



**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Financial Statements

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)



KPMG LLP
700 Oklahoma Tower
210 Park Avenue
Oklahoma City, OK 73102-5671

Independent Auditors' Report

Board of Trustees
Oklahoma State Employees
Deferred Compensation Plan:

We have audited the accompanying statements of plan net assets of the Oklahoma State Employees Deferred Compensation Plan (the Plan), as of June 30, 2006 and 2005, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards 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 Plan'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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets as of June 30, 2006 and 2005, and the changes in plan net assets for the years 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 5, 2006, on our consideration of the Plan'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.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the 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.

KPMG LLP

October 5, 2006

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Management's Discussion and Analysis

As management of the Oklahoma State Employees Deferred Compensation Plan (the Plan) which is administered by the Oklahoma Public Employees Retirement System (OPERS), we offer readers of the Plan's financial statements this narrative overview and analysis of the financial activities of the Plan for the fiscal years ended June 30, 2006, 2005 and 2004.

Financial Highlights

- The net assets available for plan benefits totaled approximately \$395.6 million at June 30, 2006 compared to approximately \$354.8 million at June 30, 2005, and approximately \$325.2 million at June 30, 2004. These funds are available for distribution to plan participants in accordance with Plan provisions.
- At June 30, 2006, the number of active, retired or inactive participants increased to 32,192 compared to 30,972 and 30,154 at June 30, 2005 and 2004, respectively.
- In October, 2005, the Board of Trustees (the Board) voted to remove the savings option from the investment line-up to reduce redundancy in investment options. The savings option was closed to new investments in May 2006, and investment balances remaining in the savings options at May 22, 2006, were transferred to the stable value fund. In June 2004, the Board voted to replace the Plan's specialty fund with an aggressive growth mid-cap fund.
- A Request for Proposals (RFP) was issued by the Board in November 2005 for potential vendors to provide recordkeeping and communication services for the Plan. A separate RFP was also issued for a stable value fund manager. After evaluation of the responses, in April 2006, the Board voted to retain Great-West to provide these services.
- The Plan's average annualized rates of return of its mutual funds for the one-year period ended June 30, 2006, ranged from a high of 32.34% to a low of negative 0.91%. This compares with a high of 37.26% and a low of 4.27% in the corresponding prior-year period. For the year ended June 30, 2004 the returns ranged from a low of 0.20% to a high of 35.90%.

Overview of the Financial Statements

The Plan is a deferred compensation plan as authorized by Section 457 of the Internal Revenue Code (IRS), as amended, through which the State of Oklahoma (the State) offers its employees the option to defer income in accordance with IRS and Plan guidelines. Participants may direct their contributions in available investment options offered by the Plan and are 100% vested in their accounts. Benefits are payable to participants, in accordance with Plan provisions, upon termination of employment with the State, retirement, death, or unforeseeable emergency based on the participant's account balance.

The Plan's financial statements are comprised of a Statement of Plan Net Assets, a Statement of Changes in Plan Net Assets, and Notes to Financial Statements.

The *statement of plan net assets* presents information on the Plan's assets and liabilities with the difference between the two reported as *net assets available for plan benefits*. This statement reflects, at fair value, the participants' balances in their selected investment options, which are available to pay benefits.

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Management's Discussion and Analysis

The *statement of changes in plan net assets* presents information showing how the Plan's net assets available for plan benefits changed during the years ended June 30, 2006 and 2005. This statement reflects contributions made by and benefits paid to participants during the period. Investing activities during the period are also presented which include interest and dividends added to participant accounts and the net appreciation or depreciation in fair value of the investments. Other transfers and fees affecting participant accounts are also reported in this statement.

The *notes to financial statements* provide additional information that is essential to a full understanding of the data provided in the financial statements. The Plan does not meet the criteria for inclusion in the financial statements of the State of Oklahoma.

Financial Analysis

Plan net assets at June 30 are summarized as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Cash and cash equivalents	\$ 53,762	\$ 50,916	\$ 47,695
Contributions receivable	637,654	551,018	—
Investments:			
Savings accounts	—	37,301,371	39,095,452
Stable value fund	130,291,404	85,817,110	75,915,904
Mutual funds	264,162,216	230,586,918	209,520,094
Annuity contracts	547,010	573,812	624,200
Total assets	<u>395,692,046</u>	<u>354,881,145</u>	<u>325,203,345</u>
Other liabilities	53,762	50,916	47,695
Ending net assets	<u>\$ 395,638,284</u>	<u>\$ 354,830,229</u>	<u>\$ 325,155,650</u>

Summarized changes in Plan net assets are as follows for the years ended June 30:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Additions:			
Contributions	\$ 31,259,125	\$ 28,726,373	\$ 27,806,066
Investment income	32,126,803	23,097,985	37,415,546
Total additions	<u>63,385,928</u>	<u>51,824,358</u>	<u>65,221,612</u>
Deductions:			
Benefits and transfers	22,322,304	21,905,169	22,085,886
Administrative fees	255,569	244,610	241,432
Total deductions	<u>22,577,873</u>	<u>22,149,779</u>	<u>22,327,318</u>
Increase in net assets	<u>\$ 40,808,055</u>	<u>\$ 29,674,579</u>	<u>\$ 42,894,294</u>

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Management's Discussion and Analysis

Contributions to the Plan increased by \$2.5 million or 8.82% in 2006 and by \$920,000 or 3.31% in 2005, reflecting the increase in the number of active participants. Participants elected to allocate their contributions to the Plan for the years ended June 30, 2006, 2005, and 2004 as follows:

	2006		2005		2004	
Savings accounts	7.3	%	9.0	%	9.9	%
Stable value fund	23.0		21.8		22.1	
Bond funds	8.0		8.4		9.0	
Balanced fund	4.7		4.3		3.5	
Large-Cap equity funds	23.3		25.4		25.9	
Mid-Cap equity fund	13.6		13.6		6.1	
Small-Cap equity funds	11.3		10.7		8.7	
Specialty fund	0.0		0.8		10.2	
International equity funds	8.8		6.0		4.6	
	100.0	%	100.0	%	100.0	%

Benefits and transfers paid to participants totaled \$22.3 million in the fiscal year ended June 30, 2006 compared to \$21.9 million in 2005 and \$22.1 million in 2004. During 2006, benefit payments for death, retirement and severance of employment increased approximately \$99,000 along with a \$194,000 increase in hardship distributions and \$123,000 increase in other payments. Benefit payments in 2005 and 2004 remained constant.

At June 30, 2006, Plan investments totaled \$395 million, an increase of \$40.7 million or 11.5% over the prior year. During this period, the returns for the total US Equity market were 9.6% while the US fixed income market declined 0.8%. Plan investments increased \$29.1 million to \$354.3 million at June 30, 2005 an increase of 8.9%. The return for the total US Equity market for this period was 8.1% and the total US. fixed income markets return was 6.8%.

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Management's Discussion and Analysis

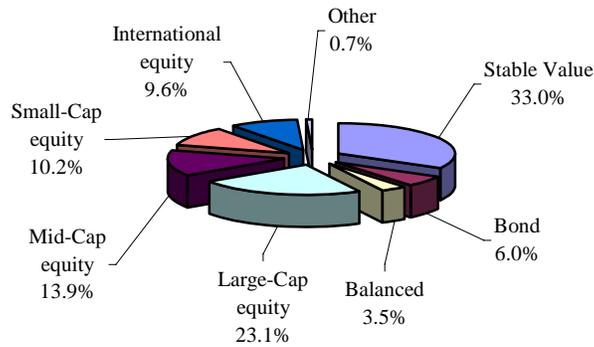
A summary of the mutual fund balances at June 30, 2006 and 2005 and the one-year annualized returns as of the fiscal years then ended is as follows:

	<u>Year ended June 30, 2006</u>			<u>Year ended June 30, 2005</u>	
	<u>Balance (000's)</u>	<u>One-Year Returns</u>		<u>Balance (000's)</u>	<u>One-Year Returns</u>
Bond funds:					
Evergreen Core Bond Fund	\$ 9,875	-0.91 %	\$	10,885	6.43 %
T. Rowe Price High-Yield Fund	6,692	5.06		5,925	9.53
T. Rowe Price Spectrum Income Fund	7,290	2.80		7,038	7.98
	<u>23,857</u>			<u>23,848</u>	
Balanced fund:					
T. Rowe Price Balanced Fund	13,862	7.50		12,067	9.00
Large-Cap equity funds:					
American Century Income & Growth	32,318	7.24		31,299	8.28
BGI S&P 500 Stock Fund	12,995	8.43		12,977	6.14
T. Rowe Price Blue Chip Growth Fund	41,886	6.51		40,839	4.37
T. Rowe Price Total Equity Market Fund	4,017	9.88		2,926	8.11
	<u>91,216</u>			<u>88,041</u>	
Mid-Cap equity fund:					
Dreyfus Premier New Leaders Fund	22,514	15.95		19,051	11.04
American Century Vista Advisor Fund	32,211	16.81		26,843	4.27
	<u>54,725</u>			<u>45,894</u>	
Small-Cap equity funds:					
Janus Small Cap Value Fund	18,834	7.48		18,043	10.05
Columbia Acorn Fund	21,367	16.44		16,716	14.58
	<u>40,201</u>			<u>34,759</u>	
International equity funds:					
American Funds EuroPacific Growth Fund	16,264	28.36		11,344	15.07
T. Rowe Price Emerging Markets Stock	21,489	32.34		12,792	37.26
	<u>37,753</u>			<u>24,136</u>	
Self-directed brokers mutual fund option	<u>2,548</u>	n/a		<u>1,842</u>	n/a
Total mutual funds	<u>\$ 264,162</u>		\$	<u>230,587</u>	

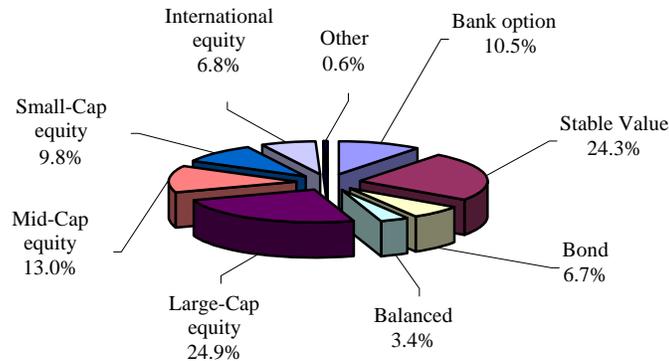
**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**
Administered by the Oklahoma Public Employees Retirement System
Management's Discussion and Analysis

At June 30, 2006 and 2005, the participant balances, including accruals, were invested as follows:

June 30, 2006



June 30, 2005



Other

Other than changes in the fair value of Plan assets as may be impacted by the stock and bond markets, no other matters are known by management to have a significant impact on the operations or financial position of the Plan.

Requests for Information

This financial report is designed to provide a general overview of the Plan's finances for all those with an interest. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Plan Administrator, Defined Contribution Plans, c/o OPERS, P.O. Box 53007, Oklahoma City, Oklahoma 73152-3007.

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Statements of Plan Net Assets

June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash and cash equivalents	\$ 53,762	\$ 50,916
Contributions receivable	637,654	551,018
Investments:		
Savings accounts	—	37,301,371
Stable value fund	130,291,404	85,817,110
Mutual Funds:		
Bond funds	23,857,008	23,848,396
Balanced funds	13,862,122	12,067,271
Large-Cap equity funds	91,215,711	88,040,778
Mid-Cap equity fund	54,724,568	45,893,684
Small-Cap equity funds	40,201,939	34,758,896
International equity funds	37,753,038	24,135,643
Self-directed brokerage mutual funds option	2,547,830	1,842,250
	<u>264,162,216</u>	<u>230,586,918</u>
Metropolitan Life Insurance Company Annuity Contracts	547,010	573,812
Total investments	<u>395,000,630</u>	<u>354,279,211</u>
Total assets	395,692,046	354,881,145
Other liabilities	<u>53,762</u>	<u>50,916</u>
Net assets available for plan benefits	<u>\$ 395,638,284</u>	<u>\$ 354,830,229</u>

See accompanying notes to financial statements.

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Statements of Changes in Plan Net Assets

Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Additions:		
Contributions:		
Participants	\$ 31,088,355	\$ 28,689,556
Plan to plan transfers	170,770	36,817
Total contributions	<u>31,259,125</u>	<u>28,726,373</u>
Investment income:		
Net appreciation in fair value of investments	15,218,590	9,640,896
Interest and dividends	16,908,213	13,457,089
Total investment income	<u>32,126,803</u>	<u>23,097,985</u>
Total additions	63,385,928	51,824,358
Deductions:		
Benefits paid to participants	22,322,304	21,905,169
Administrative fees	255,569	244,610
Total deductions	<u>22,577,873</u>	<u>22,149,779</u>
Net increase	40,808,055	29,674,579
Net assets available for plan benefits:		
Beginning of year	<u>354,830,229</u>	<u>325,155,650</u>
End of year	<u>\$ 395,638,284</u>	<u>\$ 354,830,229</u>

See accompanying notes to financial statements.

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2006 and 2005

(1) Description of the Plan

The following brief description of the Oklahoma State Employees Deferred Compensation Plan (the Plan), which is administered by the Oklahoma Public Employees Retirement System (OPERS), is provided for general information purposes only. For a more complete description of the Plan provisions, refer to the detailed Plan documents or Title 74 of the Oklahoma Statutes (O.S.).

The State of Oklahoma (the State) offers its employees a deferred compensation plan as authorized by Section 457 of the Internal Revenue Code (IRC), as amended by the Tax Reform Act of 1986, and in accordance with the provisions of Sections 1701 through 1706 of Title 74 of the O.S.

The supervisory authority for the management and operation of the Plan is the Board of Trustees (the Board) of OPERS.

The Plan is available to all State employees, as well as any elected officials receiving a salary from the State. Participants may direct the investment of their contributions in available investment options offered by the Plan. The minimum contribution amount is the equivalent of \$25 per month and participants are immediately 100% vested in their respective accounts. All interest, dividends and investment fees are allocated to participants' accounts.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) included the following provisions affecting the Plan:

- Participants may defer until future years up to the lesser of 100% of their compensation as defined by Plan documents or the maximum amount allowed each year as determined by the Internal Revenue Service, increased to \$15,000 effective January 1, 2006 from \$14,000.
- The Plan offers a catch-up program to participants, which allows them to defer annually for the three years prior to their year of retirement up to twice that Plan year's deferral limit. The amount of additional contributions in excess of the normal maximum contributions to the Plan are also limited to contributions for the years in which the participant was eligible but did not participate in the Plan or the difference between contributions made and the maximum allowable level. To be eligible for the catch-up program, the participant must be within three years of retirement with no reduced benefits.
- Participants age 50 or older may make additional contributions (\$5,000 for 2006 and \$4,000 for 2005) annually subject to certain limits.

Deferred compensation benefits are paid to participants or beneficiaries upon termination, retirement, death or unforeseeable emergency. Such benefits are based on a participant's account balance and are disbursed in a lump sum or periodic payments at the option of the participant or beneficiaries in accordance with Plan provisions.

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2006 and 2005

Effective January 1, 1998, the Board established a Trust and Trust Fund covering the Plan assets, pursuant to federal legislation enacted in 1996, requiring public employers to establish such trusts for plans meeting the requirements of Section 457 of the IRC no later than January 1, 1999. Under the terms of the Trust, the corpus or income of the Trust Fund may be used only for the exclusive benefit of the Plan participants and their beneficiaries. Prior to the establishment of the Trust, Plan assets were subject to the claims of general creditors of the State. The Board acts as trustee of the Trust. The participants' accounts are invested in accordance with the investment elections of the participants. The Board is accountable for all deferred compensation received, but has no duty to require any compensation to be deferred or to determine that the amounts received comply with the Plan or to determine that the Trust Fund is adequate to provide the benefits payable pursuant to the Plan.

At June 30, the Plan's membership consisted of the following:

	<u>2006</u>	<u>2005</u>
Active participants	24,742	23,999
Retired and inactive participants	7,450	6,973
	<u>32,192</u>	<u>30,972</u>

(2) Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements have been prepared on the economic resources measurement focus and the accrual basis of accounting. Salary deferrals are generally recorded when received and, as required by State law, are posted and transferred within ten (10) business days to the investment option as determined by the participant.

Consistent with the provisions of Statement No. 32 of the Governmental Accounting Standards Board (GASB), *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, the Plan does not meet the criteria for inclusion in the fiduciary funds of the State. The separate financial statements of the Plan present net assets available for plan benefits and changes in net assets available for plan benefits for the years ended June 30, 2006 and 2005.

Contributions Receivable

Contributions receivable included in the Statements of Plan Net Assets represent contributions withheld from participants' salaries but not yet remitted to the Plan by the state agency responsible for the payrolls.

Investments

The Plan is authorized to invest in eligible investments as prescribed in Title 74 O.S. 1701. Investments in the mutual funds are presented at their fair value based on published market prices. Investments in savings accounts, annuity contracts and the stable value fund are presented at contract value, which approximates their fair value.

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2006 and 2005

Administrative Expenses

Certain administrative functions of the Plan are provided by OPERS and the related expenses are not reflected in these financial statements. These administrative expenses would not be material to the Plan if recorded. The employers of eligible participants are required to remit directly to the Oklahoma State Employees Deferred Savings Incentive Plan (the Savings Incentive Plan) the equivalent of \$1.78 (\$1.67 in 2005) per month for reimbursement to OPERS of administrative expenses incurred on behalf of the Plan and the Savings Incentive Plan. In addition, in 2005, approximately \$62,000 of previously unused appropriated funds were used to supplement amounts received from employers. In accordance with an administrative expense allocation policy adopted by the Board, approximately \$459,700 in 2006 and \$432,900 in 2005 from these funds were remitted to OPERS to cover the Plan's allocable share of such expenses.

A \$2 fee is deducted from each participant's account balance at the end of each quarter by the recordkeeper for the Plan, for recordkeeping and communication expenses. These amounts are reflected as administrative fees in the accompanying statements of changes in plan net assets.

Federal Income Tax Status

The Plan has received a favorable private letter ruling from the Internal Revenue Service dated July 7, 1999. The ruling concludes that the Plan is an eligible deferred compensation plan as defined in Section 457 of the IRC and amounts deferred in the Plan are taxable only in the year or years in which amounts are paid out of the Plan. The Trust established under the Plan is treated as exempt from federal income taxation.

Use of Estimates

The preparation of the Plan's financial statements in conformity with U.S. generally accepted accounting principles requires the Plan administrator to make significant estimates and assumptions that affect the reported amounts of plan net assets at the date of the financial statements and the changes in plan net assets during the reporting periods and, when applicable, disclosures of contingent assets at the date of the financial statements. Actual results could differ from those estimates.

Risks and Uncertainties

The Plan provides for various investment options in any combination of savings accounts, mutual funds, and other investment securities. Investment securities are exposed to various risks, such as interest rate, market and credit risks. Due to the risks associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities may occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the accompanying statements of plan net assets.

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2006 and 2005

(3) Cash and Cash Equivalents

Cash represents cash on deposit with the State as a part of a pool maintained by the State Treasurer. At June 30, 2006 and 2005, the Plan had enrolled in OK INVEST an internal investment pool of the State Treasurer with holdings limited to high-rated money market mutual funds, obligations of the U.S. Government, U.S. Government agencies and instrumentalities and collateralized tri-party repurchase agreements. Participants are limited to qualifying agencies and funds within the State's reporting entity, and each participant maintains an interest in the underlying investment of OK INVEST and shares the risk of loss on the funds in proportion to the respective investment in the funds.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agency but not in the depositor-government's name. At June 30, 2006 and 2005, the cash equivalents in OK INVEST were not exposed to custodial credit risk because their existence is not evidenced by securities that exist in physical or book entry form. The Plan does not have a formal deposit policy for custodial credit risk.

At June 30, 2006, the carrying amount of the Plan's cash deposits and the bank balance at the Office of the State Treasurer totaled \$3,977. At June 30, 2005, as a result of outstanding checks, the carrying amount of the Plan's cash deposits and bank balance totaled \$3,977 while the bank balance at the Office of the State Treasurer in which the deposits are held totaled \$1,529,277. Generally, any funds received by the Plan, including contributions, are transferred to the recordkeeper within one business day.

At June 30, 2006 and 2005, funds were held in the Plan's name by its recordkeeper in the amounts of \$49,785 and \$46,939, respectively, representing distributions payable to participants who cannot currently be located. The funds are invested in the Plan's stable value fund which is described in note 4. The liability for these amounts is included in Other Liabilities in the Statement of Plan Net Assets.

(4) Investments

The Plan's Investment Policies and Guidelines state that the Board of OPERS has the fiduciary responsibility to provide investment and administrative services to the Plan's participants and sets forth the following objectives:

- To provide participants with a prudent menu of investment options to diversify their investment portfolios in order to efficiently achieve reasonable financial goals for retirement.
- To provide education to participants to help them build portfolios that maximize the probability of achieving their investment goals.
- To administer the Plan in an efficient manner, such that participants are able to monitor their individual portfolios and make suitable adjustments in a timely manner.
- To provide competitive investment options in major asset classes at a reasonable cost.

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2006 and 2005

- To establish criteria and procedures for the ongoing evaluation of the investment offered, which are consistent with prudent investment management and participants' needs for diverse investment options.
- To establish procedures for the selection, evaluation, review, and elimination of fund options and the Board's expectations regarding each fund option.

The menu of core investment options must include at least one offering in each of the following asset categories: Cash Equivalents, Fixed Income, Balanced, Domestic Large Cap Equity, Domestic Small and Mid Cap Equity, and International Equity. With the exception of the cash equivalent category, the Plan is structured such that all core investment options are publicly traded mutual funds.

Great-West/BenefitsCorp. (Great-West) is the Plan's recordkeeper. An "unbundled" group of mutual funds and a self-directed brokerage option is offered by various fund managers to Plan participants. In addition, a self-directed brokerage option was added in 2001 to allow participants access to a variety of other mutual fund options.

A brief description of the investment options is as follows:

Bank Option

The Savings option offered a Federal Deposit Insurance Corporation (FDIC) insured savings account. The savings account bore interest equal to the mean of the 3-month Treasury bill auctions, occurring the previous month plus an additional 0.25%. The rates for the quarter ended June 30, 2005 ranged from 3.05% to 3.17%.

In October 2005, the Board voted to remove the Savings option from the investment line-up. The Savings option was closed to new investments in May, 2006, and investment balances remaining in this option at May 22, 2006, were transferred to the SoonerSave Stable Value Fund (SoonerSave Fund).

Stable Value Fund

Great-West, as the Plan's trustee and recordkeeper, has established a separate stable value fund, the SoonerSave Fund, for the Plan and the Savings Incentive Plan. The SoonerSave Fund provides a stable rate of return by investing in a pool of government securities backed by the full faith and credit of the U.S. government and/or its agencies. In advance of each calendar quarter, Great-West establishes a rate of return for that quarter for the SoonerSave Fund. The rates in effect for the quarters ended June 30, 2006 and 2005 were 4.45% and 4.20%, respectively.

Stable value fund investment income included in the accompanying financial statements is net of annual fees which are deducted from earnings prior to posting to the participant accounts. The annual fee as a percentage of participating assets was .50% through April 30, 2006, and was reduced to .40% effective May 1, 2006.

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2006 and 2005

Mutual Funds

At June 30, 2006 and 2005, the Plan offered 14 mutual funds from 8 fund families and is composed to three (3) bond funds; eight (8) equity funds which includes large-, mid-, and small-cap funds; two (2) international equity funds; and one (1) balanced fund with a mix of bond and equity securities. A specialty (market sector) fund which was offered during 2004 was replaced during 2005 with a mid-cap equity fund. A self-directed brokerage option is also available to qualifying participants through an independent broker, which allows investment in mutual funds not offered by the Plan for a \$15 quarterly fee charged directly to the participant.

Shares of these funds are not insured, although some securities in which the funds invest may be insured or backed by the U.S. Government or its agencies. Investment income in the accompanying financial statements is net of management and other expenses charged by the funds' managers which are deducted from earnings prior to posting to the participant accounts. The mutual funds are no-load funds.

Metropolitan Life Insurance Company Annuity Contracts (Metropolitan)

Through June 30, 1995, participants could pool their deferred compensation at retirement and purchase an annuity contract from Metropolitan to receive benefits over the duration of their annuity contract.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Other than the requirement that the duration of the SoonerSave Fund cannot exceed five years, the Plan investment guidelines include no formal policy on interest rate risk. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates based upon the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price. The average effective duration in years as provided by data from Morningstar, Inc. reports were:

	June 30, 2006		June 30, 2005	
	Fair value	Weighted Average Duration	Fair value	Weighted Average Duration
<u>Fixed Income Mutual Funds</u>				
T. Rowe Price Spectrum Income Fund	\$ 7,290,215	4.00	\$ 7,038,147	3.90
Evergreen Core Bond Fund	9,874,801	4.70	10,884,967	4.30
T. Rowe Price High-Yield Fund	6,691,992	4.00	5,925,282	3.80

At June 30, 2006 and 2005, the fair value of the SoonerSave Fund was \$130,291,404 and \$85,817,110 and the weighted average duration as provided by GreatWest was 2.80 years and 3.06 years, respectively.

**OKLAHOMA STATE EMPLOYEES
DEFERRED COMPENSATION PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2006 and 2005

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the Plan. The Plan's policies and guidelines set forth specific criteria for selection of mutual fund options to be offered to participants and provide that a review and evaluation of these funds will be performed at least annually. While the guidelines set no specific rating criteria for the fixed income mutual funds, these funds are subject to the selection and review provisions as all of the other mutual fund investments. At June 30, 2006 and 2005, the weighted averaged credit ratings for the fixed income securities included in the fixed income mutual funds, as provided by Morningstar, Inc. reports, were as follows: T. Rowe Price High-Yield Fund – B, and the Evergreen Core Bond Fund – AAA. The T. Rowe Price Spectrum Income Fund was rated A at June 30, 2006 and B at June 30, 2005.

The Plan's policies and guidelines require that the credit quality of the SoonerSave Fund be that of securities issued by the U.S. government and agencies and commercial bank securities with FDIC guarantees. The investments in the SoonerSave Fund at June 30, 2006 and 2005 were primarily composed of mortgage-backed and asset-backed securities which were all rated AAA.

(5) Savings Incentive Plan

Contributions equivalent to \$25 per month for qualified participants of the Plan who are making deferrals of at least \$25 per month were remitted by the participants' employers to the Savings Incentive Plan, a separate qualified defined contribution plan established in accordance with Section 401(a) of the IRC. The funds of the Savings Incentive Plan are not included in the accompanying financial statements.



KPMG LLP
700 Oklahoma Tower
210 Park Avenue
Oklahoma City, OK 73102-5671

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

Board of Trustees
Oklahoma State Employees
Deferred Compensation Plan:

We have audited the financial statements of the Oklahoma State Employees Deferred Compensation Plan (the Plan), as of and for the year ended June 30, 2006, and have issued our report thereon dated October 5, 2006, which includes an explanatory paragraph related to required supplementary information. We conducted our audit in accordance with U.S. generally accepted auditing standards 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 Plan's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting 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 Plan'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 on 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 Board of Trustees, the Oklahoma State Auditor and Inspector, and management and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 5, 2006