KPMG

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA

(An Agency of the State of Oklahoma)

Basic Financial Statements

June 30, 2009

(With Independent Auditors' Report Thereon)

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA

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KPMG LLP
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Independent Auditors' Report

Commissioners of the Land Office
State of Oklahoma:

We have audited the accompanying financial statements of the governmental activities and each major fund of the Commissioners of the Land Office, State of Oklahoma, as of and for the year ended June 30, 2009, which collectively comprise the Commissioners of the Land Office's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commissioners of the Land Office's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Commissioners of the Land Office's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of the Commissioners of the Land Office, State of Oklahoma, are intended to present the financial position, and the changes in financial position of only that portion of the governmental activities and each major fund of the State that is attributable to the transactions of the Commissioners of the Land Office. They do not purport to, and do not, present fairly the financial position of the State of Oklahoma as of June 30, 2009, or the changes in its financial position, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Commissioners of the Land Office, State of Oklahoma, as of June 30, 2009, and the respective changes in financial position thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 26, 2009 on our consideration of the Commissioners of the Land Office'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.

Management's discussion and analysis on pages 3 through 7 and the budgetary comparison schedule on page 25 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commissioners of the Land Office's basic financial statements. The combining balance sheet and other schedules listed as other supplementary information in the Table of Contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining balance sheet and other schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

October 26, 2009

Our discussion and analysis of the Commissioners of the Land Office (the Agency), State of Oklahoma's financial performance provides an overview of the agency's financial activity for the fiscal year ended June 30, 2009. It should be read in conjunction with the financial statements, which begin, on page 8.

Financial Highlights

- Net Assets are down approximately $151 million primarily due to the net decrease in fair value of investments of $222.8 million. Mineral royalty revenues of $73.8 million were added to the permanent fund.
- Interest from investments was up $12.6 million primarily because of an increased allocation to fixed income investments. Dividend income stayed consistent with prior year.
- Distributions to beneficiaries are up $9.9 million.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Agency's basic financial statements. The Agency's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-Wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the Agency's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the Agency's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Agency is improving or deteriorating.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the changes occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The above financial statements report governmental activities. Most services normally associated with state government fall into this category, including support for both common public schools and higher education (apportionments).

The government-wide financial statements can be found on pages 8 and 9 of this report.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Agency, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

 (Continued)

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The Agency maintains two individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund and the permanent fund, both of which are considered to be major funds.

The Agency adopts an annual appropriated budget for its general fund. A budgetary comparison schedule has been provided as required supplementary information for the general fund to demonstrate compliance with this budget.

The governmental fund financial statements can be found on pages 10 and 11 of this report.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 12-24 of this report.

Government-Wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the Agency, assets exceeded liabilities by $1.4 billion at the close of the most recent fiscal year.

The largest portion of the Agency's net assets (99.6%) are subject to external restrictions on how they may be used. The Agency uses these assets to provide apportionments to beneficiaries.

Net Assets

(in thousands)

		2009	2008
Current assets	$	1,407,149	1,556,967
Capital assets, net		6,471	260
Other assets		5,659	12,368
Total assets	$	1,419,279	1,569,595
Other liabilities	$	7,446	6,795
Invested in capital assets	$	6,471	260
Restricted		1,400,223	1,555,952
Unrestricted		5,139	6,588
Total net assets	$	1,411,833	1,562,800

There was a decrease of $151 million in net assets, the key elements of the decrease are as follows:

Changes in Net Assets

(In thousands)

		2009	2008
Expenses:			
Apportionments	$	85,812	75,933
Custodial fees		5,237	5,751
Administrative		4,972	5,096
Other		358	371
Total expenses		96,379	87,151
Revenues:			
Program revenue:			
Investment earnings		(142,853)	(47,629)
Mineral royalties		73,775	106,468
Rents		11,000	11,375
Other		3,490	3,731
Total revenues		(54,588)	73,945
Change in net assets		(150,967)	(13,206)
Net assets at beginning of year		1,562,800	1,576,006
Net assets at end of year	$	1,411,833	1,562,800

- Apportionments increased by $9.9 million, from $75.9 million in fiscal year 2008 to $85.8 million in fiscal year 2009. The increase was primarily due to the increase in interest earnings, which were derived from an increased investment allocation to fixed income investments.
- The loss from Investment earnings increased by $95.2 million, from $(47.6) million in fiscal year 2008 to $(142.8) million in fiscal year 2009. The loss increased in a period of declining debt and equity values as a result of the national credit crisis.
- Mineral income decreased by $32.7 million, from $106.5 million in fiscal year 2008 to $73.8 million in fiscal year 2009. The decrease was due to lower natural gas prices and a decline in mineral leasing activity.

Financial Analysis of the Government's Funds

As noted earlier, the Agency uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The focus of the Agency's governmental funds is to provide information on near-term inflows, outflows, and balances of resources available to spend. Such information is useful in assessing the Agency's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Agency's governmental funds reported a combined ending fund balance of $1.406 billion, a decrease of $157 million in comparison with the prior year. Approximately $1.4 billion is reserved or designated to indicate that it is not available for general purposes because it has already been committed to beneficiaries. The remainder of the fund balance is unreserved, undesignated fund balance, which is available for spending at the Agency's discretion.

The general fund is the administrative fund of the Agency. At June 30, 2009, the unreserved fund balance was $5.5 million, or 94% of budgeted general fund expenditures. The unreserved fund balance of the general fund decreased by $1.5 million during the current fiscal year primarily due to a decrease in the agency's 6% operational fees derived from the trust fund revenues.

The entire balance of the permanent fund is reserved for the use and benefit of common education and thirteen Oklahoma colleges and universities. Total revenue was $(55.2) million compared to $73.2 million of prior year. Apportionments to beneficiaries totaled $85.8 million for fiscal year 2009 with $22.3 million disbursed to universities and colleges and $60.3 million disbursed to public schools. This was an increase of $9.9 million from the apportionments of fiscal year 2008.

General Fund Budgetary Highlights

During fiscal year 2009, there were no formal amendments to the Agency's general fund budget.

(Continued)

For fiscal year 2009, general fund actual expenditures (including transfers) on a budgetary basis were $5.017 million compared to the budget of $5.784 million. The $767 thousand variance was primarily due to litigation delays causing lower expenditures for legal services.

Description of Current and Expected Conditions

Energy prices and the financial markets are currently experiencing fluctuations that can impact the trust funds' mineral royalties and fair market value of financial assets, respectively.

Otherwise, the Commissioners of the Land Office are not aware of and do not anticipate any significant changes in conditions that would have a significant effect on the financial position or results of activities of the Agency in the near future.

Contacting the Agency's Financial Management

This financial report is designed to provide a general overview of the Agency's finances and to show the Agency's accountability to its beneficiaries. If you have questions about this report or need additional financial information, contact the Agency's office at 5801 Broadway Extension, Suite 200, Oklahoma City, Oklahoma 73126.

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA

Statement of Net Assets

June 30, 2009

Assets

Current assets:	
Cash and cash equivalents	$ 66,501,241
Investments	1,319,636,805
Loans receivable	45,621
Accrued interest receivable	13,016,356
Current portion of note receivable	506,754
Other receivables	7,442,278
Total current assets	1,407,149,055
Noncurrent assets:	
Capital assets, net	872,139
Land	5,599,010
Note receivable	5,658,818
Total noncurrent assets	12,129,967
Total assets	1,419,279,022
Current liabilities:	
Accounts payable and accrued expenses	1,167,370
Deferred revenue	6,278,398
Total current liabilities	7,445,768
Net assets:	
Invested in capital assets	6,471,149
Restricted for education:	
Nonexpendable	1,384,537,907
Expendable	15,685,233
Unrestricted	5,138,965
Total net assets	$ 1,411,833,254

See accompanying notes to financial statements.

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA

Statement of Activities

Year ended June 30, 2009

Expenses:	
Education:	
Apportionments to beneficiaries:	
Universities and colleges	$ 22,313,150
Public schools	60,341,452
Public buildings	3,157,555
Total apportionments	85,812,157
Custodial fees	5,236,832
Administrative expenses	4,971,631
Other expenses	219,691
Depreciation	138,091
Total program expenses	96,378,402
Program revenues:	
Investment earnings:	
Interest	67,602,777
Dividends	12,382,589
Net decrease in fair value of investments	(222,838,591)
Net investment loss	(142,853,225)
Mineral royalties	73,775,260
Rents	11,000,189
Gain on sale of land	327,969
Miscellaneous	1,598,471
Fees	329,302
Other interest	1,233,776
Total program revenues	(54,588,258)
Change in net assets	(150,966,660)
Net assets at beginning of year	1,562,799,914
Net assets at end of year	$ 1,411,833,254

See accompanying notes to financial statements.

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA

Balance Sheet – Governmental Funds

June 30, 2009

		General fund	Permanent fund		Total
Assets:					
Cash and cash equivalents	$	5,962,453	60,538,788		66,501,241
Investments		253,896	1,319,382,909		1,319,636,805
Loans receivable		—	45,621		45,621
Accrued interest receivable		—	13,016,356		13,016,356
Other receivables		89,986	7,352,292		7,442,278
Note receivable		—	6,165,572		6,165,572
Total assets	$	6,306,335	1,406,501,538		1,412,807,873
Liabilities:					
Accounts payable and accrued expenses	$	847,766	—		847,766
Deferred revenue		—	6,278,398		6,278,398
Total liabilities		847,766	6,278,398		7,126,164
Fund balance:					
Reserved for education		—	1,400,223,140		1,400,223,140
Unreserved, undesignated		5,458,569	—		5,458,569
Total fund balance	$	5,458,569	1,400,223,140		1,405,681,709
Capital assets not considered financial resources and not included in funds				$	6,471,149
Compensated absences not due and payable in the current period					(319,604)
Net assets of governmental activities				$	1,411,833,254

See accompanying notes to financial statements.

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds

Year ended June 30, 2009

	General fund	Permanent fund	Total
Revenues:			
Investment revenues:			
Interest	$ —	68,025,533	68,025,533
Dividends	—	12,382,589	12,382,589
Net decrease in fair value of investments	—	(222,838,591)	(222,838,591)
Net investment revenue	—	(142,430,469)	(142,430,469)
Fees	3,462,753	—	3,462,753
Other interest	297,972	513,048	811,020
Mineral royalties	—	73,775,260	73,775,260
Rents	—	11,000,189	11,000,189
Gain on sale of land	—	327,969	327,969
Miscellaneous revenue	—	1,598,471	1,598,471
Total revenues	3,760,725	(55,215,532)	(51,454,807)
Expenditures:			
Administrative expenses	5,019,925	3,133,451	8,153,376
Other	219,691	6,330,731	6,550,422
Custodial fees	—	5,236,832	5,236,832
Apportionments to beneficiaries:			
Universities and colleges	—	22,313,150	22,313,150
Public schools	—	60,341,452	60,341,452
Public buildings	—	3,157,555	3,157,555
Total expenditures	5,239,616	100,513,171	105,752,787
Net change in fund balances	(1,478,891)	(155,728,703)	(157,207,594)
Fund balances at beginning of year	6,937,460	1,555,951,843	1,562,889,303
Fund balances at end of year	$ 5,458,569	1,400,223,140	1,405,681,709
Net change in fund balances			$ (157,207,594)
Fixed assets purchased			147,119
Capital outlays in the governmental funds that are depreciated over time in the statement of activities			6,202,114
Decrease in liability for compensated absences			29,792
Current year depreciation expense			(138,091)
Change in net assets – governmental activities			$ (150,966,660)

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

(a) Organization

In 1906, the Government of the United States of America granted certain assets to the State of Oklahoma (the State) to be held in trust for the benefit of public education including the Common Schools of Oklahoma and other beneficiaries. The Constitution of the State of Oklahoma established the Commissioners of the Land Office (the Agency) to act as trustee for these trust assets (the Trust), which are held for the benefit of the following beneficiaries:

- Public Schools
- Public Building Fund
- University of Oklahoma
- Oklahoma State University
- Langton University
- Northern Oklahoma College
- Southeastern Oklahoma State University
- Northeastern Oklahoma State University
- University of Central Oklahoma
- East Central Oklahoma State University
- Southwestern Oklahoma State University
- Northwestern Oklahoma State University
- Cameron University
- Panhandle State University
- University of Science and Arts

(b) Basis of Presentation

The accounting and reporting policies of the Agency conform to accounting principles generally accepted in the United States applicable to governmental units. Generally accepted accounting principles for state agencies are defined as those principles prescribed by the Governmental Accounting Standards Boards (GASB). The Agency has adopted GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. GASB Statement No. 34 mandates Government-wide financial statements of net assets and activities, which are presented on the economic resources measurement focus and accrual basis of accounting requiring that certain fixed assets be recorded at cost less accumulated depreciation and the reporting of long-term liabilities.

 (Continued)

The Agency also presents fund financial statements for all of the funds relevant to the operations of the Agency. The Agency's financial statements are included in the statewide financial statements of the State of Oklahoma.

The accounts of the Agency are organized on the basis of funds, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for by providing a separate set of self-balancing accounts, which are comprised of its assets, liabilities, fund balance, revenues, and expenditures. The various funds are grouped, in the financial statements of this report, into two funds as follows:

- **General Fund** – The General Fund is classified as a Governmental Fund Type and uses the current financial resources measurement focus and modified accrual basis of accounting whereby revenues are recognized when measurable and available and expenditures are recognized when liabilities are incurred except for compensated absences which are recognized when the obligations are expected to be liquidated with expendable available financial resources. The General Fund consists of several individual accounts, including the Revolving 16 account, and the Commissioners of the Land Office (CLO) account. The Revolving 16 account contains certain fees expenditures for administration of the Trust. The CLO account receives six percent of the revenues earned by the Permanent Fund, with the exception of gains on the sale of permanent land. When revenues exceed the administrative expenses of the Agency, that amount representing the excess is allocated back to the Trusts from the CLO account.

- **Permanent Fund** – The Permanent Fund is classified as a Governmental Fund Type and is used to account for all Trust assets, liabilities, fund balances, revenues and distributions to beneficiaries. The permanent fund uses the current financial resources measurement focus and modified accrual basis of accounting whereby revenues are recognized when measurable and available and expenditures are recognized when incurred. The Permanent Fund represents the historic dollar value of the Permanent Fund assets, along with certain additions, and must be maintained in perpetuity. Additions to the Permanent Fund are made by the retention of a portion of the revenues generated by depletable assets that are considered a return of principal as a result of production.

The Agency considers all revenues available if they are collected within the current period or soon enough thereafter to be used to pay liabilities of the current period. A thirty-day period is used for revenue recognition for all governmental fund type revenues. Those revenues susceptible to accrual are interest revenue, mineral royalties, and surface leases.

When both restricted and unrestricted resources are available for use, it is the Agency's policy to use restricted resources first, and then unrestricted resources as they are needed.

(c) Budget

The Agency operates on internally generated funds under a financial work program approved by the State Legislature and administered by the Office of State Finance. The Agency does not receive any State general funds. A budgetary comparison is presented as required supplementary information on the cash basis of accounting.

(d) Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 statement. Actual results could differ from those estimates.

(e) Cash and Cash Equivalents

The Agency considers highly liquid investments with original maturities of three months or less to be cash equivalents.

(f) Loans

Installment notes and loans receivable consist of installment notes from sale of land and farm loans, respectively. The receivables are generally collectible in installments over periods ranging from 25 to 33 years. Interest rates range from 3% to 10%. All notes and loans are collateralized by a first mortgage.

The Agency has not established an allowance for uncollectible accounts relating to installment sales and farm loans. Bad debts in prior years have not been material to the financial statements. In addition, all receivables are secured by first mortgages on real estate.

(g) Land

Land in the amount of approximately $693,000 was granted by the Federal government upon statehood. This land is held in trust and is stated at $1 per acre in the financial statements at June 30, 2009. The $1 per acre was set as a nominal amount for record keeping purposes.

The Agency has also taken possession of land, which had been sold by the Agency, or on which the Agency held a first mortgage as collateral relating to farm loans made by the Agency in prior years. The land was recorded at lower of cost or market at date of foreclosure or repossession as determined by appraisals of the property. At June 30, 2009 repossessed land is carried at approximately $4,906,000.

Land is considered capital assets and is reported at amortized cost.

(h) Depreciable Capital Assets

Capital assets, which include improvements and fixtures, furniture and equipment, are assets with an estimated useful life in excess of one year. Such assets are recorded at cost. Donated fixed assets are valued at their estimated fair value on the date of donation. The costs of normal maintenance and repairs that do not add to the value of the assets or materially extend asset lives are not capitalized, while improvements and betterments are capitalized.

Depreciation has been calculated on each class of depreciable property using the straight-line method. Estimated useful lives are as follows:

Improvements	25 years
Fixtures, furniture and equipment	5 years

(i) Deferred Revenue

The deferred revenue represents lease billings not yet earned. This deferred revenue is recognized when earned in the following year.

(j) Income Taxes

Since the Agency is considered a governmental unit, it is not subject to income taxes, and no amount for taxes has been recorded in the accompanying statements.

(k) Investments

The Agency is allowed by state statutes to invest in equities, fixed income investments, and cash equivalents. Each type of investment has a minimum, maximum, and target percentage that has been established by an investment committee.

(l) Compensated Absences

In accordance with State policy, employees earn annual leave on a calendar month basis at rates of 10 to 15 hours per month. Annual leave can be accumulated from 240 to 480 hours depending on the years of continuous service in State employment. At June 30, 2009, unpaid and accumulated benefits totaled $319,604. The activity for the year is as follows:

Beginning balance	$	349,396
Leave earned		221,830
Leave used		(251,622)
Ending balance	$	319,604

(2) Deposits, Investments, and Related Policies

(a) Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of a bank failure, the Agency's deposits may not be returned or the Agency will not be able to recover collateral securities in the possession of an outside party. 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 Trust, and are held by counterparty or the counterparty's trust department but not in the name of the Trust.

(b) Deposits

The Agency uses a pooled cash concept in maintaining its bank accounts. Cash is pooled for operating and investing purposes and each fund has equity in the pooled amount. For reporting purposes, cash has been allocated to each fund based on its equity in the pooled amount. Currently, cash is deposited at the State Treasury. Since cash is deposited with the State Treasury, the cash is fully insured or collateralized by the Treasurer. Cash is also maintained by the Bank of Oklahoma's Trust Department as part of various investments accounts held in the name of the Agency. Investment policy requires that these deposits must be invested in fully collateralized interest bearing accounts.

(c) Investments

Investments are reported at fair value, which represents primarily stated market prices. Actual gains and losses realized by the Agency will be determined at the time of the sale and will be based on market conditions at that date. The Agency also has a policy which requires the Trust to have a current custodial agreement in the Agency's name with respect to investment collateral held by third party custodians. In addition, the Bank of Oklahoma maintains a blanket bond insurance policy which covers all Trust assets.

Substantially all investments are held by Bank of Oklahoma Trust Department. Funds held by Bank of Oklahoma are classified in the accompanying financial statements as follows:

Cash and cash equivalents	$ 55,732,879
Investments	1,319,636,805
Accrued interest on investments	13,016,356
Total	$ 1,388,386,040

Credit risk exists when there is a possibility that the issuer or other counterparty to an investment may be unable to fulfill its obligations. The Agency is authorized by State statutes to invest in equities, fixed income investments, and cash equivalents. Each type of investment has a minimum, maximum, and target percentage that has been established by the Agency's investment committee. The Agency considers investment grade as the top four rating categories. (AAA, AA, A, and BBB/BAA) Below investment grade corporate fixed income investments shall be limited to twenty percent of the investment manager's total portfolio. This restriction does not apply to dedicated high yield managers or convertible managers. As applicable, average credit quality ratings are disclosed in the table below to indicate associated credit risk.

Investments at June 30, 2009 consisted of the following:

		2009	
		Fair value	**Moody rating**
U.S. government agencies:			
U.S. Treasury Bond	$	49,379,102	AAA
U.S. Treasury Note		8,317,499	AAA
Federal Home Loan Mortgage Corp		55,175,486	AAA
Federal National Mortgage Corp		109,050,518	AAA
Government National Mortgage Association		16,090,396	AAA
Other		7,164,030	AAA
		245,177,031	
Municipal obligations:			
Municipal Bonds		1,181,549	AAA
Municipal Bonds		2,590,065	BAA
		3,771,614	

	2009	
	Fair value	**Moody rating**
Corporate bonds (held in U.S. Currency):		
Domestic Bonds	$ 75,485,128	A
Domestic Bonds	17,854,908	AA
Domestic Bonds	65,146,030	AAA
Domestic Bonds	133,496,032	B
Domestic Bonds	110,390,980	BA
Domestic Bonds	128,643,081	BAA
Domestic Bonds	41,938,277	BBB
Domestic Bonds	11,788,471	CA
Domestic Bonds	46,801,149	CAA
Domestic Bonds	16,050,972	CCC
Domestic Bonds	36,064,889	NR
	683,659,917	
Foreign bonds (held in U.S. Currency):		
Foreign Bonds	11,034,109	A
Foreign Bonds	3,362,250	AA
Foreign Bonds	2,926,750	B
Foreign Bonds	7,458,485	BA
Foreign Bonds	12,888,434	BAA
Foreign Bonds	9,885	C
Foreign Bonds	3,361,288	NR
	41,041,201	
Money market:		
Invesco Aim Prime Resource	47,605,182	NR
Total fixed income	$ 1,021,254,945	

NR – not rated

Concentration of credit risk is the risk of loss attributed to the magnitude of the Agency's investments in a single issuer. It is generally considered that an increased risk of loss occurs as more investments are acquired from a single issuer. The Agency has formal written policies regarding the concentration of credit risk for both unsecured fixed income investments and equity-type investments. The Trust is prohibited from holding unsecured fixed income investments in a single company in a total amount exceeding five percent (5%) of the assets of the aggregate market value of the Trust (U.S. Government and agency obligations are excluded from this restriction). With respect to equity-type investments, equity managers are restricted to maintaining no more than five percent (5%) of their portfolio in any one company (at cost) and not more than ten percent (10%) of their portfolio in any one company (at market value). At June 30, 2009, Federal National Mortgage Association represented 8.26% of the Agency's total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Investments held for longer periods are subject to increased risk of adverse interest rate changes. The Agency's policy provides that to the extent practicable, investments are matched with anticipated cash flows. Investments are diversified to minimize the risk of loss resulting from the over-concentration of assets in a specific maturity period, a single issuer, or an individual class of securities.

The Agency's closure to credit risk is as follows:

	2009	
	Fair value	**Effective duration** (years)
U.S. government securities:		
U.S. Treasury Bond	$ 49,379,102	4.221
U.S. Treasury Note	8,317,499	2.493
Government National Mortgage Association	16,090,396	3.938
Other	7,164,030	3.102
	80,951,027	
Mortgage-backed securities:		
Federal Home Loan Mortgage Corp	55,175,486	2.808
Federal National Mortgage Corp	109,050,518	2.730
	164,226,004	
Municipal obligations:		
Municipal Bonds	3,771,614	6.221
Corporate bonds (held in U.S. Currency):		
Domestic Bonds	683,659,917	6.646
Foreign Bonds	41,041,201	6.633
	724,701,118	
Money market:		
Invesco Aim Prime Resource	47,605,182	NA
Total fixed income	$ 1,021,254,945	

(3) Leasing Operations

The Agency leases to others approximately 741,615 acres of land belonging to the Trusts as of June 30, 2009, primarily for agricultural purposes.

The lease terms are generally for five-year periods (on a calendar year basis) with rents prepaid one year in advance. The annual rental amount is determined by the lessee's maximum bid amount.

The following is a schedule of the future minimum rent due to the Agency under its noncancelable leases at June 30, 2009:

2010	$	8,911,654
2011		6,678,302
2012		4,587,316
2013		2,247,203
	$	22,424,475

(4) Investment Property

In 2004, the Agency sought and received legislative authorization for an investment in a real estate property located at the Lake Texoma State Park area in southern Oklahoma. The Agency purchased 750 acres of real property from the state and federal government for the purpose of packaging the property as a resort development. The Agency paid approximately $4.9 million as an initial investment. The Agency offered the property in a "Request for Proposal" format and received and accepted an offer of $14.6 million over a six-year period. Two closings were executed in January and May, 2008 and a total of $5,600,000 and a $9,000,000 note was received. The Agency is the beneficiary on two standby letters of credit totaling $9,000,000 backing the note receivable. The note receivable has no stated interest rate, but has been discounted by the Agency at 8%. The future imputed interest and principal reduction is as follows:

Date		Principal	Interest	Total payment
01/29/2010	$	506,754	493,246	1,000,000
01/29/2011		547,295	452,705	1,000,000
01/29/2012		1,165,818	408,922	1,574,740
01/29/2013		1,896,974	315,656	2,212,630
01/29/2014		2,048,731	163,899	2,212,630
01/29/2015		—	—	—
Total	$	6,165,572	1,834,428	8,000,000

(5) Other Receivables

Other receivables at June 30, 2009 consisted of the following:

Accrued mineral royalties	$	5,261,451
Surface leases (net allowance of $603,339)		2,090,841
Gas marketing		89,986
Total	$	7,442,278

The Agency has been carrying several lease rental accounts as receivable for several years. Management has determined that an allowance for these accounts should be established. The allowance for doubtful accounts as of June 30, 2009 is $603,339. The balance of these lease rentals are considered fully collectible.

(6) Investment in Land and Mineral Rights (Unaudited)

The Agency obtained the majority of the land held in trust from a grant of the United States prior to statehood. The land is mainly in the western portion of Oklahoma, with approximately 40% of the land being located in the Oklahoma Panhandle. Management estimates the market value of the land at June 30, 2009 is $400,221,960 using land values established by in-house appraisers. Each year, one-fifth (1/5) of the land is appraised and that value is carried for five years.

Currently, the Agency owns approximately 1,108,372 mineral acres. Valuation of such properties normally requires a property-by-property reserve study. As this is not feasible, an estimated market value of the mineral rights has not been determined.

(7) Related Party Transactions

During the course of normal operations, the Agency purchases goods and services from other State agencies. The expenditures made to other State agencies during the fiscal year ending June 30, 2009 was $114,145.

(8) Employee Benefit Plans

(a) Retirement Plan

The Agency contributes to the Oklahoma Public Employees Retirement Plan (the Plan), a cost-sharing multiple-employer public employee retirement system administered by the Oklahoma Public Employees Retirement System (the System). The Plan provides retirement, disability, and death benefits to plan members and beneficiaries. The benefit provisions are established and may be amended by the legislature of the State of Oklahoma. Title 74 of the Oklahoma Statutes, Sections 901-943, as amended, assigns the authority for management and operation of the Plan to the Board of Trustees of the System. The System issues a publicly available annual financial report that includes financial statements and required supplementary information for the Plan. That annual report may be obtained by writing to the System, 6601 N. Broadway Extension, Suite 129, Oklahoma City, Oklahoma 73116 or by calling 1-800-733-9008.

(Continued)

Plan members and the Agency are required to contribute at a rate set by statute. The contribution requirements of plan members and the Agency are established and may be amended by the legislature of the State of Oklahoma. The contribution rate for the Agency and plan members is as follows:

Fiscal year 2009	
Employees	**Agency**
All salary	**All salary**
3.5%	14.5%

Fiscal year 2008	
Employees	**Agency**
All salary	**All salary**
3.5%	13.5%

The Agency and employee (combined) contributions to the Plan for the years ended June 30, 2009, 2008, and 2007, were approximately $476,000, $449,000, and $417,000, respectively, and was equal to its required contribution for each year.

(b) Deferred Compensation Plan

The State offers to its own employees, state agency employees and other duly constituted authority or instrumentality employees a deferred compensation plan created in accordance with Internal Revenue Code (IRC) Section 457 and Chapter 45 of Title 74, Oklahoma Statutes. The Oklahoma State Employees Deferred Compensation Plan (the 457 Plan), also known as SoonerSave, is a voluntary plan that allows participants to defer a portion of their salary into the 457 Plan. Participation allows a person to shelter the portion of their salary that they defer from current federal and state income tax. Taxes on the interest or investment gains on this money, while in the 457 Plan, are also deferred. The deferred compensation is not available to employees until termination, retirement, death or approved unforeseeable emergency.

Under SoonerSave, the untaxed deferred amounts are invested as directed by the participant among various 457 Plan investment options. Effective January 1, 1998, a Trust and Trust Fund covering the 457 Plan assets was established pursuant to federal legislation enacted in 1996, requiring public employers to establish such trusts for plans meeting the requirements of Section 457 of the IRC. Under terms of the Trust, the corpus or income of the Trust Fund may be used only for the exclusive benefit of the 457 Plan participants and their beneficiaries. Further information may be obtained from the Oklahoma State Employees Deferred Compensation Plan audited financial statements for the years ended June 30, 2009 and 2008. The Agency believes that it has no liabilities in respect to the State's plan.

(9) Capital Assets

The changes in the capital asset accounts for fiscal year 2009 were as follows:

	Beginning balance July 1, 2008	Increases	Decreases	Ending balance June 30, 2009
Capital assets, not being depreciated:				
Land	$ 5,599,037	—	(27)	5,599,010
Total capital assets, not being depreciated	5,599,037	—	(27)	5,599,010
Capital assets, being depreciated:				
Furniture, fixture and equipment	853,786	18,502	(6,132)	866,156
Land improvements	798,940	129,447	—	928,387
Total capital assets, being depreciated	1,652,726	147,949	(6,132)	1,794,543
Less accumulated depreciation, for:				
Furniture, fixture and equipment	593,779	99,317	(6,132)	686,964
Land improvements	196,666	38,774	—	235,440
Total accumulated depreciation	790,445	138,091	(6,132)	922,404
Total capital assets being depreciated, net	862,281	9,858	—	872,139
Governmental activities, capital assets, net	$ 6,461,318	9,858	(27)	6,471,149

(10) Commitments and Contingencies

(a) Litigation

In the normal course of operations, the Agency is a defendant in a lawsuit; however, Agency officials are of the opinion, based on the advice of general counsel, that the ultimate outcome of this litigation will not have a material adverse effect on the future operations or financial position of the Agency.

(b) Leases

The Agency leases various office equipment, as well as office space and computer equipment for 12-month terms, with options to renew each year. For the year ended June 30, 2009, total rent expense for these items was approximately $61,447 for office equipment and $263,067 for office space.

(11) Risk Management

The Agency participates in the Oklahoma Risk Management Division's (a division of the Department of Central Services) insurance pool which covers all governmental tort claims against the Agency. The Agency pays a monthly premium to the Department of Central Services to participate in the insurance pool. Premiums paid are not subject to retroactive adjustment.

SUPPLEMENTAL INFORMATION

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA

Schedule of Revenues, Expenditures, and Changes in Fund Balance – Budget to Actual
General Fund – (Non-GAAP Budgetary Basis)

Year ended June 30, 2009

(unaudited)

		Original/Final Budget		Actual	Variance favorable (unfavorable)
Revenues:					
Fees	$	—		3,462,753	3,462,753
Other interest		—		297,972	297,972
Total revenues		—		3,760,725	3,760,725
Expenditures:					
Administrative division		668,760		631,807	36,953
Legal division		876,967		429,909	447,058
Data processing division		347,956		297,449	50,507
Real estate division		1,644,979		1,519,848	125,131
Accounting division		609,447		592,982	16,465
Investment division		362,388		351,514	10,874
Minerals division		714,739		671,903	42,836
Audit division		558,333		521,399	36,934
Total expenditures		5,783,569		5,016,811	766,758
Net change in fund balance		(5,783,569)		(1,256,086)	4,527,483
Fund balance at beginning of year		6,937,460		6,937,460	—
Fund balance at end of year	$	1,153,891		5,681,374	4,527,483
Reconciliation to GAAP basis:					
Accrual Adjustments			$	(222,805)	
Fund balance			$	5,458,569	

See accompanying independent auditors’ report.

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA

Combining Balance Sheet – General Fund

June 30, 2009

Assets		Revolving 16	CLO	Combined total
Cash and cash equivalents	$	1,632,915	4,329,538	5,962,453
Investments		253,896	—	253,896
Other receivables		89,986	—	89,986
Total assets	$	1,976,797	4,329,538	6,306,335
Liabilities and Fund Balance				
Liabilities:				
Accounts payable and accrued expenses	$	847,766	—	847,766
Equity:				
Fund balances – unreserved		1,129,031	4,329,538	5,458,569
Total liabilities and equity	$	1,976,797	4,329,538	6,306,335

See accompanying independent auditors’ report.

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA

Schedule of Distributions to University and College Beneficiaries

Year ended June 30, 2009

		2009
University of Oklahoma	$	6,550,471
Oklahoma State University		5,616,168
Langston University		1,504,117
Northern Oklahoma College		1,988,334
Southeastern Oklahoma State University		739,340
University of Central Oklahoma		739,340
East Central Oklahoma State University		739,340
Northeastern Oklahoma State University		739,340
Northwestern Oklahoma State University		739,340
Southwestern Oklahoma State University		739,340
Cameron University		739,340
Oklahoma Panhandle State University		739,340
University of Science and Arts		739,340
	$	22,313,150

See accompanying independent auditors' report.

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA

Schedule of Distributions to Public School Beneficiaries

Year ended June 30, 2009

		2009
County:		
Adair	$	459,191
Alfalfa		67,395
Atoka		222,690
Beaver		109,888
Beckham		349,422
Blaine		184,947
Bryan		678,480
Caddo		558,731
Canadian		2,006,824
Carter		861,825
Cherokee		710,867
Choctaw		254,192
Cimarron		42,964
Cleveland		3,804,451
Coal		117,180
Comanche		2,058,660
Cotton		115,189
Craig		294,588
Creek		1,239,533
Custer		439,410
Delaware		644,342
Dewey		72,917
Ellis		76,550
Garfield		886,777
Garvin		507,143
Grady		852,857
Grant		82,504
Greer		93,445
Harmon		51,684
Harper		71,681
Haskell		221,028
Hughes		224,940
Jackson		486,026
Jefferson		114,250
Johnston		181,857
Kay		797,863
Kingfisher		311,752
Kiowa		164,720
Latimer		167,957
Leflore		934,067
Lincoln		555,791
Logan		424,377
Love		156,512
Major		141,730
Marshall		267,569

(Continued)

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA

Schedule of Distributions to Public School Beneficiaries

Year ended June 30, 2009

		2009
County:		
Mayes	$	699,912
McClain		625,426
McCurtain		678,745
McIntosh		296,629
Murray		218,028
Muskogee		1,292,593
Noble		212,160
Nowata		199,094
Okfuskee		212,373
Oklahoma		10,601,067
Okmulgee		673,621
Osage		394,148
Ottawa		580,804
Pawnee		250,384
Payne		954,504
Pittsburg		730,581
Pontotoc		655,794
Pottawatomie		1,210,059
Pushmataha		221,192
Roger Mills		83,425
Rogers		1,350,088
Seminole		477,678
Sequoyah		840,755
Stephens		770,004
Texas		390,173
Tillman		156,246
Tulsa		10,424,941
Wagoner		622,132
Washington		789,625
Washita		208,452
Woods		119,040
		335,013
	$	60,341,452

See accompanying independent auditors' report.

KPMG LLP
210 Park Avenue, Suite 2850
Oklahoma City, OK 73102-5683

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*

Commissioners of the Land Office
State of Oklahoma:

We have audited the financial statements of the governmental activities of the Commissioners of the Land Office, State of Oklahoma, as of and for the year ended June 30, 2009, and have issued our report thereon dated October 26, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 Commissioners of the Land Office, State of Oklahoma's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commissioners of the Land Office, State of Oklahoma's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commissioners of the Land Office, State of Oklahoma's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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

09-01 Royalty Compliance Override of Internal Controls

Management determined during the year, and KPMG reviewed as part of our audit procedures, that a management override of controls with regard to cash receipts occurred in the royalty compliance division. Through management's investigation it was determined that the embezzlement had been occurring for multiple years. In response to the finding, management took decisive legal action against the individual as well as reviewed and enhanced their mailroom and cash receipt control processes. KPMG has determined the override of controls and lack of proper segregation of duties surrounding cash receipts to be a material weakness in internal controls over financial reporting.

Management's Response

We concur with the finding. The employee who embezzled the funds was terminated and the matter was referred to the Attorney General. We reviewed the mailroom and cash receipt procedures, tightened security and implemented stronger controls.

09-02 Financial Reporting

In the course of the audit, entries were suggested by KPMG to present the financial statements in accordance with U.S. generally accepted accounting principles (GAAP). These entries related to GAAP accruals and corrections of financial reporting for the fund financial statements. Management should review and enhance the financial reporting process to ensure that information is properly presented. KPMG may assist the Agency in the preparation of the financial statements as long as management takes ownership of the process and has the appropriate knowledge base. KPMG recommends the Agency identify a position to perform these responsibilities and ensure they have the proper training to perform their assigned responsibilities.

Management's Response

We concur with the finding. The Director of Accounting will be responsible for the financing reporting process and ensuring that information is properly presented. The Director of Accounting will take steps to ensure that comprehensive expertise is developed and/or retained to prepare GAAP financial statements.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commissioners of the Land Office, State of Oklahoma's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations 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*.

We noted certain matters that we reported to management of the Commissioners of the Land Office in a separate letter dated October 26, 2009.

The Commissioners of the Land Office, State of Oklahoma's response to the finding identified in our audit is described above. We did not audit the Commissioners of the Land Office, State of Oklahoma's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Commissioners, others within the entity, and beneficiaries of the Commissioners of the Land Office, State of Oklahoma, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 26, 2009