

# Secretary of State Audit Report

Kate Brown, Secretary of State

Gary Blackmer, Director, Audits Division



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## State of Oregon

### **Oregon Short-Term Fund**

An Investment Pool of the State of Oregon  
For the Fiscal Year Ended June 30, 2010

**Office of the Secretary of State**

Kate Brown  
Secretary of State

Barry Pack  
Deputy Secretary of State



**Audits Division**

Gary Blackmer  
Director

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The Honorable Theodore R. Kulongoski, Governor, of Oregon  
The Honorable Ted Wheeler, State Treasurer  
The Oregon Investment Council  
Oregon Short-Term Fund Board

This report presents the results of our audit of the Oregon Short-Term Fund (OSTF), an investment pool of the State of Oregon, for the year ended June 30, 2010.

As required by auditing standards, we performed the audit to obtain reasonable assurance about whether the financial statements and accompanying notes have been presented fairly by management. Our Independent Auditor's Report and the financial statements for the fiscal year ended June 30, 2010, are included in the Financial Section of this report. We concluded that the financial statements are fairly presented in accordance with accounting principles generally accepted in the United States of America.

Auditing standards also require us to review the Oregon State Treasury's internal control of the Oregon Short-Term Fund and compliance with applicable laws, regulations, contracts, and grant agreements. Our report on the results of those reviews is included in the Other Reports section of this report. We noted no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Our consideration of internal control was limited to the scope necessary to achieve our audit objectives and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses as defined by generally accepted auditing standards. However, we identified a significant deficiency in internal control over financial reporting.

We appreciated the cooperation and assistance of the Oregon State Treasury management and staff during the course of our audit.

OREGON AUDITS DIVISION

Gary Blackmer  
Director

# **T A B L E   O F   C O N T E N T S**

Page

## **FINANCIAL SECTION**

Independent Auditor's Report..... 2

### Financial Statements

Statement of Net Assets ..... 4

Statement of Changes in Net Assets ..... 5

Notes to Financial Statements..... 6

## **OTHER REPORTS**

Report on Internal Control over Financial Reporting and on  
Compliance and Other Matters .....18

Schedule of Findings and Responses .....20

## FINANCIAL SECTION

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**INDEPENDENT AUDITOR'S REPORT**

We have audited the accompanying financial statements of the Oregon Short-Term Fund, an investment pool for the State of Oregon, as of and for the year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the Oregon State Treasury management. Our responsibility is to express an opinion 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 Oregon State Treasury's internal control over financial reporting relating to the Oregon Short-Term Fund. Accordingly, we express no such opinion. An audit 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 opinion.

As discussed in Note 1, the financial statements of the Oregon Short-Term Fund, an investment pool of the State of Oregon, Oregon State Treasury, are intended to present the financial position, and changes in financial position of only the Oregon Short-Term Fund. They do not purport to, and do not, present fairly the financial position of the Oregon State Treasury or the State of Oregon as of June 30, 2010, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Oregon Short-Term Fund as of June 30, 2010, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 30, 2010 on our consideration of the Oregon State Treasury's internal control over financial reporting relating to the Oregon Short-Term Fund and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. That report is presented separately in the Other Reports section as listed in the table of contents.

OREGON AUDITS DIVISION

A handwritten signature in black ink, appearing to read 'Kate Brown', with a long horizontal flourish extending to the right.

Kate Brown  
Secretary of State

August 30, 2010

State of Oregon  
**OREGON SHORT-TERM FUND**  
**Statement of Net Assets**  
**June 30, 2010**  
(Dollars in Thousands)

	<u>June 30, 2010</u>
<b>Assets:</b>	
Cash and Cash Equivalents	\$ 4,132,468
Investments	5,586,710
Due from Secretary of State (Note 5)	39
Due from Department of Transportation (Note 5)	1,250
Accrued Interest Receivable	26,991
Securities Lending Collateral (Note 3)	<u>3,101,366</u>
<b>Total Assets</b>	<u>12,848,824</u>
<b>Liabilities:</b>	
Due to Employment Department (Note 6)	57
Obligations Under Securities Lending (Note 3)	<u>3,101,366</u>
<b>Total Liabilities</b>	<u>3,101,423</u>
<b>Net Assets:</b>	
Held in Trust for Participants	<u>9,747,401</u>
<b>Total Net Assets</b>	<u><u>\$ 9,747,401</u></u>

*The accompanying notes are an integral part of the financial statements.*

State of Oregon  
**OREGON SHORT-TERM FUND**  
**Statement of Changes in Net Assets**  
**For the Year Ended June 30, 2010**  
(Dollars in Thousands)

	Year Ended June 30, 2010
<b>Additions:</b>	
Participants' Contributions	\$ 44,403,495
Investment Income, Net of Expenses (Notes 1, 4)	<u>127,972</u>
<b>Total Additions</b>	<u>44,531,467</u>
<b>Deductions:</b>	
Participants' Withdrawals	44,945,494
Distributions of Interest to Participants	70,499
Securities Lending Agent Fee Expense	860
Securities Lending Borrowers' Rebate Expense	<u>7,855</u>
<b>Total Deductions</b>	<u>45,024,708</u>
Change in Net Assets Held in Trust for Participants	(493,241)
Net Assets - Beginning	<u>10,240,642</u>
<b>Net Assets - Ending</b> (Note 7)	<u><u>\$ 9,747,401</u></u>

*The accompanying notes are an integral part of the financial statements.*

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements**  
June 30, 2010

**(1) Summary of Significant Accounting Policies**

**Reporting Entity** The Oregon Short-Term Fund (Fund) is a short-term cash investment vehicle. A number of local governments in Oregon as well as all State agencies participate in the Fund, thus it is an external investment pool as defined in Statement No. 31 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

The Fund is not registered with the U.S. Securities and Exchange Commission as an investment company. The State's investment policies are governed by Oregon Revised Statutes and the Oregon Investment Council (Council). The State Treasurer is the investment officer for the Council and is responsible for all funds entrusted to the Oregon State Treasury (OST). These funds must be invested, and the investments managed, as a prudent investor would, exercising reasonable care, skill and caution. Investments in the Fund are further governed by portfolio guidelines recommended by the Oregon Short-Term Fund Board, with Council approval, establishing diversification percentages and specifying the types and maturities of investments. The portfolio guidelines permit securities lending transactions as well as investments in repurchase agreements and reverse repurchase agreements. Portfolio guidelines are discussed in greater detail in the Investments section of Note 2.

According to ORS 293.265 and 295.002, state agencies must deposit all funds with depositories qualified by the OST. Undesignated funds not required to meet current demand are deposited in the Fund; therefore, state agencies are considered involuntary participants of the Fund. Because the Fund operates as a demand deposit account for state agency participants, the portion of the Fund belonging to state agency (internal) participants is classified as cash and cash equivalents in the State's Comprehensive Annual Financial Report. The portion of the Fund belonging to local government (external) participants is reported in an investment trust fund in the State's Comprehensive Annual Financial Report.

**Basis of Accounting** These statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Trade date accounting is observed, which means that purchases and sales of securities are recorded on the day the trade takes place with a corresponding payable to or receivable from the broker. Changes in the fair value of investments are recognized at the end of each year. The fair value of investments is determined annually and is equal to market price.

**Cash and Cash Equivalents** Investments with original maturities of three months or less are considered cash equivalents and are reported at amortized cost, which approximates fair value. Cash and Cash Equivalents also include cash in banks.

**Investments** Investments with remaining maturities of less than ninety days are carried at amortized cost, provided that the fair value of these instruments is not significantly affected by the impairment of the credit standing of the issuer or by other factors. Amortized cost approximates fair value. Investments with longer maturities are carried at fair value.

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2010

***Participants' equity; distributions of interest*** Participants' account balances in the Fund are determined by the amount of participants' deposits, adjusted for withdrawals and distributed interest. The Fund has not provided or received any legally binding guarantees with regard to balances in the Fund. Interest is calculated and accrued daily on each participant's account based on the ending account balance and a variable interest rate determined periodically by the OST. When a participant's account is overdrawn, negative interest accrues daily at the determined rate plus a premium. OST accumulates an amount to offset losses on specific investments and historically-based default rates as part of Total Net Assets. This amount is reviewed at the end of every month, and considered in setting the rate paid to participants, exclusive of unrealized gains and losses. Interest is distributed monthly on the last business day of the month. If the last day of the month is a weekend or holiday, interest is accrued through the last calendar day of the month but posted on the last business day.

**(2) Deposits and Investments**

**Deposits** On June 30, 2010 the Fund held \$73.9 million book balance in deposits with a bank balance of \$110.4 million. Insurance and collateral requirements for deposits are established by banking regulations and Oregon law. Where balances exceed the Federal Deposit Insurance amount of \$250,000, the balances are covered by collateral held in a multiple financial institution collateral pool (ORS 295.015) administered by the Oregon State Treasury in the Public Funds Collateralization Program (PFCP).

As of June 30, 2010, \$2.1 million was covered by FDIC insurance and \$108.3 million were collateralized under the PFCP.

**Investments** On June 30, 2010, the Fund held \$9.6 billion in investments, \$4.1 billion of which are classified as Cash and Cash Equivalents on the Statement of Net Assets. The Fund's portfolio rules establish the Fund's permitted investments and provide guidelines for managing the various types of risk associated with these investments (see the current portfolio rules at <http://www.ost.state.or.us/divisions/investment/index.htm>). The different risks will be discussed below.

**A. Interest rate risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Fund staff manages this risk by limiting the maturity of the investments held by the Fund. The portfolio rules require that at least 50 percent of the portfolio mature within 93 days; not more than 25 percent of the portfolio may mature in over a year; and no investments may mature over three years from settlement date. The June 30, 2010 holdings are shown in the schedule below. For variable rate securities, the next interest rate reset date is used instead of the maturity date. For variable rate securities in a fixed rate period that will switch to variable rate at a later date, the maturity is based on the final maturity of the bond, not the next variable reset date.

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2010

**Schedule of Investment Maturities**

**June 30, 2010**

(Dollars in Thousands)

Investment Type	Investment Maturities				
	Reported Amount <sup>①</sup>	94 Days to Up to 93 Days	One Year	One to Three Years	Defaulted <sup>③</sup>
Cash and Cash Equivalents: <sup>②</sup>					
Commercial Paper	\$ 1,915,605	\$ 1,915,605	\$ -	\$ -	\$ -
Agency Bonds	21,149	21,149	-	-	-
Agency Discount Notes	1,852,370	1,852,370	-	-	-
Treasury Bills	219,969	219,969	-	-	-
Time Certificates of Deposit	49,500	49,500	-	-	-
Subtotal Cash Equivalents	4,058,593	4,058,593	-	-	-
Investments: <sup>②</sup>					
Agency Bonds	2,002,628	717,755	422,278	862,595	-
Commercial Paper	99,974	99,974	-	-	-
Corporate Notes	2,562,950	1,800,350	141,908	581,695	38,997
Temporary Liquidity Guarantee	921,158	729,426	141,263	50,469	-
Subtotal Investments	5,586,710	3,347,505	705,449	1,494,759	38,997
Total	\$ 9,645,303	\$ 7,406,098	\$ 705,449	\$ 1,494,759	\$ 38,997

<sup>①</sup> Reported Amount is a combination of amortized cost and fair value. See Note 1

<sup>②</sup> Classification on Statement of Net Assets

<sup>③</sup> Lehman Brothers securities, \$191.3 million par value

**B. Credit risk**

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The Fund's policies provide minimum weighted average credit quality ratings for the Fund's holdings: AA and Aa2 for Standard and Poor's (S&P) and Moody's, respectively.

The Oregon Investment Council (OIC) made changes to the allowable minimum ratings in April, 2010. The current minimums for corporate notes are an S&P rating of A-, Moody's rating of A3 and Fitch rating of A-. Commercial paper is required to have a minimum short-term credit rating at the time of purchase from two of three ratings services with current minimum ratings from S&P of A-1, Moody's of P-1 and Fitch of F-1. Foreign government securities or their instrumentalities were added by the OIC as approved investments at the same time, and are required to have minimum credit ratings from S&P of AA-, Moody's of Aa3 and Fitch of AA-.

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2010

Occasionally, securities are downgraded but Fund policies allow them to be retained at the Senior Investment Officer's discretion. Holdings of Lehman Brothers securities totaling \$191.3 million par value had ratings from all three agencies withdrawn due to bankruptcy. Rating groups were determined using the lowest actual rating from S&P, Moody's or Fitch, and are shown below:

**Schedule of Credit Quality Distribution**  
**June 30, 2010**  
(Dollars in Thousands)

(Dollars in Thousands)							
						Rating	Total Reported
Investment Type	AAA	AA	A	BBB	Not Rated	Withdrawn	Amount
Commercial Paper	\$ -	\$ 407,951	\$ 1,607,628	\$ -	\$ -	\$ -	\$ 2,015,579
Corporate Notes	110,432	1,035,731	1,332,030	45,760	① -	38,997	2,562,950
Agency Bonds	1,593,110	-	430,667	-	-	-	2,023,777
Agency Discount Notes	1,852,370	-	-	-	-	-	1,852,370
U.S. Treasury Bills	219,969	-	-	-	-	-	219,969
Temporary Liquidity Guarantee	921,158	-	-	-	-	-	921,158
Time Certificates of Deposit	-	-	-	-	49,500	-	49,500
Total	\$ 4,697,039	\$ 1,443,682	\$ 3,370,325	\$ 45,760	\$ 49,500	\$ 38,997	\$ 9,645,303

① Securities rated BBB in this table continue to meet investment quality rules as discussed above, as they have at least one rating S&P A-, Moody's A3 or Fitch A-.

### C. Custodial credit risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the government will not be able to recover the value of an investment or collateral securities in the possession of an outside party. The Fund's portfolio rules provide that broker/dealers meet certain qualifications and that investments are delivered to and held by a third-party custodian, which holds the Fund's securities in the State of Oregon's name. Time certificates of deposit (TCDs) are not exposed to custodial credit risk, as they are covered by FDIC insurance of \$0.7 million and the balance of \$48.8 million is covered by a multiple financial institution collateral pool (ORS 295.015) administered by the Oregon State Treasury.

### D. Concentration of credit risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Fund rules provide that the maximum that may be invested in any one issuer, as a percentage of the fund's total investments, is 33 percent for U.S. Agency securities, ten percent for foreign governments and instrumentalities and five percent for both commercial paper and corporate notes. On June 30, 2010, the Fund did not hold investments with any one issuer that exceeded these limits. The schedule below lists those issuers where holdings are greater than five percent.

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2010

**Schedule of Issuers - Holdings Greater Than Five Percent**

**June 30, 2010**

(Dollars in Thousands)

<b>Issuer Name</b>	<b>Reported Amount</b>	<b>Percent of Holding</b>
Federal Home Loan Bank	1,578,291	16.36%
Federal National Mortgage Association	1,256,043	13.02%
Federal Home Loan Mortgage Corporation	858,659	8.90%

**E. Foreign currency**

The Fund portfolio rules prohibit investments that are not US dollar-denominated; therefore, the Fund is not exposed to this risk.

**(3) Securities Lending**

The OST has authorized its custodian to act as its agent in the lending of the Fund's securities pursuant to a form of loan agreement, in accordance with Fund investment policies. There have been no significant violations of the provisions of the securities lending agreement. The State's securities lending agent lent short-term and fixed income securities and received as collateral U.S. dollar-denominated cash and U.S. Agency debt. Borrowers were required to deliver collateral for each loan equal to not less than 102 percent of the market value of the loaned security. The State did not impose any restrictions during the year on the amount of the loans that the securities lending agent made on its behalf. The State is fully indemnified by its securities lending agent against losses due to borrower default. There were no losses during the year from the failure of borrowers to return loaned securities.

In 2008 the lending agent created a new fund to reinvest cash collateral received on behalf of the OSTF and Oregon state agencies other than the Public Employees Retirement System. As permitted under the fund's Declaration of Trust (Declaration), participant purchases and redemptions are transacted at \$1.00 per unit ("constant value") based on the amortized cost of the fund's investments. Accordingly, the securities lending collateral held and the obligation to the lending agent are both stated at constant value on the Statement of Net Assets. The balances of securities on loan, cash collateral received and invested collateral at market value are presented in the schedule below.

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2010

**Schedule of Securities Lending Balances**

**June 30, 2010**

(Dollars in Thousands)

	<b>Securities on Loan at</b>		<b>Invested Collateral at</b>
	<b>Fair Value</b>	<b>Collateral Received</b>	<b>Fair Value</b>
U.S. Agency Securities ①	\$ 2,042,555	\$ 2,084,761	\$ 2,084,338
Corporate Notes	995,756	1,016,689	1,016,523
Total	<u>\$ 3,038,311</u>	<u>\$ 3,101,450</u>	<u>\$ 3,100,861</u>

① Cash collateral \$2,084,678; \$83 U.S. Agency Debt

The Declaration also provides that if a significant difference exists between the constant value and the market-based net asset value of investments made with the collateral, the agent may determine that a condition exists that would create inequitable results if redemptions were made at the constant value. In that case, the agent may direct that units be redeemed at fair value, engage in in-kind redemptions, or take other actions to avoid inequitable results for the fund participants, until the difference between the constant value and the fair value is deemed immaterial.

The State and borrowers maintained the right to terminate all securities lending transactions on demand. As a consequence, the maturities of investments made with cash collateral generally do not match the maturities of the securities loans. As of June 30, 2010, the State had no credit risk exposure to borrowers related to securities on loan.

**(4) Management Fees**

In accordance with ORS 293.718, the OST may deduct monthly 0.435 basis points of the most recent market value of assets under management for administration and portfolio management. For the year ended June 30, 2010 the OST charged the Fund a monthly rate of 0.30 basis points based on average daily balances in the Fund. The fee is deducted from investment income before distributions to participants. Fees charged to the Fund totaled \$3.9 million for the year ended June 30, 2010.

**(5) Receivable from the Department of Transportation and Oregon Secretary of State**

The Oregon Department of Transportation has an agreement to borrow up to \$7.5 million for the purpose of interim financing of the Oregon Wireless Interoperability Network capital expenditures prior to the issuance of COPs. Interest is charged at a variable per annum rate equal to the greater of two (2) percent or the Oregon Short Term Fund rate plus 120 basis points. To date, the Department of Transportation has drawn \$1.3 million. The total amount loaned is due June 30, 2011.

The Oregon Secretary of State made an agreement in fiscal year 2008 with the fund to borrow \$90.3 thousand to use for costs of purchasing voting machines for Curry County. The balance at June 30, 2010 of the loan is \$38.9 thousand. Interest is charged at a fixed per annum rate of

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2010

5.66 percent. The total amount loaned is due December 31, 2012, with an option to pay \$21.2 thousand per year on December 31, commencing in 2008.

**(6) Payable to the Oregon Employment Department**

The OST maintains accounts separate from the Fund which contains employment benefit and trust funds in the name of the Oregon Employment Department, which is also a participant in the Fund. The OST processes transfers of employment taxes and benefit payments between state agencies and the Oregon Employment Department. Occasionally a transfer will be recorded between participants' accounts on one day, but the transfer of cash between the Fund and the employment benefit and trust funds does not take place until the following day, creating either a receivable from or payable to Employment.

**(7) Equity of Internal and External Participants**

The following table describes the equity of internal and external participants in the Fund's net assets, and shows that net assets are composed of participants' account balances less undistributed and unrealized losses:

	<u>June 30, 2010</u>
Net assets held in trust for participants (in thousands):	
Equity of internal participants	\$ 5,881,013
Equity of external participants	<u>3,866,388</u>
	<u>\$ 9,747,401</u>
Net assets consist of (in thousands):	
Participants' Account Balances	\$ 9,790,864
Undistributed and Unrealized Losses	(129,231)
Amounts for Losses and Historically-based Defaults	<u>85,768</u>
	<u>\$ 9,747,401</u>
Participants' Fair Value (Net Assets divided by Participants' Account Balances)	99.56%

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2010

**(8) Schedule of Investments and Cash Equivalents**

The following schedule presents by issuer the par value and reported amount of the Investments and Cash Equivalents held as of June 30, 2010 (in thousands).

**Schedule of Investments and Cash Equivalents**

**June 30, 2010**

**(Dollars in Thousands)**

	<u>Par Value</u>	<u>Reported Amount</u>	<u>Percentage</u>
U.S. Government and Agency Securities:			
Agency Bonds:			
Federal Farm Credit Bank	\$ 181,200	\$ 183,155	
Federal Home Loan Bank	671,085	672,097	
Federal Home Loan Mortgage Corporation	242,000	242,321	
Federal National Mortgage Association	904,834	926,204	
Total Agency Bonds	<u>1,999,119</u>	<u>2,023,777</u>	21.0%
Agency Discount Notes:			
Federal Home Loan Bank	906,284	906,193	
Federal Home Loan Mortgage Corporation	616,400	616,338	
Federal National Mortgage Association	329,900	329,839	
Total Agency Discount Notes	<u>1,852,584</u>	<u>1,852,370</u>	19.3%
Treasury Bills	<u>220,000</u>	<u>219,969</u>	2.3%
<b>Total U.S. Government and Agency Securities</b>	<u>4,071,703</u>	<u>4,096,116</u>	42.6%
Commercial Paper:			
Broker/Dealer:			
Goldman Sachs Group I	116,000	115,994	
ING (US) Funding LLC	137,000	136,984	
Total Broker/Dealer	<u>253,000</u>	<u>252,978</u>	2.6%
Commercial Banks:			
Union Bank NA	<u>85,000</u>	<u>84,991</u>	0.9%
Computers/Technology:			
Dell Inc.	<u>50,000</u>	<u>49,995</u>	0.5%
Electric - Transmission:			
Arkansas Electric Cooperative	<u>30,000</u>	<u>29,997</u>	0.3%

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2010

	<u>Par Value</u>	<u>Reported Amount</u>	<u>Percentage</u>
Financial:			
BankAmerica Corporation	135,000	134,992	
Citigroup Funding, Inc.	200,000	199,985	
General Electric Capital	85,000	84,990	
Prudential Funding LLC	85,000	84,994	
US Bancorp	100,000	99,994	
Total Financial	605,000	604,955	6.3%
Import/Export:			
Sumimoto Corporation of America	60,200	60,191	0.6%
Industrial:			
Hewlett Packard Company	100,000	99,992	
Koch Resources, LLC	200,000	199,981	
Total Industrial	300,000	299,973	3.1%
Investment Management:			
Alliance Bernstein	25,000	24,998	0.3%
Life/Health Insurance:			
New York Life Capital Corporation	40,000	39,999	0.4%
Medical Products:			
Johnson & Johnson	100,000	99,974	1.0%
Multi-line Insurance:			
General RE Corporation	15,000	15,000	0.2%
Oil Companies - Integrated:			
BP Capital Markets PLC	45,000	44,998	0.5%
Oil Field Services:			
Baker Hughes Inc.	114,775	114,762	1.2%
Retail - Restaurants:			
McDonald's Corporation	34,000	33,997	0.4%
Special Purpose Entity:			
Procter & Gamble International Funding	68,000	67,995	0.7%
Transport Services:			
Wheels Inc.	59,800	59,790	0.6%

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2010

	<u>Par Value</u>	<u>Reported Amount</u>	<u>Percentage</u>
Utilities - Electric:			
Emerson Electric Co.	22,500	22,497	
Nstar Electric Company	33,500	33,496	
Southern Company Funding	50,000	49,996	
Southern Company	25,000	24,997	
	<hr/>	<hr/>	
Total Utilities - Electric	131,000	130,986	1.4%
	<hr/>	<hr/>	
<b>Total Commercial Paper</b>	2,015,775	2,015,579	21.0%
	<hr/>	<hr/>	
Corporate Notes:			
Broker/Dealer:			
Goldman Sachs	10,000	9,749	
Morgan Stanley	21,300	21,164	
	<hr/>	<hr/>	
Total Broker/Dealer	31,300	30,913	0.3%
	<hr/>	<hr/>	
Commercial Bank - Non-US:			
Westpac Banking	68,000	67,448	0.7%
	<hr/>	<hr/>	
Financial and Insurance:			
BP Capital Markets PLC	48,710	45,759	
Bank America	25,000	25,000	
Barclay's Bank PLC	175,000	174,636	
Bear Stearns	169,843	169,266	
Citigroup Inc.	58,000	57,970	
Credit Suisse First Boston	104,102	105,366	
First Union National Bank	5,570	5,623	
General Electric Capital Corporation	170,006	168,011	
JP Morgan Chase and Company	93,149	93,181	
Lehman Brothers Holdings	191,302	38,997	
Met Life Global Funding	225,000	225,000	
Morgan Stanley	25,000	25,090	
New York Life Global Funding	50,000	49,958	
Rabobank Nederland	100,000	99,911	
Suncorp Metway LTD	50,000	50,027	
Teva Pharma Financial	32,500	32,588	
Toyota Motor Credit	45,000	44,969	
US Bankcorp	13,800	14,595	
UBS AG Stamford	300,000	301,241	
Wachovia Corporation	224,873	224,900	
Wells Fargo and Company	43,300	43,453	
	<hr/>	<hr/>	
Total Financial and Insurance	2,150,155	1,995,541	20.8%
	<hr/>	<hr/>	
Foreign Government Backed Securities:			
Barclays Realty Limited Partnership	60,000	60,474	
Commonwealth Bank of Australia	100,000	98,956	
	<hr/>	<hr/>	
Total Foreign Government Backed Securities	160,000	159,430	1.7%
	<hr/>	<hr/>	

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2010

	<u>Par Value</u>	<u>Reported Amount</u>	<u>Percentage</u>
REITS:			
Arden Realty Limited Partnership	9,000	9,284	
Franchise Financing Corporation	5,000	5,098	
Total REITS	14,000	14,382	0.1%
Medical - Drugs:			
Abbott Labs	14,670	15,278	
Pfizer Incorporated	50,000	50,705	
Total Medical - Drugs	64,670	65,983	0.7%
Reinsurance:			
Berkshire Hathaway	150,000	150,742	1.6%
Telephone:			
Cello Partners/Verizon Wireless	76,800	78,511	0.8%
<b>Total Corporate Notes</b>	2,714,925	2,562,950	26.7%
Government Guaranteed Corporate Securities:			
Bank of America	75,000	75,000	
Citigroup	300,000	300,963	
General Electric Capital Corporation	65,000	65,399	
Goldman Sachs Group Incorporated	125,000	125,501	
JP Morgan Chase & Company	112,000	112,282	
Morgan Stanley	189,500	191,307	
Wells Fargo & Company	50,000	50,706	
<b>Total Government Guaranteed Corporate Securities</b>	916,500	921,158	9.6%
Time Certificates of Deposit	49,500	49,500	0.5%
<b>Total Investments and Cash Equivalents</b>	\$ 9,768,403	\$ 9,645,303	100.0%

## **OTHER REPORTS**

**Office of the Secretary of State**

Kate Brown  
Secretary of State

Barry Pack  
Deputy Secretary of State



**Audits Division**

Gary Blackmer  
Director

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The Honorable Theodore R. Kulongoski, Governor of Oregon  
The Honorable Ted Wheeler, State Treasurer  
The Oregon Investment Council  
Oregon Short-Term Fund Board

**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**

We have audited the financial statements of the Oregon Short-Term Fund, an external investment pool of the State of Oregon, as of and for the year ended June 30, 2010, and have issued our report thereon dated August 30, 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 the Oregon State Treasury's internal control over financial reporting relating to the Oregon Short-Term Fund as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Oregon State Treasury's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Oregon State Treasury's internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph 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 deficiency in internal control over financial reporting, described in the

accompanying Schedule of Findings and Responses that we consider to be a significant deficiency in internal control over financial reporting, **2010-1**. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Oregon Short-Term Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Oregon State Treasury's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit the Oregon State Treasury's responses and accordingly, we express no opinion on them.

We noted certain matters that we reported to management of the Oregon State Treasury in a separate letter.

This report is intended solely for the information and use of management of the Oregon State Treasury, the Oregon Investment Council, the Oregon Short-Term Fund Board, the Governor of the State of Oregon, and the Oregon Legislative Assembly and is not intended to be and should not be used by anyone other than these specified parties.

OREGON AUDITS DIVISION

A handwritten signature in black ink, appearing to read 'Kate Brown', with a long horizontal flourish extending to the right.

Kate Brown  
Secretary of State

August 30, 2010

## **Schedule of Findings and Responses**

### **2010-1**

#### **Investments Without a Readily Determinable Fair Value**

Oregon State Treasury (Treasury) management is responsible for establishing and maintaining internal controls that provide reasonable assurance of the reliability of financial reporting for the Oregon Short-Term Fund.

Financial reporting standards require investments to be reported at fair market value. Treasury does not have a process in place to determine and report the fair market value of securities with non-readily determinable values. During fiscal year 2010, Treasury purchased a medium term note. At year-end, the position did not have a readily determinable market value. Treasury did not develop a methodology to estimate the value but instead valued the position at par of \$200 million. Without a process in place to value securities with non-readily determinable values, the potential exists for the financial statements to be unfairly stated.

We recommend Treasury management develop and implement a process to value securities with non-readily determinable values.

#### *Agency Response:*

*We generally agree, and will draft a procedure addressing the valuation of Oregon Short-Term Fund securities for which an independent fair market value has not been provided by our custodian bank.*

## **About the Secretary of State Audits Division**

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The Oregon Constitution provides that the Secretary of State shall be, by virtue of her office, Auditor of Public Accounts. The Audits Division exists to carry out this duty. The division reports to the elected Secretary of State and is independent of the Executive, Legislative, and Judicial branches of Oregon government. The division audits all state officers, agencies, boards, and commissions and oversees audits and financial reporting for local governments.

### **Audit Team**

Kelly Olson, CPA, Audit Manager

Sarah Anderson, CPA

Byron Williams, CPA

Mary Doel

This report, a public record, is intended to promote the best possible management of public resources. Copies may be obtained from:

internet: <http://www.sos.state.or.us/audits/index.html>

phone: 503-986-2255

mail: Oregon Audits Division  
255 Capitol Street NE, Suite 500  
Salem, OR 97310

The courtesies and cooperation extended by officials and employees of the Oregon State Treasury during the course of this audit were commendable and sincerely appreciated.

