Revenue (Tobacco Settlement Fund)

Agency No.	Agency Name and Purpose	FY 2001	FY 2002	FY 2003	Agency Total	Agency %
807	Health Care Authority Duties of the agency	\$27,814,025	\$23,428,344	\$9,834,659	\$61,077,028	48.9
830	Department of Human Services - Prater Willie, Child Welfare, Senior Nutrition, Oklahoma Healthcare Initiatives, duties of the agency	\$14,386,582	\$10,152,604	\$19,669,318	\$44,208,504	35.4
825	University Hospitals Authority - Duties of the agency	\$5,921,414	\$4,178,739	.....	\$10,100,153	8.1
340	Department of Health Tobacco prevention, health	\$1,833,333	\$1,725,000	\$1,966,933	\$5,525,266	4.4
452	Department of Mental Health & Substance Abuse Services Duties of the agency	\$1,490,561	\$1,051,888	\$1,129,552	\$3,672,001	2.9
650	Department of Veteran's Affairs Duties of the agency	.....	\$275,000	.....	\$275,000	.2
	TOTALS	\$51,445,915	\$40,811,575	\$32,600,462	\$124,857,952	100

**Tobacco Settlement Endowment Trust
FY 2003 Program Grants and Contracts**

Center for Health Promotion · \$475,454
Tukwila, Washington

Provides the *Oklahoma Tobacco Helpline* — a statewide, telephone-based information, referral, and behavioral counseling service — at no-charge to Oklahoma callers who are ready to quit smoking or using other tobacco products. Also provides consultation to Oklahoma health care professionals regarding effective tobacco dependence treatment. The Center for Health Promotion provides Helpline services to six other states and Oklahoma benefits from this shared service. In addition the Center provides a 10% match in year one and a 5% match in subsequent years.

.....

University of Oklahoma Health Sciences Center · \$11,612
College of Public Health · Comprehensive Cancer Center
Oklahoma City, Oklahoma

Oklahoma State University (sub-grantee)
Stillwater, Oklahoma

Evaluation of the effectiveness of the Oklahoma Tobacco Helpline, by assessing quit rates, client satisfaction, and the ability of media promotion efforts to recruit appropriate callers to the Helpline.

.....

Oklahoma State Department of Health · \$50,000
Tobacco Use Prevention Service
Oklahoma City, Oklahoma

Brothers & Co. (sub-grantee)
Tulsa, Oklahoma

- Provide technical assistance and training to the TSET Board, staff, and grantees on effective tobacco prevention interventions. Services are provided in-kind by staff funded by the Centers for Disease Control and Prevention (CDC);
- Oversee the day-to-day activities of TSET grantees in tobacco control, assuring financial accountability and progress toward objectives. TSET funds to the OSDH, \$1,600. Additional services provided in-kind by staff funded by the CDC); and
- Coordinate media promotion of the Oklahoma Tobacco Helpline. TSET funds to sub-grantee: Brothers & Co. \$50,000 through June 30, 2003.

Board of Investors

The five-member Board of Investors is responsible for safely and effectively investing the money entrusted to the Trust fund to ensure a steady and growing flow of earnings to fund the programs initiated by the Board of Directors. Initial appointed members serve staggered terms of office, and subsequent appointed members serve four-year terms. As specified in the Constitution, no more than two appointees may be appointed from any single Congressional district. All appointees must have demonstrated expertise in public or private investment funds management.



Honorable Robert A. Butkin, State Treasurer of Oklahoma. The constitutional amendment approved by Oklahoma voters in 2000 establishes the state treasurer as the chairman of the Board of Investors. Butkin spearheaded efforts to establish the Oklahoma Tobacco Settlement Endowment Trust Fund in the state constitution. A third generation Oklahoman, Butkin has established common sense values and sound business practices in the State Treasurer's Office. His reforms have saved millions of dollars for Oklahoma taxpayers. His investment of state funds has been nationally recognized for its efficiency and professionalism. First elected treasurer in 1994, Butkin was reelected in 1998 and 2002 after drawing no opponents.



David Rainbolt, appointed by the Speaker of House, serves as Vice-Chair of the Board and is the Chief Executive Officer of BancFirst Corporation. He previously served as Chief Financial Officer of BancFirst and is past president of the Oklahoma Bankers Association, Last Frontier Council Boy Scouts of American and the Oklahoma Health Center Foundation. Mr. Rainbolt serves on the executive committee of the Oklahoma State Chamber and is a trustee of the Oklahoma Industrial and Cultural Facilities Trust. His philanthropic memberships include the Presbyterian Health Foundation, Dean A. McGee Eye Institute, Oklahoma Medical Research Foundation and the State Fair of Oklahoma.



Phil Tholen, CPA, appointed by the Senate President Pro Tempore, is Executive Vice President and Member of the Board of Directors for Samson Investment Company and its subsidiaries. He also serves as Managing Member and Consultant to Baltic Resources LLC. Mr. Tholen's civic involvement includes past service on the Board of Managers for the State Insurance Fund of Oklahoma that provides workers compensation insurance to more than 50 percent of the state market and the Legislative Task Force on Judicial Selection that made recommendations for improvement of Oklahoma's judicial selection methods.



Steve Tinsley, CPA, appointed by the State Auditor, is a Deputy State Auditor. He also serves on the Oklahoma State Pension Commission, the Oklahoma College Savings Plan board, the Commissioners of the Land Office Investment Committee, and is a past Chair of the Southwest Intergovernmental Audit Forum, a five-state region encompassing federal, state and local governmental auditors. Mr. Tinsley's past experience includes public accounting and private industry. He has more than 12 years of classroom experience, teaching evening classes as an instructor for the University of Oklahoma, Rose State College and Oklahoma City University.



Jimmy Williams, CPA, appointed by the Governor, is founder and managing director of Jimmy J. Williams & Co., P.C., a certified public accounting and consulting firm in McAlester. His firm specializes in the areas of litigation support, business valuation and taxation. Mr. Williams also serves as co-founder and CEO of Asset & Investment Advisors, Inc., a registered investment advisory firm. The firm specializes in retirement, education, investment and financial planning services. He is Chief Investment Officer and Treasurer for the McAlester Regional Health Center Foundation and he formerly served as Vice President of the McAlester Chamber of Commerce.



Board of Directors

The seven-member Board of Directors is responsible for directing the earnings from the Trust to fund programs to improve the health and well-being of all Oklahomans, especially children and senior adults. Initial appointed members serve staggered terms of office, and subsequent appointed members serve seven-year terms. As specified in the Constitution, at least one appointee must be appointed from each Congressional district, and not more than two appointees may be appointed from any single Congressional district. In addition, not more than four appointees may be from any one political party. All appointees must have demonstrated expertise in public or private health care or programs related to or for the benefit of children or senior adults.



Susan Walters Bizé, appointed by the State Auditor and Inspector, was elected Chair in November 2003 after two years of service as an active board member. She is an Assistant Professor of Accounting at the University of Central Oklahoma and Of Counsel to the law firm of Lester, Loving & Davies. Ms. Bizé practiced for many years as a CPA and attorney in the public and private sectors, primarily in the areas of tax and business law. She worked with numerous state legislatures and Congress while serving as Senior Government Relations Counsel for J.C. Penney, Company, Inc., in Dallas and Washington, D.C. Upon returning to Oklahoma, Ms. Bizé served as Regional Vice-President for the American Cancer Society where she oversaw the implementation of programs in western Oklahoma. She is a member of the Oklahoma and Texas Bar Associations, the Oklahoma Society of CPA's, and volunteers for many charitable and civic organizations.



Brian Maddy, Vice-Chair, appointed by the President Pro Tempore of the Senate, serves as Chief Executive Officer of OU Physicians, the clinical practice of more than 400 physicians who also serve as faculty at the OU College of Medicine. He also serves as Associate Dean for Administration and Institutional Development for the University of Oklahoma, College of Medicine. Prior to assuming these two positions, Mr. Maddy was Vice-President of Administrative Affairs for the University of Oklahoma where he functioned as the university's Chief Financial Officer, overseeing a budget of nearly \$1 billion. He also held positions of Chief of Staff of the Oklahoma State Senate and Director and Fiscal Analyst for the Senate fiscal staff. In those positions, he developed elements of the statutory framework for public sector healthcare, criminal justice reform, cost-containment strategies and economic development initiatives including Medicaid managed care, Employees Benefits Council, Oklahoma Health Care Authority, truth-in-sentencing/community sentencing, and the Quality Jobs Act.



Marvin Apple, Secretary, appointed by the Speaker of the House, brings to the Board of Directors over 40 years of experience in the public sector of Oklahoma, working with state and local governments in the areas of public administration, education, program development, and operation. Mr. Apple served as a public health administrator with the Cherokee County Health Department and as a Quadrant Administrator for the Oklahoma State Department of Health, supervising six public health administrators responsible for the operation of nineteen county health departments in northeastern Oklahoma. Mr. Apple was instrumental in establishing the first county health coalition, and the first county health authority in Oklahoma. Presently, Mr. Apple serves as the CEO of the Cherokee County Health Services Council and in that role he has been a

major force in the creation of the Rural Health Institute and the Oklahoma Center for Rural Development located at Northeastern State University.



Donald Cooper, MD, appointed by the Governor, is Emeritus Director of the Oklahoma State University Student Health Center. With over thirty years experience in sports medicine, Dr. Cooper is known throughout the state as the “Jock Doc.” He was an active member of the President’s Council on Physical Fitness and Sports under Presidents Regan and Bush, a U.S. Olympic team physician for the XIX Olympiad, and a sports medicine consultant to the NCAA Football Rules Committee. Dr. Cooper has served on numerous state and national boards and committees, testified before Congress, appeared on national television shows, and studied and lectured on sports medicine in China and the Soviet Union. In November 1999, Dr. Cooper was inducted into the Oklahoma Hall of Fame, and was featured in the Journal of the Oklahoma State Medical Association as a “Leader in Medicine.”



Casey Killblane, appointed by the State Superintendent of Public Instruction, resides in Davis, Oklahoma with her husband and two sons on the Flying L Ranch. In addition to being a mom and housewife, Ms. Killblane owns an oil and gas company, Wentz Production, LLC. She received her B.S. in Finance from Oklahoma State University, and has had a very successful career in philanthropy working as Director of Annual Giving and Women’s Services for Sharp HealthCare Foundation in San Diego, and as Director of Community Relations for the San Diego Community Foundation. Ms. Killblane also served as Mrs. Barbara Bush’s personal aide from 1987 to 1989. She currently serves on the Davis Public School Foundation, the Murray County Election Board, and the Board of Trustees for the Davis Methodist Church. Ms. Killblane previously served on the Board of Regents for Murray State College and the State Board of Education.



D. Robert McCaffree, MD, appointed by the Attorney General, served two terms as the Board’s founding Chair from August 2001 to November 2003. Dr. McCaffree is a physician specializing in diseases of the lung and critical illness. He is Professor of Medicine in the Pulmonary Disease and Critical Care Section of the OU College of Medicine. Administratively, Dr. McCaffree is Chief of Staff at the Oklahoma City VA Medical Center and Associate Dean for Veterans’ Affairs for the College of Medicine. He is Past-chair of the Oklahoma Coalition on Health and Tobacco. He is also Past-President of the American College of Chest Physicians, in which role he was a member of the Koop-Kessler Congressional Advisory Committee on Health and Tobacco and has testified before Congress on tobacco issues. Dr. McCaffree is also a member of the Board of Directors of the American Lung Association of Oklahoma and has recently been appointed to the national ALA Council.



Suzanne Olive, MD, appointed by the State Treasurer, is a physician in private practice with the Tulsa Pulmonary and Allergy Consultants, Inc. She is also Clinical Professor of Medicine with the University of Oklahoma Health Science Center. Dr. Olive is Board Certified in Internal Medicine, Pulmonary Medicine, Allergy and Immunology, and Critical Care. She is a member of the American Medical Association, Oklahoma State Medical Association, and Tulsa County Medical Society.

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the Tobacco Settlement Endowment Trust Fund (the "Fund"), as of and for the year ended June 30, 2003, as listed in the table of contents. The Fund is a part of the reporting entity of the State of Oklahoma. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements as of and for the year ended June 30, 2002, were included in the State of Oklahoma's Comprehensive Annual Financial Report and were audited by the State Auditor and Inspector, whose report dated December 31, 2002, rendered an unqualified opinion on the State of Oklahoma's financial statements, based in part on the reports of other auditors.

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

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 changes in financial position of only that portion of the governmental activities and governmental funds of the State of Oklahoma that are attributable to the transactions of the Fund.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2003, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The required supplementary information contained in the Management's Discussion and Analysis is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it.

In accordance with Government Auditing Standards, we have also issued a report dated September 12, 2003, on our consideration of the Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

A handwritten signature in black ink that reads "Finley & Cook, PLLC". The signature is written in a cursive, flowing style.

TSET MANAGEMENT'S DISCUSSION & ANALYSIS (MD&A) · June 30, 2003

The Management's Discussion and Analysis of the Tobacco Settlement Endowment Trust Fund (the "Fund") provides an overview and overall review of the Fund's financial activities for the fiscal year ended June 30, 2003. 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 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 dividends and interest, less fees to manage the Fund, are expended for 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 principal of the Fund and to annually certify the earnings that are available for program expenditures. A Board of Directors was created to oversee Fund operating and program expenditures.

Using this Annual Report

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

Government-wide statements: Government-wide statements include a statement of net assets and a statement 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 non-current. 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 sheet and statement of revenues, expenditures, and changes in fund balance. In the fund financial statements, the revenues and expenditures of the Fund are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Under these accounting methods, revenues and assets are recognized when they become both measurable and available, and expenditures and liabilities are recognized when obligations are incurred as a result of the receipt of goods or services.

FINANCIAL HIGHLIGHTS

Statements of Net Assets and Statements of Activities (Changes in Net Assets)

The statements of net assets provide an indication of the Fund's financial condition at the end of the 2003 and 2002 fiscal years; the statements report all assets and liabilities using the accrual basis of accounting. The statements of activities report all of the revenues and expenses during the time periods indicated.

The Fund's total assets increased during the year, as the Fund deposited \$41.8 million in settlement receipts and recognized an additional \$3.8 million as net investment income. During the year, the Board of Investors formalized an investment policy resulting in the diversification of the Fund's investment portfolio, decreasing current assets, and increasing Fund investments. 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.

During the fiscal year ended June 30, 2003, the Board of Directors of the Fund hired its first full-time employees, established an office, acquired furniture and equipment to support Fund programs and operations, and established connections with and solicited information from health-related foundations and experts and programs in tobacco prevention and cessation.

The increase in total liabilities was a direct result of both Boards' start-up activities. Current liabilities include amounts payable to investment managers, vendor accounts payable, and compensated absences due to employees as of June 30, 2003. Vendor payables at year end include amounts due contractors pursuant to agreements to promote, operate, and evaluate the Oklahoma Tobacco Helpline. The Oklahoma Tobacco Helpline gives Oklahomans, who want to stop smoking or using other tobacco products, help through a toll-free statewide phone line, 1-866-PITCH'EM. The Oklahoma Tobacco Helpline is the first major tobacco prevention and cessation initiative of the Fund.

Net Assets

	2003	2002
Assets		
Current Assets	\$40,283,090	89,964,102
Investments (at fair value)	96,085,163	...
Capital Assets	9,282	...
Total Assets	136,377,535	89,964,102
Liabilities		
Current Liabilities	978,638	...
Noncurrent Liabilities	4,683	...
Total Liabilities	983,321	...
Net Assets		
Invested in Capital Assets	9,282	...
Restricted for Investment	130,808,589	87,906,344
Unrestricted	4,576,343	2,057,758
Total Net Assets	\$135,394,214	89,964,102

The increase in net assets is primarily attributable to the additional amounts received pursuant to the settlement agreement.

Statements of Activities - Revenues and Expenses

Revenues are dominated by settlement receipts which are restricted for investment purposes. 55% and 50% of all such receipts were deposited by the State into the Fund during the fiscal years ended June 30, 2003 and 2002, respectively. The \$3.9 million increase in settlement receipts from 2002 to 2003 is attributable to the 5% increase, as the total received by the State did not change significantly. The percentage of the State's settlement receipts to be received by the Fund continues to increase by 5% annually until it reaches 75% during the fiscal year ending June 30, 2007, where it remains thereafter; however, there are no guarantees regarding the State's continued receipt of funds in settlement of claims against the tobacco companies.

As settlement receipts were deposited and invested, the portfolio increased and was diversified, and total investment income increased \$2.8 million. This increase included \$1 million attributable to the net appreciation of investments in the Fund's portfolio as of June 30, 2003. Fees paid to investment managers, consultants, and custodians increased by \$415,411, resulting in an increase in net investment income of \$2.4 million from 2002 to 2003.

Operating expenses have increased from 2002 to 2003, as the Board of Directors established an office, hired two full-time employees, contracted for accounting and reporting services, and incurred other expenses typical of start-up operations. The State Treasurer provides any necessary staff support to the Board of Investors and may seek reimbursement for the cost of up to two full-time equivalent employees. During this start-up period, the Office of the State Treasurer has not sought reimbursement for administrative expenses. Operating expenses, including salaries, travel, and other operating expenses of the Board of Directors and the Board of Investors, may not exceed \$500,000 in any fiscal year.

Program expenses were incurred during 2003, as information about tobacco prevention and cessation programs was obtained and evaluated, proposals for promoting, operating, and evaluating helpline services were solicited and evaluated and contracts were awarded.

Statements of Activities

	2003	2002
Investment Income		
Interest and Dividend Income	\$3,192,080	1,442,808
Net Appreciation in Fair Value of Investments	1,088,551	...
Total Investment Income	4,280,631	1,442,808
Investment Expenses	(434,395)	(18,984)
Net Investment Income	3,846,236	1,423,824
Expenses		
Program	62,290	...
Operating	167,528	17,738
Total Expenses	229,818	17,738
Increase in Net Assets before Settlement Receipts	3,616,418	1,406,086
Contribution to Fund Principal		
Settlement Receipts	41,813,694	37,906,344
Increase in Net Assets	45,430,112	39,312,430
Net Assets - July 1, 2002	89,964,102	50,651,672
Net Assets - June 30, 2003	\$135,394,214	89,964,102

Governmental Fund - Balance Sheet

The Fund is classified as a permanent fund as the principal funds are restricted by law for investment purposes only. The dividend and interest earnings, less fees to manage the Fund, including up to \$500,000 in Fund operating expenses, are expended for 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. Accordingly, fund balance at year end includes balances which are reserved for investment purposes and unreserved that are expendable for Fund operations and programs.

Balance Sheets - Permanent Fund

	2003	2002
Assets		
Cash and Cash Equivalents	\$39,827,039	\$89,837,451
Interest and Dividends Receivable	\$456,051	\$126,651
Investments at Fair Value	\$96,085,163	...
Total Assets	\$136,368,253	\$89,964,102
Liabilities		
Accounts Payable	\$185,532	...
Net Payable to Brokers	\$789,984	...
Total Liabilities	\$975,516	...
Fund Balances		
Reserved	130,808,589	87,906,344
Unreserved	4,584,148	2,057,758
Total Fund Balances	135,392,737	89,964,102
Total Liabilities and Fund Balances	\$136,368,253	89,964,102

Revenues, Expenditures & Changes in Fund Balances - Permanent Fund

	2003	2002
Revenues		
Restricted:		
- Net Appreciation in Fair Value of Investments	\$1,088,551	...
- Settlement Receipts	41,813,694	37,906,344
Total Restricted Revenues	42,902,245	37,906,344
Interest & Dividend Income	3,192,080	1,442,808
Total Revenues	46,094,325	39,349,152
Expenditures		
Investment Management Fees	434,395	18,984
Other	231,295	17,738
Total Expenditures	665,690	36,722
Revenues in Excess of Expenditures	45,428,635	39,312,430
Fund Balances, Beginning of Year	89,964,102	50,651,672
Fund Balances, End of Year	\$135,392,737	89,964,102

Requests for Information

This report is designed to provide a general overview of the Fund's finances. Questions concerning any of the information in this report or requests for additional financial information should be addressed to Mr. Ken King, Deputy Treasurer, Office of the Okla. State Treasurer, 2300 N. Lincoln Blvd., Rm. 217, Oklahoma City, OK 73105-4895.

FINANCIAL STATEMENTS

Statements of Net Assets

	2003	2002
Assets		
Cash & Cash Equivalents	\$39,827,039	89,837,451
Receivables:		
- Accrued Interest & Dividends	456,051	126,651
Investments (at Fair Value):		
- US Government Securities	32,783,500	...
- Corporate Bonds	25,592,610	...
- Domestic Stocks	37,709,053	...
Total Investments	96,085,163	...
Capital Assets, Net of Accumulated Depreciation of \$1,228	9,282	...
Total Assets	136,377,535	89,964,102

Liabilities

Net Payable to Brokers	789,984	...
Accounts Payable	185,532	...
Compensated Absences:		
- Payable Within One Year	3,122	...
- Payable After One Year	4,683	...
Total Liabilities	983,321	...

Net Assets

Invested in Capital Assets	9,282	...
Restricted for Investment	130,808,589	87,906,344
Unrestricted	4,576,343	2,057,758
Total Net Assets	\$135,394,214	89,964,102

Statements of Activities

	2003	2002
Expenses		
Program:		
- Personnel Services	\$62,012	...
- Depreciation	278	...
Total Program Expenses	62,290	...
Operating:		
- Personnel Services	138,252	8,415
- Other	28,326	9,323
- Depreciation	950	...
Total Operating Expenses	167,528	17,738
Total Expenses	229,818	17,738
Investment Income		
Interest Income	2,628,033	1,442,808
Dividend Income	564,047	...
Net appreciation in Fair Value of Investments	1,088,551	...
Total Investment Income	4,280,631	1,442,808
Investment Expenses	(434,395)	(18,984)
Net Investment Income	3,846,236	1,423,824
Contribution to Fund Principal		
Settlement Receipts	41,813,694	37,906,344
Change in Net Assets	45,430,112	39,312,430
Net Assets, Beginning of Year	89,964,102	50,651,672
Net Assets, End of Year	\$135,394,214	89,964,102

Balance Sheets - Permanent Fund

	2003	2002
Assets		
Cash & Cash Equivalents	\$39,827,039	\$89,837,451
Receivables:		
- Accrued Interest & Dividends	\$456,051	\$126,651
Investments (at Fair Value):		
- US Government Securities	32,783,500	...
- Corporate Bonds	25,592,610	...
- Domestic Stocks	37,709,053	...
Total Investments	96,085,163	...
Total Assets	\$136,368,253	\$89,964,102
Liabilities & Fund Balances		
Liabilities:		
- Net Payable to Brokers	\$789,984	...
- Accounts Payable	\$185,532	...
Total Liabilities	\$975,516	...
Fund Balances:		
- Reserved	130,808,589	87,906,344
- Unreserved	4,584,148	2,057,758
Total Fund Balances	135,392,737	89,964,102
Total Liabilities & Fund Balances	\$136,368,253	\$89,964,102

Reconciliation of Balance Sheets - Permanent Fund to Statements of Net Assets

	2003	2002
Total Fund Balances: Permanent Fund	\$135,392,737	89,964,102
Amounts Reported in Statement of Net Assets Differ Because:		
- Capital assets used in governmental activities are not financial resources, and therefore, are not reported in the fund.	\$9,282	...
- 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	(7,805)	...
Net Assets of Permanent Fund	\$135,394,214	89,964,102

Revenues, Expenditures and Changes in Fund Balances - Permanent Fund

	2003	2002
Revenues		
Restricted:		
- Net Appreciation in Fair Value of Investments	\$1,088,551	...
- Settlement Receipts	41,813,694	37,906,344
Total Restricted Revenues	42,902,245	37,906,344
Interest Income	2,628,033	1,442,808
Dividend Income	564,047	...
Total Revenues	46,094,325	39,349,152
Expenditures		
Personnel Services	192,459	8,416
Investment Management Fees	434,395	18,984
Equipment	11,873	...
Other	26,963	9,322
Total Expenditures	665,690	36,722
Revenues in Excess of Expenditures	45,428,635	39,312,430
Other Financing Sources (uses)	...	...
Net Changes in Fund Balances	45,428,635	39,312,430
Fund Balances, Beginning of Year	89,964,102	50,651,672
Fund Balances, End of Year	\$135,392,737	89,964,102

Reconciliation of the Statements of Revenues, Expenditures, and Changes in Fund Balances - Permanent Fund to the Statements of Activities

	2003	2002
Net Changes in Fund Balances: Permanent Fund	\$45,428,635	39,312,430
Amounts Reported in Statement of Activities Differ Because:		
- Governmental funds report capital outlays as expenditures. However, in the statement 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 exceeded depreciation in the current period.	9,282	...
- Some expenses reported in the statement 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 cost of compensated absences earned but not used in the current year.	(7,805)	...
Changes in Net Assets, Per Statement of Activities	\$45,430,112	39,312,430

**NOTES TO FINANCIAL STATEMENTS
June 30, 2003 & 2002****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 were deposited into the Fund during the fiscal year ended June 30, 2002. That percentage increases by 5% annually until it reaches 75% during the fiscal year ending June 30, 2007, where it remains thereafter. 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 dividends and interest, less fees to manage the Fund, are expended for 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 of the State that are attributable to the transactions of the Fund, and not those of the entire State.

Basis of Presentation, Measurement Focus, and Basis of Accounting

Government-wide Financial Statements

The statement of net assets and the statement 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.

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 bases 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, a reconciliation is presented which briefly explains the adjustments necessary to reconcile the fund and 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 the funds invested in an SEC registered money market mutual fund, 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 include U.S. Treasury strips, collateralized mortgage obligations, asset-backed securities, 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, and investment expenses, which includes investment management and custodial fees and all other significant investment-related costs.

Capital Assets

Furniture, fixtures, and equipment 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 4- to 12-year

periods for computer systems and office furniture and fixtures, respectively.

No provision for depreciation is recorded in the general 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 disclosures. Accordingly, actual results could differ from those estimates.

Compensated Absences

Employees earn annual vacation leave at the rate of 10 hours per month for the first 5 years of service, 12 hours per month for services of 5 to 10 years, 13.33 hours per month for service of 10 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.

The amount of accrued compensated absences considered current was determined based on the amount used during the current year.

CASH AND INVESTMENTS

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

	2003	2002
Cash on Deposit with the State	\$9,065	7,259
Money Market Mutual Fund	39,817,974	89,830,192
Total	\$39,827,039	89,837,451

Deposits with financial institutions are classified depending on whether they are insured or collateralized in the following categories of credit risk: Category 1 includes

deposits that are insured or collateralized with securities held by the Fund or by the agent in the Fund's name; Category 2 includes deposits which are collateralized with securities held by the pledging financial institution's trust department or agent in the Fund's name; Category 3 includes deposits which are uncollateralized, or deposits which are collateralized and the related securities are held by the pledging financial institution or by its trust department or agent not in the Fund's name. At June 30, 2003 and 2002, cash on deposit with the State was considered Category 1 and investments in mutual funds were not subject to classification.

The Plan's investments would generally be categorized into one of three separate credit risk categories. Category 1 includes securities that are insured or registered or are held by the Fund or its agent in the Fund's name. Category 2 includes uninsured and unregistered securities which are held by the counterparties' trust departments or agents in the Fund's name. Category 3 includes uninsured and unregistered securities held by the counterparties or their trust departments or agents but not in the Fund's name. A summary of the Fund's investments at June 30 is as follows:

	2003	2002
Category 1 Classification		
- US Government Securities	\$25,619,118	...
- Corporate Bonds	17,188,451	...
- Domestic Stocks	37,709,053	...
Category 1 Total	80,516,622	...
Category 2 Classification		
- US Government Securities	7,164,382	...
- Corporate Bonds	8,404,159	...
Category 2 Total	15,568,541	...
Total Investments	\$96,085,163	...

No investment, other than in U.S. Government securities, in any one security or any one issuer represents 5% or more of the Fund's net assets.

FUND BALANCES

Before the fiscal year ended June 30, 2003, the positive difference, if any, in the aggregate fair value of the Fund during the fiscal year, was the basis for the Board of Investors to determine certified earnings. Effective with the fiscal year ended June 30, 2003, earnings that are available to be

certified for expenditure are defined pursuant to Title 62 O.S. 2003, Section 2307, as dividends and interest, less fees to manage the Fund. Certified earnings become undesignated fund balance and are available for operating and program expenses. Operating expenses include salaries, travel, and other operating expenses of the Board of Investors and the Board of Directors and may not exceed \$500,000 in any fiscal year. Operating expenses do not include program expenses or investment management expenses. The principal of the Fund and the related net appreciation (depreciation) are restricted for investment purposes only.

A reconciliation of the reserved and unreserved components of fund balance is as follows:

	Reserved for Investment	Unreserved	Total
Balance as of June 30, 2002	\$87,906,344	2,057,758	89,964,102
Settlement Receipts	41,813,694	...	41,813,694
Net Appreciation in Investments	1,088,551	...	1,088,551
Earnings Available for Certification	...	2,757,685	2,757,685
Program & Operating Expenses	...	(231,295)	(231,295)
Balance as of June 30, 2003	\$130,808,589	4,584,148	135,392,737
Balance as of June 30, 2001	\$50,000,000	651,672	50,651,672
Settlement Receipts	37,906,344	...	37,906,344
Net Appreciation in Investments	...	...	...
Earnings Available for Certification	...	1,423,824	1,423,824
Program & Operating Expenses	...	(17,738)	(17,738)
Balance as of June 30, 2002	\$87,906,344	2,057,758	89,964,102

PENSION PLAN

Plan Description

The Fund contributes to the Oklahoma Public Employees Retirement Plan (the "Plan"), a multiple-employer, cost-sharing public employee retirement plan, which is a defined benefit pension plan administered by the Oklahoma Public Employees Retirement System (OPERS). Benefit provisions are established and can be amended by the State Legislature. The Plan provides retirement, disability, and death benefits. Title 74 of the

Oklahoma Statutes, Sections 901 through 943, as amended, provides more complete information about the Plan. OPERS issues a publicly-available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to OPERS, PO Box 53007, Oklahoma City, OK 73152, or by calling 1-800-733-9008.

Funding Policy

The contribution rates for each member category of the Plan are established by and can be amended by the State Legislature and are based on actuarial calculation which is performed to determine the adequacy of contribution rates. The contribution rates applied to each participating State employee's salary for the fiscal year ended June 30, 2003, are listed below:

State Employee Contribution		State Agencies' Contribution
First \$25,000 3.0%	Above \$25,000 3.5%	All Salaries 10.0%

The Fund's contribution of \$8,377 to the Plan for the year ended June 30, 2003, was equal to the Fund's established required contribution. No contributions were made during 2002 or 2001, as the Fund had no employees.

START-UP OPERATIONS AND OPERATING EXPENSES

The Fund was created by an amendment of the State's Constitution, approved by a vote of the people of the State on November 7, 2000. The State Legislature appropriated \$50 million to the Fund and the Board of Investors and the Board of the Directors of the Fund were appointed during the fiscal year ended June 30, 2001. During the fiscal year ended June 30, 2002, settlement receipts received by the State were deposited with the Fund and invested. During these same periods, the State Legislature enacted laws to implement the provisions of the Constitutional amendment and the Board of Investors and the Board of Directors began gathering and reviewing information, hiring consultants, advisors, and service providers, and planning and adopting policies and procedures to carry out their respective responsibilities.

The Constitutional amendment 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 seek reimbursement for the cost of up to two full-time equivalent employees. During this start-up period, the Office of the State Treasurer has not sought reimbursement for administrative expenses. Also, during the fiscal year ended June 30, 2003, the Board of Directors hired its first full-time employees and established an office. Accordingly, operating expenses as reflected in the accompanying financial statements may not provide a basis for future comparison. State statutes, however, specify that annual operating expenses shall not exceed \$500,000.

COMMITMENTS AND CONTINGENCIES

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.

REPORT ON COMPLIANCE AND INTERNAL CONTROL

We have audited the financial statements of the Tobacco Settlement Endowment Trust Fund (the "Fund") as of and for the year ended June 30, 2003, and have issued our report thereon dated September 12, 2003. Our report includes an explanatory paragraph to emphasize the fact that the financial statements included only that portion of the State of Oklahoma that was attributable to the transactions of the Fund and an explanatory paragraph disclaiming an opinion on required supplementary information. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, 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 that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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

Shawnee, Oklahoma
September 12, 2003

Finley & Cook, PLLC



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