

**OKLAHOMA STATE EMPLOYEES
DEFERRED SAVINGS INCENTIVE PLAN**
Administered by the Oklahoma Public Employees Retirement System

Financial Statements

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

Independent Auditors' Report

Board of Trustees
Oklahoma State Employees
Deferred Savings Incentive Plan:

We have audited the accompanying statements of plan net assets of the Oklahoma State Employees Deferred Savings Incentive Plan (the Plan), as of June 30, 2012 and 2011, 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 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets as of June 30, 2012 and 2011, and the changes in plan net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, beginning on page 2, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2012 on our consideration of the Plan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 and 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.

Cole & Reed P.C.

Oklahoma City, Oklahoma
October 18, 2012

**OKLAHOMA STATE EMPLOYEES
DEFERRED SAVINGS INCENTIVE PLAN**

Administered by the Oklahoma Public Employees Retirement System

Management's Discussion and Analysis

As management of the Oklahoma State Employees Deferred Savings Incentive 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, 2012, 2011, and 2010.

Financial Highlights

- The net assets available for plan benefits totaled approximately \$147.2 million at June 30, 2012 compared to approximately \$142.9 million at June 30, 2011 and approximately \$120.0 million at June 30, 2010. These funds are available for distribution to plan participants in accordance with Plan provisions.
- At June 30, 2012, the number of active, retired or inactive participants increased to 35,906 compared to 35,366 and 35,198 at June 30, 2011 and 2010, respectively.
- The Plan's average annualized rates of return of its mutual funds for the one-year period ended June 30, 2012, ranged from a high of 7.01% to a low of negative 15.58%. This compares with a high of 42.32% and a low of 11.33% in the corresponding prior-year period. For the year ended June 30, 2010 the returns ranged from a low of negative 9.48% to a high of negative 24.61%.
- During 2012, the Plan did not add any investment options.

Overview of the Financial Statements

The Plan is established as a money purchase pension plan pursuant to Internal Revenue Code (IRC) Section 401(a). Participants who are employees of the State of Oklahoma (the State) and active participants in the Oklahoma State Employees Deferred Compensation Plan (Deferred Compensation Plan) are eligible to receive contributions from the State to the Plan on their behalf at, currently, the equivalent of \$25 per month. Benefits are payable to participants, in accordance with plan provisions, upon termination of employment with the State, retirement, or death based on the participants' 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.

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, 2012 and 2011. This statement reflects contributions made on behalf of or by participants along with 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. Administrative fees affecting participant accounts are also reported in this statement.

The *notes to the 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.

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

Financial Analysis

Plan net assets at June 30 are summarized as follows:

	<u>2012</u>		<u>2011</u>		<u>2010</u>
Cash and cash equivalents	\$ 832,906	\$	630,191	\$	567,828
Contributions receivable	79,642		56,860		86,888
Investments:					
Stable value fun	69,407,191		65,105,040		60,703,379
Mutual funds	<u>77,678,198</u>		<u>77,785,976</u>		<u>59,163,452</u>
Total assets	147,997,937		143,578,067		120,521,547
Other liabilities	<u>830,795</u>		<u>628,080</u>		<u>565,716</u>
 Ending net assets	 <u>\$ 147,167,142</u>	\$	 <u>142,949,987</u>	\$	 <u>119,955,831</u>

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

	<u>2012</u>		<u>2011</u>		<u>2010</u>
Additions:					
Contributions	\$ 10,301,790	\$	10,354,944	\$	9,131,691
Investments income	<u>1,668,989</u>		<u>20,638,160</u>		<u>10,255,626</u>
Total additions	11,970,779		30,723,104		19,387,317
Deductions:					
Benefit paid to participants	7,610,942		7,588,148		5,655,896
Administrative fees	<u>142,682</u>		<u>140,800</u>		<u>142,542</u>
Total dedctions	<u>7,753,624</u>		<u>7,728,948</u>		<u>5,798,438</u>
 Increase in net assets	 <u>\$ 4,217,155</u>	\$	 <u>22,994,156</u>	\$	 <u>13,588,879</u>

Total contributions to the Plan for the year ended June 30, 2012 decreased approximately \$53,000 or negative 0.51% compared to the prior year. Total contributions for the year ended June 30, 2011 increased approximately \$1,223,000 or 13.4% compared to the prior year.

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

During the years ended June 30, 2012, 2011, and 2010, Plan participants elected to allocate their State contributions as follows:

	<u>2012</u>		<u>2011</u>		<u>2010</u>
Stable value fund	43.9 %		51.5 %		47.4 %
Bond funds	4.1		3.9		4.3
Balanced fund	4.4		3.4		4.1
Large-Cap equity funds	15.5		15.8		16.6
Mid-Cap equity funds	12.0		12.8		14.8
Small-Cap equity funds	3.4		3.0		3.2
International equity funds	6.2		6.7		7.8
Target date funds	10.5		2.9		1.8
	<u>100.0 %</u>		<u>100.0 %</u>		<u>100.0 %</u>

Benefits paid to participants in 2012 increased from 2011 levels approximately \$23,000 or 0.30% and increased approximately \$1,932,000 or 34.16%, from 2011 to 2010. The 2012 and 2011 increases were mainly attributable to member retirement payments and required minimum distributions.

At June 30, 2012, Plan investments totaled \$147.1 million, an increase of \$4.2 million or 2.9% compared to the prior year. During this period, the returns for the total US Equity market were 3.84% and 7.47% for the U.S. fixed income market. At June 30, 2011, Plan investments totaled \$142.9 million, an increase of \$23.0 million or 19.2% compared to the prior year. During this period, the returns for the total US Equity market were 32.37% and 3.90% for the U.S. fixed income market.

Additions to the Plan during fiscal year 2012 decreased \$18.8 million, or negative 61.0% compared to the prior year. This is mainly attributable to investment losses during the year.

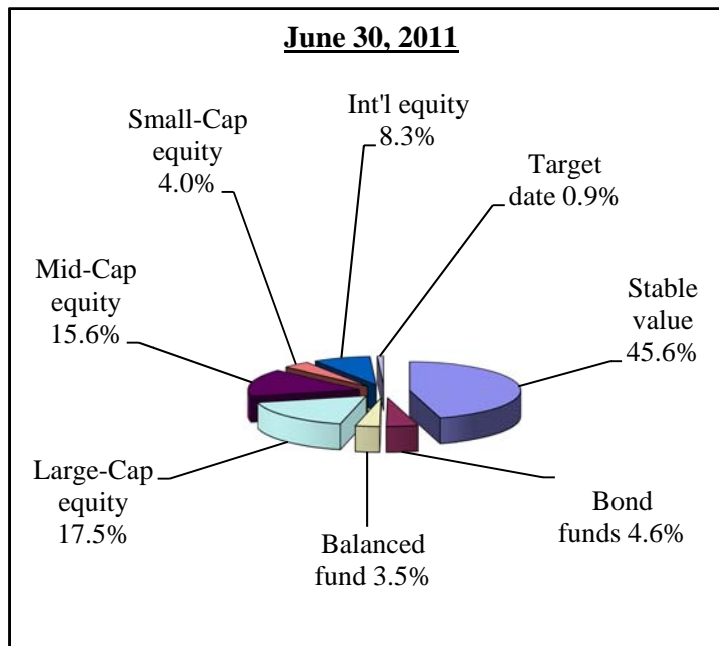
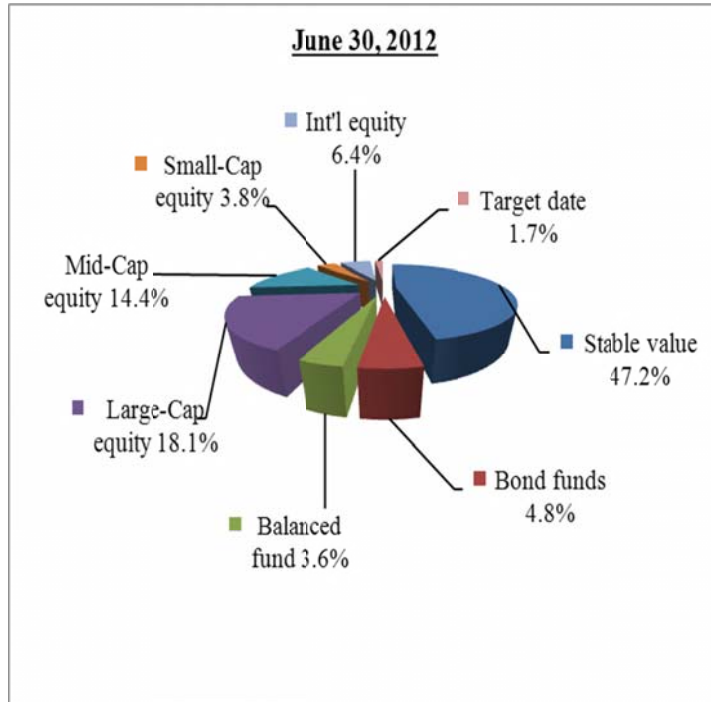
**OKLAHOMA STATE EMPLOYEES
DEFERRED SAVINGS INCENTIVE PLAN**
Administered by the Oklahoma Public Employees Retirement System
Management's Discussion and Analysis

A summary of the mutual fund balances at June 30, 2012 and 2011, and the one-year annualized returns of the fiscal years then ended is as follows:

	Year ended		Year ended	
	June 30, 2012		June 30, 2011	
	Balance (000's)	One Year Returns	Balance (000's)	One Year Returns
Balanced fund:				
T. Rowe Price Balanced Fund	\$ 5,272	2.25 %	\$ 4,998	22.78 %
Bond funds:				
T. Rowe Price High-Yield Fund	4,020	5.57	3,773	15.34
T. Rowe Price Spectrum Income Fund	3,011	5.08	2,782	11.33
	<u>7,031</u>		<u>6,555</u>	
International funds:				
American Funds EuroPacific Growth Fund	3,395	-12.93	4,078	29.03
T. Rowe Price Emerging Markets Stock	6,055	-15.58	7,753	27.38
	<u>9,450</u>		<u>11,831</u>	
Large-Cap funds:				
American Century Income and Growth	6,450	4.75	6,194	30.31
Blackrock S&P 500 Stock Fund	3,958	5.30	3,774	30.49
T. Rowe Price Blue Chip Growth Fund	14,799	7.01	13,811	35.53
T. Rowe Price Total Equity Market Fund	1,383	3.63	1,294	31.72
	<u>26,590</u>		<u>25,073</u>	
Mid-Cap equity funds:				
American Century Vista Advisor Fund	9,918	-4.79	10,532	42.32
Artisian Mid-Cap Value Fund	5,884	-0.53	5,883	33.57
Columbia Acorn Fund	5,455	-2.78	5,826	39.46
	<u>21,257</u>		<u>22,241</u>	
Small-Cap equity funds:				
Perkins Small-Cap Value Fund	5,295	-3.86	5,602	22.71
Blackrock Small-Cap Growth Equity	274	-6.54	161	41.02
	<u>5,569</u>		<u>5,763</u>	
Target date funds:				
Vanguard Target Retirement 2010	283	4.06	134	17.41
Vanguard Target Retirement 2020	956	1.75	418	22.13
Vanguard Target Retirement 2030	634	0.16	401	26.59
Vanguard Target Retirement 2040	451	-0.91	246	28.93
Vanguard Target Retirement 2050	185	-0.85	126	28.96
	<u>2,509</u>		<u>1,325</u>	
Total mutual funds	\$ <u>77,678</u>		\$ <u>77,786</u>	

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

At June 30, 2012 and 2011, the participant balances, including accruals, were invested as follows:



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

Economic Factors

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 3007, Oklahoma City, Oklahoma 73152-3007.

**OKLAHOMA STATE EMPLOYEES
DEFERRED SAVINGS INCENTIVE PLAN**
Administered by the Oklahoma Public Employees Retirement System

Statements of Plan Net Assets

June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash	\$ 832,906	\$ 630,191
Contributions receivable	79,642	56,860
Investments:		
Stable value fund	69,407,191	65,105,040
Mutual Funds:		
Bond funds	7,031,173	6,554,965
Balanced funds	5,271,722	4,998,467
Large-Cap equity funds	26,590,533	25,073,204
Mid-Cap equity fund	21,256,048	22,241,248
Small-Cap equity funds	5,569,245	5,762,504
International equity funds	9,450,521	11,831,054
Target date funds	2,508,956	1,324,534
Total mutual funds	<u>77,678,198</u>	<u>77,785,976</u>
Total investments	<u>147,085,389</u>	<u>142,891,016</u>
Total assets	<u>147,997,937</u>	<u>143,578,067</u>
Liabilities:		
OPERS administrative reimbursement collections in excess of remittances	293,073	215,404
Other payables	537,722	412,676
Total liabilities	<u>830,795</u>	<u>628,080</u>
Net assets available for plan benefits	<u>\$ 147,167,142</u>	<u>\$ 142,949,987</u>

See accompanying notes to financial statements.

**OKLAHOMA STATE EMPLOYEES
DEFERRED SAVINGS INCENTIVE PLAN**
Administered by the Oklahoma Public Employees Retirement System

Statements of Changes in Plan Net Assets

June 30, 2012 and 2011

	2012	2011
Additions:		
Contributions:		
Participants	\$ 7,220,413	\$ 7,341,877
Plan to plan transfers	3,081,377	3,013,067
Total contributions	10,301,790	10,354,944
Investment income:		
Net appreciation (depreciation) in fair value of investments	(2,753,085)	16,641,355
Interest and dividends	4,422,074	3,726,805
Total investment income	1,668,989	20,368,160
Total additions	11,970,779	30,723,104
Deductions:		
Benefits paid to participants	7,610,942	7,588,148
Administrative fees	142,682	140,800
Total deductions	7,753,624	7,728,948
Net increase	4,217,155	22,994,156
Net assets available for plan benefits:		
Beginning of year	142,949,987	119,955,831
End of year	\$ 147,167,142	\$ 142,949,987

See accompanying notes to financial statements.

**OKLAHOMA STATE EMPLOYEES
DEFERRED SAVINGS INCENTIVE PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2012 and 2011

(1) Description of the Plan

The following brief description of the Oklahoma State Employees Deferred Savings Incentive 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.).

Effective January 1, 1998, the State of Oklahoma (the State) established the Plan as a money purchase pension plan pursuant to Internal Revenue Code (IRC) Section 401(a). The Plan is intended to qualify as a governmental plan within the definition of IRC Section 414(d) and is not subject to the Employee Retirement Income Security Act of 1974 (ERISA). The Plan and its related Trust are intended to meet the requirements of IRC Sections 401(a) and 501(a).

Any qualified participant, who is a State employee that is an active participant in the Oklahoma State Employees Deferred Compensation Plan (Deferred Compensation Plan), is eligible for a contribution of the amount determined by the State Legislature, currently the equivalent of \$25 per month. The Deferred Compensation Plan is a voluntary deferred compensation plan offered to State employees, as defined, which is authorized by Section 457 of the IRC, as amended by the Tax Reform Act of 1986. Participation in the Plan is automatic in the month of participation in the Deferred Compensation Plan and is not voluntary.

Upon cessation of contributions to the Deferred Compensation Plan, termination of employment with the State, retirement, or death, a participant will no longer be eligible for contributions from the State into the Plan. Participants are at all times 100% vested in their Plan account. Participant contributions are not required or permitted. Qualified participants may make rollover contributions to the Plan, provided such rollover contributions meet the applicable requirements of the IRC. Plan participants may direct the investment of the contributions in available investment options offered by the Plan. All interest, dividends, and investment fees are allocated to the participants' accounts.

Plan benefits are paid to participants or beneficiaries upon termination, retirement, or death. Such benefits are based on a participant's account balance and are disbursed in a lump sum or periodic payments or may be rolled over to a qualified plan at the option of the participant or beneficiaries.

The employers of eligible participants are required to remit directly to the Plan the equivalent of \$25 per month for each qualified participant. The amounts remitted by the employers are reflected in the accompanying statements of changes in plan net assets as contributions from the State.

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

**OKLAHOMA STATE EMPLOYEES
DEFERRED SAVINGS INCENTIVE PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2012 and 2011

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

	2012	2011
Active participants	24,354	24,493
Retired and inactive participants	11,552	10,873
	35,906	35,366

(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. Certain prior year information has been reclassified to conform to the current year presentation.

Contributions Receivable

Contributions receivable included in the Statements of Plan Net Assets represent employer contributions not yet remitted to the Plan by the state agency responsible for payrolls.

Investments

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

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 were required to remit directly to the Plan the equivalent of \$1.54 (\$1.52 in 2011) per month for reimbursement to OPERS of administrative expenses incurred on behalf of the Plan and the Deferred Compensation Plan. In accordance with an administrative expense allocation policy adopted by the Board, approximately \$92,000 in 2012 and \$89,000 in 2011 was the Plan's share of such expenses.

A \$1 participant administrative services fee is deducted from each participant's account balance at the end of each quarter by the recordkeeper for the Plan. These amounts are reflected as administrative fees in the accompanying statements of changes in plan net assets.

**OKLAHOMA STATE EMPLOYEES
DEFERRED SAVINGS INCENTIVE PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2012 and 2011

Effective with the fiscal year beginning July 1, 2006, and with optional renewals for four succeeding terms of one year, the Board entered into an agreement with Great-West/BenefitCorp. (Great-West) for recordkeeping services for the Plan and the Deferred Compensation Plan. At the April 14, 2011 Board meeting the agreement was renewed for an additional year. Under terms of this agreement, as amended, Great-West will receive an administrative service fee comprised of the following four components: (1) per participant administrative service fee; (2) per participant self-directed brokerage option service fee; (3) mutual fund re-allowance revenue; and (4) Stable Value Fund revenue.

The agreement defines specific fees for each component and a maximum administrative fee of \$37.50 per participant per year that Great-West can receive as compensation. In the event that the compensation received by Great-West exceeds the maximum fee, the Plan and the Deferred Compensation Plan are entitled to a credit of that amount, which would first be offset by any revenue deficits. Great-West has established an Excess Revenue Sharing Account, currently invested in the Stable Value Fund, into which the estimated excess credits are deposited quarterly, pending final accounting within 60 days of year end. The Board may authorize Great-West to utilize the excess credits to provide additional services or options to the Plan and the Deferred Compensation Plan or to participants.

Federal Income Tax Status

The Plan has received a favorable determination letter from the Internal Revenue Service dated January 31, 2000, affirming that the Plan, in its present form, is qualified under the IRC and is entitled to favorable tax treatment. The Plan has been amended since receiving the determination letter; however, the plan administrator believes that the Plan is designed and is currently being operated in substantial compliance with the applicable requirements of the IRC and will retain its status as a qualified plan.

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 SAVINGS INCENTIVE PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2012 and 2011

(3) Cash and Cash Equivalents

Cash and cash equivalents represent cash and cash equivalents on deposit with the State as a part of a pool maintained by the State Treasurer. At June 30, 2012 and 2011, 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 collateralized certificates of deposit, mortgage-backed pass-through agency securities and 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, 2012 and 2011, 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, 2012 and 2011, the carrying amount of the Plan's cash deposits and the bank balances at the Office of the State Treasurer totaled \$620,125 and \$452,626 respectively. Generally, any funds received by the Plan, including contributions, are transferred to the recordkeeper within one day.

At June 30, 2012 and 2011, cash of \$1,712 and \$1,771, respectively, was held in the Plan's name by its recordkeeper 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 this amount is included in Other Payables in the Statements of Plan Net Assets.

At June 30, 2012 and 2011, funds were also held in the Plan's name by its recordkeeper in the stable value fund in the amount of \$524,791 and \$400,537, respectively. These funds represent the estimated revenue share amount plus earnings, resulting from the Excess Revenue Sharing agreement described in Note 2. The liability for this amount is included in Other Payables in the Statements of Plan Net Assets.

(4) Investments

The Plan's Investment Policies and Guidelines state that the Board of Trustees 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 which maximize the probability of achieving their investment goals.

**OKLAHOMA STATE EMPLOYEES
DEFERRED SAVINGS INCENTIVE PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2012 and 2011

- 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.
- 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.

An "unbundled" group of mutual funds offered by various fund managers is available to Plan participants.

A brief description of the investment options is as follows:

Stable Value Fund

Great-West, as the Plan's trustee and recordkeeper, has established a separate stable value fund, the SoonerSave Stable Value Fund (SoonerSave Fund), for the Plan and the Deferred Compensation Plan. The SoonerSave Fund provides a stable rate of return by investing in a pool of government securities backed by 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 rate in effect for the quarters ended June 30, 2012 and 2011 was 2.95% and 3.65%, 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.

Mutual Funds

As of June 30, 2012, no funds were added to the Plan. At June 30, 2012 and 2011 the Plan offered 19 mutual funds from 8 fund families. The composition is two (2) bond funds; nine (9) equity funds which includes large-, mid-, and small-cap funds; two (2) international equity funds; one (1) balanced fund with a mix of bond and equity securities; and (5) target date funds.

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.

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

**OKLAHOMA STATE EMPLOYEES
DEFERRED SAVINGS INCENTIVE PLAN**

Administered by the Oklahoma Public Employees Retirement System

Notes to Financial Statements

June 30, 2012 and 2011

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:

<u>Fixed Income Mutual Fund</u>	<u>June 30, 2012</u>		<u>June 30, 2011</u>	
	<u>Fair Value</u>	<u>Weighted Average Duration</u>	<u>Fair Value</u>	<u>Weighted Average Duration</u>
T. Rowe Price Spectrum Income Fund	\$ 3,011,092	4.74	\$ 2,782,190	4.97
T. Rowe Price High-Yield Fund	4,020,081	6.11	3,772,775	3.82

At June 30, 2012 and 2011, the fair value of the SoonerSave Stable Value Fund was \$69,407,191 and \$65,105,040 and the weighted average duration as provided by GreatWest was 2.7 years and 3.75 years, respectively.

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 are all of the other mutual fund investments. The weighted averaged credit rating 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 at June 30, 2012 and June 30, 2011. The T. Rowe Price Spectrum Income Fund was rated BB at June 30, 2012 and June 30, 2011.

The Plan's policies and guidelines require that the credit quality of the SoonerSave Stable Value Fund be that of securities issues by the U.S. government and agencies and commercial bank securities with FDIC guarantees. The investments in the SoonerSave Stable Value Fund at June 30, 2012 and 2011 were primarily composed of mortgage-backed which were all rated AA+/AAA.

**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 Savings Incentive Plan:

We have audited the financial statements of the Oklahoma State Employees Deferred Savings Incentive Plan (the Plan), as of and for the year ended June 30, 2012, and have issued our report thereon dated October 18, 2012. 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

Management of the Plan is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Plan'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 Plan's internal control over financial reporting. Accordingly, we do not express an opinion of the effectiveness on the Plan's internal control over financial reporting.

A *deficiency in internal control* 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, 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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 of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



This report is intended solely for the information and use of the 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.

Cole & Reed P.C.

Oklahoma City, Oklahoma
October 18, 2012