

State of Oregon Department of State Lands  
Common School Fund

Annual Financial Statements  
For the Fiscal Year Ended June 30, 2013

State of Oregon Department of State Lands  
Common School Fund  
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June 30, 2013

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## FINANCIAL SECTION

## **INDEPENDENT AUDITOR'S REPORT**

State Land Board  
Department of State Lands  
Salem, Oregon

We have audited the accompanying financial statements of the Common School Fund, a major governmental fund of the State of Oregon as of and for the year ended June 30, 2013, and the related notes to the financial statements, as listed in the table of contents.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

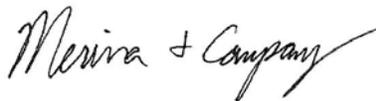
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2013, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### **Emphasis of Matter**

As discussed in Note 1, the financial statements present only the Common School Fund and do not purport to, and do not, present fairly the financial position of the State of Oregon or the Department of State Lands, as of June 30, 2013, the changes in their financial position, or where applicable, their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 24, 2013, on our consideration of Common School Fund'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* in considering Common School Fund's internal control over financial reporting and compliance.



Merina & Company, LLP  
West Linn, Oregon  
October 24, 2013

## BASIC FINANCIAL STATEMENTS

**State of Oregon Department of State Lands**  
**Common School Fund**  
**Balance Sheet**  
**as of June 30, 2013**

**ASSETS**

Cash and Cash Equivalents	\$	41,550,526
Investments		1,159,082,634
Custodial Assets		15,054,961
Securities Lending Collateral		24,962,488
Accounts and interest receivable, net		15,096,410
Due from Other Funds		431,605
Inventories		2,577
Advances to other funds		300,000
Contracts, Notes, and Other Receivables		1,084,010

**Total Assets** \$ 1,257,565,211

**LIABILITIES AND FUND BALANCES**

**Liabilities**

Accounts and Interest Payable	\$	34,121,517
Obligations Under Securities Lending		24,962,488
Due to Other Funds		2,683,563
Deferred Revenue		1,084,010
Custodial Liabilities		195,979,411

**Total Liabilities** 258,830,989

**Fund Balances**

Nonspendable		
Reserve for inventories		2,577
Restricted by:		
Oregon Constitution		724,614,204
Enabling Legislation		274,058,834
Donors and Other External Parties		58,607

**Total Fund Balances** 998,734,222

**Total Liabilities and Fund Balances** \$ 1,257,565,211

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

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**State of Oregon Department of State Lands**  
**Common School Fund**  
**Statement of Revenues, Expenditures, and Changes in Fund Balances**  
**For the Year Ended June 30, 2013**

**Revenues:**

Licenses and fees	\$ 846,533
Services Provided	106,944
Fines and Forfeitures	63,194
Rents and Royalties	4,532,381
Net (loss) from Investments	143,289,900
Sales	645,479
Donations	854
Unclaimed property revenue	21,523,182
Other Revenues	3,038,978

<b>Total Revenues</b>	<u>174,047,445</u>
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**Expenditures:**

Personal Services	6,775,140
Services and Supplies	5,017,999
Capital Outlay	2,994,651
Investment Expenses	3,994,410

<b>Total Expenditures</b>	<u>18,782,200</u>
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<b>Excess (Deficiency) of Revenues over (Under) Expenditures</b>	<u>155,265,245</u>
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**Other Financing Sources:**

Transfers From Other Funds	2,377,393
Transfers to Other Funds or Other State Agencies	(60,106,829)
Insurance Recoveries	1,850,856

<b>Total Other Financing Sources</b>	<u>(55,878,580)</u>
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<b>Net Change in Fund Balance</b>	<u>99,386,665</u>
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<b>Fund Balances - Beginning</b>	899,400,041
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Prior period adjustments	(52,449)
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<b>Fund Balance - Beginning - As Restated</b>	<u>899,347,592</u>
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Changes in inventories	<u>(36)</u>
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<b>Fund Balances - Ending</b>	<u><u>\$998,734,222</u></u>
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The accompanying notes are an integral part of the basic financial statements.

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State of Oregon Department of State Lands  
Common School Fund  
Notes to the Financial Statements as of June 30, 2013

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying financial statements of the Oregon Department of State Lands' Common School Fund have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), and the American Institute of Certified Public Accountants (AICPA).

***A – THE REPORTING ENTITY***

The Department of State Lands (Department) is the administrative agency of the State Land Board handling the day-to-day work of the board in managing the land and other resources dedicated to the Common School Fund. The State Land Board, which consists of the Governor, the Secretary of State and the State Treasurer, is the trustee of the fund as outlined in the Oregon Constitution.

The Common School Fund, a governmental fund, was established at statehood and is intended to generate earnings to distribute to public schools. The Common School Fund accounts for programs that manage state-owned land, including a leasing program that generates annual revenues, for the benefit of the public school system. Estate funds that become the property of the state, unclaimed property, and income derived from unclaimed property are also accounted for in this fund. Statutory and constitutional provisions stipulate that the assets of the fund, including investment income, must be used for common school purposes. The primary funding sources for these programs include investment income, leasing revenues, forest management, unclaimed property receipts, and transfers from other funds.

***B – FUND FINANCIAL STATEMENTS***

The governmental fund financial statements are a balance sheet and a statement of revenues, expenditures and changes in fund balances.

Governmental fund balance sheets are presented in an Assets = Liabilities and Fund Balance format. Further information for receivables not expected to be collected within one year of the date of the financial statements and payables reported in the financial statements is discussed in Note 4.

The governmental fund statement of revenues, expenditures, and changes in fund balances reports revenues by type and expenditures by function. Other financing sources, uses and transfers are reported in the last section of the statement.

***C - MEASUREMENT FOCUS AND BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION***

The Common School Fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they are both measurable and available. Revenues are considered to be available when they are collectible within the current year. Expenditures are recognized when a liability is incurred, as under accrual accounting.

***D – DEPOSITS AND INVESTMENTS***

DEPOSITS

Cash deposits not held in a cash management or investment pool are classified as cash and cash equivalents. Cash deposits that are held in a cash management or investment pool are classified as cash and cash equivalents when the pool has the general characteristics of a demand deposit account. Cash and cash equivalents include: Cash on hand, cash and investments held by the Office of the State Treasurer in the Oregon Short-term Fund (OSTF), cash deposits held in demand deposit accounts with custodial banks, and cash deposits of debt proceeds in investment funds held by a trustee.

INVESTMENTS

Investments are reported at fair market value with the following exceptions, which are reported using cost-based measures:

- Investments in private equities are reported at cost.

State of Oregon Department of State Lands  
Common School Fund  
Notes to the Financial Statements as of June 30, 2013

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- Investments in the OSTF with remaining maturities of up to 90 days are carried at amortized cost, which approximates fair value. The Department reports these investments as cash and cash equivalents on the balance sheet, but as investments in Note 2.

Changes in the fair market value of investments are recognized as investment income (loss) in the current year.

**DERIVATIVES**

In accordance with State investment policies, the Office of the State Treasurer participates in contracts that have derivative characteristics. The fair value of all derivative instruments within the Common School Fund are reported on the governmental funds balance sheet as investments, accounts and interest receivable, and accounts and interest payable. The change in fair value for all Common School Fund derivative instruments is reported with investment income on the governmental funds statement of revenues, expenditures, and changes in fund balances.

**SECURITIES LENDING**

Securities lending amounts are reported at the value of the cash collateral received. The security lending liability is reported at the cash amount received as collateral.

***E – RECEIVABLES AND PAYABLES***

Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as “advances to other funds.”

Receivables consist of revenues earned or accrued in the current period and are shown net of estimated uncollectible amounts.

Payables consist of amounts owed to vendors for operational expense, other state agencies for services received and investment liabilities outstanding.

***F – INTERFUND TRANSACTIONS***

Interfund transactions are transactions between the Common School Fund and other funds included in the Oregon Comprehensive Annual Financial Report. Interfund balances (due to/from other funds and advances to/from other funds) result from the time lag between dates that (1) interfund goods and services are provided or reimbursable expenditures/expenses occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made. Advances to/from other funds are not expected to be repaid within one year. See Note 7 for more on inter-fund balances.

***G – INVENTORIES***

Inventories, which consist primarily of operating supplies, are stated at cost utilizing the first-in, first-out cost valuation method. In governmental funds, inventories are recorded as expenditures when purchased. Reported inventories in governmental funds are offset by nonspendable fund balance since the fund balance associated with inventory is not a spendable form.

***H – RESTRICTED ASSETS***

Custodial assets are non-cash assets held in trust for third parties in the Unclaimed Property Program.

***I – FUND EQUITY***

The difference between assets and liabilities is labeled as “Fund Balance” on governmental fund financial statements.

In governmental funds, fund balance is reported in five components: (1) nonspendable, (2) restricted, (3) committed, (4) assigned, and (5) unassigned.

*Nonspendable fund balances* include amounts that cannot be spent because they are either not in spendable form or they are legally or contractually required to be maintained intact.

State of Oregon Department of State Lands  
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Notes to the Financial Statements as of June 30, 2013

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*Restricted fund balances* result from constraints imposed on net assets by law through constitutional provisions or enabling legislation or by parties outside the State, such as creditors, grantors, contributors, or laws or regulations of other governments. Common School Fund Balances are either nonspendable or restricted.

For fund balance classification purposes, the Department determines the appropriate classification of each of their detail-level funds based on the resources accounted for in those funds and the constraints on spending those resources. The Department expends resources from the appropriate fund based on each fund's specific spending constraints.

The restricted fund balance category has been further broken down on the Balance Sheet to indicate the various sources of those constraints.

**NOTE 2 – DEPOSITS AND INVESTMENTS**

Common School Fund Investment Portfolio held at Treasury

Investments of the Common School Fund held by the Treasurer require the exercise of prudent and reasonable care in the context of the fund's investment portfolio and as part of an overall investment strategy. The Treasurer is required to diversify investments unless it is not prudent to do so. In addition, the Treasurer must exercise reasonable care to incorporate risk and return objectives suitable to the particular investment fund. The Treasurer has a policy and procedure that addresses objectives and strategies for investments of the Common School Fund.

The Common School Fund's investment policies are governed by statute and the Oregon Investment Council (Council). The State Treasurer (Treasurer) is the investment officer for the Council. The Treasurer works with the State Land Board to ensure implementation of the asset allocation policy that meets the business needs of the Fund. The Council does not make asset allocation changes without considering input from the State Land Board. In accordance with Oregon statutes, the investment funds are invested, and the investments of those funds managed, as a prudent investor would do, exercising reasonable care, skill and caution. The Treasurer is authorized to use demand deposit accounts, fixed income investments, and direct equity investment transactions, although the majority of equity investments are directed by external investment managers under contract with the Council. Investments are managed around a 70% equity/30% fixed income target with a range of +/- 5%, as detailed below. The Common School Fund's actual asset allocation is monitored monthly relative to established asset allocation policy targets and ranges. A deviation outside of any of the ranges triggers a review and rebalancing back toward the target asset allocation with due consideration given to the liquidity of the investments and transaction costs. Whenever possible, cash flows into and out of the fund are used to rebalance between asset classes. Cash is held only for business operating purposes.

<b>Asset Class</b>	<b>Benchmark</b>	<b>Target Allocation</b>	<b>Range</b>
Domestic Equities	Russell 3000 Index	30%	25% - 35%
International Equities	MSCI ACWI ex-US	30%	25% - 35 %
Private Equity	Russell 3000 + 300 bps	10%	0% -12%
	Total Equities	70%	65% - 75%
US Fixed Income	Barclays Capital Universal Bond Index	30%	25% - 35%
Cash		0%	0% - 3%
Policy Mix	Weighted aggregate of indexes listed above at target allocation	100%	

Common School Fund participation in the Oregon Short Term Fund held at Treasury

The Treasurer maintains the OSTF, a cash and investment pool that is available for use by the Common School Fund. Because the pool operates as a demand deposit account, the Common School Fund portion of the OSTF is classified on the financial statements as cash and cash equivalents. A separate financial report for the OSTF is prepared by the Treasurer. Copies of the report may be obtained from the

State of Oregon Department of State Lands  
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Notes to the Financial Statements as of June 30, 2013

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Office of the State Treasurer, Finance Division, 350 Winter Street NE, Suite 100 Salem, Oregon 97301-3896.

Common School Fund Investments held Outside Treasury

Statutes govern the placement of investments of the Common School Fund held outside the Treasury as part of trust agreements or mandatory asset holdings by regulatory agencies. The Common School Fund investment portfolio includes \$14,879,962 held outside the Treasury and included in the \$15,054,961 identified as custodial assets on the balance sheet.

A real estate investment portfolio held by the Department of State lands includes one parcel valued at \$1,100,974 and included in investments on the balance sheet.

**A – DEPOSITS**

Custodial Credit Risk for Deposits

The custodial credit risk for deposits is the risk that, in the event of a bank failure, the Department will not be able to recover deposits or collateral securities that are in the possession of an outside party. The Department does not have a formal policy regarding custodial credit risk for deposits. However, banking regulations and Oregon law establish the insurance and collateral requirements for deposit in the OSTF.

Oregon Revised Statutes (ORS) Chapter 295 governs the collateralization of public funds. Bank depositories are required to pledge collateral against any public fund deposits in excess of the deposit insurance amounts. This requirement provides additional protection for public funds in the event of a bank loss. ORS Chapter 295 sets the specific value of the collateral, as well as the types of collateral that are acceptable.

ORS Chapter 295 provides the statutory authority for the Public Funds Collateralization Program (PFCP). The PFCP is an application created by the Treasury to facilitate bank depository, custodian, and public official compliance with the ORS Chapter 295. Under the PFCP, banks are required to report quarterly to the Treasury, providing quarter-end public fund balances in excess of Federal Deposit Insurance Corporation (FDIC) limits. Banks are also required to report their net worth and FDIC Capitalization information. The FDIC assigns each bank a capitalization category quarterly; well capitalized, adequately capitalized or undercapitalized. Based on this information, the bank's minimum collateral required to be pledged with the custodian and the maximum liability in the pool of all banks is calculated for the next quarter. The maximum liability is reported to the bank, the Treasury and the custodian.

Barring any exceptions, a bank depository is required to pledge collateral valued at 10 percent or more of the bank's quarter-end public fund deposits if the bank is well capitalized and 110 percent if the bank is adequately capitalized, undercapitalized, or assigned to pledge 110 percent by Treasury.

There are three exceptions to this calculation, and any exceptions are required to be collateralized at 100 percent.

1. A bank may not accept public fund deposits from one depositor in excess of the bank's net worth. If the bank has a drop in net worth that takes it out of compliance, the bank is required to post 100 percent collateral on any amount the depositor has in excess of the bank's net worth while working to eliminate that excess.
2. A bank may not hold aggregate public funds in excess of a percentage of the bank's net worth based on its capitalization category (100 percent for undercapitalized, 150 percent for adequately capitalized, 200 percent for well capitalized) unless approved for a period of 90 days or less by the Treasury.
3. A bank may hold in excess of 30 percent of all aggregate public funds reported by all banks holding Oregon public funds, only if the excess is collateralized at 100 percent.

State of Oregon Department of State Lands  
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Notes to the Financial Statements as of June 30, 2013

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All deposits in the OSTF at June 30, 2013, were with financial institutions participating in the FDIC's Transaction Account Guarantee Program. Under that program, all non-interest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules. Consequently, the entire bank balance of un-invested OSTF deposits was fully insured.

As of June 30, 2013 \$118,029 in other bank balances of the Common School Fund was held by an investment firm, not covered by the FDIC rules. However the firm is a member of the Securities Investor Protection Corporation which provides protection up to \$500,000, of which \$250,000 applies to cash credit balances. Consequently the entire bank balance of un-invested Common School Fund deposits was fully insured.

***B – INVESTMENTS***

**Custodial Credit Risk**

Custodial credit risk for investments of the Common School Fund is the risk that, in the event of the failure of the counter party to a transaction, the State will not be able to recover the value of an investment or collateral securities in the possession of an outside party. The Council has no formal policy regarding the holding of securities by a custodian or counter party. For the year ended June 30, 2013, no investment holdings of the Common School Fund held at Treasury were exposed to custodial credit risk.

At June 30, 2013 the Common School Fund held \$14,761,932 in investments outside the treasury. These investments were held with Wedbush, an investment firm. The firm is a member of the Securities Investor Protection Corporation (SIPC) which provides protection up to \$500,000 of which a maximum of \$250,000 applies to cash credit balances. In addition to the coverage provide by the SIPC, the Firm has purchased from Lloyd's of London an excess SIPC bond that provides additional coverage for up to \$25,000,000 in cash and securities for each client, subject to an aggregate loss limit of \$100,000,000. The excess SIPC bond, together with SIPC coverage, provides for cash credit balances to each client to a maximum of \$1,000,000. This protection will replace client's cash and/or securities that are otherwise unrecoverable. It does not cover clients from losses resulting from the decline in the market value of securities in their accounts. No investment holdings of the Common School Fund held outside the Treasury were exposed to custodial credit risk.

**Interest Rate Risk**

Interest rate risk is the risk (variable in value) borne by an interest bearing asset such as a loan or a bond, due to variability of interest rates. Approximately 30 percent of the Common School Fund's investment portfolio is invested in fixed income securities. Investment policy for fixed income investments of the Common School Fund is to maintain a well-diversified bond portfolio, managed to maximize total return, that reflects the overall characteristics of the Barclays Capital Universal Index Benchmark and to invest opportunistically, using innovative investment approaches within a controlled and defined portfolio allocation.

**Credit Risk and Concentration of Credit Risk**

Credit risk refers to the risk that a borrower will default on any type of debt by failing to make payments which it is obligated to make. Treasury investment policies for fixed income investments of the Common School Fund maintain an overall portfolio quality of at least "A" or higher; maintain an average bond duration level of +/-20% of the Barclays Capital Universal Index. No more than 30% of the total fixed income portfolio at market value, may be maintained in securities rated less than Baa3. No more than 10% of the total fixed income portfolio, at market value, may be maintained in Rule 144A securities. Not more than 25% of the fixed income allocation shall be invested in a single industry, or Government Agency. Use of leverage in any fixed income securities is not allowed (excluding use of securities in a securities lending program).

State of Oregon Department of State Lands  
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Notes to the Financial Statements as of June 30, 2013

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Highly Sensitive Investments

The Common School Fund held approximately \$44.4 million in debt instruments backed by pooled mortgages, TBAs (to-be-announced federal agency-issued mortgage pools), CMOs, or fixed-rate mortgages. These securities represent a stream of principal and interest payments from underlying mortgages and consequently, the value of these securities can be volatile as interest rates fluctuate. Assets with these characteristics may also be susceptible to prepayment by the mortgage holders which may result in a decrease in total interest realized. Additionally, the risk of default exits and collateral held may potentially be insufficient to cover the principal due. The Common School Fund also held approximately \$5.1 million of asset-backed securities backed primarily by student loan and manufactured housing loan receivables.

State of Oregon Department of State Lands  
Common School Fund  
Notes to the Financial Statements as of June 30, 2013

<i>The credit rating and average effective duration for the Common School Fund's investments, held at Treasury, at June 30, 2013.</i>						
Investment Type	Credit Rating	<1 Year	1-5 Years	6-10 Years	More than 10 Years	Total Market Value
U.S. Treasury Obligations	Not rated	20,141	3,830,418	5,590,610	9,826,688	19,267,856
U.S. Treasury Strips	Not rated	4,049,489		197,952		4,247,441
U.S. Treasury Tips	Not rated				1,812,951	1,812,951
U.S. Federal Agency Debt	AA	2,422,449			145,526	2,567,976
U.S. Federal Agency Debt	Not rated	10,148,086				10,148,086
U.S. Federal Agency Mortgages	AAA	19,643				19,643
U.S. Federal Agency Mortgages	AA	178,403			28,913,692	29,092,096
U.S. Federal Agency Mortgages	Not rated	2,848,951		230,501	3,322,751	6,402,202
Corporate Bonds	AA		748,863	448,822		1,197,685
Corporate Bonds	A	1,332,610	7,382,136	3,656,178	2,592,350	14,963,273
Corporate Bonds	BBB	1,540,486	4,370,381	5,508,913	4,979,206	16,398,986
Corporate Bonds	BB		310,468	1,287,353	635,545	2,233,365
Corporate Bonds	B	36,720	63,341	230,125	306,205	636,391
Non-US Government Debt	BBB		2,235	2,287,918	685,730	2,975,883
International Debt Securities	AA		210,161	19,991		230,161
International Debt Securities	A		792,304	2,206,869		2,999,173
International Debt Securities	BBB	403,588	1,076,575	2,406,861	700,378	4,587,402
International Debt Securities	BB		173,220	152,445	27,450	353,114
International Debt Securities	B	89,500	11	16,740		106,251
Asset-backed securities	AAA	589,702			205,882	795,584
Asset-backed securities	AA	977,281				977,281
Asset-backed securities	A	501,864			63,500	565,364
Asset-backed securities	BBB	430,096		11,644		441,740
Asset-backed securities	B	340,255				340,255
Asset-backed securities	CCC	285,365				285,365
Asset-backed securities	CC	1,702,268				1,702,268
Collateralized Mortgage Obligations	AAA	213			450,496	450,709
Collateralized Mortgage Obligations	AA	62,673			110,169	172,842
Collateralized Mortgage Obligations	A	500,098			231,822	731,919
Collateralized Mortgage Obligations	BBB	1,333,573			85,238	1,418,812
Collateralized Mortgage Obligations	BB	947,820			74,032	1,021,852
Collateralized Mortgage Obligations	B	2,134,500				2,134,500
Collateralized Mortgage Obligations	CCC	2,361,175				2,361,175
Collateralized Mortgage Obligations	CC	615,198				615,198
Collateralized Mortgage Obligations	Not rated	25,331				25,331
Mutual Funds, Domestic Fixed Income	AA		156,762,120			156,762,120
Mutual Funds, Domestic Fixed Income	B		16,358,715			16,358,715
Mutual Funds, International Fixed Income	AA			3,328,081		3,328,081
Mutual Funds, International Fixed Income	BB		3,121,804			3,121,804
<b>Total Debt Investments</b>		<b>35,897,479</b>	<b>195,202,750</b>	<b>27,581,002</b>	<b>55,169,611</b>	<b>313,850,843</b>
Equity – Domestic						300,325,023
Equity International						251,869,751
Equity Mutual Funds – Domestic						189,942,379
Private Equity – Domestic						97,174,085
Real Estate – Domestic						842,481
Real Estate – International						3,923,677
Rights & Warrants – International						35,195
Lehman Receivable						18,226
<b>Grand Total Held at Treasury</b>						<b>1,157,981,660</b>
Investments Not Held At Treasury – Real Estate						1,100,974 <sup>1</sup>
<b>Grand Total Investments</b>						<b>\$1,159,082,634</b>

<sup>1</sup>See Investments Held Outside of Treasury note disclosure

State of Oregon Department of State Lands  
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Notes to the Financial Statements as of June 30, 2013

*Notes on investments held at Treasury:*

Fixed income securities are classified using final maturity date or next rate reset date, whichever is sooner. Fixed income mutual funds are classified by effective duration, the measurement used by the fund manager.

**Foreign Currency Risk**

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. State agencies are required to deposit moneys in state-qualified depositories under Oregon law. Exceptions due to foreign field offices and related circumstances are approved by the Treasurer. International debt securities denominated in U.S. dollars are not subject to currency risk if the investment's obligations will be paid in U.S. dollars. Investment policies for fixed income investments under the management of the Treasurer provides for investments of the Common School Fund in non-dollar denominated securities within a target allocation range of 25 to 35 percent of their portfolio. For investments not under the management of the Treasurer there are no formal policies on foreign currency risk.

**Deposits and Investments (U.S. Dollars)**

Foreign Currency Denominations	Deposits	International Equity Securities	Non-US Government Debt	Real Estate	Rights and Warrants	Grand Total
Australian Dollar	\$ 150,150	\$ 12,934,450		\$ 923,617		\$ 14,008,217
Canadian Dollar	106,561	11,471,779				11,578,341
Swiss Franc	53,680	15,577,346				15,631,026
Danish Krone	32,745	2,266,965				2,299,710
Euro	163,732	64,627,894		1,228,961	35,195	66,055,782
British Pound	60,978	34,511,108		182,196		34,754,282
Hong Kong Dollar	82,719	3,747,409		1,062,331		4,892,458
Israeli Shekel	24,835	215,447		135,235		375,517
Japanese Yen	468,776	57,750,815		162,148		58,381,739
Mexican Peso	75,657		2,287,918			2,363,575
Norwegian Krone	100,033	2,466,893				2,566,926
New Zealand Dollar	8,423	694,389				702,812
Swedish Krona	34,562	6,715,251				6,749,813
Singapore Dollar	51,978	2,050,463		229,189		2,331,629
<b>Total</b>	<b>\$ 1,414,827</b>	<b>\$ 215,030,209</b>	<b>\$ 2,287,918</b>	<b>\$ 3,923,677</b>	<b>\$ 35,195</b>	<b>\$ 222,691,827</b>

State of Oregon Department of State Lands  
Common School Fund  
Notes to the Financial Statements as of June 30, 2013

Investments Held Outside of the Treasury

In addition to investments held at Treasury the Common School Fund investment portfolio includes real estate valued at \$1,100,974.

*The credit rating and average effective duration for the Common School Fund's investments, held outside the treasury at June 30, 2013.:*

<b>Investment Type</b>	<b>Credit Rating</b>	<b>Rating Agency</b>	<b>&lt; 1 Year</b>	<b>1-5 Years</b>	<b>6-10 Years</b>	<b>More than 10 Years</b>	<b>Total Market Value</b>
U.S. Agency Securities	AAA	S&P		2,850	4,150	13,801	20,801
U.S. Treasury Strips	AAA	S&P	1,989		4,427		6,416
GNMA	AAA	S&P		3			3
Domestic Equity Securities	n/a	n/a	n/a	n/a	n/a	n/a	12,047,861
Municipal Bonds	AAA		4,996	9,471	4,196	19,738	38,401
Mutual Funds – Fixed Income Only	n/a		2,611,609				2,611,609
Alternative Equities	n/a	n/a	n/a	n/a	n/a	n/a	10,521
Real Estate & Real Estate Mortgages	n/a	n/a	n/a	n/a	n/a	n/a	26,319
<b>Total</b>			<b>2,618,594</b>	<b>12,324</b>	<b>12,773</b>	<b>33,539</b>	<b>14,761,931</b>

Some custodial assets held outside of the Treasury are not investments.

**C – SECURITIES LENDING**

In accordance with the State of Oregon investment policies, state agencies may participate in securities lending. The office of the State Treasurer has authorized its custodian to act as its agent in the lending of the State's securities pursuant to a form of loan agreement. There were no significant violations of the provisions of securities lending agreements during the fiscal year.

During the fiscal year 2013 the State's securities lending agent lent short-term and fixed income securities from both the Common School Fund and the Oregon Short Term Fund and received as collateral U.S. dollar-denominated cash and cash equivalents totaling \$24,962,488 (24,169,446 + 793,042). On June 30, 2013, the State and the Common School Fund had no credit risk exposure to borrowers related to securities on loan.

State of Oregon Department of State Lands  
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Common School Fund Securities on loan at June 30, 2013 is presented in the following schedule:

<b><i>Collateral received, securities on loan, and investments of cash collateral of the Common School Fund as of June 30, 2013:</i></b>	
Cash collateral received for securities on loan:	
Domestic equity	4,273,364
Domestic fixed income	417,825
International equity	<u>19,478,257</u>
Total cash collateral received for securities on loan	24,169,446
Non-cash collateral for securities on loan:	
International equity	<u>340,150</u>
Total collateral received for all securities on loan:	\$24,509,596
Fair value of securities on loan:	
Domestic equity	4,126,452
Domestic fixed income	409,146
International equity	<u>18,546,677</u>
Total Fair value of all securities on loan	\$23,082,275
Fair value of investments made with cash collateral received for securities on loan:	
Domestic equity	4,273,364
Domestic fixed income	417,825
International equity	<u>19,478,257</u>
Total fair value of all investments made with cash collateral received for securities on loan	\$24,169,446

The Common School Fund's allocated portion of the OSTF securities on loan at June 30, 2013 is presented in the following schedule:

<b>Collateral received, securities on loan, and investments of cash collateral of the Oregon Short Term Fund as of June 30, 2013:</b>		
	<b>Total OSTF</b>	<b>CSF</b>
Cash collateral received for securities on loan	\$850,185,218	\$793,042
Fair value of all securities on loan	\$833,166,939	\$1,108,041
Fair value of all investments made with cash collateral received for securities on loan	\$596,311,410	\$793,042
The securities on loan from the OSTF in total included:		
U.S. Treasury securities	81.06%	
U.S. Agency securities	4.08%	
Domestic fixed income securities	<u>14.86%</u>	
Total	100.00%	

### **NOTE 3 – DERIVATIVES**

Derivatives are financial instruments whose value is derived from underlying assets, reference rates, or indexes. They generally take the form of contracts in which two parties agree to make payments at a later date based on the value of the underlying assets, reference rates, or indexes. The main types of derivatives are futures, forwards, options and swaps.

In the Common School Fund portfolio, forward currency exchange contracts may be used to gain exposure or hedge against the effects of fluctuations in foreign currency exchange rates. A foreign currency exchange contract is a forward contract that is a commitment to purchase or sell a foreign currency at the future date at a negotiated forward rate. Foreign currency forward contracts are privately negotiated contracts with customized terms and are transacted in over-the-counter markets. Risk associated with such contracts includes movement in the value of foreign currencies and the failure of the counter party to perform.

State of Oregon Department of State Lands  
Common School Fund  
Notes to the Financial Statements as of June 30, 2013

<i>The foreign currency exchange contracts within the Common School Fund as of June 30, 2013:</i>						
<b>Description</b>	<b>Delivery Dates</b>	<b>Notional Value</b>	<b>Unrealized Gain(Loss)</b>	<b>Change in Unrealized Gain(Loss)</b>	<b>Prior Year Unrealized Gains(Loss)</b>	<b>Realized Gain(Loss)</b>
<b>Foreign currency exchange contracts purchased:</b>						
Australian Dollar	9/18/2013	1,195,304	(40,777)	(263,869)	375	(222,717)
Canadian Dollar	9/18/2013	13,176,439	(413,848)	(755,487)	65,878	(275,761)
Danish Krone	9/18/2013	6,461,387	(113,407)	181,000	-	294,407
Eurodollar	9/18/2013	2,460,346	(52,778)	785,009	-	837,787
Hong Kong Dollar	9/18/2013	13,351,069	8,176	(980)	351	(8,806)
Israeli Shekel	9/18/2013	-	-	45,298	-	45,298
Japanese Yen	9/18/2013	-	-	(262,448)	(17,785)	(280,233)
New Zealand Dollar	9/18/2013	8,463,607	(211,601)	(210,691)	213	1,123
Norwegian Krone	9/18/2013	90,266	(2,229)	(29,819)	14,336	(13,254)
Pound Sterling	9/18/2013	1,072,183	(25,596)	(14,177)	23,967	35,386
Singapore Dollar	9/18/2013	1,451,049	4,281	(724)	18,426	13,422
Swedish Krona	9/18/2013	-	-	152,126	7,526	159,651
Swiss Franc	9/18/2013	1,947,173	(36,513)	393,131	119,319	548,963
<b>Total</b>		<b>49,668,824</b>	<b>(884,292)</b>	<b>18,368</b>	<b>232,604</b>	<b>1,135,265</b>
<b>Foreign currency exchange contracts sold:</b>						
Australian Dollar	9/18/2013	6,226,161	179,857	154,998	(20,941)	(45,800)
Canadian Dollar	9/18/2013	-	-	(62,326)	(317)	(62,643)
Danish Krone	9/18/2013	552,134	16,549	(279,451)	-	(296,001)
Eurodollar	9/18/2013	23,544,876	398,521	(994,974)	(146,301)	(1,539,796)
Hong Kong Dollar	9/18/2013	860,576	(386)	(5,732)	(327)	(5,673)
Israeli Shekel	9/18/2013	380,496	2,722	(110,165)	-	(112,886)
Japanese Yen	9/18/2013	9,283,186	183,196	949,650	12,084	778,539
New Zealand Dollar	9/18/2013	-	-	(126,763)	(10,039)	(136,802)
Norwegian Krone	9/18/2013	1,539,327	83,490	30,941	(14,073)	(66,622)
Pound Sterling	9/18/2013	599,965	18,861	(401,740)	(22,738)	(443,339)
Singapore Dollar	9/18/2013	5,775	106	(3,893)	(108)	(4,106)
Swedish Krona	9/18/2013	1,698,673	42,482	(203,811)	(12,850)	(259,143)
Swiss Franc	9/18/2013	4,665,762	55,740	(345,641)	(119,154)	(520,536)
<b>Total</b>		<b>49,356,928</b>	<b>981,136</b>	<b>(1,398,907)</b>	<b>(334,765)</b>	<b>(2,714,807)</b>
<b>Total</b>		<b>99,025,752</b>	<b>96,843</b>	<b>(1,380,538)</b>	<b>(102,161)</b>	<b>(1,579,542)</b>

In the Common School Fund portfolio, rights and warrants are often obtained and held due to existing investments. Rights are the right, but not the obligation, to purchase newly issued equity shares, often in proportion to the number of shares currently owned, in a specified company, at a pre-established price on or within a predetermined date. A warrant provides the holder the right, but not the obligation, to purchase securities from the issuing entity at a specific price and within a certain period. Rights and warrants are privately transacted in over-the-counter markets. Both are subject to general market risk and liquidity risk.

<i>The fair value of rights and warrants within the Common School Fund portfolio as of June 30, 2013:</i>							
<b>Type</b>	<b>Expiration Date</b>	<b>Related Number of Shares</b>	<b>Market Value</b>	<b>Unrealized Gain/Loss</b>	<b>Change in Unrealized Gain/Loss</b>	<b>Prior Year unrealized Gain/Loss</b>	<b>Realized Gain/Loss</b>
Rights	7/4/2013-8/28/2013	54,431	35,195	4,578	756	13,626	9,803
<b>Total Rights &amp; Warrants</b>			<b>35,195</b>	<b>4,578</b>	<b>756</b>	<b>13,626</b>	<b>9,803</b>

The fair value of all derivative instruments within the Common School Fund are reported on the governmental funds balance sheet as investments, accounts and interest receivable, and accounts and interest payable. The change in fair value for all Common School Fund derivative instruments is reported with investment income on the governmental funds statement of revenues, expenditures and changes in fund balance.

State of Oregon Department of State Lands  
Common School Fund  
Notes to the Financial Statements as of June 30, 2013

**NOTE 4 – RECEIVABLES AND PAYABLES**

**A – RECEIVABLES**

The following tables disaggregate accounts and interest receivable (net), and contracts, notes and other receivables balances in the financial statements. Contracts, notes, and other receivables are not expected to be collected within one year of the date of the financial statements.

<i>Receivables reported at 6/30/2013:</i>	
<b>Governmental Activities</b>	<b>Amount</b>
General accounts	\$144,371
Due from federal government	352,232
Interest receivable	1,511,364
Broker receivable	13,088,599
Contracts	1,137,018
	Gross receivables 16,233,584
	Allowance for un-collectibles (53,164)
	Total receivables, net \$16,180,420

<b>Receivables reported on the Balance Sheet as:</b>	
	<b>Amount</b>
Accounts and interest receivable, net	\$15,096,410
Contracts, notes, and other receivables, net	1,084,010
	Total receivables, net \$16,180,420

**B – PAYABLES**

The following tables disaggregate accounts payable reported in the financial statements.

<i>Payables reported at 6/30/2013:</i>	
<b>Governmental activities</b>	<b>Amount</b>
General accounts payable	\$1,369,052
Broker payable	32,752,465
	Total payables \$34,121,517

**C – CUSTODIAL LIABILITIES**

Custodial liabilities consist of unclaimed property held in custody by the Department in perpetuity for the rightful owner as required by ORS 98.302-98.436 and 98.991-98.992.

The unclaimed property liability is reported at 39% of the total unclaimed property being held. An annual adjustment is made to this account to reduce the amount reported to the amount actually expected to be paid out based on a history of the account. The total legal liability for the unclaimed property program as of June 30, 2013 was \$470,042,840. The accumulated annual adjustment as of June 30, 2013 was \$274,063,430.

**NOTE 5 – LEASES**

**OPERATING LEASES**

The Department has entered into various non-cancelable rental agreements that are accounted for as operating leases because the agreements do not meet the criteria to be classified as capital leases. Operating lease payments are chargeable as rent and reported in services and supplies. Rental costs for operating leases for the year ended June 30, 2013, were \$119,214.

<i>Future minimum rental payments for operating leases in effect as of June 30, 2013:</i>	
<b>Year ending June 30</b>	<b>Payments</b>
2014	\$122,651
2015	122,839
2016	55,820
Total future minimum rents:	\$301,310

State of Oregon Department of State Lands  
Common School Fund  
Notes to the Financial Statements as of June 30, 2013

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**NOTE 6 – POLLUTION REMEDIATION OBLIGATION**

Pollution remediation obligations address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities, including pre-cleanup activities, government oversight and enforcement-related activities, and post remediation monitoring. Excluded from pollution remediation obligations are obligations for pollution prevention and control activities, fines and penalties, landfill closure and post closure care, and other future remediation activities required upon retirement of an asset.

The Common School Fund recognizes a pollution remediation obligation when it can reasonably estimate the range of expected cash outlays. As of June 30, 2013 the Department of State Lands is involved in negotiations related to a confidential, non-judicial mediation process that will result in an allocation of costs associated with the investigation and cleanup of contamination in the Portland Harbor Superfund site. There are over 200 parties, private and public, that may eventually bear a share of the costs. It is too early in the Environmental Protection Agency’s remedial action process to estimate the total cleanup costs that may be shared by the liable parties and what portion of that, if any, will be assessed against the Common School Fund. The Portland Harbor Superfund site is discussed in greater detail in Note 15.

**NOTE 7 – INTER-FUND TRANSACTIONS**

Inter-fund balances reported in the fund financial statements as of June 30, 2013.

<i>Due to other funds:</i>	
Environmental Management Fund	\$2,683,431
Capital Projects Fund	132
<i>Total due to other funds</i>	<u>\$2,683,563</u>
<i>Advances to other funds :</i>	
Environmental Management Fund	\$300,000
<i>Total advances to other funds</i>	<u>\$300,000</u>
<i>Due from other funds:</i>	
General Fund	\$11,337
Environmental Management Fund	376,377
Public Transportation Fund	43,891
<i>Total due from other funds:</i>	<u>\$431,605</u>

**NOTE 8 – EMPLOYEE RETIREMENT PLANS**

The Oregon Public Employees Retirement System (PERS) provides retirement plans for Department employees. PERS is administered by the Public Employees Retirement Board (Board), as required by Oregon Revised Statutes (ORS) chapters 238 and 238A. Copies of the Oregon Public Employees Retirement System annual financial reports may be obtained at:  
[www.oregon.gov/PERS/section/financial\\_reports/financials.shtml](http://www.oregon.gov/PERS/section/financial_reports/financials.shtml).

**OREGON PUBLIC EMPLOYEES RETIREMENT SYSTEM (PERS)**

The Department’s employees who were plan members before August 29, 2003, participate in the Oregon Public Employees Retirement System (PERS), a cost-sharing multiple-employer defined benefit pension plan. The PERS has two tiers of benefits. Employees hired before January 1, 1996 are in Tier One. Tier One employee benefits are reduced if retirement occurs prior to age 58 with fewer than 30 years of service. Tier Two members are eligible for full benefit options as established by ORS chapter 23. Options include survivorship benefits and lump sum distributions. The PERS also provides death and disability benefits.

**OREGON PUBLIC SERVICE RETIREMENT PLAN (OPSRP)**

The 2003 Oregon Legislature created the Oregon Public Service Retirement Plan (OPSRP), a cost-sharing multiple-employer plan. OPSRP is a hybrid pension plan with two components: the Pension Program (defined benefit) and the Individual Account Program (defined contribution). Department

State of Oregon Department of State Lands  
Common School Fund  
Notes to the Financial Statements as of June 30, 2013

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employees hired after August 28, 2003 participate in OPSRP after completing six months of service. The OPSRP Pension Program provides a monthly pension payable for life as well as death and disability benefits as established by ORS chapter 238A

Beginning January 1, 2004, PERS members became members of the Individual Account Program (IAP) portion of OPSRP. PERS members retain their existing PERS accounts, but member contributions are now deposited in the IAP account rather than into the member's PERS account. All covered employees are required by state statute to contribute a percentage of their salary to the IAP. Current law permits employers to pay the employee contribution, which the Department does.

**PLAN RATES**

For the PERS Pension and the OPSRP Pension, the Department must contribute actuarially computed amounts as determined by the Board. The funding policies provide for monthly employer contributions. Rates are subject to change as a result of subsequent actuarial valuations.

The required contribution rates as a percentage of subject salary are:

<u>Year ended June 30</u>	<u>PERS</u>	<u>OPSRP</u>	<u>IAP</u>
2013	8.80%	7.44%	6.00%
2012	8.80%	7.44%	6.00%
2011	1.69%	2.63%	6.00%

For subject salary paid after June 30, 2013, the PERS Pension and the OPSRP Pension rates will be 9.86% and 8.14%.

**ANNUAL PENSION COST**

The annual pension cost is the actual contribution to PERS (which equals the required contribution) plus the 6% employee contribution which the Department has agreed to pay. The annual cost for the year ended June 30, 2013 and the two preceding years are:

<u>Year ended June 30</u>	<u>PERS</u>	<u>OPSRP</u>	<u>IAP</u>
2013	\$300,441	\$157,068	\$305,696
2012	\$301,245	\$153,967	\$303,643
2011	\$130,510	\$203,101	\$463,347

**NOTE 9 – DEFERRED COMPENSATION PLANS**

The Oregon Savings Growth Plan (OSGP) is a deferred compensation plan available to eligible state employees. Employee contributions are deposited into the Deferred Compensation Fund established by Oregon Revised Statute 243.411. To participate, an employee enters into an individual agreement with the State to defer current earnings to be paid at a future date. The PERS administers the plan. As a trustee of the assets, PERS contracts with ING to maintain OSGP participant records. The Office of the State Treasurer, as custodian of the assets, contracts with State Street Bank and Trust Company to provide financial services. PERS may assess a charge to participants not to exceed 2 percent on amounts deferred, both contributions and investment earnings, to cover costs incurred for administering the program.

Participants direct the selection of investment options and also bear any market risk. Although the State has no liability for losses under the OSGP, the State does have the prudent investor responsibility of due care. Activity of the OSGP is reported in the Oregon Comprehensive Annual Financial Report under the Deferred Compensation Plan in the fiduciary funds combining financial statements.

**NOTE 10 – RISK FINANCING**

The State of Oregon administers property and casualty programs covering State government through its Insurance Fund. The Insurance Fund services claims for: direct physical loss or damage to state property; tort liability claims brought against the State, its officers, employees or agents; workers'

State of Oregon Department of State Lands  
Common School Fund  
Notes to the Financial Statements as of June 30, 2013

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compensation; employee dishonesty; and faithful performance coverage for certain positions by law to be covered and other key positions.

As a state agency, the Department participates in the Insurance Fund. The cost of servicing insurance claims and payments is covered by charging an assessment to each entity based on its share of services provided in a prior period. The total statewide coverage assessment is based on independent biennial actuarial forecasts and administrative expenses, less carry-forward or equity in the Insurance fund.

For the Common School Fund the amount of claim settlements did not exceed insurance coverage for each of the past three years.

**NOTE 11 – PRIOR PERIOD ADJUSTMENT**

A prior period adjustment of \$52,449 was recorded in Fiscal Year 2013 due to the determination that a portion of a restitution settlement established prior to 2011 is not expected to be collected.

**NOTE 12 - COMMITMENTS**

Commitments are defined as existing arrangements to enter into future transactions or events, such as contractual obligations with vendors for future purchases or services at specified prices and sometimes at specified quantities. Commitments may also include agreements to make grants and loans.

The Oregon Investment Council has entered into agreements that commit the investment managers for the Common School Fund (CSF), upon request, to additional investment purchases up to a predetermined amount. As of June 30, 2013 the Common School Fund had \$121.8 million in commitments to purchase private equity investments. These amounts are unfunded and are not recorded in the financial statements.

**NOTE 13 – RELATED PARTY DISCLOSURES**

The Oregon State Treasurer is a constitutional officer within the executive branch of the state of Oregon, elected by statewide vote. As chief financial officer for the state, the Treasurer heads the Oregon State Treasury. The Oregon State Treasury acts as the central bank for all state agencies and is the largest financial institution in the state. The Treasury manages the portfolio of investments for the state's funds, including the Common School Fund.

The State Land Board, which consists of the Governor, the Secretary of State and the State Treasurer, is the trustee of the Common School Fund as outlined in the Oregon Constitution. The Common School Fund's investment policies are governed by statute and the Oregon Investment Council. The State Treasurer is the investment officer for the Investment Council. During the year ended June 30, 2013 the Common School Fund paid the Oregon State Treasury \$283,927 in fees for the management of the Common School Fund investment portfolio.

**NOTE 14– CONTINGENCIES**

***A – PORTLAND HARBOR SUPERFUND SITE***

The Department of State Lands is involved in negotiations related to a confidential, non-judicial mediation process that will result in an allocation of costs associated with the investigation and cleanup of sediment contamination in the Portland Harbor, a ten-mile stretch of the lower Willamette River area that the U.S. Environmental Protection Agency (EPA) has listed as a Superfund site under the federal Superfund law (CERCLA). The Department of State lands is one of over 200 parties, private companies, and public entities that may eventually be found liable for a share of the costs related to investigation and cleanup of the site.

***B –ALLOCATION OF INVESTMENT INCOME TO COMMON SCHOOL FUND BALANCE***

The State Land Board, during the February 14, 2012 Land Board meeting directed the Department of State Lands to make two transfers, totaling \$75.7 million from the distributable income account of the Common School Fund to the non-distributable corpus of the Common School Fund. This was done in

State of Oregon Department of State Lands  
Common School Fund  
Notes to the Financial Statements as of June 30, 2013

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response to recommendations coming from a Secretary of State performance audit of the Common School Fund.

On June 30, 2012 a transfer \$37,850,000 in investment income of the distributable income account was transferred to the non-distributable corpus of the Common School Fund. Another transfer of the same amount was made June 30, 2013.

*GOVERNMENTAL AUDITING STANDARDS*  
**COMPLIANCE**

**INDEPENDENT AUDITOR'S 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***

State Land Board  
Department of State Lands  
Salem, Oregon

We have audited, 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, the Balance Sheet and the related Statement of Revenues, Expenditures, and Changes in Fund Balance of the Common School Fund, a major governmental fund of the State of Oregon, as of and for the year ended June 30, 2013, and the related notes to the financial statements, and have issued our report thereon dated October 24, 2013.

The financial statements present only the Fund are not intended to present fairly the financial position of the State of Oregon or the Department of State Lands and the results of their operations in conformity with accounting principles generally accepted in the United States of America.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Common School Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 Common School Funds' internal control. Accordingly, we do not express an opinion on the effectiveness of the Common School Funds' internal control.

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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and responses as item 2013-1 that we consider to be a significant deficiency.

### **Compliance and Other Matters**

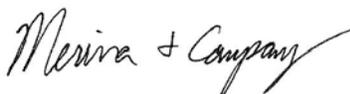
As part of obtaining reasonable assurance about whether the Common School Funds' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and 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*.

### **Common School Funds' Response to Findings**

Common School Fund's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. Common School Fund's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Merina & Company, LLP  
West Linn, Oregon  
October 24, 2013

State of Oregon Department of State Lands  
Common School Fund  
Schedule of Findings and Responses  
June 30, 2013

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**Internal Control over Financial Reporting:**

**2013-1**

Condition: The Agency failed to perform reconciliation of significant accounts in a timely or accurate manner.

Criteria: Internal controls should be in place to ensure that reconciliation of significant accounts is completed in a timely and accurate manner.

Cause: The procedures that were in place did not ensure that significant accounts were reconciled in a timely or accurate manner.

Effect: Because of the failure to perform reconciliation of significant accounts in a timely manner or accurate manner, significant accounts did not have correct balances.

Recommendation: Procedures should be implemented to ensure significant accounts are reconciled in a timely or accurate manner and reviewed by a supervisor.

Managements Response: Agency management agrees with the finding and is taking appropriate action to address the situation.

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