

**building
partnerships**
for better health

Vision

Improving the health of every Oklahoman.

Mission

The mission of the Board of Directors of the Oklahoma 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.

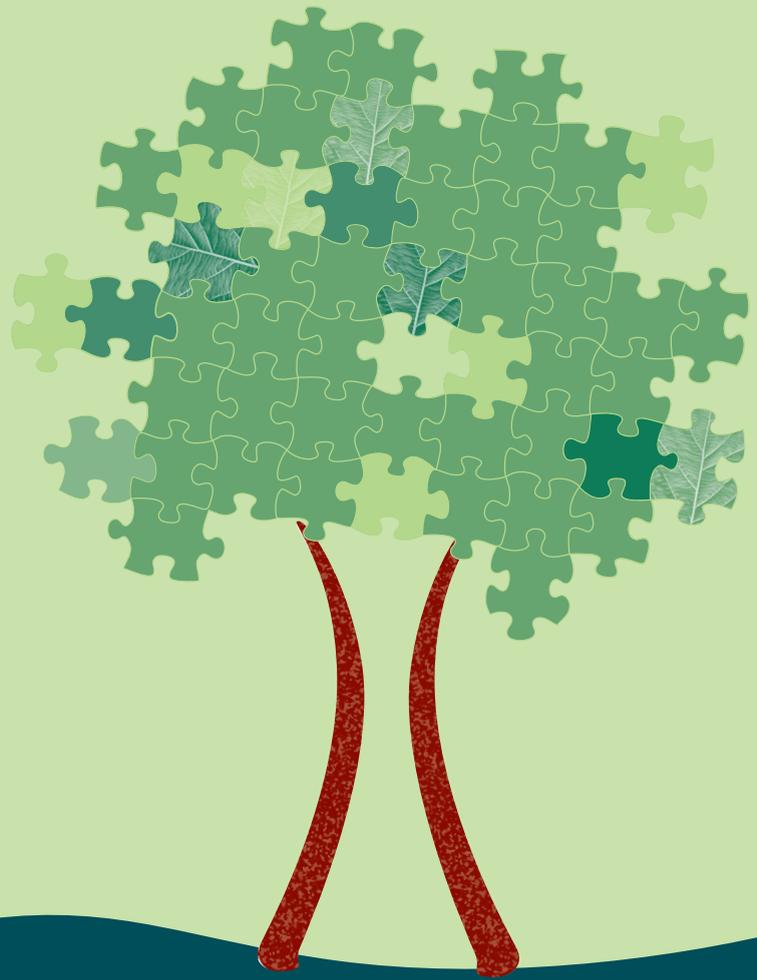
To work cooperatively with other public and private organizations and funders to support joint efforts that will use funds efficiently, avoid duplication, minimize administrative expense, and provide the opportunity for sustained activity.

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.



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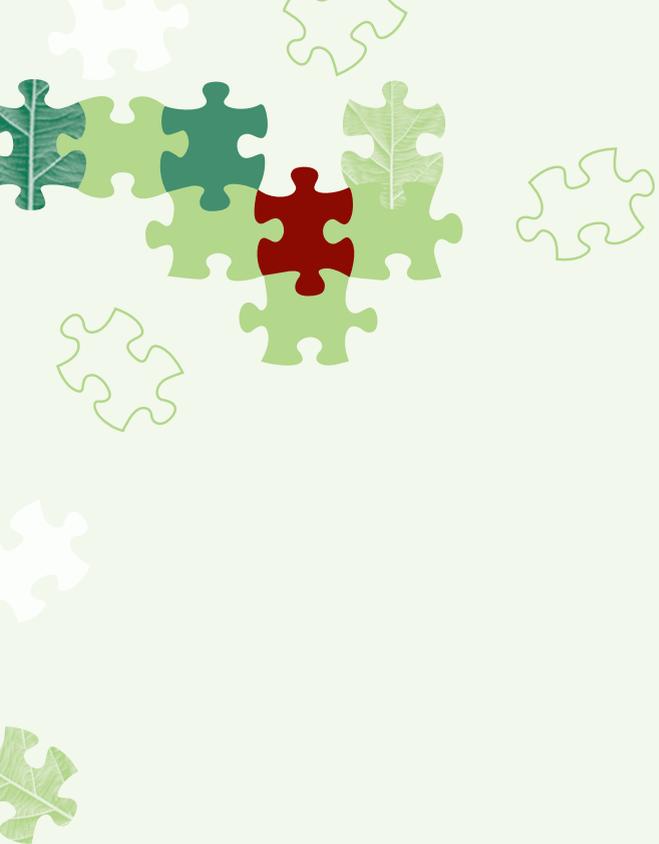
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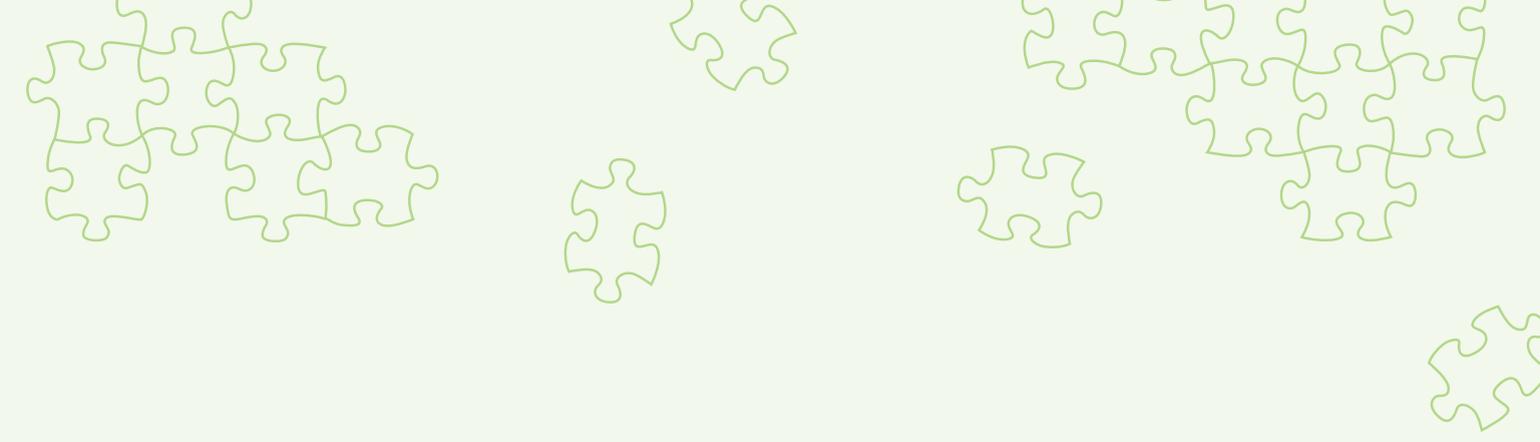
background

In 1998 the historic Master Settlement Agreement was reached between 46 states and the tobacco industry. Oklahoma's Attorney General, Drew Edmondson, was one of eight attorneys general to serve on the negotiating team.

In addition to bans on tobacco industry advertising and marketing to children, the settlement pays the states about \$200 billion in recovery funds. Oklahoma's share of the settlement is estimated to be approximately \$2 billion over a 25 year period, with the payments continuing in perpetuity. The State of Oklahoma was awarded an additional \$268 million because of the Attorney General's strategic contribution in the settlement agreement.

In November 2000 the Oklahoma Tobacco Settlement Endowment Trust (TSET) was established through a voter-approved Constitutional amendment. The ballot measure passed 69% to 31%.

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 (see the "Financials" section of this report).



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.



board of directors

Dear Fellow Oklahomans,

The past year has been filled with new growth in TSET programs and partnerships to prevent and reduce tobacco use in our great state. Oklahomans from all walks of life and all areas of the state have actively demonstrated their strong commitment and ongoing support of TSET's mission, programs, and activities.

Our Communities of Excellence program grantees worked successfully with highly-productive local coalitions to: promote tobacco-free campus policies among school districts and hospitals; encourage local ordinances to address tobacco-free workplaces and limit youth access to tobacco products; increase calls to the Oklahoma Tobacco Helpline; work with employers and insurers to increase the tobacco dependence benefits available to employees; form new Students Working Against Tobacco (SWAT) youth empowerment teams across the state; and educate the public about the impact of tobacco use and how they can make their communities healthier places to work and live.

In addition, four new grantees were selected to prepare plans to address tobacco use among "specific populations," to include interventions for the deaf and hard of hearing, college students, rural youth at risk for smokeless tobacco use, and youth and adults in low income housing. These grantees will begin to implement their plans in FY 2007 and FY 2008.

Through a funding partnership between TSET and the Oklahoma State Department of Health, the Oklahoma Tobacco Helpline was able to serve over 16,000 tobacco users last year, up from the previous record of 12,000 the year before. And because smoking cessation is one of the most cost-effective preventive health measures available, TSET worked closely with the Oklahoma Health Care Authority to promote Helpline services to Medicaid beneficiaries, an especially high-risk group, and to design a smoking cessation benefit in which Medicaid health care providers will be reimbursed for addressing tobacco with their patients.

Through a continued funding partnership, the TSET and the American Legacy Foundation funded a media campaign to counter the tobacco industry's marketing to our youth and young adults. TSET also launched a new media campaign to educate youth and adults about the hazardous chemicals in tobacco products and to inspire Oklahomans to imagine a world without secondhand smoke.

In FY 2006, the Board of Directors also continued a strategic planning effort to develop plans to further fulfill the mission of TSET. As a next step, the board made a commitment to fund research by FY 2010 that will advance our ability to prevent and address cancer and other tobacco-related illnesses. In the coming year,

the Board will continue to plan and prepare to make the vision of the Endowment a reality.

As you can read from the above, this has been an exciting, productive and fulfilling year. But this is just the beginning! For those of us who have been working on reducing the effects of the tobacco scourge on our friends and families, each year brings new successes and expanded hopes and expectations for the future. This makes our efforts fun and satisfying. I have enjoyed this tenure as Chair and will look forward to the work of your Board in the future. And remember — as successful as we have been in the early years of our efforts, you ain't seen nothin' yet!



D. Robert McCaffree, MD
Chair, Board of Directors
November 2005 - November 2006

The seven-member Board of Directors is responsible for directing the earnings from the Endowment 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.



Kenneth D. Rowe, appointed by the President Pro Tempore of the Senate, was elected board Chair in November 2006. Mr. Rowe serves the University of Oklahoma Health Sciences Center as the Vice President for Administrative Affairs. He also serves on the Board of Directors of the Oklahoma Arts Institute, Inc, the Academic Physicians Insurance Company, and the not for profit, Health Sciences Facility, Inc. Mr. Rowe previously served on the Operating Board of Heartland Health Plan of Oklahoma, and the Tulsa Medical Education Foundation Board. He also worked for two years as the Director of Internal Auditing for the University of Oklahoma, serving OU, Cameron University, and Rogers State University. Ken earned a Bachelor of Science degree in Accounting from East Central University and a Master of Accountancy from the University of Oklahoma. Mr. Rowe is a licensed CPA and a Certified Fraud Examiner. He is a member of the Certified Fraud Examiners, American Institute of Certified Public Accountants, and the Oklahoma Society of Certified Public Accountants.



Don Cooper, MD, appointed by the Governor, is a founding board member

and was elected Vice Chair in November 2005 and re-elected in November 2006. Dr. Cooper 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 Reagan 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”.



Oklahoma County Students Working Against Tobacco (SWAT) spokespersons participate in a news conference announcing the Oklahoma City School Board’s adoption of a 24/7 Tobacco-Free School Policy. To date, 90 public school districts in Oklahoma have adopted tobacco-free campus policies. The Oklahoma County SWAT team is one part of the Communities of Excellence program coordinated by the Central Oklahoma Turning Point Coalition.



George E. Foster, OD, 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 Past-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 Instruc-

tion, 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 Methodist Church, Ardmore District. Ms. Killblane previously served on the Board of Regents for Murray State College and the State Board of Education.



W.R. "Bill" Lissau, appointed by the State Treasurer. As President

of The William K. Warren Foundation from 1981 to 2004 and currently Vice Chairman of the Board, Bill has devoted much of his time to the welfare of his community. Upholding the legacy of the Warren Foundation in making a difference in the community, Bill has spearheaded innumerable contributions to local and national charitable organizations. Bill also serves on the Board of Directors of the Saint Francis Health System and as President of the Saint Francis Hospital at Broken Arrow Foundation. Bill is a graduate of The University of Tulsa with a B.S. degree in Business Administration. He has served on the boards of numerous organizations. In 2004, Bill was selected by Governor Brad Henry to serve as Treasurer of the Governor's Committee for Passage of the Tobacco Tax, SQ 713. Bill's honors include: Bishop Kelley High School—Hall of Fame; Oklahoma State Senate Citizen Leadership Award, 1999 National Multiple Sclerosis Society Hope Award; 2000 American Diabetes Association "Man of the Year," and as the Alzheimer's Association Honorary Chairman in 2005.



Robert McCaffree, MD, appointed by the Attorney General, is a founding

board member and served as the board's first Chair from August 2001 to November 2003. He was re-elected Chair in November 2005 and served until November 2006. 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 a 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 the Central States and is President-elect of the Oklahoma County Medical Society.



Susan Walters Bizé, appointed by the State Auditor and Inspector, is

a founding board member. She also served as Chair of the Board from November 2003 to November 2005. Ms. Bizé is an Adjunct Professor at the University of Central Oklahoma and Of Counsel to the law firm of Lester, Loving & Davies. She 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 JC Penney, Company, Inc, in Dallas and Washington, DC. 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 holds Bachelor of Arts and Master of Accountancy degrees from Rice University, and a Doctorate of Jurisprudence from the University of Texas. She is a member of the Oklahoma and Texas Bar Associations, the Oklahoma Society of CPAs, and serves on the Board of Directors of a variety of charitable and civic organizations.



board of investors

Dear Citizens,

I am pleased to report the Oklahoma Tobacco Settlement Endowment Trust Fund is fully invested, earning money to fund programs to help Oklahomans stop smoking and to keep others from starting.

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

In August, our board was able to certify more than \$6.8 million in investment income for use combating tobacco addiction in Oklahoma. This certification reflected a \$2.2 million or 48.8 percent increase over the funds made available last year.

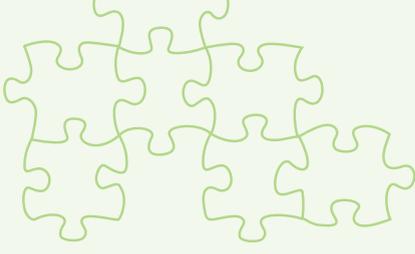
Cost-saving initiatives we have instituted during the past year will generate an additional \$3.3 million during the next five years that can be spent to help combat tobacco addiction in Oklahoma.

More than five years ago, the voters of Oklahoma wisely approved the constitutional amendment to create the endowment trust fund. This permanent investment means a guaranteed source of funding for generations to come.

I truly appreciate the positive spirit of cooperation that exists between the two boards created by the constitutional amendment. I look forward to more success in the years to come!



Scott Meacham
Oklahoma State Treasurer
Chair, Board of Investors



For Kick Butts Day 2006, the Tahlequah Students Working Against Tobacco (SWAT) Team was one of 45 local SWAT teams across the state creating public displays of 1200 pairs of shoes, calling attention to the 1200 people who die each day from tobacco use. The national Kick Butts Day is sponsored by the Campaign for Tobacco-Free Kids. The Tahlequah SWAT team is one part of the Communities of Excellence program coordinated by the Community Health Coalition of Cherokee County.

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.



*The Honorable
Scott Meacham, State
Treasurer.*

The constitutional amendment approved by Oklahoma voters in November 2000 establishes the State Treasurer as the chairman of the Board of Investors. Meacham became state treasurer on June 1, 2005, appointed by Governor Brad Henry to fill the unexpired term of Robert Butkin. Prior to becoming treasurer, Meacham served as Director of the Office of State Finance. He continues to serve on the governor's cabinet as Secretary of Finance and Revenue. A Certified Financial Planner, Meacham formerly served as Chief Executive Officer for First National Bank & Trust of Elk City. Under his direction, the bank almost tripled in size and saw its profits increase by 175%.



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.



David Hinkle, appointed by the State Auditor and Inspector, serves as Economic Development Director for Choctaw County in Southeastern Oklahoma. Mr. Hinkle also serves as the President of First Interstate Financial Services Corp., a Native American owned Governmental Financial Advisory Firm and as the Chief Financial Officer and Controller of GovLease Corp. an Internet Leasing corporation. Mr. Hinkle brings over 18 years of experience in finance and is well known as an expert in economic development. From 1988 to 1996 he served as Senior Vice President of the Oklahoma Development Finance Authority and in 1996 Mr. Hinkle established Alliance Securities Corp., a Section 20 Broker Dealer operation with over 100 salesmen for Bank of Oklahoma Financial Corp, and served as its Executive Vice President until 1999.



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.



fy 2006 highlights

Infrastructure

Amendments to the Oklahoma Tobacco Settlement Endowment Trust Fund Act were enacted during the 2006 legislative session. These amendments provided TSET an exemption from the Central Purchasing Act for program grants and contracts, allowed the allocation of certain expenditures to the program budget, and expanded the cap on administrative expenses from \$500,000 to an amount not to exceed 15% of certified earnings.

The board continually strives to maintain a small staff and minimal administrative expenses. Through Fiscal Year 2006 the agency employed a total of three full-time staff. As required by statute, the agency also contracts with the State Treasurer's Office for staff to provide support for the Board of Investors and oversight of investment management activities.

Many of TSET's essential operating services are provided through contracts with a variety of state agencies. For example, financial management and information technology services are provided through the Office of State Finance, legal services are provided through the Attorney General's Office, and payroll services are provided through the Office of Personnel Management.



Funding Strategy

In the early years of the Endowment the Board of Directors has dedicated all of the available earnings to effective tobacco use prevention and cessation initiatives for the following reasons:

- A focused and strategic approach to program funding provides the greatest opportunity for impact and measurable outcomes.
- It was the intent of the Master Settlement Agreement that states would use settlement funds to reduce tobacco use and tobacco-caused illness and death.
- 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.
- TSET resources and other state funding combined are not yet even 50% of the \$22 million per year recommended by the Centers for Disease Control and Prevention (CDC) as the minimum amount needed to fund an effective, comprehensive statewide tobacco control program in Oklahoma.
- Earnings from the Endowment alone may not be sufficient to fully fund a statewide tobacco control program until FY 2015.

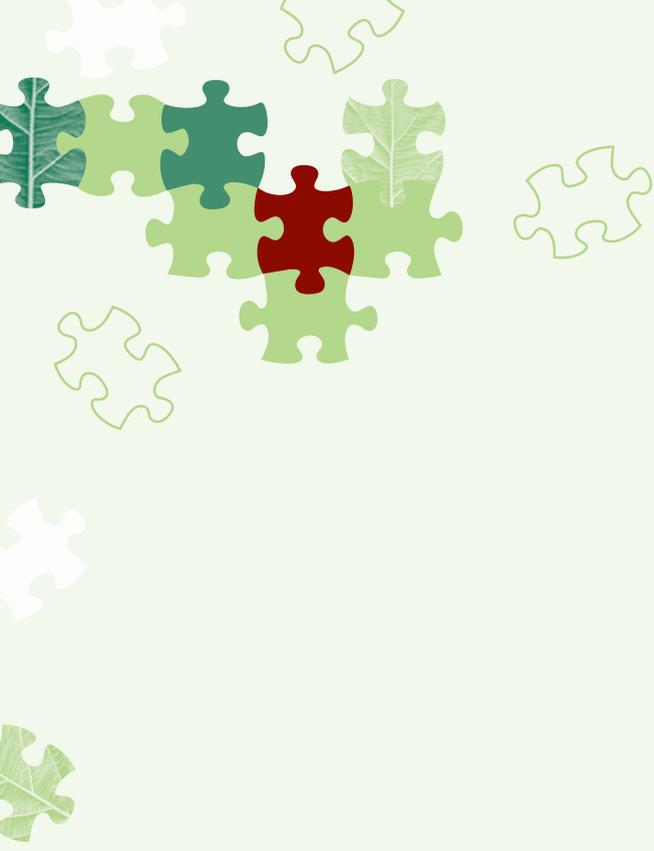
In FY 2006 the Board of Directors also began a strategic planning process to assess and prepare for future program and research funding. To date, the board has determined that by FY 2010, increasing percentages of the available earnings will be dedicated to research programs from 10% in FY 2010 to a maximum of 25% over time. In FY 2007 the board will engage in an ongoing strategic planning process to further develop funding strategies for the future.

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.

The Board of Investors has maintained a policy to assure that tobacco settlement funds are not invested in tobacco companies. In addition, the Board of Directors has required a "Certification of Non-Acceptance of Tobacco Funds" for its grantees.

In FY 2006, the Board of Directors and Board of Investors also adopted a resolution commending school districts and the Oklahoma State School Boards Association for supporting the adoption of "24/7" tobacco-free campus policies by school districts throughout Oklahoma.



looking ahead

In FY 2007, the Board of Directors will continue a strategic planning process to prepare to fund research beginning in FY 2010 which will help to prevent and address cancer and other tobacco-related diseases, as specified in the Constitutional amendment that created the Endowment. The Board will also plan for funding additional programs in the future.

TSET will begin limited production of public education counter-marketing campaigns that will reach a wide range of audiences with effective messages to prevent youth from beginning tobacco use, reduce exposure to secondhand smoke, and promote quitting among youth and adults. These campaigns will be tailored specifically to reach Oklahomans, especially those populations most at risk for tobacco use and tobacco related disease.

The Communities of Excellence grantees will continue to accomplish their plans to prevent and reduce tobacco use throughout Oklahoma and the new Addressing Tobacco in Specific Populations grantees will develop their four-year plans to reach populations at high risk for tobacco use and tobacco related disease.

A Request for Proposals to bring additional counties or tribal nations into the Communities of Excellence program will be released in the late FY 2007.

TSET will also continue to seek out funding partnerships to expand program support and help fulfill the TSET mission.

Efforts to partner with employers and insurers will be intensified in order to promote insurance coverage of effective tobacco dependence treatment in order to reach a greater percentage of Oklahoma tobacco users. An emphasis on tobacco cessation systems is not only cost-effective, but it will yield a return on investment due to lower rates of disease and medical costs associated with treatment of cancer, heart disease, and other tobacco-caused illnesses.

Due to Oklahoma's poor overall health status rankings, we must continue to work together with many state and local partners to aggressively impact tobacco-caused illnesses if we are to be successful in improving the health status of Oklahomans.



A billboard sponsored by the Jackson County Community Health Action Team promotes the Oklahoma Tobacco Helpline the Hispanic/Latino population. Billboards were designed for TSET grantees and other partners by Brothers & Co., using focus group information from the Tulsa Health Department. Ad development was funded by the Oklahoma State Department of Health with grant funds from the American Legacy Foundation.



fy 2006 programs

In FY 2006 the TSET continued funding for the Oklahoma Tobacco Helpline, Communities of Excellence in Tobacco Control Program, media campaigns, program support services, and program evaluation — all essential components of an effective, comprehensive approach to tobacco control in Oklahoma. In addition, a new program, Addressing Tobacco in Specific Populations, was initiated to address some of Oklahoma’s tobacco-related health disparities.

Oklahoma Tobacco Helpline

The Oklahoma Tobacco Helpline at 1-800-QUIT-NOW is a professional telephone-based tobacco cessation counseling service, provided at no charge to Oklahomans with a desire to quit smoking or using other tobacco products. Participants engage in a series of counseling calls with the same “Quit Coach” throughout their quitting process.

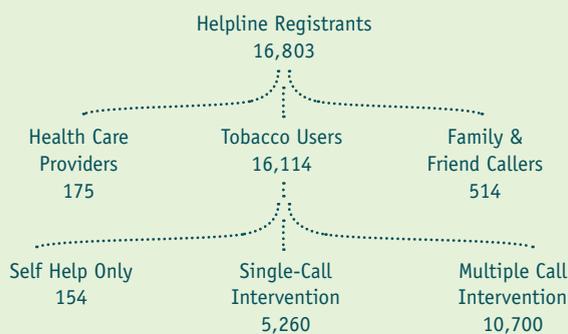
- In FY 2006, the TSET leveraged tobacco tax dollars through a funding partnership with the Oklahoma State Department of Health. These combined resources supported Helpline services to over 16,000 Oklahoma tobacco users.
- Free nicotine patches or gum (NRT) were offered to the uninsured and Medicare participants enrolled in the Helpline program, and a limited time two-week “starter kit” of NRT was also provided to the insured during a Father’s Day promotion.

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 as they require no transportation, or child care, and the services are available at the participant's convenience and tailored to their individual needs.

Of these, 10,700 (67.0%) enrolled in the multiple call proactive telephone counseling cessation program, while 5,260 (33.0%) requested the single call telephone counseling cessation program. There were 154 individuals who requested tobacco cessation self-help materials only. An additional 175 health care providers and 514 friends and family members accessed the Helpline for tobacco cessation information.

**Flow Chart of Helpline Registrants
July 1, 2005 - June 30, 2006**



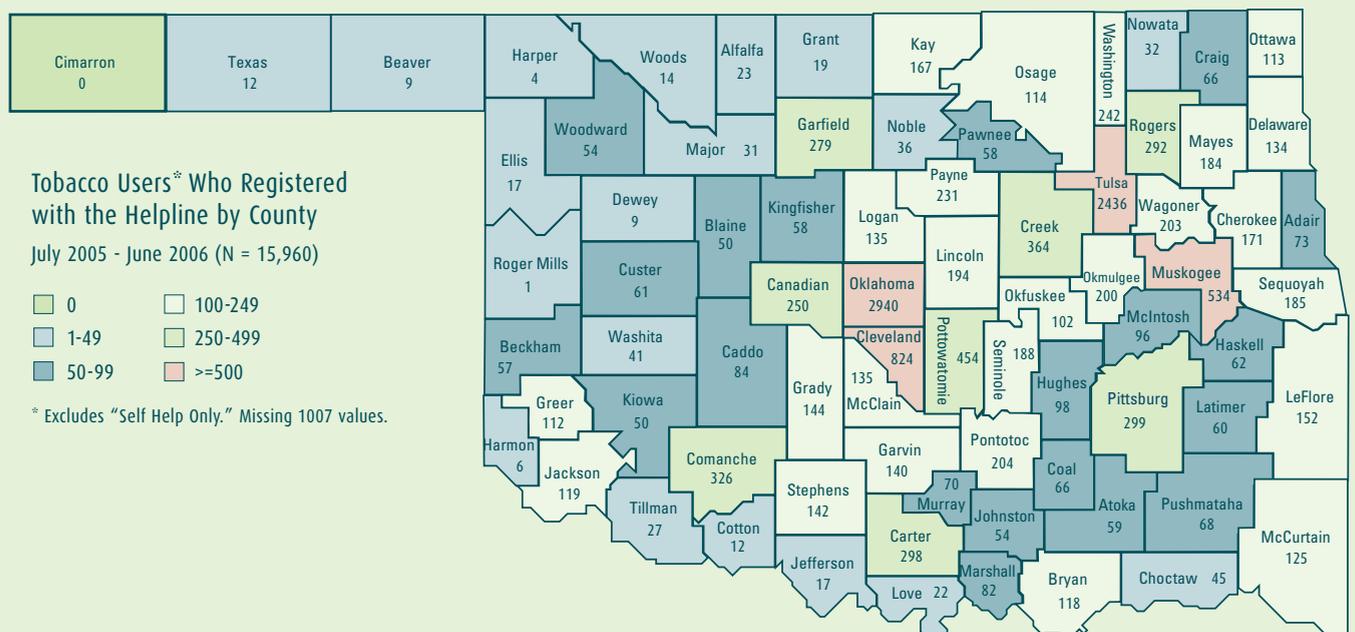
During FY 2006, 7,524 tobacco users received the multiple call intervention plus nicotine replacement therapy (NRT).

Key Findings from the FY 2006 Oklahoma Tobacco Helpline Evaluation Report:

Results

The Oklahoma Tobacco Helpline Evaluation Report revealed that from July 1, 2005 through June 30, 2006, a total of 16,114 Oklahoma tobacco users registered with the Helpline to receive tobacco cessation services.

- Utilization of the Oklahoma Tobacco Helpline remained high in FY 2006, with 16,803 registrants during the year.
- Tobacco users from 76 Oklahoma counties contacted the Helpline for services in FY 2006. (see map)



- Data indicate that the majority of callers to the Helpline are long-term, heavy tobacco users.
- Satisfaction with Helpline services remains high at over 90%. Those receiving counseling plus nicotine replacement therapy (NRT) from the Helpline report the highest satisfaction levels.
- Quit rates varied by intervention received. Among follow-up survey participants, 39.3% of those receiving the multiple call intervention report 30-day abstinence at 4-months, compared to 20% of those receiving the single call intervention. Thirty-day abstinence rates were highest for those enrolled in the multiple call program who also received NRT (45.2%).
- Among counseling plus NRT recipients, the 30-day abstinence rate was 45.2% at the 4-month follow-up, 38.7% at the 7-month follow-up, and 30.9% at the 13-month follow-up.
- While the 30-day abstinence rates are somewhat lower for registrants receiving the single call intervention, they are impressive with 23.1% reporting 30-day abstinence 13-months following registration with the Helpline.
- The proportion of callers who identified themselves as Native American and African American increased in FY 2006, as compared to FY 2005.
- Quit rates also varied by special population cohort. American Indian participants had some of the highest quit rates reported. Overall more than 41% of respondents reported not smoking for 30 or more days, and again, recipients of NRT and counseling reported the highest 30-day abstinence rates, 47.8%.
- The quit rates observed for participants in the Oklahoma Tobacco Helpline compare favorably to the quit rates experienced by other state quitlines and far exceed the quit rates for “cold turkey” (approximately 5%).

Communities of Excellence in Tobacco Control

Community-based programs are the backbone of any effective, comprehensive tobacco control program. In October 2005 the Board of Directors recommended renewal of Communities of Excellence program grant awards for 16 coalitions to implement comprehensive, community-based tobacco prevention and cessation programs which currently cover 25 counties and three tribal nations. Renewals were based on successful completion of a planning period and submission of a comprehensive four-year strategic plan.

Communities of Excellence coalitions are as varied as the communities they serve and include representation from coalitions such as Turning Point, substance abuse prevention, tobacco control, child abuse prevention, and community health and wellness.

Grantees and their coalitions work in each of four goal areas: preventing youth initiation to tobacco, promoting cessation among youth and adults, reducing exposure to secondhand smoke, and eliminating disparities in tobacco use among populations.

Results

The successful planning and implementation of activities during the planning year and the first year of implementation resulted in many successes across the state.

Key Findings from the Planning Phase

During the planning phase, Communities of Excellence grantees and coalitions:

- Mobilized their community partners to strategically plan and implement comprehensive tobacco control programs in their communities. Sixteen TSET-funded grantees and one Oklahoma State Department of Health-funded grantee successfully completed the



planning process and transitioned to the implementation phase of the program.

- Worked effectively to perform the administrative and management duties related to the project
- Assessed training needs and provided or attended a significant number of trainings and conferences to build capacity in tobacco control
- Sought new partners, developed new collaborative relationships, and increased participation in the CX program by coalition members and community partners

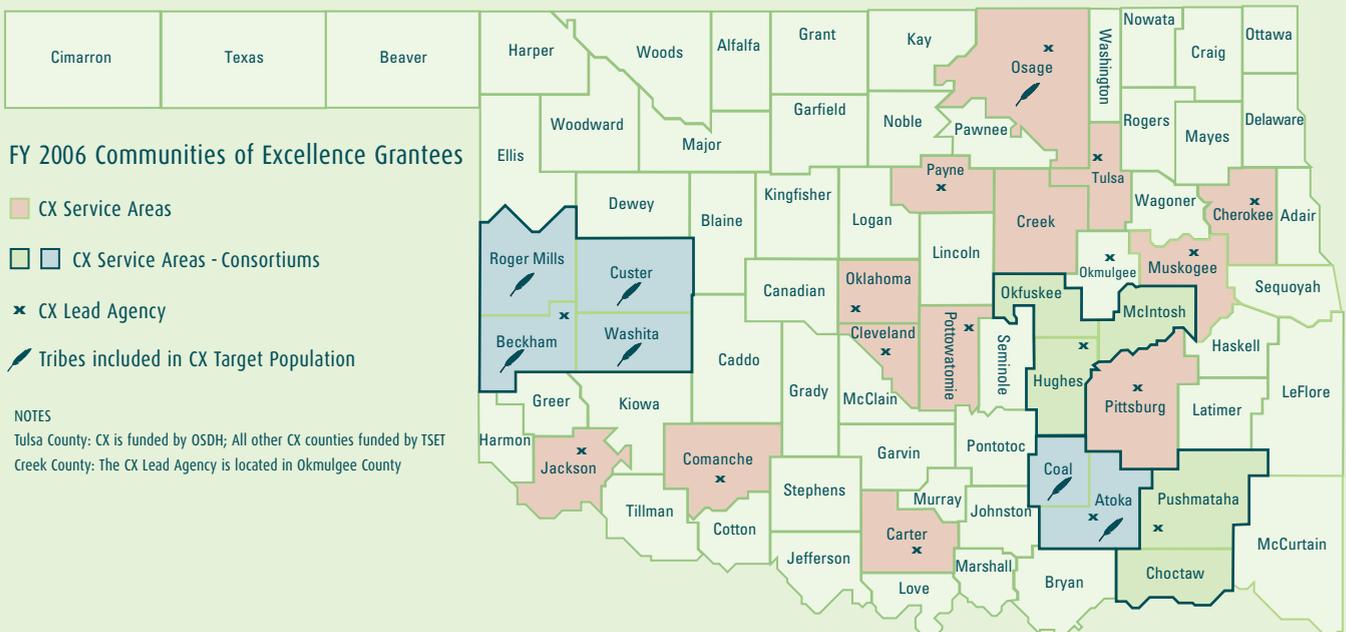
Overwhelmingly, grantees reported that the planning process allowed them to identify priorities within their own communities, create a plan that is “owned” by the coalition, and articulate goals, objectives and work plans unique to their particular community.

During the planning year, grantees were encouraged to engage in limited community interventions and public education campaigns.

- Seventy-three events or campaigns were conducted.
- 124 earned media pieces focused attention on the problem of tobacco use and what people can do to reduce tobacco use in their communities.
- Grantees were successful in initiating, developing, and implementing Students Working Against Tobacco (SWAT) youth empowerment teams. Across all grantees, nearly 50% of the reported activities/interventions were SWAT-led.
- Passage of proclamations and involvement in Kick Butts Day, World No Tobacco Day, and the Great American Smoke Out were also commonly reported activities.

Key Findings from the First Year of Implementation

Coalition Satisfaction and Functioning · In April and May 2006, the Coalition Satisfaction and Functioning Survey (CSFS) was administered with the primary aim of aiding grantees in assessing satisfaction with program planning, involvement of the community,



implementation, quality of services and progress made by coalition members.

- Overall satisfaction with the coalitions was high with 67% reporting that they were very satisfied and 30% reporting that they were somewhat satisfied with the coalition.
- The element of satisfaction garnering the most “very satisfied” responses was the ability to carry out planned activities, with 74.7% selecting this option.
- Survey results indicated high levels of confidence in among coalition coordinators and the coalitions themselves.

Short-Term Outcomes · Eight core “tobacco control indicators” serve as short-term outcomes for the CX program evaluation. Each grantee reported baseline measures for these indicators, as well as movement in the indicators during the first year of implementation.

Many of the indicators have policy or system change as the outcome versus individual level change. The assumption, based upon best practices, is that policy and system changes act as a catalyst for change within communities so that the environmental context supports the idea that tobacco use is not the norm, thus facilitating individual level changes. Therefore, it is to be expected that when sufficient progress has been made toward policy and system changes within a given indicator, statewide tobacco use indicators such as youth initiation to tobacco use and prevalence of tobacco use among youth and adults will also improve.

Preliminary data from the CX Annual Reports for the first year of implementation highlight the following successes:

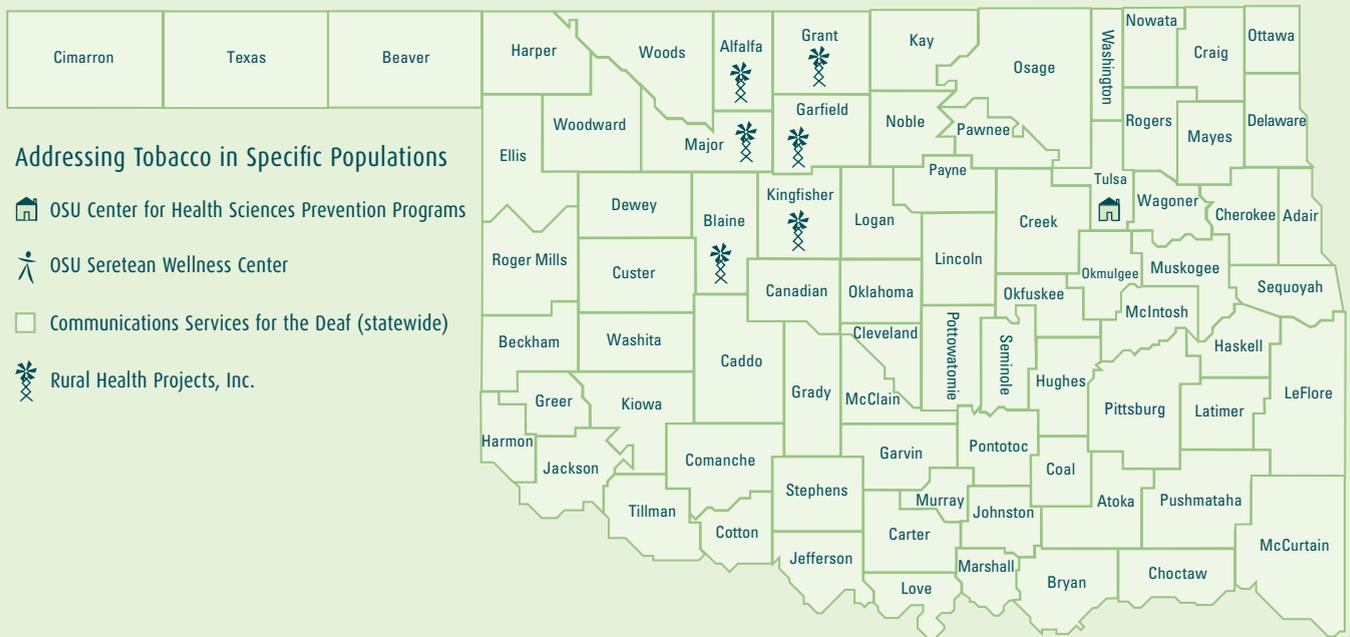
- The number of public school districts or private schools with 24/7 tobacco-free campuses increased by 27 during the first year of implementation.

- Approximately one out of five school districts and/or private schools in the communities served by the CX program have adopted 24/7 policies . Choctaw County became the first county in the state in which 100% of public school districts have adopted 24/7 tobacco-free campus policies.
- The number of incorporated areas and/or tribal nations with ordinances or laws that meet the provisions of the Oklahoma Smoking in Public Places and Indoor Workplaces Act doubled during the first year of implementation (from 8 at baseline to 16 after the first year of implementation).
- The average number of calls to the Oklahoma Tobacco Helpline from CX counties increased by 21% from baseline to year one implementation.
- The number of locally earned media spots that expose the deceptive practices of the tobacco industry increased 4-fold during the first year of implementation, from 50 at baseline to more than 200 reported during the first year of implementation.

Addressing Tobacco in Specific Populations

In FY 2006 TSET released a Request for Proposals to prevent and reduce tobacco use among specific populations. Four grantees were selected to begin a nine-month planning period in FY 2007 followed by a four year implementation phase. The selected applicants are:

- Rural Health Projects, Inc., Enid, Oklahoma, serving rural youth at risk for smokeless tobacco use in six rural counties in northwest Oklahoma.
- OSU Seretean Wellness Center, Stillwater, Oklahoma, serving college students in Stillwater and a planned expansion to OSU campuses statewide



- OSU Health Sciences Center, Tulsa, Oklahoma, serving youth and adults in low-income housing in Tulsa and a planned expansion to Payne and Creek counties.
- Communication Services for the Deaf, Tulsa, Oklahoma, serving the deaf and hard of hearing statewide.

Public Education Counter-Marketing Campaigns

During FY 2006, TSET partnered with the American Legacy Foundation, Oklahoma State Department of Health, and the Oklahoma Health Care Authority to provide a variety of public education media campaigns in order to reduce tobacco use among youth and adults, reduce secondhand smoke exposure, and promote quitting among adults:

- In partnership with the American Legacy Foundation, youth ages 12-17 throughout Oklahoma received a “heavy dose” of truth® television 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. In FY 2006 the truth® campaign is estimated to have reached 58.5% of Oklahoma teens an average of 22.8 times.

- In addition, TSET ran pre-produced television and theater ads provided through the Centers for Disease Control and Prevention to inform youth and adults of the cancer-causing chemicals in cigarettes, the hazards of secondhand smoke, and to promote tobacco-free environments. TSET’s counter-marketing campaign is estimated to have reached an average of 81.6% of Oklahomans an average of 4.1 times weekly in three-week flights airing February 27th through June 25th.
- To increase use of the Oklahoma Tobacco Helpline by African Americans, Native Americans, and Latino/Hispanic Americans, the TSET partnered with the Oklahoma State Department of Health to develop and run radio, print, and billboard ads. Initial funding for ad development and placement was provided by a grant from the American Legacy Foundation to the OSDH. The ads have been made available to Communities of Excellence grantees and are currently being used throughout the state.

- TSET also assisted the Oklahoma Health Care Authority with their mailing of a promotional flyer to 150,000 Medicaid beneficiaries to inform them of the Helpline services and the tobacco cessation pharmacy benefit available through Oklahoma Medicaid. The mailing directly resulted in over 2,000 additional calls to the Helpline and word-of-mouth referrals also increased as an indirect result of the mailing.

Results

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.

Although a direct causal link cannot be established, the heavy dose of truth® ads over the past five years has likely contributed to the significant declines in the prevalence of youth smoking in Oklahoma. According to data from the Youth Tobacco Survey, the prevalence of cigarette smoking declined more than 31% from 1999 to 2005 among high school students, and more than 42% among middle school students. The proportion of middle school youth reporting ever trying a cigarette declined 30% from 1999 to 2005. At the same time that youth smoking prevalence rates were going down, the proportion of Oklahoma high school youth who recognized the truth® brand from the counter-marketing campaigns was about 51% from 2002 to 2005.

Program Support Services

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.

Program Evaluation

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, Department of Biostatistics and Epidemiology, provides an external evaluation of TSET-funded tobacco control programs and provides evaluation consultation to the TSET board, staff, and grantees.

Through a sub-contract, the Oklahoma State University, Department of Marketing provided evaluation of the Helpline's promotional efforts as well as formative research to inform future media campaigns designed to prevent tobacco use among Oklahoma youth ages 12-17.



Gruen Von Behrens, a national spokesperson for the prevention of smokeless tobacco use, shares his personal experiences to prevent smokeless tobacco use among youth in Osage County, sponsored by the Osage County Community Partnership Board. Von Behrens is a 28-year-old oral cancer survivor who has had 35 disfiguring surgeries to save his life. He first tried spit tobacco at age 13 and was diagnosed with squamous cell carcinoma at age 17.

financials

Tobacco Settlement Payments and Schedule of Deposits by Fiscal Year

Fiscal Year Ending	Tobacco Settlement Payments to the State of Oklahoma	Schedule of Deposits to the Oklahoma Legislature	Deposits to the Tobacco Settlement Endowment Trust
2000	\$86,521,018	100%	0%
2001	\$65,328,241	100%	0%
2002	\$75,872,921	50%	50%
2003	\$76,024,898	45%	55%
2004	\$65,062,578	40%	60%
2005	\$66,034,977	35%	65%
2006	\$60,620,418	30%	70%
2007		25%	75%

(and all subsequent years)

Distribution of Oklahoma's Tobacco Settlement Payments



Distribution of Oklahoma's Tobacco Settlement Payments (Cumulative)

October 6, 1999 - June 30, 2006

\$495,465,051

**State Legislature
Tobacco Settlement Fund**
\$231,802,949

\$45,313,044 of the \$231.8 million available to the State Legislature was placed in the general revenue fund prior to November 2000. The remaining \$186.4 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 27. These funds are not part of the Endowment.

**Tobacco Settlement
Endowment Trust**
\$254,114,630

\$254.1 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.

**Attorney General's Office
Evidence Fund**
\$9,547,472

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.

Appropriations by the Oklahoma State Legislature from the Oklahoma Tobacco Settlement Fund

Agency Name & Purpose	FY 2001-03	FY 2004	FY 2005	FY 2006	Agency Total	Percent
Health Care Authority	\$61,077,028	\$9,002,276	\$16,408,305	\$0	\$86,487,609	47.12%
Dept. of Human Services	\$44,208,504	\$15,610,837	\$4,345,788	\$13,304,491	\$77,469,620	42.21%
Univ. Hospitals Authority	\$10,100,153	\$0	\$0	\$0	\$10,100,153	5.50%
Dept. of Health	\$5,525,266	\$0	\$0	\$0	\$5,525,266	3.01%
Dept. of Mental Health & Substance Abuse Services	\$3,672,001	\$0	\$0	\$0	\$3,672,001	2.00%
Dept. of Veteran's Affairs	\$275,000	\$0	\$0	\$0	\$275,000	0.15%
Totals	\$124,857,952	\$24,613,113	\$20,754,093	\$13,304,491	\$183,529,649	100%

Tobacco Settlement Endowment Trust Earnings Certified by the Board of Investors

FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	Total to Date
\$651,619	\$1,442,846	\$2,757,686	\$3,459,855	\$4,598,794	\$6,843,383	\$19,754,183

In FY 2001 and FY 2002 investment management fees were paid out of certified earnings. Earnings in subsequent years were certified net of fees. Operating expenses of the Tobacco Settlement Endowment Trust are paid out of certified earnings. Each fiscal year, earnings are certified for the prior fiscal year. Earnings may not be spent until they are certified. For example, the amount of certified earnings from FY 2006 would not be available for expenditure until FY 2007.

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 the State of Oklahoma, and as a result, the eventual earnings from the endowment.

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 authorize 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.

The endowment is a long-term strategy in which the earnings from investments will 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.

FY 2006 Program Contracts

Oklahoma Tobacco Helpline

Free & Clear, Inc.
Seattle, Washington
\$3,000,000

Provide a telephone-based tobacco cessation behavioral counseling service at no-charge to all Oklahomans who are ready to quit smoking or using other tobacco products. Also provide consultation to Oklahoma health care professionals regarding effective tobacco dependence treatment. TSET funds to Free & Clear, Inc, \$1,750,000 through June 30, 2006. OSDH funds to Free & Clear, Inc, \$1,250,000 through June 30, 2006.

Countermarketing

Oklahoma State Department of Health
Oklahoma City, OK
\$1,221,150

Subcontractor: Brothers & Co
Tulsa, OK

Coordinate media promotion of the Oklahoma Tobacco Helpline and other counter-marketing campaigns. TSET funds to the OSDH \$75,000. TSET funds to subcontractor: Brothers & Co, \$1,146,150 through June 30, 2006.

Evaluation

Board of Regents of the University of Oklahoma
Health Sciences Center
Oklahoma City, OK
\$436,867

Subcontractor: Oklahoma State University
Stillwater, OK

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, \$372,867. TSET funds to subcontractor: Oklahoma State University, \$64,000 through June 30, 2006.

Program Support, Training & Technical Assistance

Oklahoma State Department of Health
Oklahoma City, OK
\$340,120

Provide technical assistance and training to the TSET Board, staff, and grantees on effective tobacco prevention interventions. Oversee day-to-day activities of TSET grantees in tobacco control, assuring financial accountability and progress toward objectives. TSET funds to the OSDH, \$340,120 through June 30, 2006. Additional services provided in-kind by staff funded by the CDC.

Grant Year 2006 Communities of Excellence Grantees

October 1, 2005 - September 30, 2006

Grantee Name	Location	Amount	Coalition	Counties/Tribes Served
Atoka County Health Dept.	Atoka	\$100,000	Atoka/Coal Partnership for Change	Atoka & Coal Counties & Choctaw Nation of Okla.
Bill Willis Community Mental Health Center	Tahlequah	\$99,220	Community Health Coalition of Cherokee County	Cherokee County
City of Elk City	Elk City	\$104,862	Western Oklahoma Coalition for Community Strengthening	Beckham, Roger Mills & Custer Counties and the Cheyenne-Arapaho Tribe
Comanche County Memorial Hospital	Lawton	\$163,000	Southwest Tobacco Free Oklahoma Coalition	Comanche County
Community Children's Shelter & Family Service Center, Inc.	Ardmore	\$100,00	Carter County Turning Point	Carter County
Gateway to Prevention and Recovery	Shawnee	\$99,053	Shawnee Asset Building Alliance	Pottawatomie County
John Crow IV Foundation	Dustin	\$100,000	Rural Community Substance Abuse Prevention Coalition	Hughes, McIntosh & Okfuskee Counties
Muskogee County Health Dept.	Muskogee	\$199,722	Muskogee Turning Point	Muskogee County
Norman Regional Hospital	Norman	\$100,000	Cleveland County Turning Point	Cleveland County
Oklahoma City-County Health Dept.	OKC	\$100,000	Central Oklahoma Turning Point	Oklahoma County
Osage Tribe of Indians	Pawhuska	\$100,000	Osage County Community Partnership Board	Osage County and Osage Tribe of Indians
Pan OK Area Prevention Center: OSU Center for Health Sciences	Stillwater	\$100,000	Stillwater Mayor's Wellness Committee	Payne County
Pittsburg County Health Dept.	McAlester	\$100,000	SouthEast Tobacco-Free Oklahoma Coalition	Pittsburg County
Pushmataha County Health Dept.	Antlers	\$100,000	Pushmataha County Turning Point Coalition & Choctaw County Consortium	Pushmataha and Choctaw Counties
Southwest OK Community Action Group, Inc.	Altus	\$100,000	Jackson County Community Health Action Team	Jackson County
Tri-County Area Prevention Resource Center: OSU Center for Health Sciences	Morris	\$100,000	Child Abuse Prevention Task Force District XI, Creek County Chapter	Creek County

Independent Auditors' Report

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

We have audited the accompanying financial statements of the governmental activities and permanent fund of the Tobacco Settlement Endowment Trust Fund (the "Fund"), as of and for the years ended June 30, 2006 and 2005. The Fund is a part of the reporting entity of the State of Oklahoma. These financial statements are the responsibility of the Fund's management. Our responsibility is to express opinions on these financial statements based on our audits.

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

As discussed in Note 1, the financial statements of the Fund, a permanent fund of the State of Oklahoma, are intended to present the financial position and 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, 2006 and 2005, 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 governmental activities and permanent fund of the Fund as of June 30, 2006 and 2005, and the respective changes in financial position thereof 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 13, 2006, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit



September 13, 2006

Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A) of the Tobacco Settlement Endowment Trust Fund (the "Fund") provides an overview and overall review of the Fund's financial activities for the fiscal years ended June 30, 2006 and 2005. 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 2006 and 2005 fiscal years; the statements report all assets and liabilities using the accrual basis of accounting.

Statements of Net Assets

	2006	2005
<i>Assets</i>		
Current Assets	\$64,060,896	31,780,847
Investments (at fair value)	266,618,097	215,316,517
Capital Assets	25,596	31,346
Total Assets	330,704,589	247,128,710
<i>Liabilities</i>		
Current Liabilities	2,906,150	1,711,026
Liability Under Securities Lending	30,367,838	-
Noncurrent Liabilities	18,479	15,567
Total Liabilities	33,292,467	1,726,593
<i>Net Assets</i>		
Invested in Capital Assets	25,596	31,346
Restricted for Investment	287,701,209	237,521,063
Unrestricted	9,685,317	7,849,708
Total Net Assets	\$297,412,122	245,402,117

The Fund's total net assets increased \$52 million during the year, as the Fund invested an additional \$42.4 million in settlement receipts, recognized an additional \$14.6 million as net investment income, and expended \$6.3 million on programs and operations. Total investments increased from \$215 million at the beginning of the year to \$266.6 million as of year-end, as the Board of Investors invested cash and cash equivalents held at the beginning of the year and additional settlement receipts were deposited during the year. The Fund recognized \$7.7 million from the net appreciation of the fair value of the portfolio and earned \$6.8 million in interest and dividends, net of investment management fees which were certified by the Board of Investors for FY-2007 funding. 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.

Approximately \$12 million of the cash held at June 30, 2006, represents funds retained in anticipation of the conversion of the Large Cap Growth Fund asset class to a new Large Cap Growth Index fund. The Board of Investors approved this conversion in an effort to reduce investment management fees in subsequent periods. Cash balances also include restricted cash in excess of \$30 million which represents cash collateral presented to the fund by security borrowers through the Board's securities lending effort. Use of this cash is restricted unless the borrower was to default in the return of the securities borrowed.

2006 Total Assets



2005 Total Assets

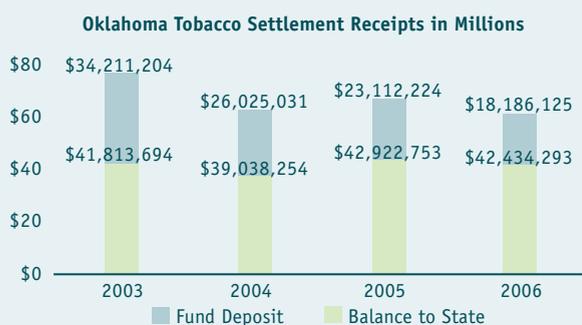


Statements of Activities – Income and Expenses

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

Statements of Activities	2006	2005
<i>Investment Income</i>		
Interest and Dividend Income	\$8,461,166	5,842,629
Securities Lending Income	8,412	-
Net Appreciation in Fair Value of Investments	7,737,441	12,740,308
Total Investment Income	16,207,019	18,582,937
Investment Expenses	(1,617,784)	(1,289,343)
Net Investment Income	14,589,235	17,293,594
<i>Other Income</i>		
Contract Income	1,250,000	581,323
<i>Expenses</i>		
Program	5,775,871	3,549,528
Operating	487,652	435,254
Total Expenses	6,263,523	3,984,782
Increase in Net Assets before Settlement Receipts	9,575,712	13,890,135
<i>Contribution to Fund Principal Settlement Receipts</i>		
	42,434,293	42,922,753
Increase in Net Assets	52,010,005	56,812,888
Net Assets - Beginning of Year	245,402,117	188,589,229
Net Assets - End of Year	\$297,412,122	245,402,117

Revenues continue to be dominated by settlement receipts which are restricted for investment purposes. During the fiscal years ended June 30, 2006 and 2005, 70% and 65%, respectively, of settlement receipts paid to the State were deposited by the State into the Fund. The percentage of the State's settlement receipts to be received by the Fund 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 \$488,460 from 2005.



There are no guarantees regarding the State's continued receipt of funds in the settlement of claims against the tobacco companies. A decrease in settlement receipts can be attributed to several factors.

According to figures compiled by the Tobacco Tax Bureau of the United States Department of Treasury, cigarette sales in 2005 declined by 4.2% from 2004 levels making it the largest one-year percentage decrease in cigarette sales since 1999. There has been a continued long-term decline in cigarette sales in the United States since the state Attorneys General negotiated the Tobacco Master Settlement Agreement. Since

1998, cigarette sales have fallen more than 21%. A decline in smoking can be attributable to a decline in settlement receipts.

Since 1998, 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. As shown below, a significant amount of the payment from the April 15, 2006, calculation was not received by the settling states and has been deposited in disputed accounts.

FY 2006	Final Calculation	Percent	Deposit to Trust 70%	Percent
Independent Auditor's Okla.				
Final Calculation	\$68,149,565	100.0%	\$47,704,695	100.0%
Received	59,878,586	87.9%	41,915,010	87.9%
Amount Not Received				
	\$8,270,979	12.1%	\$5,789,685	12.1%
FY 2005	Final Calculation	Percent	Deposit to Trust 65%	Percent
Independent Auditor's Okla.				
Final Calculation	\$67,174,063	100.0%	\$43,663,141	100.0%
Received	65,312,054	97.2%	42,452,853	97.2%
Amount Not Received				
	\$1,862,009	2.8%	\$1,210,288	2.8%

A participating manufacturer who disputes the final calculation presented by independent auditors may pay the disputed amount into the disputed payments accounts to avoid any accrual of interest until the issue is resolved. Noted disputes during the FY-2006 calculation include various computation interpretations and completeness or accuracy of data; however, significant disputes involve the application of the non-participating manufacturer adjustment in 2003. Subsequent disputes are anticipated for the 2004, 2005, and probably the 2006 calculation. These participating manufacturers maintain that they are entitled to withhold, whether by means of offset or otherwise, from their 2006 payment or to place in the disputed payments account the amount attributable to the NPM Adjustment for 2003. The settling states do not agree with this position and litigation is pending in this matter.

In addition, disputes from the participating manufacturers have been presented indicating that some settling states have not had a qualifying statute in full force during the entire calendar year immediately preceding the year in which the payment in question is due, yet they have enforced the provisions of such statute during the entire calendar year. The settling states do not agree with this position and litigation is pending in this matter.

As settlement receipts were deposited and invested and the portfolio was diversified during the fiscal year ended June 30, 2006, net investment income decreased by \$2.7 million over the \$17.3 million recognized during the 2005 fiscal year. Mixed results are attributable to this decrease. Interest and dividend income increased \$2.6 million while the net appreciation of investment in the Funds' portfolio decreased \$5 million. Fees paid to investment managers, consultants, and custodians increased \$328 thousand.

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 use prevention and cessation programs; research and treatment efforts in Oklahoma to prevent and combat cancer and other tobacco-related diseases; and other programs to maintain or improve the health of Oklahomans with a particular emphasis on children and senior adults. The Board of Directors has adopted a strategic plan to maximize the impact of the limited earnings available in the early years by focusing on reducing tobacco use in Oklahoma. During the fiscal year ended June 30, 2006, the Board of Directors increased program funding by more than \$2.2 million. Additional funding was provided for the Oklahoma Tobacco Helpline, a toll-free statewide phone line, 1-800-QUIT-NOW, to meet the growing demand for telephone-based tobacco cessation counseling. The Board of Directors continued to fund a youth prevention counter-marketing campaign. FY-2006 campaigns included ads to educate youth on the harmful ingredients contained in tobacco products nationally referred to as truth®. The American Legacy Foundation runs the national truth® campaign and the TSET enhances the reach of that campaign in Oklahoma.

During 2006, the Board of Directors also increased funding for 16 comprehensive community-based programs across the state of Oklahoma to implement programs, to prevent initiation to tobacco products among youth, to promote quitting among youth and adults, to reduce exposure to secondhand smoke, and to reduce tobacco-related health disparities. These 16 grants provide services in 23 counties and three tribal nations.

In FY-2006, the Board of Directors continued an agreement with the Oklahoma State Department of Health to provide additional funding to meet the increasing demand for the statewide telephone-based Oklahoma Tobacco Helpline. According to the terms of the contract, OSDH agrees to pay the Board of Directors at the beginning of the contract period up to 31 days of estimated Helpline costs, and reimburse additional Helpline expenses paid out of the beginning deposit throughout the year. Total revenue from this contract was \$1,250,000 and \$581,323 for 2006 and 2005, respectively. Adjustments to the cash balance are requested by the Board of Directors through pro forma invoices monthly. These funds are restricted for the purpose of the Helpline.

During the fiscal years ended June 30, 2005 and 2006, operating expenses increased by \$52,398 from \$435,254 to \$487,652. Personnel, accounting, and other office-related operating expenses initiated during the 2005 fiscal year were incurred for a full 12-month period during the fiscal year ended June 30, 2006. Effective July 1, 2005, the Office of the State Treasurer requested, and both Boards approved, that \$85,000 be provided to the State Treasurer as funding for staff support to the Board of Investors for FY-2006. 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, the 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

	2006	2005
<i>Assets</i>		
Cash and Cash Equivalents	\$60,824,847	27,956,277
Interest & Dividends Receivable	1,401,206	1,116,523
Securities Lending Receivable	3,550	-
Contract Receivable	-	359,238
Net Receivable from Brokers	1,831,293	2,348,809
Investments at Fair Value	266,618,097	215,316,517
Total Assets	\$330,678,993	247,097,364
<i>Liabilities</i>		
Accounts Payable & Other Liabilities	2,893,830	1,700,648
Liability Under Securities Lending	30,367,838	-
Total Liabilities	33,261,668	1,700,648
<i>Fund Balances</i>		
Reserved	287,701,209	237,521,063
Unreserved	9,716,116	7,875,653
Total Fund Balances	297,417,325	245,396,716
Total Liabilities & Fund Balances	\$330,678,993	247,097,364

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

	2006	2005
<i>Revenues</i>		
Restricted:		
· Net Appreciation in Fair Value of Investments	\$7,737,441	12,740,308
· Settlement Receipts	42,434,293	42,922,753
· Securities Lending Income	8,412	-
Total Restricted Revenues	50,180,146	55,663,061
Interest & Dividend Income	8,461,166	5,842,629
Contract Income	1,250,000	581,323
Total Revenues	59,891,312	62,087,013
<i>Expenditures</i>		
Personnel & Administrative	426,245	360,709
Counseling Services	2,793,937	1,699,370
Media & Program Promotion	1,368,462	959,011
Community Programs	1,273,017	713,511
Evaluation Services	339,899	177,080
Investment Management Fees	1,617,784	1,289,343
Equipment	4,686	32,567
Other	46,673	54,490
Total Expenditures	7,870,703	5,286,081
Net Changes in Fund Balances	52,020,609	56,800,932
Fund Balances, Beginning of Year	245,396,716	188,595,784
Fund Balances, End of Year	\$297,417,325	245,396,716

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Fund's finances. Questions concerning the information in this report or requests for additional financial information should be addressed to Dr. James Wilbanks, Director of Revenue & Policy, Office of the Oklahoma State Treasurer, 2300 N. Lincoln Blvd., Room 217, Oklahoma City, OK 73105-4895.

Financial Statements

Statements of Net Assets

	2006	2005
<i>Assets</i>		
Cash & Cash Equivalents:		
· Unrestricted Cash	\$30,207,008	27,745,156
· Restricted Cash	250,001	211,121
· Securities Lending Collateral – Restricted Cash	30,367,838	–
Total Cash & Cash Equivalents	60,824,847	27,956,277
<i>Receivables:</i>		
· Interest & Dividends	1,401,206	1,116,523
· Net Receivable from Brokers	1,831,293	2,348,809
· Contract Receivable	–	359,238
· Securities Lending Receivable	3,550	–
Total Receivables	3,236,049	3,824,570
<i>Investments (at Fair Value):</i>		
· US Government Securities	41,682,352	34,588,399
· Domestic Corporate Bonds	43,543,212	44,708,830
· Foreign Corporate Bonds	3,972,063	2,694,188
· Market Neutral Commingled Funds	30,887,662	–
· Domestic Stocks	115,949,897	109,928,973
· Foreign Stocks	30,582,911	23,396,127
Total Investments, at Fair Value	266,618,097	215,316,517
<i>Capital Assets, Net of Accumulated Depreciation of \$16,049 and \$8,569 as of June 30, 2006 and 2005, respectively.</i>		
	25,596	31,346
Total Assets	330,704,589	247,128,710
<i>Liabilities</i>		
Accounts Payable	2,893,830	1,582,733
Deferred Contract Income	–	117,915
Liability Under Securities Lending	30,367,838	–
<i>Compensated Absences:</i>		
· Payable Within One Year	12,320	10,378
· Payable After One Year	18,479	15,567
Total Liabilities	33,292,467	1,726,593
<i>Net Assets</i>		
Invested in Capital Assets	25,596	31,346
Restricted for Investment	287,701,209	237,521,063
Unrestricted	9,685,317	7,849,708
Total Net Assets	\$297,412,122	245,402,117

Statements of Activities

	2006	2005
<i>Expenses</i>		
<i>Program:</i>		
· Counseling Services	\$2,793,937	1,699,370
· Media & Program Promotion	1,368,462	959,011
· Community Programs	1,273,017	713,511
· Evaluation Services	339,899	177,080
· Depreciation	556	556
Total Program Expenses	5,775,871	3,549,528
<i>Operating:</i>		
· Personnel & Administrative	431,099	371,731
· Other	49,628	59,367
· Depreciation	6,925	4,156
Total Operating Expenses	487,652	435,254
Total Expenses	6,263,523	3,984,782
<i>Investment Income</i>		
Interest Income	5,353,583	4,233,466
Dividend Income	3,107,583	1,609,163
Securities Lending Income	8,412	–
Net appreciation in Fair Value of Investments	7,737,441	12,740,308
Total Investment Income	16,207,019	18,582,937
Investment Expenses	(1,617,784)	(1,289,343)
Net Investment Income	14,589,235	17,293,594
<i>Other Income</i>		
Contract Income	1,250,000	581,323
<i>Contribution to Fund Principal</i>		
Settlement Receipts	42,434,293	42,922,753
Change in Net Assets	52,010,005	56,812,888
Net Assets, Beginning of Year	245,402,117	188,589,229
Net Assets, End of Year	\$297,412,122	245,402,117

See Independent Auditors' Report.

See accompanying notes to financial statements.

Balance Sheets - Permanent Fund		
	2006	2005
<i>Assets</i>		
Cash & Cash Equivalents:		
· Unrestricted Cash	\$30,207,008	27,745,156
· Restricted Cash	250,001	211,121
· Securities Lending Collateral – Restricted Cash	30,367,838	–
Total Cash & Cash Equivalents	60,824,847	27,956,277
Receivables:		
· Interest & Dividends	1,401,206	1,116,523
· Securities Lending Receivable	3,550	–
· Net Receivable from Brokers	1,831,293	2,348,809
· Contract Receivable	–	359,238
Total Receivables	3,236,049	3,824,570
Investments (at Fair Value):		
· US Government Securities	41,682,352	34,588,399
· Domestic Corporate Bonds	43,543,212	44,708,830
· Foreign Corporate Bonds	3,972,063	2,694,188
· Market Neutral Commingled Funds	30,887,662	–
· Domestic Stocks	115,949,897	109,928,973
· Foreign Stocks	30,582,911	23,396,127
Total Investments	266,618,097	215,316,517
Total Assets	\$330,678,993	247,097,364
<i>Liabilities & Fund Balances</i>		
Liabilities:		
· Accounts Payable	2,893,830	1,582,733
· Deferred Contract Income	–	117,915
· Liability Under Securities Lending	30,367,838	–
Total Liabilities	33,261,668	1,700,648
Fund Balances:		
· Reserved for Investment	287,701,209	237,521,063
· Unreserved	9,716,116	7,875,653
Total Fund Balances	297,417,325	245,396,716
Total Liabilities & Fund Balances	\$330,678,993	247,097,364

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

	2006	2005
Total Fund Balances - Permanent Fund	\$297,417,325	245,396,716
Amounts Reported in the Statement of Net Assets are Different Because:		
· Capital assets used in govern- mental activities are not financial resources and therefore are not reported in the fund.	25,596	31,346
· 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	(30,799)	(25,945)
Net Assets	\$297,412,122	245,402,117

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

	2006	2005
<i>Revenues</i>		
Restricted:		
· Net Appreciation in Fair Value of Investments	\$7,737,441	12,740,308
· Settlement Receipts	42,434,293	42,922,753
· Securities Lending Income	8,412	–
Total Restricted Revenues	50,180,146	55,663,061
Interest Income	5,353,583	4,233,466
Dividend Income	3,107,583	1,609,163
Contract Income	1,250,000	581,323
Total Revenues	59,891,312	62,087,013
<i>Expenditures</i>		
Personnel & Administrative	426,245	360,709
Counseling Services	2,793,937	1,699,370
Media & Program Promotion	1,368,462	959,011
Community Programs	1,273,017	713,511
Evaluation Services	339,899	177,080
Investment Management Fees	1,617,784	1,289,343
Equipment	4,686	32,567
Other	46,673	54,490
Total Expenditures	7,870,703	5,286,081
Net Changes in Fund Balances	52,020,609	56,800,932
Fund Balances, Beginning of Year	245,396,716	188,595,784
Fund Balances, End of Year	\$297,417,325	245,396,716

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

	2006	2005
Net Changes in Fund Balances – Permanent Fund	\$52,020,609	56,800,932
Amounts Reported in the Statement of Activities are Different Because:		
· Governmental funds report capital out- lays 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.	(5,750)	22,978
· Some expenses reported in the state- ment 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.	(4,854)	(11,022)
Changes in Net Assets, Per Statements of Activities	\$52,010,005	56,812,888

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

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 and governmental funds of the State that is attributable to the transactions of the Fund, and not those of the entire State.

Basis of Presentation, Measurement Focus, and Basis of Accounting

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

Governmental fund financial statements. As a permanent fund, the Fund is reported in the governmental fund financial statements using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Since the Fund predominantly accounts for financial resources,

revenue recognition is generally consistent between the accrual and modified accrual basis of accounting. Settlement receipts are recognized as revenue when they are received by the State and their use is restricted as noted above.

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

Since the governmental fund financial statements are presented on a different measurement focus and basis of accounting than the government-wide financial statements, 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, which are reported as cash equivalents and reported at cost, which approximates fair value. Debt and equity securities are reported at fair value, as determined by the Fund's custodial agent, using pricing services or prices quoted by independent brokers based on the latest reported sales prices at current exchange rates for securities traded on national or international exchanges.

The Fund invests in various traditional financial instruments that fall under the broad definition of derivatives. The Fund's derivatives 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, securities lending income, and investment expenses, which includes investment management and custodial fees and all other significant investment-related costs.

Securities Lending

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

The market values of securities loaned and cash collateral maintained for those securities at June 30, 2006, were:

	Market Value
US Government Securities	\$10,552,532
US Corporate Bonds	2,330,785
Foreign Corporate Bonds	147,469
US Equity	16,061,723
Foreign Equity	555,034

	\$29,647,543

Cash Collateral Maintained for Securities Loaned	\$30,367,838

Borrowers were required to deliver and maintain collateral for each loan with a market value equal to 102% of the current market value of the loaned securities. Collateral delivered in non U.S. currency is required to be equal to 105% of the market value of the securities loaned; however, at June 30, 2006 all collateral was presented as cash in U.S. currency. The total value of the collateral held at June 30, 2006, was \$720,295 more than the current market value of the securities loaned; thus, no credit risk existed at the balance sheet date from these transactions. Collateral was unmatched to the securities loaned with a one-day maturity. Collateral cannot be used by the Trust except in the event of default.

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 governmental fund financial statements, as expenditures for capital assets are recorded as period costs when the capital assets are purchased.

Use of Estimates

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

Compensated Absences

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

	2006	2005
Cash on Deposit with the State	\$11,579	90,309
Contractual Restricted Cash	250,001	211,121
Collateral from Securities Lending -		
Restricted Cash	30,367,838	-
Money Market Mutual Fund	30,195,429	27,654,847

	\$60,824,847	27,956,277

In excess of \$12 million of the cash invested in money market mutual funds will be funded to the large cap growth asset allocation when the transition to a new large cap growth index manager is completed in early fiscal year 2007.

Restricted Cash - Contractual restricted cash represents the net cash balance of funds advanced to the Board of Directors for the reimbursement of the program expenses related to the Oklahoma Tobacco Helpline. According to contract terms, the Oklahoma State Department of Health (OSDH) pays the Board of Directors up to 31 days of estimated Helpline costs at the beginning of the contract. OSDH agrees to reimburse additional Helpline expenses throughout the year funded through monthly pro forma invoicing. Total revenue from this contract was \$1,250,000 and \$581,323 for 2006 and 2005, respectively. Cash collateral from securities lending activity is identified as restricted cash as it can not be used by the Trust unless there is default in the return of the securities loaned.

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

Credit Risk - Fixed income securities are subject to credit risk. A bond's credit quality rating is one method of assessing the ability of the issuer to meet its obligation. Exposure to credit risk as of June 30, 2006, was as follows:

	Fair Value	Moody Rating
<i>US Government Agencies</i>		
US Treasury Bonds	\$5,231,000	(1)
US Treasury Notes	11,836,000	(1)
Federal Home Loan Bank	3,066,000	AAA
Federal Home Loan Mortgage Corp.	8,250,000	AAA
Federal National Mortgage Corp.	12,306,000	AAA
Other	993,000	Other
	41,682,000	
<i>Corporate Bonds</i>		
Domestic Bonds	2,546,000	A
Domestic Bonds	1,912,000	AA
Domestic Bonds	9,434,000	AAA
Domestic Bonds	12,661,000	B
Domestic Bonds	12,769,000	BA
Domestic Bonds	3,703,000	BAA
Domestic Bonds	44,000	BBB
Domestic Bonds	398,000	CAA
Domestic Bonds	76,000	Other
	43,543,000	
Foreign Bonds	521,000	A
Foreign Bonds	270,000	AA
Foreign Bonds	845,000	AAA
Foreign Bonds	1,048,000	B
Foreign Bonds	1,168,000	BA
Foreign Bonds	120,000	BAA
	3,972,000	
Total Fair Value of Credit Risk	\$89,197,000	

(1) Backed by full faith and credit of the US Government.

Concentration of Credit Risk - The Fund limits its exposure to concentration of credit risk through its investment policy and asset allocation policy. Within asset classes, individual securities are limited to not more than 6% of the investment manager's portfolio; however, securities of one issuer could be represented in more than one asset class. No investments in any one organization, excluding those guaranteed by the U.S. Government, represent 5% or more of the Fund's net assets at June 30, 2006.

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

	Fair Value	Effective Duration Years
<i>US Government Securities (government guaranteed):</i>		
· US Treasury Bonds	\$5,231,000	12.94
· US Treasury Notes	11,836,000	5.35
· Federal Home Loan Bank	3,066,000	3.10
· GNMA	211,000	16.66
· SLMA	782,000	3.87
<i>Mortgage-backed Securities</i>		
· Federal Home Loan Mortgage Corp.	8,250,000	3.18
· Federal National Mortgage Corp.	12,306,000	3.05
<i>Corporate Bonds</i>		
· Domestic Bonds	43,543,000	6.35
· Foreign Bonds	3,972,000	5.64
Total Fixed Income	\$89,197,000	

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

Foreign Currency	Fair Value	Type
Australian Dollar	\$533,000	Equity
Bermuda Dollar	200,000	FX Inc
British Pound Sterling	5,128,000	Equity
British Pound Sterling	127,000	FX Inc
Canadian Dollar	503,000	Equity
Canadian Dollar	1,299,000	FX Inc
Cayman Dollar	287,000	FX Inc
Danish Kroner	716,000	Equity
Egyptian Pound	227,000	FX Inc
Euro	12,495,000	Equity
Euro	893,000	FX Inc
Hong Kong Dollar	877,000	Equity
Israeli Shekel	1,990,000	Equity
Israeli Shekel	303,000	FX Inc
Japanese Yen	5,376,000	Equity
Korean Won	314,000	Equity
Mexican Peso	82,000	FX Inc
New Taiwan Dollar	277,000	Equity
New Zealand Dollar	299,000	Equity
Norwegian Krone	432,000	Equity
Singapore Dollar	413,000	Equity
Singapore Dollar	554,000	FX Inc
South Korean Won	130,000	Equity
Swedish Krona	263,000	Equity
Swiss Franc	837,000	Equity
	\$34,555,000	

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 the unreserved fund balance. The Board of Directors manages program and operating expenses that are expended from the unreserved fund balance. Contract

revenue is the reimbursement of program expenses related to the Oklahoma Tobacco Helpline and is considered a reduction to unreserved 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. A reconciliation of the reserved and unreserved components of the fund balances is as follows:

	Reserved for Investment	Unreserved	Total
Balance, June 30, 2005	\$237,521,063	7,875,653	245,396,716
Settlement Receipts	42,434,293	-	42,434,293
Net Appreciation in Fair Value of Investments	7,737,441	-	7,737,441
Securities Lending Income	8,412	-	8,412
Contract Income	-	1,250,000	1,250,000
Expendable Earnings	-	6,843,382	6,843,382
Program & Operating Expenses	-	(6,252,919)	(6,252,919)
Balance, June 30, 2006	\$287,701,209	9,716,116	297,417,325
Balance, June 30, 2004	\$181,858,002	6,737,782	188,595,784
Settlement Receipts	42,922,753	-	42,922,753
Net Appreciation in Fair Value of Investments	12,740,308	-	12,740,308
Contract Income	-	581,323	581,323
Expendable Earnings	-	4,553,286	4,553,286
Program & Operating Expenses	-	(3,996,738)	(3,996,738)
Balance, June 30, 2005	\$237,521,063	7,875,653	245,396,716

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, Oklahoma 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, 2006 and 2005 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 \$21,228, \$16,088, and \$11,297 to the Plan for the years ended June 30, 2006, 2005, and 2004, 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.

Effective July 1, 2005, both Boards have approved that \$85,000 be provided to the Office of the State Treasurer as funding for staff support to the Board of Investors for FY-2006. Presently, State statutes specify that annual operating expenses shall not exceed \$500,000; however, there is legislation to change this during the next fiscal year. The effect of the change will be to increase the amount that can be spent.

COMMITMENTS AND CONTINGENCIES

Contracts

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

Settlement Receipts

As permitted by the Master Settlement Agreement between the State of Oklahoma and the participating manufacturers, the participating manufacturers have disputed the amount due to the State of Oklahoma based on the final calculation and have placed the disputed funds in an escrow account. For the years ended June 30, 2006 and 2005, the Fund's portion of the disputed final calculation was approximately \$5,800,000 and \$1,200,000, respectively. These amounts were deposited in the escrow account for each of the respective years.

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

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

We have audited the financial statements of the governmental activities and permanent fund of the Tobacco Settlement Endowment Trust Fund (the "Fund") as of and for the year ended June 30, 2006, and have issued our report thereon dated September 13, 2006. The Fund is a part of the reporting entity of the State of Oklahoma. Our report includes an explanatory paragraph to emphasize the fact that the financial statements 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.

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 opinions on the financial statements and not to provide an opinion 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 that might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud 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.

Compliance and Other Matters

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

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



September 13, 2006



Oklahoma Tobacco Settlement
Endowment Trust

Tracey Strader, Executive Director

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