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MISSION

The mission of the Board of Directors of the Tobacco Settlement Endowment Trust fund is to improve the health and quality of life of all Oklahomans through accountable programs and services that address the hazards of tobacco use and other health issues.

VALUES & BEHAVIORS

To encourage programs and initiatives that are based on the best research available, follow practices with proven results, and provide the best opportunity for success.

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To work cooperatively with other public and private organizations and funders to support joint efforts that will use funds efficiently, avoid duplication, minimize administrative expense, and provide the opportunity for sustained activity.

.....

To plan and encourage community-based comprehensive services for all areas of Oklahoma, including urban and rural communities.

.....

To require measurable outcomes, appropriate evaluation, and annual evaluation reporting of all funded programs.

.....

To make funding decisions based on the priorities of the Board and the merits of the proposal, independent of political influence and conflict of interest.

.....

To encourage grantees to match grant monies awarded with monetary commitments and in-kind matches.



Executive Director's Message



It is hard to find anyone in our state who hasn't been personally affected by tobacco use and its devastating effects on our loved ones. In addition to the heartbreak of personal loss, we also pay the price for tobacco-caused illnesses, to the tune of \$600 per year for every man, woman, and child in Oklahoma. Like it or not, tobacco use affects us all.

It is for these very reasons, each of us also has a stake in the use of the Master Settlement Agreement funds, the growth of the Oklahoma Tobacco Settlement Endowment Trust, and the programs funded with its earnings. I believe that the creation of the Endowment is one of the greatest accomplishments in our state's history, and I am honored to be a part of it.

The Endowment's first programs have been funded to help people break their addiction to tobacco products, prevent youth from starting, and promote community actions to reduce tobacco use and protect everyone from secondhand smoke. With each passing year, the impact of these programs will be increasingly evident in Oklahoma's improved health status.

For the past two years, I have had the privilege of working closely with the Board of Directors and Board of Investors. Both boards bring a wealth of expertise, experience, and dedication to improving the health and well-being of all Oklahomans. As Oklahomans, we are truly fortunate to have this outstanding group of state leaders charting the course for the Endowment's current and future growth.

While the Endowment's progress is exciting, it is only through expanding our partnerships with other individuals, organizations, and coalitions that we will achieve our goal of cutting tobacco use in half by 2010. By working together, we will achieve a healthier Oklahoma!

A handwritten signature in cursive script that reads "Tracey Strader". The signature is written in black ink on a light-colored background.

Tracey Strader
Executive Director
Oklahoma Tobacco Settlement Endowment Trust

Board of Directors · Chair's Message



Dear Fellow Oklahomans,

Fiscal Year 2004 has been a year of growth and excitement for the Oklahoma Tobacco Settlement Endowment Trust. With the earnings available in FY 2004, the Board of Directors increased funding to meet the demand for the Oklahoma Tobacco Helpline (1-866-PITCH-EM), initiated public education campaigns to reduce teen smoking, and launched a community grants program that will assist coalitions across the state in reducing tobacco use and its harmful effects.

The Board of Directors remains firmly committed to fulfilling the promise of the Master Tobacco Settlement Agreement. The Endowment will continue to leverage its earnings by partnering with public and private organizations to fund the most effective programs to reduce youth smoking, save lives, and reduce tobacco-related health care costs. By strategically focusing its funding, the Endowment can help Oklahoma cut tobacco use in half by 2010.

As wisely established by Oklahoma voters in November 2000, the Endowment is a long-term trust in which over half of each year's tobacco settlement payments are invested for current earnings and long-term growth. As the earnings grow progressively over time, eventually the annual earnings will exceed the annual tobacco settlement payments. At that point, Oklahoma will be in the enviable position, among all states, of having an ongoing source of revenue that is independent of the tobacco industry. This secure and substantial resource will be available to fund programs to improve the health and well-being of all Oklahomans for many generations. We should all be proud that Oklahoma is becoming recognized as a national model for the responsible and appropriate use of tobacco settlement payments.

Sincerely,



Susan Walters Bizé

Chair, Board of Directors

Oklahoma Tobacco Settlement Endowment Trust

Board of Investors · Chair's Message



Dear Fellow Oklahomans,

I'm pleased to report the Oklahoma Tobacco Settlement Endowment Trust Fund is fully invested, earning money to fund programs to help people stop smoking and to keep many from ever smoking that first cigarette.

The members of the Fund's Board of Investors have consistently worked to safely invest Oklahoma's share of the National Tobacco Settlement to put that money to work permanently to generate funding for cessation and prevention programs.

As the balance in the fund grows, more earnings are being made to pay for more efforts to combat tobacco addiction in Oklahoma.

The voters of Oklahoma showed their wisdom in November 2000 by approving a constitutional amendment to create the endowment trust fund. This permanent investment means funding will be generated for generations to come.

Again this year, 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 enjoying 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
Chair, Oklahoma Tobacco Settlement Endowment
Trust Fund Board of Investors

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.



D. Robert McCaffree, MD, appointed by the Attorney General, was elected Vice Chair in February 2004 after having served two terms as 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.



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."



George E. Foster, O.D., appointed by the Speaker of the House, is Dean of the College of Optometry at Northeastern State University and Chairman of the Cherokee County Health Services Council. He is President of the Association of Schools and Colleges of Optometry, a member of the Leadership Oklahoma Class VII, National Rural Health Association, Oklahoma Academy for State Goals, an Associate member of the American Public Health Association, and is an active member of a number of other state and national professional associations and civic organizations. Dr. Foster brings to the Board of Directors over 40 years of experience in the public health sector, working with the state and local governments in the areas of education, public health, and program development and implementation. Dr. Foster is committed to assuring that access, accountability and affordability with dignity are the hallmarks of health care delivery in the rural setting.



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.



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.



Kenneth D. Rowe, appointed by the President Pro Tempore of the Senate, currently serves the University of Oklahoma Health Sciences Center as the Vice President for Administrative Affairs. He also serves on the Operating Board of the Medicaid HMO, Heartland Health Plan of Oklahoma, the Tulsa Medical Education Foundation Board, and the not for profit, Health Sciences Facility, Inc. Board. Prior to this position, he worked for two years as the Director of Internal Auditing for the University of Oklahoma, directing the internal audit activities for OU, Cameron University, and Rogers State University. Preceding this role, he had thirteen years of experience in the banking industry where he conducted fraud investigations and internal audits for large bank holding companies. Ken earned a Bachelor of Science degree in Accounting from East Central University and a Master of Accountancy from the University of Oklahoma. In addition to being a licensed C.P.A., he is also a Certified Fraud Examiner, and is a member of the American Institute of Certified Public Accountants.

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.

Background

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

The constitutional amendment assures that an increasing proportion of each tobacco settlement payment to the State of Oklahoma is placed in the endowment, from 50% in FY 2001 up to 75% in FY 2007 and each year thereafter. The remaining balance of each payment is available for appropriation by the Oklahoma State Legislature.

The constitutional amendment created a Board of Investors to invest the endowment trust funds, and a Board of Directors to expend only the earnings from the Endowment's investments 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.

Tobacco settlement payments to the states, including Oklahoma, have been lower than originally projected as a result of our nation's declining tobacco use rates and other factors. In contrast, the earnings from the Endowment continue to increase gradually with each passing year.

Eventually the annual earnings from the Endowment will be greater than the annual deposits from the tobacco settlement payments. This steadily increasing 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 other health initiatives over time.

FY 2004 Highlights

Infrastructure

As specified in the Tobacco Settlement Endowment Trust Fund Act, the agency operates under a \$500,000 cap on operating expenses. The agency consists of two full-time staff, an Executive Director and Executive Administrative Assistant, with plans to add a Director of Grants and Programs in FY 2005. Many essential operating services are provided

through contracts with a variety of state agencies. For example, financial management services are provided through the Office of State Finance, legal services are provided through the Attorney General's Office, and purchasing services related to grants and contracts are provided through the Department of Central Services.

Strategic Planning

In FY 2004, a consultant was hired to assist the Board in updating the strategic plan, establishing a governance model, short and long-term funding priorities, grantmaking approaches and guidelines, and grant review and selection processes.

As a result of the strategic planning process, the Board made a commitment to dedicate all of the earnings for the next three to five years to effective tobacco use prevention and cessation initiatives, based on the following:

1. The intent of the Master Settlement Agreement was that states would use settlement funds to reduce tobacco use and tobacco-caused illness and death.
2. Tobacco use remains Oklahoma's leading cause of preventable death, killing about 6,000 Oklahomans and costing Oklahoma over \$2 billion in direct and indirect costs each year.

3. While the Centers for Disease Control and Prevention (CDC) recommends that between \$22 million and \$56 million is needed to fund an effective, statewide program to significantly reduce tobacco use and tobacco-caused disease and death in Oklahoma, such programs have received less than \$2 million per year in other state appropriated funding.
4. Earnings from the Endowment alone will not be sufficient to fully fund a statewide tobacco prevention program for at least ten years.

A strategic focus on dramatically reducing tobacco use in Oklahoma will maximize the impact of the limited earnings available and leverage funds and other resources from other funding partners such as the CDC, Medicaid, and the American Legacy Foundation. This focus will involve communities, schools, businesses, and families in improving the health and well-being of all Oklahomans, particularly children and senior adults.

Funding Strategy

As a result of the strategic planning process, the Board of Directors authorized additional program funding and created a plan for future growth. In making these program and budget decisions the Board was guided in part by recommendations from the Oklahoma Tobacco Use Prevention and Cessation Advisory Committee, which was created by the Oklahoma Tobacco Use Prevention and Cessation Act in 2001. Resources for program support and evaluation are incorporated in these plans.

The Board's strategic action plans include:

- Continue support for the Oklahoma Tobacco Helpline operations as needed to meet the demand for services, and assure ongoing support for promotion and evaluation of the Helpline.
- Initiate comprehensive community programs and increase funding authorizations for community-based

programs over the next five years as new earnings become available, in order to fully implement comprehensive tobacco control programs in counties and tribes throughout the state.

- Initiate and maintain counter-marketing campaigns with a primary focus on youth prevention, in partnership with the American Legacy Foundation and other funding partners as appropriate.
- Initiate funding for statewide public education campaigns on effective actions that reduce tobacco use.
- Initiate support for tobacco control programs that address specific populations such as pregnant women, college students, spit tobacco users, racial and ethnic minorities, senior adults and others.
- Initiate a strategic planning process to prioritize subsequent program areas and strategies for funding to begin in FY 2010.

Programs

Oklahoma Tobacco Helpline

Utilizing certified earnings from FY 2003 and carryover funds, the Board of Directors launched their first program, the Oklahoma Tobacco Helpline. Available toll-free at 1-866-PITCH-EM (1-866-748-2436), the Helpline is 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. Participants engage in a series of counseling calls with the same Helpline Specialist throughout their quitting process.

Proactive telephone-based cessation counseling services have shown strong evidence of effectiveness in reaching large numbers of tobacco

users with an effective program to help them successfully quit tobacco. Helplines reduce the barriers found in traditional programs, such as a lack of transportation or child care. Helpline services are tailored to the individuals' needs and are available at the participants' convenience.

In addition to funding the Helpline's direct services, a limited promotional campaign and an independent evaluation were also funded.

Public Education Counter-Marketing Campaigns

In partnership with the American Legacy Foundation, youth ages 12-17 throughout Oklahoma received a heavy dose of truth® television and radio ads. The truth® campaign has been shown to effectively reduce youth smoking by countering the tobacco industry's marketing tactics and pro-tobacco influences on our vulnerable youth. The American Legacy Foundation provides pre-produced ads and a dollar-for-dollar match on truth® media buys. Launched in May 2004, the campaign is estimated to have reached 72.9% of Oklahoma teens an average of 9.7 times during the last two months of the fiscal year.

In partnership with the American Cancer Society, American Lung Association, American Heart Association, Oklahoma Alliance on Health or Tobacco and the Campaign for Tobacco-Free Kids, educational ads on effective actions to reduce youth smoking were placed in 210 daily and weekly newspapers throughout the state. The Oklahoma Press

Service estimates that the campaign reached a circulation of 3.7 million.

Mass media campaigns, when combined with other activities to reduce tobacco use, have shown strong evidence of effectiveness in reducing youth initiation of tobacco use, reducing consumption of tobacco products, and increasing cessation among tobacco users.

Communities of Excellence in Tobacco Control

In May 2004 the Board of Directors released a Request for Proposals to fund up to 20 coalitions to plan and implement comprehensive, community-based tobacco prevention and cessation programs within counties and tribal nations. Grant awards will be made by October 2004.

The Communities of Excellence grantees will advance the goals of preventing youth tobacco use, promoting cessation among youth and adults, protecting all Oklahomans from secondhand smoke, and eliminating disparities in tobacco use among populations.

Program Support & Evaluation

Program support services such as coordination, communications, technical assistance and training are essential to assuring successful outcomes for each program initiative. Program support services for the Endowment's tobacco control programs are provided by the Oklahoma State Department of Health (OSDH), Tobacco Use Prevention Service. This partnership leverages the expertise

and resources of the OSDH, avoids duplication, and assures that programs funded by the Board of Directors are coordinated with other initiatives of the Oklahoma Tobacco Control Program.

Evaluation is critical to the Endowment's progress as it enables the Board of Directors to assess program

outcomes, improve program effectiveness, and use the information to inform decisions about future program development. The University of Oklahoma, College of Public Health, through the Comprehensive Cancer Center, provides an independent evaluation of TSET-funded tobacco control programs.

Policies and Resolutions

The most effective tobacco control programs promote and work within the context of public, private and organizational policies that de-normalize the use of tobacco products.

In FY 2003, 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.

In FY 2004, the Board adopted a resolution commending the Oklahoma

Department of Mental Health and Substance Abuse Services' "Tobacco-Free Workplace Program," which prohibits all tobacco use in facilities and on the grounds of all ODMHSAS sites.

The Board also adopted a resolution commending the Oklahoma Health Care Authority's Expanded Coverage of Tobacco Cessation Products. The Oklahoma Medicaid program now covers all tobacco cessation products without a prior authorization, and provides these products in addition to the participant's routine medications.

Program Results

As most of the TSET's programs are new, evaluation results are currently only available for the Oklahoma Tobacco Helpline.

The University of Oklahoma Health Sciences Center, College of Public Health, Department of Biostatistics and Epidemiology is the independent evaluator for the Oklahoma Tobacco Helpline. The evaluation team collects data to evaluate participant satisfaction with the Oklahoma Tobacco Helpline and quit progress.

From August 2003 through June 2004, a total of 3,676 Oklahoma tobacco users registered with the Oklahoma Tobacco Helpline to receive tobacco cessation services. Of these, 1,945 (53%) enrolled in the "5-call" proactive telephone counseling cessation program, while 1,681 (46%) requested the "1-call" telephone counseling cessation program. There were 50 (1%) individuals who requested tobacco cessation self-help materials only. An additional 31 health care providers and 126 friends and family members (proxy) accessed the Helpline for tobacco cessation information.

The Oklahoma Tobacco Helpline is reaching smokers in nearly all parts of Oklahoma (see map). Tobacco users from 73 of Oklahoma's 77

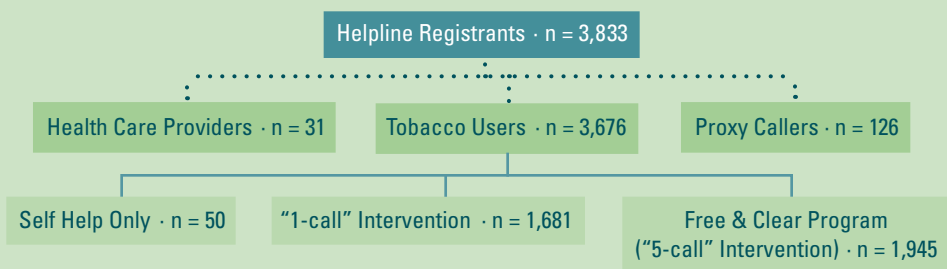
counties have contacted the Helpline for services. As expected, nearly half of all calls have come from residents in Oklahoma (n=519) and Tulsa (n=1,180) counties. Other counties with at least 50 residents calling the Helpline include Canadian, Cleveland, Creek, Garfield, Grady, Pottawatomie, and Wagoner counties.

As is typical with most tobacco quit-lines, nearly two-thirds of all callers to the Oklahoma Tobacco Helpline are female (64%). Callers to the Oklahoma Tobacco Helpline represent all race/ethnic groups including Native American (7%), African American (7%), and Caucasian (80%) residents. Only 4% of callers report that they are of Hispanic ethnicity. The age distribution of callers is slightly older than that of the general population, with 33% greater than 50 years of age.

The Helpline also appears to be providing services to "heavy" tobacco users. Among those who answered the question, 84% reported having used tobacco for more than 10 years. Among cigarette smokers, 17% reported smoking more than one pack of cigarettes per day.

One measure of a tobacco quitline's effectiveness is 7-day abstinence. At three, six, and 12 months after

Figure 1
Flow Chart of Helpline Registrants, August 2003 - June 2004



Looking Ahead

The Board of Directors will begin FY 2005 with an expansion of the Oklahoma Tobacco Helpline's services to reach a greater number of people and to help to begin providing nicotine replacement products for Helpline participants who are totally uninsured or on Medicare. The truth® counter-marketing campaign will continue to reach Oklahoma's vulnerable youth, and the Communities of Excellence grantees will embark on the planning phase of their grants in order to create a strategic plan that will assure a successful implementation of their comprehensive programs. In addition, a new grant initiative will be developed to fund programs that target specific populations such as pregnant women, spit tobacco users, college students, and other populations at greatest risk for tobacco use and tobacco caused disease and death.

FY 2004 Financials

Tobacco Settlement Payments

FY 2000	\$86,521,018
FY 2001	\$65,328,240
FY 2002	\$75,872,921
FY 2003	\$76,024,898
FY 2004	\$65,062,578
Total	\$368,809,657

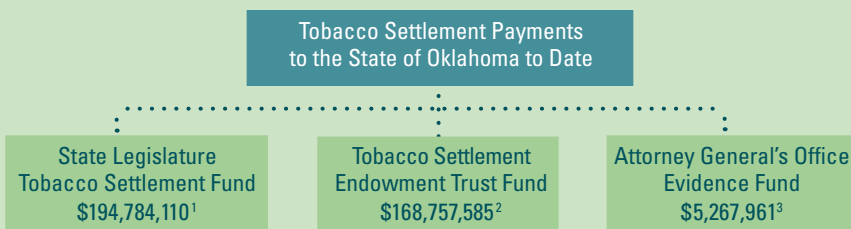
Schedule of Deposits

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

* and all subsequent years

Tobacco Settlement Payments to the State of Oklahoma

June 6, 1999 - June 30, 2004

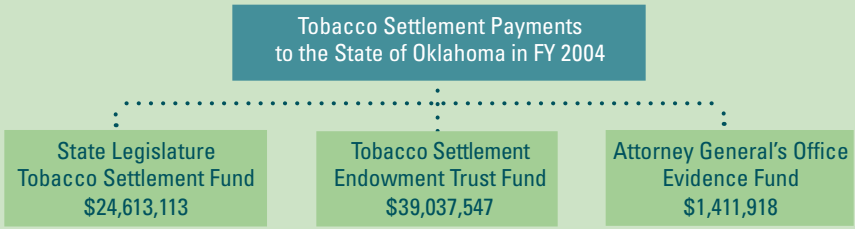


1 \$45,313,044 of the \$194.7 million available to the State Legislature was placed in the general revenue fund prior to November 2000. The remaining \$149.4 million was placed in the state's Tobacco Settlement Fund and has been appropriated for various health and human services programs as detailed in the "Appropriations by the Oklahoma State Legislature from the Tobacco Settlement Fund" table on page 13. These funds are not part of the Endowment.

2 The \$168.7 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.

Tobacco Settlement Payments to the State of Oklahoma
Fiscal Year 2004



Legislative Appropriations

From the General Revenue (Tobacco Settlement Fund)

Agency No., Name, Purpose	FY 2001	FY 2002	FY 2003	FY 2004	Totals	%
807 Health Care Authority Duties of the agency	\$27,814,025	\$23,428,344	\$9,834,659	\$9,002,276	\$70,079,304	46.9
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	\$15,610,837	\$59,819,341	40.0
825 University Hospitals Authority · Duties of the agency	\$5,921,414	\$4,178,739	.....	.....	\$10,100,153	6.8
340 Department of Health Tobacco prevention, health	\$1,833,333	\$1,725,000	\$1,966,933	.....	\$5,525,266	3.7
452 Department of Mental Health & Substance Abuse Services Duties of the agency	\$1,490,561	\$1,051,888	\$1,129,552	.....	\$3,672,001	2.5
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	\$24,613,113	\$149,471,065	100

**Tobacco Settlement Endowment Trust
Earnings Certified by the Board of Investors**

FY 2002	\$651,619
FY 2003	\$1,442,846
FY 2004	\$2,757,686
FY 2005	\$3,449,455

Note: In FY 2002 and FY 2003, investment management fees were paid out of certified earnings. Earnings in subsequent years were certified net of fees. Operating and program expenses of the Tobacco Settlement Endowment Trust are paid out of certified earnings.

Master Settlement Agreement payments from the tobacco companies to the State of Oklahoma have been lower than originally predicted because the payments are tied to market share, volume of sales and a number of other factors.

Declining rates of tobacco use nationally, new tobacco manufacturers

that have entered the market but do not participate in the Master Settlement Agreement, and the fact that the tobacco industry continues to lose legal battles impact the unpredictable nature of the annual tobacco industry payments to Oklahoma.

This, in turn, impacts the amount of earnings available each year.

To account for this unpredictability, the Board of Investors uses a “look back” method when certifying earnings from the endowment. This assures that the Board of Directors does not obligate funding for grant programs until the funds are actually available for use. Based on this “look back” method, it is likely that that funds certified in one year may not be expended until the following year.

**Tobacco Settlement Endowment Trust
FY 2004 Program Grants and Contracts**

Center for Health Promotion • Tukwila, Washington • \$560,793

To provide 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. TSET funds to the Center for Health Promotion, \$560,793 through June 30, 2004. The Center provides a 10% match in year one and a 5% match in subsequent years.

.....
Oklahoma State Department of Health • Tobacco Use Prevention Service
Oklahoma City, Oklahoma • \$431,298

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 OSDH, \$43,275 through June 30, 2004. TSET funds to sub-grantee: Brothers & Co. \$200,000 through June 30, 2004; and
- Coordinate youth-prevention counter-marketing campaign. TSET funds to sub-grantee: Brothers & Co. \$186,423 through June 30, 2004. Matching funds from the American Legacy Foundation, \$177,423 through June 30, 2004.

.....
Oklahoma Press Service • Oklahoma City, Oklahoma • \$290,000

To provide a public education campaign on effective actions to reduce youth smoking in Oklahoma. Print ads in newspapers throughout the state were used to reach a more mature, highly educated population of individuals who are more likely to care about the health of their communities. TSET funds to OPS, \$290,000 through June 30, 2004.

.....
University of Oklahoma - Health Sciences Center • College of Public Health
Comprehensive Cancer Center • Oklahoma City, Oklahoma • \$91,332

Oklahoma State University (sub-grantee) • Stillwater, Oklahoma

Evaluation of the effectiveness of the Oklahoma Tobacco Helpline, media promotion of the Helpline, and the youth prevention counter-marketing campaign. TSET funds to the University of Oklahoma, \$91,332 through June 30, 2004. TSET funds to sub-grantee: Oklahoma State University, \$19,676 through June 30, 2004.

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 years ended June 30, 2004 and 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 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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. They do not purport to, and do not, present fairly the financial position of the State of Oklahoma as of June 30, 2004 and 2003, and the changes in the State of Oklahoma's financial position for the years then ended in conformity with accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2004 and 2003, and the changes in its financial position for the years 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 10, 2004, 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.

September 10, 2004

Finley & Cook, PLLC

TSET MANAGEMENT'S DISCUSSION & ANALYSIS (MD&A)

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 years ended June 30, 2004 and 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'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 dividends and interest, less fees to manage the Fund, 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 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

The statements of net assets provide an indication of the Fund's financial condition at the end of the 2004 and 2003 fiscal years; the statements report all assets and liabilities using the accrual basis of accounting.

Statement of Net Assets

	2004	2003
Assets		
Current Assets	\$8,162,793	40,283,090
Investments (at fair value)	181,767,120	96,085,163
Capital Assets	8,368	9,282
Total Assets	189,938,281	136,377,535
Liabilities		
Current Liabilities	1,340,098	978,638
Noncurrent Liabilities	8,954	4,683
Total Liabilities	1,349,052	983,321
Net Assets		
Invested in Capital Assets	8,368	9,282
Restricted for Investment	181,858,002	130,808,589
Unrestricted	6,722,859	4,576,343
Total Net Assets	\$188,589,229	135,394,214

The Fund's total net assets increased \$53 million during the year, as the Fund invested an additional \$39 million in settlement receipts, recognized an additional \$15.5 million as net investment income, and expended \$1.4 million on programs and operations. Total investments increased from \$96 million at the beginning of the year to \$182 million as of year-end, as the Board of Investors invested cash and cash equivalents held at the beginning of the year and the additional settlement receipts deposited during the year. The Fund recognized an additional \$12 million from the net appreciation of the fair value of the portfolio. The Board of Investors increased the allocation to equities and continued to diversify the Fund's investment portfolio to include international equities. 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.

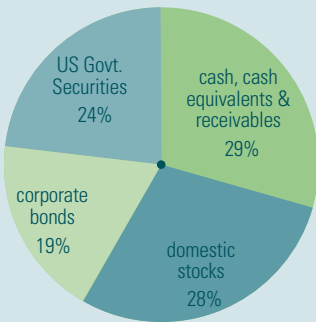
Statements of Activities – Revenues and Expenses

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

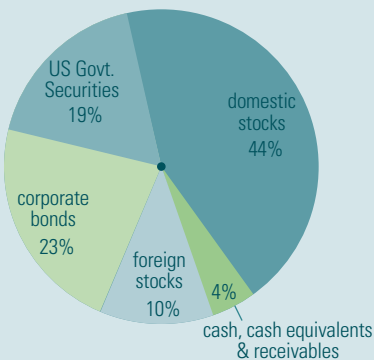
Statements of Activities

	2004	2003
Investment Income		
Interest and Dividend Income	\$4,424,905	3,192,080
Net Appreciation in Fair Value of Investments	12,011,159	1,088,551
Total Investment Income	16,436,064	4,280,631
Investment Expenses	(919,743)	(434,395)
Net Investment Income	15,516,321	3,846,236
Expenses		
Program	1,100,697	62,290
Operating	258,863	167,528
Total Expenses	1,359,560	229,818
Increase in Net Assets before Settlement Receipts	14,156,761	3,616,418
Contribution to Fund Principal		
Settlement Receipts	39,038,254	41,813,694
Increase in Net Assets	53,195,015	45,430,112
Net Assets - Beginning of Year	135,394,214	89,964,102
Net Assets - End of Year	\$188,589,229	135,394,214

2003 Total Assets



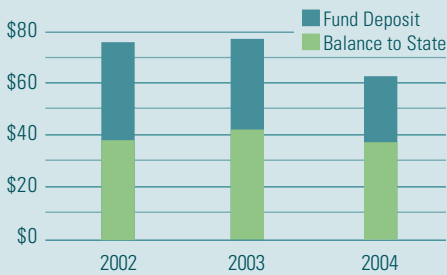
2004 Total Assets



Revenues continue to be dominated by settlement receipts which are restricted for investment purposes. 55% and 60% of settlement receipts paid to the State during the fiscal years ended June 30, 2003 and 2004, respectively, were deposited by the State into the Fund. 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. As reflected below, settlement receipts deposited by the Fund decreased by \$2.8 million from 2003 to 2004 despite the 5% increase in the percentage of the total receipts deposited to the Fund. According to the National Association of Attorneys General, since the Master Settlement Agreement between the tobacco companies and the states took effect, youth smoking rates nationally have dropped by more than 25% and overall smoking has declined nearly 20%. Accordingly, the decline in settlement

receipts may be attributable to the decline in smoking. In addition, increasing numbers of new tobacco manufacturers, not participating in the Master Settlement Agreement, have entered the market. These new tobacco manufacturers impact the market share of the participating manufacturers and this in turn reduces the amount of the settlement payments to the states. There are no guarantees regarding the State's continued receipt of funds in settlement of claims against the tobacco companies.

Oklahoma Tobacco Settlement Receipts in Millions



As settlement receipts were deposited and invested and the portfolio was diversified during the fiscal year ended June 30, 2004, net investment income increased by \$11.7 million over the \$3.8 million recognized during the 2003 fiscal year. This increase over the previous year includes \$1.2 million in additional interest and dividend income and a \$10.9 million increase in the net appreciation of investments in the Fund's portfolio as of June 30, 2004, that were offset by a \$485,000 increase in fees paid to investment managers, consultants, and custodians.

As previously noted, the Fund's principal is restricted for investment purposes only. The dividend and interest income earned, less the fees spent to manage the Fund, 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 Oklaho-

mans or to enhance health care services provided to Oklahomans. The Board of Directors has adopted a strategic plan to maximize the impact of the limited earnings available and focus on reducing tobacco use in Oklahoma. During the fiscal year ended June 30, 2004, the Board of Directors increased program funding by more than \$1 million. Additional funding was provided for the Oklahoma Tobacco Helpline, a toll-free statewide phone line, 1-866-PITCH 'EM, established to meet a growing demand for telephone-based tobacco cessation counseling. The Board of Directors began funding a youth prevention counter-marketing campaign, nationally referred to as truth@. The American Legacy Foundation matches these funds dollar-for-dollar through the Oklahoma State Department of Health. Additionally, the Board of Directors initiated a public education program to inform opinion leaders about effective public and voluntary policies that work to reduce tobacco use in Oklahoma, as recommended in the Oklahoma State Plan for Tobacco Use Prevention and Cessation.

During the fiscal years ended June 30, 2003 and 2004, operating expenses increased by \$91,000 from \$167,000 to \$258,000. Personnel, accounting, and other office-related operating expenses initiated during the 2003 fiscal year were incurred for a full 12-month period during the fiscal year ended June 30, 2004. The State Treasurer continued to provide staff support to the Board of Investors without seeking reimbursement for the costs. Effective July 1, 2004, the Office of the State Treasurer has requested and both Boards have approved that \$65,000 be provided to the State Treasurer as funding for staff support to the Board of Investors for 2005. 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.

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 dividend and interest earnings, less fees to manage the Fund, 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, fund balance at year-end includes balances which are reserved for investment purposes and balances which are unreserved that are expendable for operations and programs of the Fund.

Balance Sheets - Permanent Fund

	2004	2003
Assets		
Cash and Cash Equivalents	\$7,278,553	39,827,039
Interest & Dividends Receivable	884,240	456,051
Investments at Fair Value	181,767,120	96,085,163
Total Assets	189,929,913	136,368,253
Liabilities		
Accounts Payable	710,871	185,532
Net Payable to Brokers	623,258	789,984
Total Liabilities	1,334,129	975,516
Fund Balances		
Reserved	181,858,002	130,808,589
Unreserved	6,737,782	4,584,148
Total Fund Balances	188,595,784	135,392,737
Total Liabilities and Fund Balances	\$189,929,913	136,368,253

Revenues, Expenditures & Changes in Fund Balances - Permanent Fund

	2004	2003
Revenues		
Restricted:		
- Net Appreciation in Fair Value of Investments	\$12,011,159	1,088,551
- Settlement Receipts	39,038,254	41,813,694
Total Restricted Revenues	51,049,413	42,902,245
Interest & Dividend Income	4,424,905	3,192,080
Total Revenues	55,474,318	46,094,325
Expenditures		
Personnel & Administrative	218,697	130,447
Counseling Services	459,915	-
Media & Program Promotion	571,460	50,400
Evaluation Services	68,766	11,612
Investment Management Fees	919,743	434,395
Equipment	3,670	11,873
Other	29,020	26,963
Total Expenditures	2,271,271	665,690
Revenues in Excess of Expenditures	53,203,047	45,428,635
Fund Balances, Beginning of Year	135,392,737	89,964,102
Fund Balances, End of Year	\$188,595,784	135,392,737

Requests for Information

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

FINANCIAL STATEMENTS

Statements of Net Assets

	2004	2003
Assets		
Cash & Cash Equivalents	\$7,278,553	39,827,039
Receivables:		
- Accrued Interest & Dividends	884,240	456,051
Investments (at Fair Value):		
- US Government Securities	35,223,772	32,783,500
- Corporate Bonds	44,362,503	25,592,610
- Domestic Stocks	83,778,309	37,709,053
- Foreign Stocks	18,402,536	...
Total Investments	181,767,120	96,085,163
Capital Assets, Net of Accumulated Depreciation of \$3,857 and \$1,228 as of June 30, 2004 and 2003, respectively.	8,368	9,282
Total Assets	<u>189,938,281</u>	<u>136,377,535</u>
Liabilities		
Net Payable to Brokers	623,258	789,984
Accounts Payable	710,871	185,532
Compensated Absences:		
- Payable Within One Year	5,969	3,122
- Payable After One Year	8,954	4,683
Total Liabilities	<u>1,349,052</u>	<u>983,321</u>
Net Assets		
Invested in Capital Assets	8,368	9,282
Restricted for Investment	181,858,002	130,808,589
Unrestricted	6,722,859	4,576,343
Total Net Assets	<u>\$188,589,229</u>	<u>135,394,214</u>

Statements of Activities

	2004	2003
Expenses		
Program:		
- Counseling Services	\$459,915	...
- Media & Program Promotion	571,460	50,400
- Evaluation Services	68,766	11,612
- Depreciation	556	278
Total Program Expenses	1,100,697	62,290
Operating:		
- Personnel Services	224,763	138,252
- Other	32,027	28,326
- Depreciation	2,073	950
Total Operating Expenses	258,863	167,528
Total Expenses	<u>1,359,560</u>	<u>229,818</u>
Investment Income		
Interest Income	3,052,825	2,628,033
Dividend Income	1,372,080	564,047
Net appreciation in Fair Value of Investments	12,011,159	1,088,551
Total Investment Income	<u>16,436,064</u>	<u>4,280,631</u>
Investment Expenses	(919,743)	(434,395)
Net Investment Income	<u>15,516,321</u>	<u>3,846,236</u>
Contribution to Fund Principal		
Settlement Receipts	39,038,254	41,813,694
Change in Net Assets	<u>53,195,015</u>	<u>45,430,112</u>
Net Assets, Beginning of Year	135,394,214	89,964,102
Net Assets, End of Year	<u>\$188,589,229</u>	<u>135,394,214</u>

Balance Sheets - Permanent Fund

	2004	2003
Assets		
Cash & Cash Equivalents	\$7,278,553	39,827,039
Receivables:		
- Accrued Interest & Dividends	884,240	456,051
Investments (at Fair Value):		
- US Government Securities	35,223,772	32,783,500
- Corporate Bonds	44,362,503	25,592,610
- Domestic Stocks	83,778,309	37,709,053
- Foreign Stocks	18,402,536	...
Total Investments	181,767,120	96,085,163
Total Assets	<u>\$189,929,913</u>	<u>136,368,253</u>
Liabilities & Fund Balances		
Liabilities:		
- Net Payable to Brokers	623,258	789,984
- Accounts Payable	710,871	185,532
Total Liabilities	<u>1,334,129</u>	<u>975,516</u>
Fund Balances:		
- Reserved	181,858,002	130,808,589
- Unreserved	6,737,782	4,584,148
Total Fund Balances	<u>188,595,784</u>	<u>135,392,737</u>
Total Liabilities & Fund Balances	<u>\$189,929,913</u>	<u>136,368,253</u>

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

	2004	2003
Total Fund Balances:	\$188,595,784	135,392,737
Permanent Fund		

Amounts Reported in the Statement of Net Assets are Different Because:

- Capital assets used in governmental activities are not financial resources, and therefore, are not reported in the fund.	8,368	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	(14,923)	(7,805)
Net Assets of Permanent Fund	<u>\$188,589,229</u>	<u>135,394,214</u>

Statements of Revenues, Expenditures and Changes in Fund Balances - Permanent Fund

	2004	2003
Revenues		
Restricted:		
· Net Appreciation in Fair Value of Investments	\$12,011,159	1,088,551
· Settlement Receipts	39,038,254	41,813,694
Total Restricted Revenues	51,049,413	42,902,245
Interest Income	3,052,825	2,628,033
Dividend Income	1,372,080	564,047
Total Revenues	55,474,318	46,094,325
Expenditures		
Personnel Services	218,697	130,447
Counseling Services	459,915	...
Media & Program Promotion	571,460	50,400
Evaluation Services	68,766	11,612
Investment Management Fees	919,743	434,395
Equipment	3,670	11,873
Other	29,020	26,963
Total Expenditures	2,271,271	665,690
Revenues in Excess of Expenditures	53,203,047	45,428,635
Other Financing Sources (uses)	...	...
Net Changes in Fund Balances	53,203,047	45,428,635
Fund Balances, Beginning of Year	135,392,737	89,964,102
Fund Balances, End of Year	\$188,595,784	135,392,737

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

	2004	2003
Net Changes in Fund Balances: Permanent Fund	\$53,203,047	45,428,635
Amounts Reported in the Statement of Activities are Different 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 were (less than) greater than depreciation in the current period.	(914)	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.	(7,118)	(7,805)
Changes in Net Assets, Per Statement of Activities	\$53,195,015	45,430,112

NOTES TO FINANCIAL STATEMENTS

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.

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 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.

Advertising Costs

All costs associated with advertising are expensed as incurred.

CASH AND INVESTMENTS

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

	2004	2003
Cash on Deposit with the State	\$57,531	9,065
Money Market Mutual Fund	7,221,022	39,817,974
Total	\$7,278,553	39,827,039

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, 2004 and 2003, 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:

	2004	2003
Category 1 Classification		
· US Government Securities	\$28,634,185	25,619,118
· Corporate Bonds	38,817,937	17,188,451
· Domestic Stocks	83,778,309	37,709,053
· Foreign Stocks	18,402,536	...
Category 1 Total	169,632,967	80,516,622
Category 2 Classification		
· US Government Securities	6,589,587	7,164,382
· Corporate Bonds	5,544,566	8,404,159
Category 2 Total	12,134,153	15,568,541
Total Investments	\$181,767,120	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

Principal funds that are reserved for investment purposes only are composed of settlement receipts and the net appreciation or depreciation in the fair value of invested funds. Annual earnings that are available for expenditure are defined by law as dividends and interest, less fees to manage the Fund, and are recorded as additions to unreserved fund balance. The Board of Directors manages program and operating expenses that are expended from the unreserved fund balance. 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.

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

	Reserved for Investment	Unreserved	Total
Balance as of June 30, 2003	\$130,808,589	4,584,148	135,392,737
Settlement Receipts	39,038,254	...	39,038,254
Net Appreciation in Investments	12,011,159	...	12,011,159
Expendable Earnings	...	3,505,162	3,505,162
Program & Operating Expenses	...	(1,351,528)	(1,351,528)
Balance as of June 30, 2004	\$181,858,002	6,737,782	188,595,784
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
Expendable Earnings	...	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

The Board of Directors has determined that 10% of the unreserved fund balance be designated as a reserve for future periods should annual earnings prove insufficient to cover expenses.

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 years ended June 30, 2004 and 2003, are listed below:

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

The Fund's contribution of \$11,297 and \$8,377 to the Plan for the years ended June 30, 2004 and 2003, respectively, was equal to the Fund's established required contribution.

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. From inception through the fiscal year ending June 30, 2004, the Office of the State Treasurer has not sought reimbursement for such administrative expenses. Accordingly, operating expenses as reflected in the accompanying financial statements may not provide a basis for future comparison.

Effective July 1, 2004, both Boards have approved that \$65,000 be provided to the Office of the State Treasurer as funding for staff support to the Board of Investors for 2005. State statutes 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, 2004, and have issued our report thereon dated September 10, 2004. 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.

September 10, 2004

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