

Report No. 2008-26

September 8, 2008



Charles A. Hibner, Director, Audits Division

Bill Bradbury, Secretary of State

# Secretary of State Audit Report

State of Oregon

**Oregon Short-Term Fund**

An Investment Pool of the State of Oregon

For the Year Ended June 30, 2008

**Report Prepared by the Office of State Treasurer**



**Office of the Secretary of State**

Bill Bradbury  
Secretary of State

Jean Straight  
Deputy Secretary of State



**Audits Division**

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The Honorable Ted Kulongoski  
Governor of Oregon

The Honorable Randall Edwards, State Treasurer,  
the Oregon Investment Council, and the  
Oregon Short-Term Fund Board

This report presents the results of our annual audit of the Oregon Short-Term Fund (OSTF), an investment pool of the State of Oregon.

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 year ended June 30, 2008, 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 Office of the State Treasurer's internal control and compliance with applicable laws, regulations, contracts, grant agreements, and other matters, as it relates to the Oregon Short-Term Fund. Our report on the results of those reviews is included in the Other Reports section of this report. 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 did identify a control deficiency that we consider a material weakness in internal control over financial reporting. In addition, we noted other matters that we will report to the Office of the State Treasurer management in a separate letter.

We appreciated the cooperation and assistance of the Office of the State Treasurer management and staff during the course of our audit.

Sincerely,  
OREGON AUDITS DIVISION

A handwritten signature in blue ink, appearing to read "C.A. Hibner", with a long, sweeping underline.

Charles A. Hibner, CPA  
Director



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**FINANCIAL SECTION**



**Office of the Secretary of State**

Bill Bradbury  
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The Honorable Randall Edwards, State Treasurer,  
the Oregon Investment Council, and the  
Oregon Short-Term Fund Board  
Office of the State Treasurer  
350 Winter Street NE, Suite 100  
Salem, Oregon 97310-3896

**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, 2008, as listed in the table of contents. These financial statements are the responsibility of the Office of the State Treasurer 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 Office of the State Treasurer'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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Oregon Short-Term Fund 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 State of Oregon as of June 30, 2008, 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, 2008, and the changes in financial position thereof 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 29, 2008 on our consideration of Office of the State Treasurer's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. 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 "Bill Bradbury". The signature is fluid and cursive, with a long, sweeping tail on the final letter.

Bill Bradbury  
Secretary of State

August 29, 2008

State of Oregon  
**OREGON SHORT-TERM FUND**  
**Statement of Net Assets**  
**June 30, 2008**  
(Dollars in Thousands)

	<u>June 30, 2008</u>
<b>Assets:</b>	
Cash and Cash Equivalents	\$ 4,316,944
Investments	5,353,330
Due from Department of Forestry (Note 5)	5,000
Due from Secretary of State (Note 5)	90
Accrued Interest Receivable	41,210
Securities Lending Collateral (Note 3)	<u>4,812,942</u>
<b>Total Assets</b>	<u>14,529,516</u>
<b>Liabilities:</b>	
Due to Employment Department (Note 6)	118
Obligations Under Securities Lending (Note 3)	<u>4,841,687</u>
<b>Total Liabilities</b>	<u>4,841,805</u>
<b>Net Assets:</b>	
Held in Trust for Participants (Note 7)	<u>9,687,711</u>
<b>Total Net Assets</b>	<u>\$ 9,687,711</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, 2008**  
(Dollars in Thousands)

	<u>Year Ended June 30, 2008</u>
<b>Additions:</b>	
Participants' Contributions	\$ 43,632,751
Investment Income, Net of Expenses (Notes 1, 4)	<u>607,539</u>
<b>Total Additions</b>	<u>44,240,290</u>
<b>Deductions:</b>	
Participants' Withdrawals	44,487,347
Distributions of Interest to Participants	483,403
Securities Lending Agent Fees Expense	2,808
Securities Lending Borrowers' Rebate Expense	<u>161,760</u>
<b>Total Deductions</b>	<u>45,135,318</u>
Change in Net Assets Held in Trust For Participants	(895,028)
Net Assets - Beginning	<u>10,582,739</u>
<b>Net Assets – Ending</b> (Note 7)	<u>\$ 9,687,711</u>

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



**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements**  
June 30, 2008

**(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 Office of the State Treasurer (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. The Fund was in compliance with all portfolio guidelines at June 30, 2008. Portfolio guidelines are discussed in greater detail in the Investments section of Note 2.

According to ORS 293.265 and 295.025, 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 includes cash in banks.

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2008

**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.

**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. The total interest paid to participants each month approximates the actual earnings of the Fund 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, 2008 the Fund held \$11.8 million book balance in deposits with a bank balance of \$46.6 million. Insurance and collateral requirements for deposits are established by banking regulations and Oregon law. FDIC insurance of \$100,000 applies to the deposits in each depository. Where balances continually exceeded \$100,000, ORS 295.025 required the depositor to obtain certificates of participation (COPs) in the amount of the excess deposit from its pool manager. ORS 295.005 provided that the pool manager can be the OST, an insured bank or trust company, the Federal Reserve Bank, or the Federal Home Loan Bank. Depository banks were required to pledge securities with a value of at least 25 percent of the COPs, and the securities were held by a custodian for the benefit of the State of Oregon. The pool manager ensured that the value of the securities pledged was at least 25 percent of the COPs.

The balances in excess of the FDIC insurance plus 25 percent of the COP are considered exposed to custodial credit risk. Custodial credit risk for deposits is the risk that, in the event of the bank failure, the Fund will be unable to recover deposits or collateral securities in possession of an outside party. As of June 30, 2008, the balances exposed to custodial credit risk totaled \$4.6 million.

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2008

**Investments**

On June 30, 2008, the Fund held \$9.7 billion in net assets, \$4.3 billion of which are classified as 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, 2008 holdings are shown in the schedule below. For variable rate securities, the next interest rate reset date is used instead of the maturity date.

**Oregon Short Term Fund Investments**

June 30, 2008  
(Dollars in Thousands)

Investment Type:	Investment Maturities			
	Reported Amount ①	Up to 93 Days	94 Days to One Year	One to Three Years
Cash Equivalents: ②				
Bank Notes	\$ 265,000	\$ 265,000	\$ -	\$ -
Commercial Paper	1,579,867	1,579,867	-	-
U.S. Agency Securities	2,314,205	2,314,205	-	-
Time Certificates of Deposit	146,050	146,050	-	-
Subtotal Cash Equivalents	\$ 4,305,122	\$ 4,305,122	\$ -	\$ -
Investments: ②				
U.S. Agency Securities	\$ 2,779,541	\$ 877,844	\$ 169,605	\$ 1,732,092
Bank Notes	43,890	43,890	-	-
Corporate Notes	2,529,899	2,208,969	166,131	154,799
Subtotal Investments	\$ 5,353,330	\$ 3,130,703	\$ 335,736	\$ 1,886,891
Total	\$ 9,658,452	\$ 7,435,825	\$ 335,736	\$ 1,886,891

① Reported Amount is a combination of amortized cost and fair value. See Note 1.

② Classification on Statement of Net Assets.

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2008

**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. On June 30, 2008, the Fund's weighted average rating was between the AA+/Aa1 and AA/Aa2 ratings.

The Fund has policies that require a minimum credit rating at the time of purchase for corporate notes from one of three ratings services. The minimums are a Standard and Poor's ratings of AA-, Moody's of Aa3 and Fitch of AA-. The Fund also requires commercial paper to have a minimum short-term credit rating at the time of purchase from two of three ratings services. Minimums are a Standard and Poor's ratings of A-1, Moody's of P-1 and Fitch of F-1.

Occasionally, securities are downgraded but Fund policies allow them to be retained at the Senior Investment Officer's discretion. The Fund is holding corporate notes at June 30, 2008 totaling \$438.9 million that have been downgraded, but are still investment grade quality. The schedule below summarizes the fund's holdings by grouped S&P rating.

**Schedule of Credit Quality Distributions**  
June 30, 2008  
(Dollars in Thousands)

<b>Investment Type:</b>	<b>AAA</b>	<b>AA</b>	<b>A</b>	<b>Not Rated</b>	<b>Total Reported Amount</b>
Bank Notes	\$ -	\$ 43,890	\$ 115,000	\$ 150,000	\$ 308,890
Commercial Paper	-	753,916	825,952	-	1,579,868
Corporate Notes	81,746	1,613,032	835,121	-	2,529,899
U.S. Agency Securities	5,093,745	-	-	-	5,093,745
Time Certificates of Deposit	-	-	-	146,050	146,050
<b>Total</b>	<b>\$ 5,175,491</b>	<b>\$ 2,410,838</b>	<b>\$ 1,776,073</b>	<b>\$ 296,050</b>	<b>\$ 9,658,452</b>

**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. The time certificates of deposit

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2008

(TCDs) are exposed to custodial credit risk since they are collateralized by securities pledged by the bank equal to 25 percent of the COPS provided by the bank. The uninsured and uncollateralized exposure related to the TCDs is \$108.3 million.

**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 and five percent for both commercial paper and corporate notes. On June 30, 2008, the Fund did not hold investments with any one issuer that exceeded these limits.

**E. Foreign currency**

The Fund portfolio rules prohibit investments that are not U.S. 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. Borrowers were required to deliver cash 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.

The balances of securities on loan and cash collateral received are presented in the schedule below. Cash collateral is invested in a short-term investment fund (STIF) maintained by the custodial agent; the STIF's balance is also presented below. The STIF is not rated by a nationally recognized statistical rating organization (NRSRO), although the Fund's portfolio rules provide minimum requirements with respect to the credit quality of the STIF.

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, 2008, the State had no credit risk exposure to borrowers related to securities on loan.

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2008

**Schedule of Securities Lending Balances**  
June 30, 2008  
(Dollars in Thousands)

	<b>Securities on Loan at Fair Value</b>	<b>Collateral Received</b>	<b>Invested Collateral at Fair Value (STIF Fund)</b>
U.S. Agency Securities	\$ 4,676,506	\$ 4,769,888	\$ 4,741,569
Corporate Notes	70,155	71,799	71,373
<b>Total</b>	<b>\$ 4,746,661</b>	<b>\$ 4,841,687</b>	<b>\$ 4,812,942</b>

**(4) Management Fees**

In accordance with ORS 293.718, the Office of the State Treasurer 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, 2008 the Office of the State Treasurer 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 \$3.87 million for the year ended June 30, 2008.

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

The Oregon Department of Forestry has an agreement to borrow up to \$5 million to use for short-term cash flow needs through June 30, 2009. Interest is charged at a fixed per annum rate 4.40 percent. To date, the Department of Forestry has drawn \$5 million. The total amount loaned is due June 30, 2009.

The Oregon Secretary of State has an agreement to borrow \$90.3 thousand to use for costs of purchasing voting machines for Curry County. Interest is charged at a fixed per annum rate 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 contain 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

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2008

not take place until the following day, creating either a receivable from or payable to the Oregon Employment Department.

**(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, 2008</u>
Net Assets Held in Trust for Participants (in thousands):	
Equity of Internal Participants	\$ 5,643,419
Equity of External Participants	<u>4,044,292</u>
	<u>\$ 9,687,711</u>
Net Assets Consist of: (in thousands)	
Participants' Account Balances	\$ 9,728,144
Undistributed and Unrealized Losses	<u>(40,433)</u>
	<u>\$ 9,687,711</u>
Participants' Fair Value (Net Assets divided by Participants' Account Balances)	<u>99.58%</u>

**(8) Prior Period Financial Statements**

When comparing prior year financial statements to current year results, Participants' Contributions and Participants' Withdrawals reported for the year ended June 30, 2007, should each be increased by \$7.1 billion. The net effect of this adjustment on the Change in Net Assets Held in Trust for Participants and Total Net Assets is zero for the year ended June 30, 2007. Participant balances reported for 2007 were not affected.

**(9) 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, 2008.

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2008

**Schedule of Investments and Cash Equivalents**  
June 30, 2008  
(Dollars in Thousands)

	<u>Par Value</u>	<u>Reported Amount</u>	<u>Percentage</u>
<b>INVESTMENTS AND CASH EQUIVALENTS:</b>			
U.S. Government and Agency Securities:			
Agency Bonds:			
Federal Agricultural Mortgage Corporation	\$ 100,000	\$ 99,780	
Federal Farm Credit Bank	256,375	256,464	
Federal Home Loan Bank	938,130	943,956	
Federal Home Loan Mortgage Corporation	637,345	640,852	
Federal National Mortgage Association	<u>644,315</u>	<u>643,660</u>	
Total Agency Bonds	<u>2,576,165</u>	<u>2,584,712</u>	26.7%
Agency Discount Notes:			
Federal Agricultural Mortgage Corporation	224,650	224,547	
Federal Farm Credit Bank	170,000	169,876	
Federal Home Loan Bank	1,003,267	1,001,680	
Federal Home Loan Mortgage Corporation	515,000	514,255	
Federal National Mortgage Association	<u>600,000</u>	<u>598,676</u>	
Total Agency Discount Notes	<u>2,512,917</u>	<u>2,509,034</u>	26.0%
Total U.S. Government and Agency Securities	\$ <u>5,089,082</u>	\$ <u>5,093,746</u>	52.7%
Commercial Paper:			
Financial:			
American Honda Finance	\$ 110,000	\$ 109,724	
Barclays U.S. Fund	100,000	99,615	
Citigroup Funding, Inc.	50,000	49,793	
JP Morgan Chase and Company	50,000	49,960	
Toyota Motor Credit	275,000	274,614	
US Bancorp	100,000	99,749	
UBS Finance Delaware, LLC	25,367	25,344	
Wells Fargo and Company	<u>50,000</u>	<u>49,955</u>	
Total Financial	<u>760,367</u>	<u>758,754</u>	7.8%
Industrial:			
El Dupont	50,000	49,983	
Koch Resources, LLC	<u>200,000</u>	<u>199,885</u>	
Total Industrial	<u>250,000</u>	<u>249,868</u>	2.6%

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2008

	<u>Par Value</u>	<u>Reported Amount</u>	<u>Percentage</u>
Investment Management:			
Alliance Bernstein	105,000	104,885	1.1%
Utility - Electric:			
Emerson Electric Company	30,150	30,133	
FPL Capital Group	195,012	194,924	
National Rural Utility Co-op	129,629	129,422	
Nstar Electric Company	33,500	33,496	
Southern Company Funding	69,894	69,852	
Southern Company	8,550	8,534	
Total Utility – Electric	466,735	466,361	4.8%
Total Commercial Paper	\$ 1,582,102	\$ 1,579,868	16.3%
Corporate Notes:			
Bank Notes:			
Bank of America	115,000	115,000	
HSBC Finance Group	9,750	9,664	
Wachovia Corporation	25,000	24,296	
Wells Fargo Bank	150,000	150,000	
World Savings Bank	10,000	9,930	
Total Bank Notes	309,750	308,890	3.2%
Broker/Dealer:			
Bear Stearns	10,000	9,885	
Credit Suisse USA, Inc.	143,850	142,854	
Goldman Sachs	224,742	221,036	
Merrill Lynch and Company	148,626	145,260	
Morgan Stanley	276,156	270,576	
Total Broker/Dealer	803,374	789,611	8.2%
Financial and Insurance:			
American Honda Finance	138,430	137,701	
Associates Corporation	66,815	67,261	
Bank America	45,750	45,151	
Bank of New York	40,000	39,974	
Bear Stearns	15,100	14,688	
Citigroup Inc.	76,075	74,155	
Credit Suisse First Boston	70,102	68,979	
General Electric Capital Corporation	81,065	81,746	

**OREGON SHORT-TERM FUND**  
**Notes to Financial Statements (continued)**  
June 30, 2008

	<u>Par Value</u>	<u>Reported Amount</u>	<u>Percentage</u>
Goldman Sachs	14,250	14,225	
Household Finance Corporation	74,540	74,737	
HSBC Finance Corporation	161,620	158,177	
International Lease Finance Corporation	98,930	97,220	
JP Morgan Chase and Company	202,199	202,108	
Lehman Brothers Holdings	191,302	179,300	
Nationwide Life	86,000	84,717	
UBS AG Stamford	200,000	199,180	
Wachovia Corporation	159,000	156,825	
Wells Fargo and Company	<u>39,565</u>	<u>39,078</u>	
 Total Financial and Insurance	 <u>1,760,743</u>	 <u>1,735,222</u>	 18.0%
 Industrial:			
Pepsi Bottling	<u>5,000</u>	<u>5,065</u>	0.1%
 Total Corporate Notes	 \$ <u>2,878,867</u>	 \$ <u>2,838,788</u>	 29.5%
 Time Certificates of Deposit	 \$ <u>146,050</u>	 \$ <u>146,050</u>	 1.5%
 <b>Total Investments and Cash Equivalents</b>	 \$ <u><u>9,696,101</u></u>	 \$ <u><u>9,658,452</u></u>	 100.0%

## **OTHER REPORTS**



**Office of the Secretary of State**

Bill Bradbury  
Secretary of State

Jean Straight  
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The Honorable Randall Edwards, State Treasurer,  
the Oregon Investment Council, and the  
Oregon Short-Term Fund Board  
Office of the State Treasurer  
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**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 investment pool of the State of Oregon, as of and for the year ended June 30, 2008, and have issued our report thereon dated August 29, 2008. 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 Office of the State Treasurer's internal control over financial reporting, as it relates 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 Office of the State Treasurer's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Office of the State Treasurer's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider a material weakness.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying Schedule of Findings and Responses to be a material weakness in internal control over financial reporting.

### **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*.

We noted certain matters that we will report to management of the Office of the State Treasurer in a separate letter.

The Office of the State Treasurer's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Responses. We did not audit the Office of the State Treasurer's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Oregon State Treasurer, the Oregon Short-Term Fund Board, the Oregon Investment Council, management of the Office of the State Treasurer, 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



Bill Bradbury  
Secretary of State

August 29, 2008

## **Schedule of Findings and Responses**

### **Internal Controls Over Financial Reporting**

The Office of the State Treasurer (OST) 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 relates to the preparation of financial statements that are fairly presented in conformity with generally accepted accounting principles.

OST's controls over its financial reporting process for the Oregon Short-Term Fund were not sufficient to prevent or detect a significant error in the compilation of the financial statements. This error resulted in material understatements of Participants' Contributions and Participants' Withdrawals in the Statement of Changes in Net Assets on the 2007 Oregon Short-Term Fund financial statements, but had no effect on the net assets of that statement (see 2008 financial statement note 8 on page 15). The error is a financial reporting error and had no effect upon the individual participants' accounts.

The underlying cause of this error would have materially understated Participants' Contributions and Participants' Withdrawals in the current-year Statement of Changes in Net Assets if it was not corrected. However, once we brought this error to management's attention, OST made adjustments to ensure its current-year financial statements were appropriately prepared.

**We recommend** that OST management establish and maintain a documented internal control structure over financial reporting for the Oregon Short-Term Fund to prevent errors in the financial statement, and detect and correct errors in a timely manner.

**Agency Response:** *The Office of the State Treasurer agrees that there was an equal and offsetting misclassification in the compilation of participants' contributions and withdrawals. OST corrected this for the current year statements as noted in the finding and will review, and revise as necessary, our policies and procedures relating to controls over financial reporting for the OSTF.*



# **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 his 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.

## **DIRECTORY OF KEY OFFICIALS**

Director	Charles A. Hibner, CPA
Deputy Director	William K. Garber, MPA, CGFM
Deputy Director	Mary E. Wenger, CPA

## **AUDIT TEAM**

Julianne Kennedy, CPA, Audit Manager  
Richard Rowzee, CPA  
Brandon Weber

*The courtesies and cooperation extended by management and staff of the Office of the State Treasurer during the course of our audit were commendable and sincerely appreciated.*

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  
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