COMPSOURCE OKLAHOMA

Basic Financial Statements

December 31, 2011 and 2010

(With Independent Auditors’ Report Thereon)

This section of CompSource Oklahoma's (CompSource's) annual financial report presents a discussion and analysis of the financial performance of CompSource for the years ended December 31, 2011, 2010, and 2009. Please read it in conjunction with the financial statements, which follow this section. The following table summarizes the financial position and results of operations of CompSource for 2011, 2010, and 2009.

Assets	**2011**	**2010**	**2009**
Current investments	$ 1,267,537,890	1,223,236,735	1,127,645,650
Other current assets	129,976,921	206,761,219	266,417,636
Property, plant, and equipment	15,246,299	20,187,171	19,209,435
Other invested asset	6,349,511	6,468,673	6,554,774
Note receivable from Multiple Injury Trust Fund	20,139,560	21,590,491	22,944,150
	$ 1,439,250,181	1,478,244,289	1,442,771,645
Liabilities and Fund Equity			
Current reserve for losses and loss adjustment expenses	$ 211,266,822	206,309,257	200,064,561
Other current liabilities	129,494,126	208,519,789	261,963,635
Noncurrent reserve for losses and loss adjustment expenses	779,933,694	751,035,027	725,116,471
	1,120,694,642	1,165,864,073	1,187,144,667
Fund equity, invested in capital assets	15,246,299	20,187,171	19,209,435
Fund equity, restricted for catastrophes	5,000,000	5,000,000	5,000,000
Fund equity, unrestricted	298,309,240	287,193,045	231,417,543
	318,555,539	312,380,216	255,626,978
	$ 1,439,250,181	1,478,244,289	1,442,771,645
Revenues, Expenses, and Change in Fund Equity			
Net premiums earned	$ 253,036,546	247,263,713	243,919,452
Net investment income	66,270,580	112,167,966	124,537,707
	319,307,126	359,431,679	368,457,159
Losses and loss adjustment expenses	268,218,738	262,099,534	264,643,758
Other operating expenses	45,176,362	40,950,384	39,317,232
	313,395,100	303,049,918	303,960,990
Total nonoperating revenues	263,297	371,477	430,994
Dividends to policyholders	—	—	—
Change in fund equity	$ 6,175,323	56,753,238	64,927,163

Overview of the Financial Statements

CompSource's financial statements are prepared on the basis of accounting principles generally accepted in the United States of America for governmental entities and insurance enterprises where applicable. The primary purpose of CompSource is to provide a source of workers' compensation insurance for all Oklahoma employers, state agencies, and other governmental units as set forth in Title 85 of the Oklahoma Statutes. CompSource operates in a manner similar to any other insurance company. CompSource is a component unit of the State of Oklahoma and is combined with other unrelated funds to comprise the major component units of the State of Oklahoma. CompSource meets the definition of both a major component and that of an enterprise fund. Financial statements are presented on the accrual basis of accounting. The three basic financial statements presented within the financial statements are as follows:

- Balance Sheet – This statement presents information reflecting CompSource's assets, liabilities, and fund equity. Fund equity represents the amount of total assets less total liabilities. The balance sheet is categorized as to current and noncurrent assets and liabilities. For purposes of the financial statements, current assets and liabilities are those assets and liabilities with immediate liquidity or which are collectible or becoming due within 12 months of the statement date. CompSource's investment balances are considered current assets, as all investments are considered to be highly liquid.
- Statement of Revenues, Expenses, and Changes in Fund Equity – This statement reflects the operating revenues and expenses, as well as nonoperating revenues and expenses, and dividends during the operating year. Major sources of operating revenues are premium income and investment income with major sources of operating expenses being losses and loss adjustment expenses related to claims. The change in fund equity before dividends to policyholders for an enterprise fund is similar to net profit or loss for any other insurance company.
- Statement of Cash Flows – The statement of cash flows is presented on the direct method of reporting, which reflects cash flows from operating, financing, and investing activities. Cash collections and payments are reflected in this statement to arrive at the net increase or decrease in cash for the calendar year.

Financial Position

- CompSource's current investments, which are recorded at fair value, increased by approximately \$44 million, or 3.6%, during 2011, as volatile U.S. capital markets reacted to the sluggish economic recovery and global uncertainty. The increase in current investments resulted from growth in the fair values of debt securities of approximately \$28 million and the re-investment of dividend and interest income of approximately \$46 million, which more than offset declines in the fair value of equity securities of approximately \$8 million, a \$20 million transfer to operating cash, and a decline in short-term investments of approximately \$3 million. Total return, which is a combined measurement of both investment income earned and the change in fair values declined to 5.4% for 2011. CompSource's debt securities, which consist primarily of U.S. government bonds, investment grade corporate bonds, and mortgage-backed securities, comprised 82% of current investments and had a total return of 6.9% during 2011. Equity securities, which consist of large capitalization index funds and an actively managed portfolio of small and mid-capitalization stocks comprised 15% of current investments and produced a negative total return of 2.5% for 2011.

- CompSource's current investments increased by approximately $96 million, or 8.5%, during 2010. The increase resulted from growth in the fair values of debt and equity securities of approximately $66 million and the re-investment of interest and dividend income totaling approximately $46 million, which more than offset a $15 million transfer to operating cash. The total return on all investments during 2010 was 9.9%. The total returns on debt and equity securities were 7.5% and 24.5%, respectively, for 2010.
- Other current assets decreased by approximately $77 million during 2011, which is attributable to declines in securities lending collateral of approximately $80 million and decreases in the receivable from the Oklahoma Tax Commission and due from brokers totaling approximately $1 million. These decreases more than offset an increase in operating cash of $4 million. The decline in securities lending collateral is due to decreased securities lending activity from the continuation of an orderly wind down of the securities lending program. The decrease in the receivable from the Oklahoma Tax Commission is due to a decline in the Multiple Injury Trust Fund tax rate, while the decline in due from brokers is caused by a decline in pending sales of securities at year-end. The increase in operating cash is the result of increased premium collections and transfers from current investments.
- The decrease in other current assets of approximately $60 million during 2010 is attributable to decreases in operating cash of approximately $14 million and the asset for securities lending collateral of approximately $54 million, which were offset by an increase in premiums due of approximately $7 million and increases in due from brokers and other assets totaling approximately $1 million. The decline in operating cash is primarily attributable to a decrease in premiums collected and increases in taxes paid, while the decline in securities lending collateral is due to decreased securities lending activity from the orderly wind down of the securities lending program. An increase in premiums written fueled the increase in premiums due, while increased sales of current investments at the end of 2010 resulted in the increase in due from brokers. The increase in other assets is principally caused by an increase in deferred acquisition costs related to increased premium taxes.
- The current and noncurrent reserves for losses and loss adjustment expenses are based on CompSource's independent actuary's and management's best estimate and are based on case basis estimates for losses reported and CompSource's historical loss experience for claims incurred but not reported. The reserves for loss adjustment expenses include an estimate for unallocated operating costs to process, and ultimately settle, incurred but unpaid claims. The reserves are subject to the outcome of future events, including changes in the medical condition of claimants, medical inflation, awards by the Workers' Compensation Court, and legislative changes. Adjustments to the reserves based on subsequent developments or other changes in the estimate are reflected in results of operations in the period in which such adjustments become known.
- During 2011, current and noncurrent reserves for losses and loss adjustment expenses increased by approximately $5 million, or 2.4%, and approximately $29 million, or 3.8%, respectively. These increases reflect the continuing trend toward higher claim severity due to rising medical and indemnity costs and include increases in case reserves and the actuarially determined estimate for claims incurred but not reported.
- The increases in current and noncurrent reserves for losses and loss adjustment expenses during 2010 of approximately $6 million, or 3.1%, and approximately $26 million, or 3.6%, respectively, also arise due to increases in claim severity.

(Continued)

- The decrease in other current liabilities during 2011 of approximately $79 million is primarily due to declines in the payable for securities lending collateral of approximately $81 million and due to brokers of approximately $1 million, which were offset by an increase in unearned premiums and policyholder deposit premiums of approximately $3 million. The decline in the liability for securities lending collateral is due to a decline in securities lending activity resulting from the continuation of an orderly wind down of the securities lending program. The decrease in due to brokers is from a decline in pending purchases of investment securities at year-end. The increase in unearned premiums and policyholder deposit premiums is attributable to increases in premiums written on annual policies and an increase in deposit premium for excess coverage policies.
- Other current liabilities decreased by approximately $53 million during 2010 primarily due to a decline in the payable for securities lending collateral of approximately $55 million, which was offset by an increase in unearned premiums and policyholder deposit premiums of approximately $2 million. The decline in the liability for securities lending collateral is due to a decline in securities lending activity resulting from the orderly wind down of the securities lending program. The increase in unearned premiums and policyholder deposit premiums is, again, chiefly due to an increase in premiums written on annual policies.
- Total fund equity increased by approximately $6 million and $57 million during 2011 and 2010, respectively, due to net investment income sufficient to offset operating expenses that exceeded net premiums earned in both years. Additional analysis is provided in the Results of Operations Section of Management's Discussion and Analysis for both 2011 and 2010.

Results of Operations

- Net premiums earned increased by approximately $6 million during 2011, or 2.3%, primarily due to an increase in premium for certain group programs.
- During 2010, net premiums earned rose by approximately $3 million, or 1.4%, reflecting the impact from an overall 5% rate increase effective in November 2009 and changes in premium for certain group programs.
- Net investment income declined by approximately $46 million during 2011, or 40.9%, caused primarily by slowing growth in the fair value of investments reflective of the sluggish economy. The net increase in fair value of investments of approximately $21 million for 2011 represents a decline of approximately $46 million from 2010. Interest and dividend income, net of investment expense, for 2011 of approximately $46 million was unchanged as compared to 2010.
- The decrease in net investment income of approximately $12 million during 2010, or 9.9%, was also caused by slowing growth in the fair value of investments, as returns for both debt and equity securities moderated as compared to 2009. The net increase in the fair value of investments of $66 million during 2010 reflected a decline of approximately $12 million from 2009.

- Losses and loss adjustment expenses represent medical, indemnity, and other expenses for workers' compensation claims incurred during the year to process, adjust and settle workers' compensation claims. Losses and loss adjustment expenses include estimates for losses and loss adjustment expenses incurred but not reported during the year. CompSource's calendar year loss ratio, which is derived as the ratio of losses and loss adjustment expenses to net premiums earned, was 106% for 2011, unchanged from the 106% recorded for 2010. The total amount of losses and loss adjustment expenses increased during 2011 by approximately $6 million, or 2.3%, as accident year loss ratios remained elevated as compared to historical averages. Total losses and loss adjustment expenses decreased by approximately $3 million, or 1%, during 2010, reflecting some improvement from the overall 5% rate increase. CompSource continues in its efforts to control claim costs through programs designed to combat medical and prescription drug cost inflation and assist policyholders in loss prevention and control.
- Other operating expenses increased by approximately $4 million, or 10.3%, during 2011, primarily due to increases in general, administrative, and underwriting expenses which more than offset declines in the provision for doubtful accounts and the Multiple Injury Trust Fund Tax. The increase in general and administrative expenses is directly attributable to the impairment of capitalized nonoperating system software during 2011, while the increase in underwriting expenses is primarily caused by an increase in agent commission expense which was driven by an increase in premium written subject to commission. The decline in the provision for bad debt expenses is reflective of a decline in delinquent accounts, while the decrease in the Multiple Injury Trust Fund tax is due to a decline in the tax rate.
- The increase in other operating expenses of approximately $2 million during 2010 resulted chiefly from increases in underwriting expenses, general and administrative expenses, the market equalization assessment, and the provision for doubtful accounts. Underwriting expenses rose due to increases in premiums written subject to agent commissions, while higher maintenance expenses on information technology drove increases in general and administrative expenses. Increases in premiums written and premiums due lead to higher expenses for the market equalization assessment and increased provision for doubtful accounts, respectively. The market equalization assessment resulted from the enactment of a new statute during 2009 that requires CompSource to pay an assessment based on 2.25% of premium written to the credit of the general fund of the State of Oklahoma.

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Independent Auditors' Report

The Board of Managers
CompSource Oklahoma:

We have audited the balance sheets of CompSource Oklahoma (CompSource), a component unit of the State of Oklahoma, as of December 31, 2011 and 2010, and the related statements of revenues, expenses, and changes in fund equity and cash flows for the years then ended. These financial statements are the responsibility of CompSource'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. 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 CompSource's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CompSource Oklahoma as of December 31, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 1 through 5 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 a report dated March 28, 2012 on our consideration of CompSource's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. 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 read in conjunction with this report in assessing the results of our audits.

KPMG LLP

March 28, 2012

COMPSOURCE OKLAHOMA

Balance Sheets

December 31, 2011 and 2010

Assets		**2011**	**2010**
Current assets:			
Cash and cash equivalents	$	25,028,695	20,720,499
Investments:			
Debt securities		1,039,298,827	986,525,154
Equity securities		186,137,130	191,772,083
Short-term investments		42,101,933	44,939,498
Total current investments		1,267,537,890	1,223,236,735
Accrued investment income		9,885,539	9,773,164
Premiums due and other receivables, net		48,596,723	48,629,689
Note receivable from Multiple Injury Trust Fund, current portion		1,474,591	1,375,732
Receivable from Oklahoma Tax Commission		3,774,699	4,301,749
Due from brokers		84,383	711,505
Other assets		3,546,937	3,376,920
Security lending short-term investment trust		37,585,354	117,871,961
Total current assets		1,397,514,811	1,429,997,954
Noncurrent assets:			
Other invested asset		6,349,511	6,468,673
Note receivable from Multiple Injury Trust Fund		20,139,560	21,590,491
Property, plant, and equipment, net		15,246,299	20,187,171
Total noncurrent assets		41,735,370	48,246,335
Total assets	$	1,439,250,181	1,478,244,289
Liabilities and Fund Equity			
Current liabilities:			
Reserve for losses	$	195,370,739	190,596,790
Reserve for loss adjustment expenses		15,896,083	15,712,467
Unearned premiums and policyholder deposit premiums		73,288,989	70,641,127
Accounts payable and other liabilities		14,688,978	15,077,637
Due to brokers		—	828,688
Payable under security lending agreement		41,516,159	121,972,337
Total current liabilities		340,760,948	414,829,046
Noncurrent liabilities:			
Reserve for losses		721,250,129	693,836,368
Reserve for loss adjustment expenses		58,683,565	57,198,659
Total noncurrent liabilities		779,933,694	751,035,027
Total liabilities		1,120,694,642	1,165,864,073
Fund equity:			
Fund equity, invested in capital assets		15,246,299	20,187,171
Fund equity, restricted for catastrophes		5,000,000	5,000,000
Fund equity, unrestricted		298,309,240	287,193,045
Total fund equity		318,555,539	312,380,216
Contingencies (notes 6, 8, and 14)			
Total liabilities and fund equity	$	1,439,250,181	1,478,244,289

See accompanying notes to basic financial statements.

COMPSOURCE OKLAHOMA

Statements of Revenues, Expenses, and Changes in Fund Equity

Years ended December 31, 2011 and 2010

	2011	2010
Operating revenues:		
Gross premiums earned	$ 300,425,631	298,815,582
Discounts	(47,389,085)	(51,551,869)
Net premiums earned	253,036,546	247,263,713
Investment income:		
Interest and dividend income, net of investment expense	45,575,518	45,683,313
Net increase in fair value of investments	20,531,114	66,327,485
Security lending investment income	178,964	429,603
Rebates and fees paid on security lending agreement	(15,016)	(272,435)
Net investment income	66,270,580	112,167,966
Total operating revenues	319,307,126	359,431,679
Operating expenses:		
Losses and loss adjustment expenses	268,218,738	262,099,534
Underwriting expenses	13,099,642	12,357,312
General and administrative expenses	19,738,888	15,355,355
Workers' Compensation Court tax	2,516,039	2,436,219
Multiple Injury Trust Fund tax	1,908,552	2,103,219
Market equalization assessment	5,661,312	5,481,248
Provision for doubtful accounts	901,436	1,748,745
Depreciation expense	1,350,493	1,468,286
Total operating expenses	313,395,100	303,049,918
Operating income	5,912,026	56,381,761
Nonoperating revenues:		
Other income	263,297	368,347
Gain (loss) on disposal of assets	—	3,130
Total nonoperating revenues	263,297	371,477
Change in fund equity	6,175,323	56,753,238
Fund equity, beginning of year	312,380,216	255,626,978
Fund equity, end of year	$ 318,555,539	312,380,216

See accompanying notes to basic financial statements.

COMPSOURCE OKLAHOMA

Statements of Cash Flows

Years ended December 31, 2011 and 2010

		2011	2010
Cash flows from operating activities:			
Premiums collected	$	253,339,922	239,889,458
Policyholder deposit premiums collected (refunded)		1,113,472	(463,497)
Losses paid		(214,713,041)	(210,152,468)
Loss adjustment expenses paid		(19,682,148)	(19,735,093)
Underwriting expenses paid		(7,810,900)	(7,769,477)
Agent commission expenses paid		(5,001,396)	(4,385,682)
General and administrative expenses paid		(13,273,185)	(13,371,827)
Workers' Compensation Court tax paid		(2,532,964)	(2,480,236)
Multiple Injury Trust Fund tax paid		(5,962,455)	(6,439,060)
Multiple Injury Trust Fund tax rebate received		4,301,749	4,178,642
Market Equalization tax paid		(5,599,255)	(5,516,403)
Reinsurance expenses paid		(1,978,828)	(1,878,255)
Other states' coverage expenses paid		(188,533)	(171,318)
Investment income received		45,630,269	45,812,723
Other income		512,620	357,114
Net cash provided by operating activities		28,155,327	17,874,621
Cash flows from capital and related financing activities:			
Purchase of property and equipment		(1,144,146)	(2,899,980)
Proceeds from sale of property and equipment		—	9,934
Net cash used in capital and related financing activities		(1,144,146)	(2,890,046)
Cash flows from investing activities:			
Proceeds from sales and maturities of investments		128,982,896	137,913,473
Purchase of investments		(155,760,052)	(163,175,987)
Payments received on other invested asset		86,100	81,728
Net (increase) decrease in short-term investments		2,837,565	(4,690,663)
Net change in due to (from) brokers		(201,566)	77,228
(Decrease) in payable under security lending agreement		(80,286,607)	(54,536,608)
Decrease in security lending short-term investment trust		80,286,607	54,536,608
Payments received on note from Multiple Injury Trust Fund		1,352,072	1,261,429
Net cash used in investing activities		(22,702,985)	(28,532,792)
Net decrease in cash		4,308,196	(13,548,217)
Cash, beginning of year		20,720,499	34,268,716
Cash, end of year	$	25,028,695	20,720,499
Supplemental disclosures – noncash capital activities:			
Fixed assets included in accounts payable	$	57,849	322,068
Net change in securities lending short-term investment fair value		169,571	689,545

(Continued)

COMPSOURCE OKLAHOMA

Statements of Cash Flows

Years ended December 31, 2011 and 2010

	2011	2010
Reconciliation of change in fund equity to net cash provided by operating activities:		
Change in fund equity	$ 6,175,323	56,753,238
Adjustments to reconcile change in fund equity to net cash provided by operating activities:		
Net increase in fair value of investments	(20,531,114)	(66,327,485)
Provision for doubtful accounts	901,436	1,748,745
Depreciation	1,350,493	1,468,286
(Gain) loss on disposal and impairment of equipment recorded	4,470,306	(3,130)
Increase in accrued investment income	(112,375)	(83,359)
(Increase) in premiums due and other receivables	(976,840)	(9,153,127)
Decrease (increase) in receivable from Oklahoma Tax Commission	527,050	(123,107)
Increase in deferred acquisition costs	(19,718)	(268,358)
(Increase) decrease in other assets	(8,888)	51,086
Increase in reserve for losses	32,187,710	30,835,060
Increase in reserve for loss adjustment expenses	1,668,522	1,328,192
Increase in unearned premiums	1,534,410	2,000,567
Decrease in policyholder deposit premiums	1,113,452	(463,497)
Increase in accounts payable and other liabilities	(124,440)	111,510
Net cash provided by operating activities	$ 28,155,327	17,874,621

See accompanying notes to basic financial statements.

(1) Operational Authority and Summary of Significant Accounting Policies

(a) Operational Authority

CompSource Oklahoma (CompSource) was created in 1933 under Title 85 of the Oklahoma Statutes (Title 85). The primary purpose of CompSource is to provide a source for workers' compensation insurance for all Oklahoma employers. CompSource operates in a manner similar to any other insurance company. It is governed by a Board of Managers (the Board) and is administered by the President and Chief Executive Officer, who is appointed by the Board.

CompSource is a component unit of the State of Oklahoma (the State) and is combined with other unrelated funds to comprise the major component units of the State. CompSource meets the definition of both a major component and that of an enterprise fund. Enterprise funds are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expense, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

(b) Principles of Presentation

CompSource has prepared its financial statements in accordance with U.S. generally accepted accounting principles. CompSource has implemented Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*.

The GASB establishes the U.S. generally accepted accounting principles hierarchy for enterprise funds. The hierarchy requires that proprietary activities apply all applicable GASB pronouncements. The entity must also apply Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, to the extent that they do not conflict with GASB pronouncements. The entity can elect, at its option, to apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. CompSource has elected to adopt this option.

The financial statements have been prepared on the basis of U.S. generally accepted accounting principles for governmental entities and insurance enterprises, where applicable, which differs from the basis of accounting followed in statutory reporting (see note 13).

U.S. generally accepted accounting principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. Management adjusts such estimates and assumptions when facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

(c) Investments

The investment policy adopted by the Board is more restrictive than state statutes requiring CompSource to invest primarily in fixed income securities, including "A"-rated debt securities, commercial paper, and money market funds. In addition, no more than 20% of the investment portfolio may be invested in equity securities.

All of CompSource's debt and equity securities are recorded at fair value based on quoted market prices. If quoted prices are not available from active exchanges for identical instruments, then fair values are estimated using quoted prices from less active markets, quoted prices of securities with similar characteristics, or by pricing models utilizing other significant observable inputs. The changes in fair value of investments are included in the statements of revenues, expenses, and changes in fund equity. Dividend and interest income is recognized when earned. The cost of securities sold is determined by the first-in first-out method. Purchases and sales of investments are recorded as of the trade date.

Short-term investments consist of high-grade money market mutual funds and high-grade commercial paper. Short-term investments are reported at cost, which approximates fair value. Bonds maturing one year or less from date of purchase are also included in short-term investments and are reported at fair value.

The security lending short-term investment trust represents investment in The Bank of New York Mellon's Short-Term Investment Trust and is carried at fair value with changes in fair value of investments included in the statements of revenue, expenses and changes in fund equity.

(d) Allowance for Doubtful Accounts

CompSource provides an allowance for doubtful accounts by charging operations for estimated premiums receivable that will not be collected. The adequacy of the allowance is determined by management based on several factors, including historical loss experience, review of past due accounts, and business and economic conditions. The allowance for doubtful accounts was approximately $2,703,000 and $3,058,000 at December 31, 2011 and 2010, respectively.

(e) Deferred Policy Acquisition Costs

Policy acquisition costs consisting of agent commissions, Market Equalization Assessment, Workers' Compensation Court tax, and Multiple Injury Trust Fund tax are deferred and charged to operations over the periods in which the related premiums are earned. Deferred policy acquisition costs are subject to recoverability testing, which considers anticipated investment income at the end of each accounting period and are written off if determined to be unrecoverable. Deferred policy acquisition costs are included in other assets on the balance sheet. Deferred policy acquisition costs amounted to approximately $1,559,000 and $1,539,000 at December 31, 2011 and 2010, respectively.

(f) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets. When assets are disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in operations. The cost of maintenance and repairs is charged to operations as incurred; significant renewals and betterments are capitalized. CompSource recognized an impairment during 2011 related to capitalized nonoperating system software, which is reflected within general and administrative expenses on the statements of revenues, expenses, and changes in fund equity.

(g) Operating Revenues and Expenses

Balances classified as operating revenues and expenses are those that comprise CompSource's principal ongoing operations. Since CompSource's operations are similar to those of any other insurance company, most revenues and expenses are considered operating.

(h) Losses and Loss Adjustment Expenses

Reserves for losses and allocated loss adjustment expenses are provided based on case basis estimates for losses reported and CompSource's historical loss experience for claims incurred but not reported (IBNR). Reserves for unallocated loss adjustment expenses are estimated based on CompSource's historical ratios of paid unallocated loss adjustment expenses to paid losses and allocated loss adjustment expenses to estimated outstanding losses and allocated loss adjustment expenses. Adjustments to the liability based on subsequent developments or other changes in the estimate are reflected in results of operations in the period in which such adjustments become known. Although such estimates are CompSource's best estimates of the expected values, the actual results may vary from these values and such variances could be significant (see note 6).

(i) Excess-of-Loss Coverage

CompSource administers claim payments and provides excess-of-loss coverage to certain governmental entities. The premiums and fees received in connection with these transactions are included in gross premiums earned and were approximately $11,321,000 and $9,866,000 in 2011 and 2010, respectively. The liability for claims in excess of the respective retention limits for all policy years was approximately $74,130,000 and $66,054,000 at December 31, 2011 and 2010, respectively, and is included in reserves for losses in the balance sheet.

(j) Policyholder Deposit Premiums

Policyholder deposit premiums are collected in advance to reduce credit risk for premiums collected on a monthly or quarterly basis. At the end of the policy period, the deposit is applied to either final audit premium, renewal deposit premium, or refunded to the policyholder. Policyholder deposit premiums amounted to approximately $39,055,000 and $37,942,000 at December 31, 2011 and 2010, respectively.

(k) Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and a liability as the benefits accrue to the eligible employees up to a maximum of 480 hours. There are no accumulating sick leave benefits that vest for which any liability must be recognized. Accounts payable and other liabilities include a liability for vested or accumulated vacation leave at December 31, 2011 and 2010 of approximately $1,806,000 and $1,792,000, respectively.

(l) Revenue Recognition

Insureds pay premiums on a monthly, quarterly, or annual basis. Earned premiums are recognized as income as follows:

Monthly – One-twelfth of the estimated annual premium income is accrued each month. Actual payroll information for a month is submitted by the insured during the following month, and the difference between the accrual and the premium based on the actual payroll information is recognized at that time.

Quarterly – One-twelfth of the estimated annual premium income is accrued each month. Actual payroll information for a quarter is submitted by the insured during the month following the end of the quarter, and the difference between the accrual and the premium based on the actual payroll information is recognized at that time.

Annual – One-twelfth of the annual premium is recognized each month. Unearned premiums represent the portion of the annual premiums that is applicable to the unexpired term of the policies in force.

Unearned premiums amounted to approximately $34,234,000 and $32,699,000 at December 31, 2011 and 2010, respectively.

CompSource estimates earned but unbilled audit premium and records the amount as an adjustment to earned premium during the policy period. At the end of the policy period, CompSource audits the payroll information provided by the insured and any adjustments to earned premium are recognized in income.

(m) Workers' Compensation Court Tax

The Workers' Compensation Court tax is equal to one percent of all direct premiums written, and is imposed on all insurance companies that write workers' compensation insurance policies in Oklahoma. This tax supports the operations of the Workers' Compensation Court.

(n) Multiple Injury Trust Fund Tax

The Multiple Injury Trust Fund tax is based on a statutory formula used by the Workers' Compensation Court of the State of Oklahoma. The rates are in effect for each July 1 through June 30 and are adjusted annually. Payors of the tax are eligible to receive a rebate equal to two-thirds of the premium tax assessment. The Multiple Injury Trust Fund tax expense in the statements of revenues, expenses, and changes in fund equity reflects the premium tax expense incurred during 2011 and 2010, net of the rebate. Receivables from the Oklahoma Tax Commission for the rebate are recorded when the premium tax liability is incurred.

(o) Market Equalization Assessment

As set forth in Section 401 of Title 85, CompSource is required to pay a market equalization assessment. The assessment, which is payable annually to the State Treasury to the credit of the General Revenue Fund, is equal to 2.25% of all of CompSource's direct written premiums. The assessment amounted to approximately $5,712,000 and $5,597,000 in 2011 and 2010, respectively.

(p) Administrative Expenses

As set forth in Title 85, CompSource's administrative expenses at no time shall exceed 20% of earned premiums for the year. For the year ended December 31, 2011, CompSource's percentage of administrative expense (general and administrative expense and depreciation expense) to net earned premiums was 8.3%.

(q) Income Taxes

As described in note 1 to the financial statements, CompSource was created under and derives its operational authority from Title 85 of the Oklahoma Statutes. As the assured market for workers' compensation insurance, the primary purpose of CompSource is to provide a source for workers' compensation insurance for all Oklahoma employers. CompSource also meets the definition of a component unit of the State as defined by GASB Statement No. 14, *The Financial Reporting Entity*. Management believes CompSource is a tax-exempt entity pursuant to Internal Revenue Code Section 501(c)(27)(B). Accordingly, the financial statements do not include a provision for federal or state income tax.

(2) Fair Values of Financial Instruments

Accounting Standards Codification Topic 825, *Fair Value Measurements and Disclosures*, requires CompSource to disclose estimated fair values for its financial instruments. Fair value estimates are made at a point in time, based on relevant market data as well as the best information available about the financial instruments. Fair value estimates for financial instruments for which no or limited observable market data is available are based on judgments regarding current economic conditions, credit and interest rate risk, and loss experience. These estimates involve significant uncertainties and judgments and cannot be determined with precision. As a result, such calculated fair value estimates may not be realizable in a current sale or immediate settlement of the instrument. In addition, changes in the underlying assumptions used in the fair value measurement technique, including discount rate and estimates of future cash flows, could significantly affect these fair values. Fair value estimates, methods, and assumptions at December 31, 2011 and 2010 are described below for CompSource's financial instruments:

Cash and cash equivalents, short-term investments, accrued investment income, premiums due and other receivables, security lending short-term investment trust, due to and due from brokers, receivable from Oklahoma Tax Commission, accounts payable and other liabilities, and payable for securities lending agreement. The carrying amounts reported in the balance sheets approximate their fair values because of the short maturity of these financial instruments.

Investment securities. The carrying amounts reported in the balance sheets are at fair value for investment securities. Fair values for debt securities are based on quoted market prices, where available. If quoted market prices are not available from active exchanges for identical instruments, the fair values are estimated using quoted prices from less active markets, quoted prices of securities with similar characteristics or by pricing models utilizing other significant observable inputs. The fair values for equity securities are based on quoted market prices for exchange listed common stocks and net asset values of units in commingled funds which are managed by an investment company investing in actively traded exchange-listed common stocks.

Note receivable from Multiple Injury Trust Fund. The carrying amount of the note receivable in the balance sheet was approximately $21,614,000 and $22,966,000 as of December 31, 2011 and 2010, respectively. The fair values of approximately $22,297,000 and $23,433,000 as of December 31, 2011 and 2010, respectively, are estimated based on the discounted cash flows to be received using an estimated yield-to-maturity of a debt instrument of similar credit quality and maturity.

(3) Cash Equivalents and Investments

Amounts on deposit with the Office of the State Treasurer (State Treasurer) were $22,581,095 and $18,482,899 as of December 31, 2011 and 2010, respectively. These deposits consist of cash deposited to *OK INVEST*, an internal investment pool of the State Treasurer with holdings limited to high-rated money market mutual funds, obligations of the U.S. government, U.S. government agencies and instrumentalities, and collateralized tri-party repurchase agreements. Participants are limited to qualifying agencies and funds within the State's reporting entity, and each participant maintains an interest in the underlying investments of *OK INVEST* and shares the risk of loss on the funds in proportion to the respective investment in the funds.

The composition of investments at fair value at December 31, 2011 and 2010 is as follows:

		2011	2010
Equity securities	$	186,137,130	191,772,083
Fixed income securities:			
U.S. government obligations and government-sponsored agencies		248,974,385	245,517,866
Corporate obligations		553,165,889	508,024,743
Mortgage-backed securities		237,158,553	232,982,545
Short-term investments		42,101,933	44,939,498
Total current investments	$	1,267,537,890	1,223,236,735

CompSource has pledged a U.S. Treasury note to the U.S. Department of Labor to secure certain liabilities for workers' compensation claims as required by the Federal Longshore and Harbor Workers' Compensation Act. The book value of the note was $351,609 and $361,094 at December 31, 2011 and 2010, respectively; the fair value of the note was $351,642 and $360,896 at December 31, 2011 and 2010, respectively.

CompSource has pledged a U.S. Treasury note to secure a letter of credit issued on behalf of CompSource for a reinsurance contract utilized during 2011 and 2010. The book value of the note was $1,333,500 and $2,499,937 at December 31, 2011 and 2010, respectively; the fair value of the note was $1,336,500 and $2,518,850 at December 31, 2011 and 2010, respectively.

(a) Custodial Credit Risk

CompSource has no investments subject to custodial credit risk, except for those securities held by broker-dealers under security loans for noncash collateral, which consisted of approximately $139,810,000 and $13,883,000 in U.S. government obligations, government-sponsored agencies obligations, and corporate obligations as of December 31, 2011 and 2010, respectively.

(b) Credit Risk

CompSource's Board-approved investment policy sets forth the asset classes among which CompSource's investments shall be allocated. The investment policy further defines the components of the fixed income portfolio and provides that the allocation to these components is to be determined by the Board. CompSource manages its exposure to credit risk through limits on credit quality ratings within each component of the fixed income portfolio, as set forth in the investment policy.

A minimum of 75% of fixed income securities must be rated "A-" or better by two of the top three rating agencies (Moody's, Standard and Poor's, or Fitch). Up to 25% of the fixed income portfolio may be rated "Baa3/BBB-" by two of the top three agencies at all times. No securities rated below "Baa3/BBB-" (as determined by any two of the three rating agencies) at the time of purchase may be added to the fixed income portfolio.

Convertible bonds must be investment grade, which is considered to be a rating of "Baa3/BBB-" or better, at the time of purchase. Subsequent downgrades below "Baa3/BBB-" of any fixed income security by two or more of the three rating agencies is considered not in compliance and must be sold within 30 days unless specific permission to hold the security has been granted in writing by CompSource.

Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are not considered to have credit risk.

The credit risk profile as listed by Moody's or S&P for fixed income securities, excluding U.S. government obligations, at December 31, 2011 and 2010 is as follows:

	2011					
	Aaa/AAA	**Aa/AA**	**A/A**	**Baa/BBB**	**Below investment grade/not rated**	**Total**
Fixed income securities:						
Corporate obligations	$ 29,200,930	61,109,369	317,935,778	142,308,762	2,611,050	553,165,889
Loan-backed and structured securities	234,605,891	75,576	368,880	713,396	1,394,810	237,158,553
Short-term investments	20,499,321	18,599,410	—	3,003,202	—	42,101,933
	$ 284,306,142	79,784,355	318,304,658	146,025,360	4,005,860	832,426,375

	2010					
	Aaa/AAA	**Aa/AA**	**A/A**	**Baa/BBB**	**Below investment grade/not rated**	**Total**
Fixed income securities:						
Corporate obligations	$ 22,983,616	41,672,637	315,178,734	126,862,148	1,327,608	508,024,743
Loan-backed and structured securities	225,055,425	1,950,199	190,505	280,554	5,505,862	232,982,545
Short-term investments	44,939,498	—	—	—	—	44,939,498
	$ 292,978,539	43,622,836	315,369,239	127,142,702	6,833,470	785,946,786

(c) Concentration of Credit Risk

CompSource debt securities investments at December 31, 2011 had no single issuer investments that exceeded more than five percent of the total investment portfolio. CompSource's investment policy prohibits more than five percent of a portfolio to be invested in a single issuer (except for U.S. government and its agency obligations, which are exempt from this policy).

(d) Interest Rate Risk

CompSource, through its Board-approved investment policy, manages its exposure to fair value losses arising from increasing interest rates by limiting the effective duration for the nonconvertible fixed income portfolio to not greater than plus or minus one year of the target duration of the portfolio on an option-adjusted basis. The investment policy also prohibits investments in stripped mortgage-backed securities, such as interest-only or principal-only securities, and inverse floaters. The investment policy also places certain restrictions on asset allocation parameters, relative to the assigned benchmark, of the fixed income portfolio.

The effective duration, on an option-adjusted basis, for fixed income securities at December 31, 2011 and 2010 is as follows:

	2011		2010	
	Fair value	**Effective duration (in years)**	**Fair value**	**Effective duration (in years)**
Fixed income securities:				
U.S. government obligations	$ 248,974,385	5.54	$ 245,517,866	5.59
Corporate obligations – nonconvertible	469,079,505	4.80	419,693,450	4.72
Corporate obligations – convertible	84,086,384	6.02	88,331,293	7.07
Loan-backed and structured securities	237,158,553	2.73	232,982,545	3.45
	$ 1,039,298,827		$ 986,525,154	

CompSource's short-term investments consist of a short-term investment pool that restricts maturities such that cost approximates fair value, and commercial paper rated either A-1 by S&P or P-1 by Moody's.

Components of the net increase (decrease) in fair value of investments for the years ended December 31, 2011 and 2010 were as follows:

	2011	2010
Net change in unrealized gains on investments	$ 18,672,592	70,911,214
Net realized gains (losses) on sale of investments	1,858,522	(4,583,729)
	$ 20,531,114	66,327,485

Major categories of net investment income for the years ended December 31, 2011 and 2010 are summarized as follows:

		2011	2010
Fixed maturities	$	42,367,991	42,480,567
Equity securities		2,926,133	2,565,446
Net increase in fair value of investments		20,531,114	66,327,485
Short-term investments		662,756	818,630
Security lending short-term investment, net		163,948	157,168
Note receivable from Multiple Injury Trust Fund		1,548,996	1,641,227
		68,200,938	113,990,523
Investment expenses		(1,930,358)	(1,822,557)
	$	66,270,580	112,167,966

(e) Security Lending Activity

CompSource's investment policy provides for its participation in a securities lending program. The program is administered by CompSource's master custodian. Certain securities of CompSource are loaned to participating brokers, who must provide collateral in the form of cash, U.S. Treasury or government agency securities, or letters of credit issued by approved banks. Under the terms of the agreement, collateralization of the fair value of the loaned securities must be provided in the amount of 102% for loans of securities for which the principal trading market is the United States.

The market value of securities on loan was approximately $180,364,000 and $133,133,000 at December 31, 2011 and 2010, respectively. Total collateral provided by participating brokers was approximately $184,390,000 and $136,154,000 at December 31, 2011 and 2010, respectively, consisting of both cash and noncash collateral. Cash collateral provided amounted to $41,516,000 and $121,972,000 at December 31, 2011 and 2010, respectively. Noncash collateral provided, consisting of U.S. government obligations, amounted to $142,874,000 and $14,182,000 at December 31, 2011 and 2010, respectively. Because CompSource cannot pledge or sell collateral securities received unless the borrower defaults, the noncash collateral and related liability are not presented in the balance sheet.

Cash collateral provided by brokers participating in the securities lending program is invested in a cash collateral pool which is managed by CompSource's master custodian. The security lending short-term investment trust represents CompSource's proportionate share of the cash collateral pool, and a liquidating trust, at fair value. The payable under the security lending agreement represents CompSource's proportionate share of the cash collateral pool, and a liquidating trust, at cost.

Investments of the cash collateral pool consist of repurchase agreements, commercial paper, fixed and floating rate asset-backed debt securities, and floating rate notes. CompSource's proportionate share of expected maturities of the investments of the cash collateral pool was as follows at December 31, 2011:

Maturity		Amortized cost	Fair value
Less than or equal to 30 days	$	36,189,044	36,188,635
31 – 60 days		—	—
61 – 90 days		—	—
91 – 365 days		197,156	193,812
Greater than one year		1,252,075	1,202,907
Total cash collateral pool		37,638,275	37,585,354
Liquidating Trust		3,877,884	—
Total	$	41,516,159	37,585,354

The difference between the amortized cost and fair value of CompSource's proportionate share of the investments of the cash collateral pool at December 31, 2011 represents an unrealized loss of approximately $53,000.

The difference between the amortized cost and fair value of CompSource's proportionate share of the liquidating trust represents cumulative realized losses in debt securities issued by a structured investment vehicle. These realized losses have been included in net investment income in prior years. The structured investment vehicle was placed in receivership and was transferred out of the cash collateral pool into a liquidating trust effective October 1, 2008.

At December 31, 2011 and 2010, respectively, CompSource had no credit risk exposure to borrowers because the amounts CompSource owes the borrowers exceeds the amounts the borrowers owe CompSource. Furthermore, the contract with CompSource's master custodian requires it to indemnify CompSource if the borrowers fail to return the lent securities. There have been no losses on security lending transactions during 2011 and 2010 resulting from the default of a borrower or the lending agent.

All securities loans can be terminated on demand by either CompSource or the borrower, although the average term of the loans is 118 days. Cash collateral is invested in the master custodian's short-term investment trust, which at year-end has a weighted average maturity of 4 days. The relationship between the maturities of the investment trust and CompSource's loans is affected by the maturities of the securities loans made by other entities that use the master custodian's trust, which CompSource cannot determine. CompSource began an orderly wind down of the securities lending program during 2009.

(4) Note Receivable from the Multiple Injury Trust Fund

During 2011 and 2010, the note receivable from the Multiple Injury Trust Fund (Trust Fund) amounted to $21,614,151 and $22,966,223, respectively. Advances to the Trust Fund were made in prior years as permitted by Title 85 Section 387(B). The agreements were entered into to satisfy delinquent permanent partial disability awards and simple interest due on such awards owed by the Trust Fund. An Addendum to the Multiple Injury Trust Fund Loan Agreement, entered into on December 4, 2009, left a balance due of approximately $25,363,000. The single remaining note bears interest at a rate of 7% annually and is payable in quarterly installments with the final payment due on March 31, 2022. The loan and line of credit are secured by Trust Fund revenues, any equity or other interest of the State of Oklahoma, and any amounts appropriated or otherwise available to the Trust Fund. The loan and the line of credit are also secured by any underlying claims paid by virtue of these agreements including but not limited to any special priority, right to interest, or enforcement mechanism available. Legislation was enacted to establish a Multiple Injury Trust Fund tax based on a statutory formula used by the Workers' Compensation Court of the State of Oklahoma. Effective January 1, 2010 through June 30, 2010, the tax rate was 2.60%; effective July 1, 2010 through June 30, 2011, the tax rate was 2.59%; and effective July 1, 2011 the tax rate was 1.98% of direct written premiums on workers' compensation risks located in this state. This cash flow is estimated to be sufficient to service the interest and principal on the loans and line of credit.

Included in other assets are approximately $73,000 and $109,000 of receivables from the Trust Fund for administrative charges at December 31, 2011 and 2010, respectively.

(5) Property, Plant, and Equipment

Property, plant, and equipment activity for the year ended December 31, 2011 was as follows:

	Estimated useful life (years)	December 31, 2010	Additions	Dispositions	December 31, 2011
Land	—	$ 1,179,000	—	—	1,179,000
Building and improvements	20 – 40	18,993,921	15,751	—	19,009,672
Furniture and equipment	3 – 10	14,659,568	864,176	(4,546,362)	10,977,382
		34,832,489	879,927	(4,546,362)	31,166,054
Accumulated depreciation:					
Building		(5,817,500)	(571,515)	—	(6,389,015)
Equipment		(8,827,818)	(778,978)	76,056	(9,530,740)
		$ 20,187,171	(470,566)	(4,470,306)	15,246,299

Property, plant, and equipment activity for the year ended December 31, 2010 was as follows:

	Estimated useful life (years)	December 31, 2009	Additions	Dispositions	December 31, 2010
Land	—	$ 1,179,000	—	—	1,179,000
Building and improvements	20 – 40	18,829,626	164,295	—	18,993,921
Furniture and equipment	3 – 10	12,625,445	2,288,531	(254,408)	14,659,568
		32,634,071	2,452,826	(254,408)	34,832,489
Accumulated depreciation					
Building		(5,251,275)	(566,225)	—	(5,817,500)
Equipment		(8,173,361)	(902,061)	247,604	(8,827,818)
		$ 19,209,435	984,540	(6,804)	20,187,171

(6) Reserve for Losses and Loss Adjustment Expenses

CompSource estimates losses and loss adjustment expenses based on historical experience and payment and reporting patterns. These estimates are based on data available at the time of the estimate and are reviewed by CompSource's independent consulting actuary.

Inherent in the estimates of the ultimate liability for unpaid claims are expected trends in claim severity, claim frequency, and other factors that may vary as claims are settled. The amount and uncertainty in the estimates are affected by such factors as the knowledge of the actual facts and circumstances and amount of historical claims experience relative to the development period that has been affected by the change in premium levels and increase in closing and settlement of claims. The ultimate cost of insurance claims can be positively or adversely affected by costs such as medical expenses and awards by the Workers' Compensation Court.

(Continued)

Activity in the reserve for losses and loss adjustment expenses is summarized as follows (in thousands):

		2011	**2010**
Balance, beginning of year	$	957,344	925,181
Less reinsurance recoverables		(873)	(922)
Net balance, beginning of year		956,471	924,259
Incurred losses and loss adjustment expenses:			
Current year		270,593	259,342
Prior years		(2,374)	2,758
Total incurred		268,219	262,100
Paid losses and loss adjustment expenses:			
Current year		32,836	36,429
Prior years		201,559	193,459
Total paid		234,395	229,888
Net balance, end of year		990,295	956,471
Plus reinsurance recoverables		906	873
Balance, end of year	$	991,201	957,344

As a result of changes in estimates of insured events in prior years, the provision for losses and loss adjustment expenses decreased by approximately $2,374,000 in 2011 due to less than anticipated incurred but not reported losses and loss adjustment expenses which were partially offset by unfavorable development of case-basis reserves and increased by approximately $2,758,000 in 2010 due to unfavorable development of case-basis reserves which was partially offset by less than anticipated incurred but not reported losses and loss adjustment expenses.

At December 31, 2011 and 2010, CompSource recorded the liability for losses and loss adjustment expenses based on an estimate of its independent consulting actuary. The gross reserves of approximately $991 million and $957 million are the independent actuary's and management's best estimates of reserves at December 31, 2011 and 2010, respectively.

CompSource estimates current and noncurrent reserves for losses and loss adjustment expenses based on historical paid losses and loss adjustment expenses.

(7) Premium Deficiency Reserves

As of December 31, 2011, the actuarial analysis indicated that a premium deficiency reserve was not required for CompSource. CompSource did consider anticipated investment income as a factor in this analysis.

(8) Reinsurance Transactions

CompSource limits the maximum net loss that can arise from risks by entering into reinsurance agreements to assign risk to other insurers on a catastrophic basis. Premiums for this reinsurance were approximately $2,108,000 and $2,057,000 in 2011 and 2010, respectively. No losses in 2011 or 2010 have been ceded under the catastrophic reinsurance agreement.

Included in other assets are reinsurance recoverables with a single reinsurer of approximately $906,000 and $873,000 at December 31, 2011 and 2010, respectively.

Reinsurance contracts do not relieve CompSource from its primary obligation to policyholders. Failure of reinsurers to honor their obligations could result in losses to CompSource. Management believes that all reinsurers presently used are rated A or better by A.M. Best and are financially sound and will be able to meet their contractual obligations.

(9) Restricted Fund Equity

Title 85, Section 386 of the Oklahoma Statutes requires the accumulation of surplus funds or catastrophic reserves until such time as, in the judgment of the Board, such surplus funds or catastrophic reserves shall be sufficiently large to cover a catastrophic hazard and other unanticipated losses. Fund equity restricted for catastrophes totaled $5,000,000 at December 31, 2011 and 2010, respectively.

(10) Operating Leases

In the ordinary course of business, CompSource enters into various operating leases for office and storage space and equipment. Total operating lease expense approximated $292,000 and $206,000 for 2011 and 2010, respectively.

(11) Pension Plan

(a) Plan Description

CompSource 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. 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, P.O. Box 53007, Oklahoma City, Oklahoma 73152-3007 or by calling 1-800-733-9008.

(Continued)

(b) Funding Policy

Employees and CompSource are required to contribute at a rate set by statute. The contribution requirements of employees and CompSource are established and may be amended by the legislature of the State. The contribution rate for CompSource and employees for 2011 and 2010 is as follows:

	Employee rate	**Employer rate**
January 1, 2010 – December 31, 2010	3.5%	15.5%
January 1, 2011 – June 30, 2011	3.5%	15.5%
July 1, 2011 – December 31, 2011	3.5%	16.5%

CompSource's contributions to the Plan for the years ended December 31, 2011, 2010, and 2009 were approximately $2,364,000, $2,307,000, and $2,274,000, respectively, and equal its required contributions for each year. Employee contributions for the years ended December 31, 2011, 2010, and 2009 were approximately $529,000, $536,000, and $540,000, respectively.

(12) Deferred Compensation Plan and Deferred Savings Incentive 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 Section 457 and Chapter 45 of Title 74, Oklahoma Statutes. The Oklahoma State Employees Deferred Compensation Plan (the DCP), also known as SoonerSave, is a voluntary plan that allows participants to defer a portion of their salary into the DCP. Participation allows employees to shelter the portion of their salary that is deferred from current federal and state income tax. Taxes on the interest or investment gains on this money, while in the DCP, 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 DCP investment options. Under terms of the Trust, tax deferred amounts may be used only for the exclusive benefit of the DCP participants and their beneficiaries. Further information may be obtained from the Oklahoma State Employees Deferred Compensation Plan audited financial statements for the year ended June 30, 2011. CompSource believes that it has no liabilities in respect to the State's DCP.

A monthly contribution of $25 is made by CompSource for each employee qualified to participate in a defined contribution plan, the Savings Plan, which was established pursuant to Section 401(a) of the Internal Revenue Code. The Savings Plan is administered by the Oklahoma Public Employees Retirement System.

(13) Statutory Reporting

CompSource files statutory financial statements with the Oklahoma Insurance Department (the Department). Accounting principles used to prepare those statutory financial statements differ from financial statements prepared on the basis of accounting principles generally accepted in the United States of America.

The reconciliation between statutory surplus and total fund equity at December 31 is as follows:

		2011	2010
Statutory surplus as filed	$	219,511,267	235,804,102
Net unrealized gains on debt securities		95,953,207	69,521,883
Nonadmitted assets		1,532,068	5,514,952
Deferred acquisition costs		1,558,997	1,539,279
Total fund equity	$	318,555,539	312,380,216

The reconciliation between statutory net loss and change in fund equity at December 31 is as follows:

		2011	2010
Statutory net loss as filed	$	(11,728,151)	(6,906,438)
Change in net unrealized gains on debt and equity securities		17,664,881	69,821,982
Unrealized gains on U.S. government inflation protected securities		1,049,479	352,431
Change in net unrealized (losses) due to other-than-temporary impairments for statutory purposes		(830,604)	(6,783,094)
Change in deferred acquisition costs		19,718	268,357
Change in fund equity	$	6,175,323	56,753,238

The Department may conduct an examination of CompSource in the same manner as a domestic insurance company if the examination does not conflict with any provisions in Title 85 of the Oklahoma Statutes. The Department may also recommend adjustments to certain accounts based on its judgment about information available at the time of the examination.

(14) Contingencies

At December 31, 2011, CompSource was a defendant in a policyholder suit, filed August 25, 2011, regarding the provision of coverage and breach of contract. While it is not possible to predict with certainty when this matter will be completely resolved, it is possible that the disposition of the litigation could occur in the near term. In the opinion of Compsource's management, after considering the advice of counsel, the ultimate resolution of this proceeding could have a material effect on CompSource's financial condition, changes in financial condition, and cash flow. At December 31, 2011, the financial statements do not include any expenses or liabilities related to the above action, as a loss has not been deemed probable or estimable. Management is vigorously defending this case.

Also at December 31, 2011, CompSource was a defendant in a policyholder suit, filed October 30, 2009, regarding the refund of premium for a canceled workers' compensation insurance policy. The suit also seeks class action status for certain policies canceled under similar circumstances. While it is not possible to predict with certainty when this matter will be completely resolved, it is possible that the disposition of the litigation could occur in the near term. In the opinion of CompSource's management, after considering the advice of counsel, the ultimate resolution of this proceeding could have a material effect on CompSource's financial condition, changes in financial condition, and cash flow. At December 31, 2011, the financial statements do not include any expenses or liabilities related to the above action, as a loss has not been deemed probable or estimable. Management is vigorously defending this case.

CompSource is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of CompSource's management, after considering the advice of counsel, the ultimate disposition of these matters will not have a material adverse effect on CompSource's financial condition, changes in financial condition and cash flow.