



COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA
(An Agency of the State of Oklahoma)

Basic Financial Statements

June 30, 2010

(With Independent Auditors' Report Thereon)

COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA
(An Agency of the State of Oklahoma)

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

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, 2010, 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 to the financial statements, 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, 2010, or the changes in its financial position, for the year then ended in conformity with U.S. generally accepted accounting principles.

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, 2010, 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 28, 2010 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 audits.

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 sheets 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 28, 2010

**COMMISSIONERS OF THE LAND OFFICE
STATE OF OKLAHOMA**

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Management's Discussion and Analysis

June 30, 2010

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, 2010. It should be read in conjunction with the financial statements, which begin, on page 8.

Financial Highlights

- Net Assets are up approximately \$228 million primarily due to the net increase in fair value of investments of \$188 million. The Commissioners of the Land Office Modernization Act, which was passed into law during 2010, authorized a portion of current year mineral revenues to be distributed. Of the \$67.3 million in mineral revenues, royalties of \$40.3 million were added to the permanent fund and \$27.0 million in lease bonuses and delay rentals were distributed.
- Interest from investments was up \$7.9 million, from \$67.6 million in fiscal year 2009 to \$75.5 million in fiscal year 2010.
- Distributions to beneficiaries were up \$31.5 million, from \$85.8 million in fiscal year 2009 to \$117.3 million in fiscal year 2010, primarily due to the distribution of Lease Bonus and Delay Rental revenues.

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.

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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.

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 through 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 \$1.6 billion at the close of the most recent fiscal year.

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The largest portion of the Agency's net assets (99%) 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)

	<u>2010</u>	<u>2009</u>
Current assets	\$ 1,636,073	1,407,149
Capital assets, net	6,421	6,471
Other assets	<u>5,111</u>	<u>5,659</u>
Total assets	<u>\$ 1,647,605</u>	<u>1,419,279</u>
Other liabilities	\$ 7,668	7,446
Invested in capital assets	\$ 6,421	6,471
Restricted	1,623,905	1,400,223
Unrestricted	<u>9,611</u>	<u>5,139</u>
Total net assets	<u>\$ 1,639,937</u>	<u>1,411,833</u>

There was an increase of \$228 million in net assets, the key elements of the increase are as follows:

Changes in Net Assets

(In thousands)

	<u>2010</u>	<u>2009</u>
Expenses:		
Apportionments	\$ 117,330	85,812
Custodial fees	5,409	5,237
Administrative	4,945	4,972
Other	<u>466</u>	<u>358</u>
Total expenses	<u>128,150</u>	<u>96,379</u>
Revenues:		
Program revenue:		
Investment earnings	273,882	(142,853)
Mineral revenues	67,254	73,775
Rents	11,880	11,000
Other	<u>3,238</u>	<u>3,490</u>
Total revenues	<u>356,254</u>	<u>(54,588)</u>
Change in net assets	228,104	(150,967)
Net assets at beginning of year	<u>1,411,833</u>	<u>1,562,800</u>
Net assets at end of year	<u>\$ 1,639,937</u>	<u>1,411,833</u>

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- Apportionments increased from \$85.8 million in fiscal year 2009 to \$117.3 million in fiscal year 2010. The increase was primarily due to the new legislation authorizing the distribution of mineral lease bonus revenues.
- Investment earnings increased from \$(142.8) million in fiscal year 2009 to \$273.9 million in fiscal year 2010. Most of the increase was due to an increase in the fair market value of investments.
- Mineral income decreased from \$73.8 million in fiscal year 2009 to \$67.3 million in fiscal year 2010. 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 \$1.63 billion, an increase of \$228.1 million in comparison with the prior year. Approximately \$1.62 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, 2010, the unreserved fund balance was \$9.9 million, or 166% of budgeted general fund expenditures. The unreserved fund balance of the general fund increased by \$4.4 million from June 30, 2009 primarily due to an increase 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, which includes the increase in fair market value of investments, was \$355.7 million compared to \$(55.2) million of prior year, which included the decrease in fair market value of investments. Apportionments to beneficiaries totaled \$117.3 million for fiscal year 2010 with \$31.2 million disbursed to universities and colleges and \$83.2 million disbursed to public schools. This was an increase of \$31.5 million from the apportionments of fiscal year 2009.

General Fund Budgetary Highlights

For fiscal year 2010, general fund actual expenditures (including transfers) on a budgetary basis were \$5.0 million compared to the budget of \$6.0 million. The \$1.0 million variance was primarily due to delays in the implementation of a technology upgrade.

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Description of Current and Expected Conditions

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 120 N. Robinson, Suite 1000W, Oklahoma City, Oklahoma 73102.

COMMISSIONERS OF THE LAND OFFICE
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Statements of Net Assets

June 30, 2010

Assets

Current assets:	
Cash and cash equivalents	\$ 97,330,983
Investments	1,515,879,917
Loans receivable	29,031
Accrued interest receivable	13,313,954
Current portion of note receivable	547,295
Other receivables	<u>8,971,480</u>
Total current assets	<u>1,636,072,660</u>
Noncurrent assets:	
Capital assets, net	821,977
Land	5,598,968
Note receivable	<u>5,111,523</u>
Total noncurrent assets	<u>11,532,468</u>
Total assets	<u>1,647,605,128</u>
Current liabilities:	
Accounts payable and accrued expenses	1,357,247
Deferred revenue	<u>6,311,186</u>
Total current liabilities	<u>7,668,433</u>
Net assets:	
Invested in capital assets	6,420,945
Restricted for education:	
Nonexpendable	1,604,176,301
Expendable	19,728,713
Unrestricted	<u>9,610,736</u>
Total net assets	<u>\$ 1,639,936,695</u>

See accompanying notes to financial statements.

COMMISSIONERS OF THE LAND OFFICE
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Statements of Activities

June 30, 2010

Expenses:	
Education:	
Apportionments to beneficiaries:	
Universities and colleges	\$ 31,160,557
Public schools	83,212,998
Public buildings	<u>2,955,950</u>
Total apportionments	117,329,505
Custodial fees	5,409,511
Administrative expenses	4,945,546
Other expenses	337,196
Depreciation	<u>129,037</u>
Total program expenses	<u>128,150,795</u>
Program revenues:	
Investment earnings:	
Interest	75,470,000
Dividends	9,997,077
Net increase in fair value of investments	<u>188,415,783</u>
Net investment gain	273,882,860
Mineral revenues	67,253,616
Rents	11,879,686
Gain on sale of land	209,958
Miscellaneous	1,754,382
Fees	341,960
Other interest	<u>931,774</u>
Total program revenues	<u>356,254,236</u>
Change in net assets	228,103,441
Net assets at beginning of year	<u>1,411,833,254</u>
Net assets at end of year	<u><u>\$ 1,639,936,695</u></u>

See accompanying notes to financial statements.

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Balance Sheet – Governmental Funds

June 30, 2010

	General fund	Permanent fund	Total
Assets:			
Cash and cash equivalents	\$ 10,539,422	86,791,561	97,330,983
Investments	253,994	1,515,625,923	1,515,879,917
Loans receivable	—	29,031	29,031
Accrued interest receivable	—	13,313,954	13,313,954
Other receivables	174,567	8,796,913	8,971,480
Note receivable	—	5,658,818	5,658,818
Total assets	\$ 10,967,983	1,630,216,200	1,641,184,183
Liabilities:			
Accounts payable and accrued expenses	\$ 1,073,227	—	1,073,227
Deferred revenue	—	6,311,186	6,311,186
Total liabilities	1,073,227	6,311,186	7,384,413
Fund balance:			
Reserved for education	—	1,623,905,014	1,623,905,014
Unreserved, undesignated	9,894,756	—	9,894,756
Total fund balance	\$ 9,894,756	1,623,905,014	1,633,799,770
Capital assets not considered financial resources and not included in funds			6,420,945
Compensated absences not due and payable in the current period			(284,020)
Net assets of governmental activities			\$ 1,639,936,695

See accompanying notes to financial statements.

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

Year ended June 30, 2010

	General fund	Permanent fund	Total
Revenues:			
Investment revenues:			
Interest	\$ —	75,694,339	75,694,339
Dividends	—	9,997,077	9,997,077
Net increase in fair value of investments	—	188,415,783	188,415,783
Net investment revenue	—	274,107,199	274,107,199
Fees	9,560,011	—	9,560,011
Other interest	214,189	493,247	707,436
Mineral revenues	—	67,253,616	67,253,616
Rents	—	11,879,686	11,879,686
Gain on sale of land	—	209,958	209,958
Miscellaneous revenue	—	1,754,382	1,754,382
Total revenues	9,774,200	355,698,088	365,472,288
Expenditures:			
Administrative expenses	5,000,817	9,218,051	14,218,868
Other	337,196	59,147	396,343
Custodial fees	—	5,409,511	5,409,511
Apportionments to beneficiaries:			
Universities and colleges	—	31,160,557	31,160,557
Public schools	—	83,212,998	83,212,998
Public buildings	—	2,955,950	2,955,950
Total expenditures	5,338,013	132,016,214	137,354,227
Net change in fund balances	4,436,187	223,681,874	228,118,061
Fund balances at beginning of year	5,458,569	1,400,223,140	1,405,681,709
Fund balances at end of year	\$ 9,894,756	1,623,905,014	1,633,799,770
Net change in fund balances			\$ 228,118,061
Fixed assets purchased			78,876
Decrease in liability for compensated absences			35,541
Current year depreciation expense			(129,037)
Change in net assets – governmental activities			\$ 228,103,441

See accompanying notes to financial statements.

COMMISSIONERS OF THE LAND OFFICE
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Notes to Financial Statements

June 30, 2010

(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.

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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 revenues, 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.

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June 30, 2010

(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***

The Federal government granted the Agency upon statehood approximately 3.1 million acres of land, of which approximately 693,000 acres remain at June 30, 2010. This land is held in trust and is stated at \$1 per acre in the financial statements at June 30, 2010. The \$1 per acre was set as a nominal amount for recordkeeping purposes.

The Agency has repossessed approximately 50,000 acres, 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, 2010, repossessed land is carried at approximately \$4,906,000.

Land is considered capital assets and is reported at cost.

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(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, 2010, unpaid and accumulated benefits totaled \$284,020. The activity for the year is as follows:

Beginning balance	\$ 319,604
Leave earned	196,779
Leave used	<u>(232,363)</u>
Ending balance	<u>\$ 284,020</u>

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Notes to Financial Statements

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(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 that 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 that 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	\$ 78,573,893
Investments	1,515,879,917
Accrued interest on investments	<u>13,313,954</u>
Total	<u><u>\$ 1,607,767,764</u></u>

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

COMMISSIONERS OF THE LAND OFFICE
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Notes to Financial Statements

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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.

Fixed income investments at June 30, 2010 consisted of the following:

	2010	
	Fair value	Moody rating
U.S. government agencies:		
U.S. Treasury Bond	\$ 53,175,139	AAA
U.S. Treasury Note	9,388,501	AAA
Federal Home Loan Mortgage Corp	59,671,968	AAA
Federal National Mortgage Corp	129,247,271	AAA
Government National Mortgage Association	35,095,761	AAA
Other	6,088,427	AAA
	<u>292,667,067</u>	
Municipal obligations:		
Municipal Bonds	758,658	AAA
Municipal Bonds	1,062,255	AA
Municipal Bonds	8,165,559	A
	<u>9,986,472</u>	
Corporate bonds (held in U.S. Currency):		
Domestic Bonds	57,775,370	A
Domestic Bonds	25,873,876	AA
Domestic Bonds	39,591,366	AAA
Domestic Bonds	167,737,307	B
Domestic Bonds	115,777,643	BA
Domestic Bonds	157,915,973	BAA
Domestic Bonds	32,029,091	BBB
Domestic Bonds	40,659,257	BB
Domestic Bonds	2,157,387	C
Domestic Bonds	45,182,641	CAA
Domestic Bonds	5,420,870	CCC
Domestic Bonds	80,517,829	NR
	<u>770,638,610</u>	

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	2010	
	Fair value	Moody rating
Foreign bonds (held in U.S. Currency):		
Foreign Bonds	\$ 5,937,484	A
Foreign Bonds	2,089,644	AA
Foreign Bonds	5,946,807	B
Foreign Bonds	3,523,724	BA
Foreign Bonds	15,565,277	BAA
Foreign Bonds	1,544,132	BB
Foreign Bonds	1,150,625	BBB
Foreign Bonds	724,733	CAA
Foreign Bonds	1,565,580	P-2
Foreign Bonds	830,440	NR
	38,878,446	
Money market:		
Invesco Aim Prime Resource	36,826,601	NR
Total fixed income	\$ 1,148,997,196	

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. With the exception of U.S. Government and Agency issues, no more than 10% of the bond portfolio at market will be invested in the securities of a single issuer or 5% of the bond portfolio in an individual issue. Equity managers shall not invest more than 10% of its portfolio market value in any one company. Equity managers may invest up to 5% of their portfolio's market value at the time of the initial purchase in a single entity. At June 30, 2010, Federal National Mortgage Corp represented 8.53% 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.

**COMMISSIONERS OF THE LAND OFFICE
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The Agency's closure to interest rate risk is as follows:

	2010	
	Fair value	Effective duration (years)
U.S. government securities:		
U.S. Treasury Bond	\$ 53,175,139	4.190
U.S. Treasury Note	9,388,501	3.207
Government National Mortgage Association	35,095,761	4.207
Other	6,088,427	3.078
	<u>103,747,828</u>	
Mortgage-backed securities:		
Federal Home Loan Mortgage Corp	59,671,968	1.625
Federal National Mortgage Corp	129,247,271	2.470
	<u>188,919,239</u>	
Municipal obligations:		
Municipal Bonds	9,986,472	8.268
Corporate bonds (held in U.S. Currency):		
Domestic Bonds	770,638,610	5.670
Foreign Bonds	38,878,446	5.841
	<u>809,517,056</u>	
Money market:		
Invesco Aim Prime Resource	36,826,601	NA
Total fixed income	<u>\$ 1,148,997,196</u>	

(3) Leasing Operations

The Agency leases to others approximately 743,000 acres of land belonging to the Trusts as of June 30, 2010, 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.

COMMISSIONERS OF THE LAND OFFICE
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June 30, 2010

The following is a schedule of the future minimum rent due to the Agency under its noncancelable leases at June 30, 2010:

2011		\$	8,409,462
2012			6,498,576
2013			4,254,843
2014			1,983,415
			21,146,296
		\$	21,146,296

(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 cash 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
01/29/2011	\$ 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
Total	\$ 5,658,818	1,341,182	7,000,000

(5) Other Receivables

Other receivables at June 30, 2010 consisted of the following:

Accrued mineral royalties		\$	6,580,351
Surface leases (net allowance of \$603,339)			2,216,562
Gas marketing			174,567
			8,971,480
Total		\$	8,971,480

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June 30, 2010

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, 2010 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, 2010 is \$438,276,174 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 1,107,533 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, 2010 was \$214,771.

(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, 5801 N. Broadway Extension, Suite 400, Oklahoma City, Oklahoma 73118 or by calling 1-800-733-9008.

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June 30, 2010

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 2010	
Employees	Agency
All salary	All salary
3.5%	15.5%
Fiscal year 2009	
Employees	Agency
All salary	All salary
3.5%	14.5%

The Agency and employee (combined) contributions to the Plan for the years ended June 30, 2010, 2009, and 2008 were approximately \$491,000, \$476,000, and \$449,000, 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, 2010 and 2009. The Agency believes that it has no liabilities in respect to the State's plan.

**COMMISSIONERS OF THE LAND OFFICE
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Notes to Financial Statements

June 30, 2010

(9) Capital Assets

The changes in the capital asset accounts for fiscal years 2010 and 2009 were as follows:

	<u>Beginning balance July 1, 2009</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending balance June 30, 2010</u>
Capital assets, not being depreciated:				
Land	\$ 5,599,010		(42)	5,598,968
Total capital assets, not being depreciated	<u>5,599,010</u>	<u>—</u>	<u>(42)</u>	<u>5,598,968</u>
Capital assets, being depreciated:				
Furniture, fixture and equipment	866,156	19,685	(166,728)	719,113
Land improvements	<u>928,387</u>	<u>59,190</u>	<u>—</u>	<u>987,577</u>
Total capital assets, being depreciated	<u>1,794,543</u>	<u>78,875</u>	<u>(166,728)</u>	<u>1,706,690</u>
Less accumulated depreciation, for:				
Furniture, fixture and equipment	686,964	78,496	(159,092)	606,368
Land improvements	<u>235,440</u>	<u>42,905</u>	<u>—</u>	<u>278,345</u>
Total accumulated depreciation	<u>922,404</u>	<u>121,401</u>	<u>(159,092)</u>	<u>884,713</u>
Total capital assets being depreciated, net	<u>872,139</u>	<u>(42,526)</u>	<u>(7,636)</u>	<u>821,977</u>
Governmental activities, capital assets, net	<u>\$ 6,471,149</u>	<u>(42,526)</u>	<u>(7,678)</u>	<u>6,420,945</u>

(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.

COMMISSIONERS OF THE LAND OFFICE
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Notes to Financial Statements

June 30, 2010

(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, 2010, total rent expense for these items was approximately \$43,236 for office equipment and \$262,956 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
(An Agency of the 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, 2010

(unaudited)

	<u>Budgeted amounts</u>		<u>Actual</u>	<u>Variance favorable (unfavorable)</u>
	<u>Original</u>	<u>Final</u>		
Revenues:				
Fees	\$ —	—	9,560,011	9,560,011
Other interest	—	—	214,189	214,189
Total revenues	—	—	9,774,200	9,774,200
Expenditures:				
Administrative division	701,099	837,640	721,626	116,014
Legal division	774,157	774,157	494,748	279,409
Data processing division	286,283	614,742	290,153	324,589
Real estate division	1,516,521	1,531,521	1,406,004	125,517
Accounting division	624,428	624,428	602,132	22,296
Investment division	390,654	390,654	368,139	22,515
Minerals division	716,406	716,406	658,677	57,729
Audit division	480,609	481,150	436,848	44,302
Total expenditures	5,490,157	5,970,698	4,978,327	992,371
Net change in fund balance	(5,490,157)	(5,970,698)	4,795,873	10,766,571
Fund balance at beginning of year		5,458,569	5,458,569	—
Fund balance at end of year		\$ (512,129)	10,254,442	10,766,571
Reconciliation to GAAP basis:				
Accrual Adjustments			(359,686)	
Fund balance			\$ 9,894,756	

See accompanying independent auditors' report.

**COMMISSIONERS OF THE LAND OFFICE
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Combining Balance Sheet – General Fund

June 30, 2010

Assets	<u>Revolving 16</u>	<u>CLO</u>	<u>Combined total</u>
Cash and cash equivalents	\$ 1,584,195	8,955,227	10,539,422
Investments	253,994	—	253,994
Other receivables	174,567	—	174,567
Total assets	<u>\$ 2,012,756</u>	<u>8,955,227</u>	<u>10,967,983</u>
Liabilities and Fund Balance			
Liabilities:			
Accounts payable and accrued expenses	\$ 1,073,227	—	1,073,227
Equity:			
Fund balances – unreserved	939,529	8,955,227	9,894,756
Total liabilities and equity	<u>\$ 2,012,756</u>	<u>8,955,227</u>	<u>10,967,983</u>

See accompanying independent auditors' report.

COMMISSIONERS OF THE LAND OFFICE
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Schedule of Distributions to University and College Beneficiaries

Year ended June 30, 2010

University of Oklahoma	\$ 10,124,506
Oklahoma State University	7,914,344
Northern Oklahoma College	2,644,875
Langston University	1,801,282
Southeastern Oklahoma State University	963,950
University of Central Oklahoma	963,950
East Central Oklahoma State University	963,950
Northeastern Oklahoma State University	963,950
Northwestern Oklahoma State University	963,950
Southwestern Oklahoma State University	963,950
Cameron University	963,950
Oklahoma Panhandle State University	963,950
University of Science and Arts	963,950
	<hr/>
	\$ <u>31,160,557</u>

See accompanying independent auditors' report.

COMMISSIONERS OF THE LAND OFFICE
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Schedule of Distributions to Public School Beneficiaries

Year ended June 30, 2010

County:	
Adair	\$ 624,135
Alfalfa	90,024
Atoka	306,017
Beaver	147,773
Beckham	488,110
Blaine	246,550
Bryan	919,121
Caddo	761,961
Canadian	2,815,510
Carter	1,183,372
Cherokee	969,883
Choctaw	345,518
Cimarron	57,191
Cleveland	5,293,965
Coal	164,128
Comanche	2,835,946
Cotton	157,986
Craig	393,777
Creek	1,681,029
Custer	616,098
Delaware	880,518
Dewey	107,500
Ellis	105,406
Garfield	1,241,450
Garvin	691,205
Grady	1,168,715
Grant	110,432
Greer	124,498
Harmon	70,500
Harper	96,206
Haskell	300,247
Hughes	310,828
Jackson	677,755
Jefferson	156,550
Johnston	250,419
Kay	1,079,167
Kingfisher	430,132
Kiowa	219,583
Latimer	225,419
Leflore	1,281,956
Lincoln	751,466
Logan	581,255
Love	212,472
Major	192,511
Marshall	363,981

COMMISSIONERS OF THE LAND OFFICE
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Schedule of Distributions to Public School Beneficiaries
Year ended June 30, 2010

County:	
Mayes	\$ 955,741
McClain	883,680
McCurtain	918,311
McIntosh	420,302
Murray	301,682
Muskogee	1,767,896
Noble	279,702
Nowata	272,687
Okfuskee	274,375
Oklahoma	14,739,226
Okmulgee	926,585
Osage	529,161
Ottawa	783,057
Pawnee	346,355
Payne	1,319,389
Pittsburg	1,032,560
Pontotoc	897,869
Pottawatomie	1,677,221
Pushmataha	295,839
Roger Mills	122,683
Rogers	1,867,715
Seminole	659,315
Sequoyah	1,165,239
Stephens	1,060,462
Texas	542,984
Tillman	204,325
Tulsa	14,379,001
Wagoner	870,821
Washington	1,058,858
Washita	290,940
Woods	164,147
Woodward	476,605
	<hr/>
	\$ <u><u>83,212,998</u></u>

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 and each major fund of the Commissioners of the Land Office, State of Oklahoma, as of and for the year ended June 30, 2010, and have issued our report thereon dated October 28, 2010. 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 opinions 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.

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.

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. However, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency and is described below. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

10-01 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 financial 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*.

The Commissioners of the Land Office, State of Oklahoma's response to the finding identified in our audits 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 28, 2010